

HOME BANCSHARES INC

Form 10-Q

November 07, 2007

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, 2007**

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, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act.

Large accelerated filer Accelerated filer Non-accelerated filer

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-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: 17,244,848 shares as of October 31, 2007.

HOME BANCSHARES, INC.
FORM 10-Q
September 30, 2007
INDEX

| | Page No. |
|---|----------|
| <u>Part I:</u> <u>Financial Information</u> | |
| <u>Item 1.</u> <u>Financial Statements</u> | |
| <u>Consolidated Balance Sheets – September 30, 2007 (Unaudited) and December 31, 2006</u> | 4 |
| <u>Consolidated Statements of Income (Unaudited) – Three months and nine months ended September 30, 2007 and 2006</u> | 5 |
| <u>Consolidated Statements of Stockholders’ Equity (Unaudited) – Nine months ended September 30, 2007 and 2006</u> | 6-7 |
| <u>Consolidated Statements of Cash Flows (Unaudited) – Nine months ended September 30, 2007 and 2006</u> | 8 |
| <u>Condensed Notes to Consolidated Financial Statements (Unaudited)</u> | 9-23 |
| <u>Report of Independent Registered Public Accounting Firm</u> | 24 |
| <u>Item 2.</u> <u>Management’s Discussion and Analysis of Financial Condition and Results of Operations</u> | 25-54 |
| <u>Item 3.</u> <u>Quantitative and Qualitative Disclosure About Market Risk</u> | 55-57 |
| <u>Item 4.</u> <u>Controls and Procedures</u> | 58 |
| <u>Part</u> <u>II:</u> <u>Other Information</u> | |
| <u>Item 1.</u> <u>Legal Proceedings</u> | 59 |
| <u>Item 1A.</u> <u>Risk Factors</u> | 59 |
| <u>Item 2.</u> <u>Unregistered Sales of Equity Securities and Use of Proceeds</u> | 59 |
| <u>Item 3.</u> <u>Defaults Upon Senior Securities</u> | 59 |
| <u>Item 4.</u> <u>Submission of Matters to a Vote of Security Holders</u> | 59 |
| <u>Item 5.</u> <u>Other Information</u> | 59 |
| <u>Item 6.</u> <u>Exhibits</u> | 59 |
| <u>Signatures</u> | 60 |

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Awareness of Independent Registered Public Accounting Firm

CEO Certification Pursuant to Rule 13a-14(a)/15d-14(a)

CFO Certification Pursuant to Rule 13a-14(a)/15d-14(a)

CEO Certification Pursuant 18 U.S.C. Section 1350

CFO Certification Pursuant 18 U.S.C. Section 1350

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, expressions, you should consider them as identifying forward-looking statements, although we may use other phrasing. These forward-looking statements involve risks and uncertainties and are based on our beliefs and assumptions, and on the information available to us at the time that these disclosures were prepared. These forward-looking statements involve risks and uncertainties and may not be realized due to a variety of factors, including, but not limited to, the following:

the effects of future economic conditions, including inflation or a 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 20, 2007.

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

| (In thousands, except share data) | September 30, 2007 (Unaudited) | December 31, 2006 |
|---|---|------------------------------|
| Assets | | |
| Cash and due from banks | \$ 46,471 | \$ 53,004 |
| Interest-bearing deposits with other banks | 2,573 | 6,696 |
| Cash and cash equivalents | 49,044 | 59,700 |
| Federal funds sold | 11,145 | 9,003 |
| Investment securities available for sale | 447,826 | 531,891 |
| Loans receivable | 1,560,374 | 1,416,295 |
| Allowance for loan losses | (28,636) | (26,111) |
| Loans receivable, net | 1,531,738 | 1,390,184 |
| Bank premises and equipment, net | 66,770 | 57,339 |
| Foreclosed assets held for sale | 4,915 | 435 |
| Cash value of life insurance | 47,468 | 42,149 |
| Investments in unconsolidated affiliates | 14,982 | 12,449 |
| Accrued interest receivable | 15,186 | 13,736 |
| Deferred tax asset, net | 9,499 | 8,361 |
| Goodwill | 37,527 | 37,527 |
| Core deposit and other intangibles | 8,141 | 9,458 |
| Other assets | 23,431 | 18,416 |
| Total assets | \$ 2,267,672 | \$ 2,190,648 |
| Liabilities and Stockholders Equity | | |
| Deposits: | | |
| Demand and non-interest-bearing | \$ 217,666 | \$ 215,142 |
| Savings and interest-bearing transaction accounts | 569,797 | 582,425 |
| Time deposits | 811,108 | 809,627 |
| Total deposits | 1,598,571 | 1,607,194 |
| Federal funds purchased | 8,690 | 25,270 |
| Securities sold under agreements to repurchase | 131,007 | 118,825 |
| FHLB borrowed funds | 226,028 | 151,768 |
| Accrued interest payable and other liabilities | 12,204 | 11,509 |
| Subordinated debentures | 44,595 | 44,663 |
| Total liabilities | 2,021,095 | 1,959,229 |
| Stockholders equity: | | |
| Common stock, par value \$0.01 in 2007 and 2006; shares authorized 50,000,000 | 172 | 172 |

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in 2007 and 25,000,000 in 2006; shares issued and outstanding
17,243,036

in 2007 and 17,205,649 in 2006

| | | |
|--|---------------------|---------------------|
| Capital surplus | 195,429 | 194,595 |
| Retained earnings | 54,871 | 41,544 |
| Accumulated other comprehensive loss | (3,895) | (4,892) |
| Total stockholders equity | 246,577 | 231,419 |
| Total liabilities and stockholders equity | \$ 2,267,672 | \$ 2,190,648 |

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, | |
|--|-------------------------------------|---------------|------------------------------------|---------------|
| | 2007 | 2006 | 2007 | 2006 |
| | (Unaudited) | | | |
| Interest income: | | | | |
| Loans | \$ 31,116 | \$ 26,748 | \$ 89,180 | \$ 72,593 |
| Investment securities | | | | |
| Taxable | 4,133 | 4,738 | 12,992 | 14,174 |
| Tax-exempt | 1,043 | 883 | 3,094 | 2,815 |
| Deposits - other banks | 53 | 38 | 132 | 103 |
| Federal funds sold | 36 | 51 | 311 | 393 |
| Total interest income | 36,381 | 32,458 | 105,709 | 90,078 |
| Interest expense: | | | | |
| Interest on deposits | 14,416 | 12,010 | 42,640 | 32,683 |
| Federal funds purchased | 194 | 178 | 646 | 636 |
| FHLB borrowed funds | 2,426 | 1,825 | 6,270 | 4,787 |
| Securities sold under agreements to repurchase | 1,267 | 1,258 | 3,772 | 3,122 |
| Subordinated debentures | 758 | 751 | 2,254 | 2,245 |
| Total interest expense | 19,061 | 16,022 | 55,582 | 43,473 |
| Net interest income | 17,320 | 16,436 | 50,127 | 46,605 |
| Provision for loan losses | 547 | 649 | 2,047 | 1,723 |
| Net interest income after provision for loan losses | 16,773 | 15,787 | 48,080 | 44,882 |
| Non-interest income: | | | | |
| Service charges on deposit accounts | 2,816 | 2,354 | 8,073 | 6,669 |
| Other services charges and fees | 1,342 | 541 | 4,176 | 1,736 |
| Trust fees | 27 | 166 | 81 | 487 |
| Data processing fees | 192 | 215 | 619 | 623 |
| Mortgage banking income | 451 | 435 | 1,277 | 1,285 |
| Insurance commissions | 153 | 153 | 613 | 642 |
| Income from title services | 181 | 233 | 575 | 752 |
| Increase in cash value of life insurance | 607 | 55 | 1,822 | 161 |
| Dividends from FHLB, FRB & bankers' bank | 218 | 180 | 652 | 440 |
| Equity in earnings of unconsolidated affiliates | 47 | (65) | (123) | (213) |
| Gain on sale of SBA loans | | | 170 | 34 |
| Gain (loss) on sale of premises and equipment, net | (31) | 129 | 150 | 157 |
| Gain on securities, net | | | | 1 |
| Other income | 309 | 302 | 1,015 | 924 |

| | | | | |
|---|----------|----------|-----------|-----------|
| Total non-interest income | 6,312 | 4,698 | 19,100 | 13,698 |
| Non-interest expense: | | | | |
| Salaries and employee benefits | 7,739 | 7,376 | 22,936 | 22,123 |
| Occupancy and equipment | 2,446 | 2,223 | 6,998 | 6,351 |
| Data processing expense | 644 | 651 | 1,958 | 1,888 |
| Other operating expenses | 4,770 | 3,987 | 13,965 | 11,637 |
| Total non-interest expense | 15,599 | 14,237 | 45,857 | 41,999 |
| Income before income taxes | | | | |
| Income tax expense | 7,486 | 6,248 | 21,323 | 16,581 |
| | 2,258 | 1,960 | 6,273 | 5,141 |
| Net income available to all shareholders | | | | |
| Less: Preferred stock dividends | 5,228 | 4,288 | 15,050 | 11,440 |
| | | 49 | | 359 |
| Income available to common shareholders | | | | |
| | \$ 5,228 | \$ 4,239 | \$ 15,050 | \$ 11,081 |
| Basic earnings per share | | | | |
| | \$ 0.30 | \$ 0.26 | \$ 0.87 | \$ 0.82 |
| Diluted earnings per share | | | | |
| | \$ 0.30 | \$ 0.25 | \$ 0.86 | \$ 0.74 |

See Condensed Notes to Consolidated Financial Statement.

Table of Contents

Home BancShares, Inc.
Consolidated Statements of Stockholders Equity

| (In thousands, except share data) | Preferred Stock A | Preferred Stock B | Common Stock | Capital Surplus | Retained Earnings | Accumulated Other Comprehensive Income (Loss) | Total |
|--|-------------------------|-------------------------|-----------------|--------------------|----------------------|---|------------|
| Balance at January 1, 2006 | \$ 21 | \$ 2 | \$ 121 | \$ 146,285 | \$ 27,331 | \$ (7,903) | \$ 165,857 |
| Comprehensive income (loss): | | | | | | | |
| Net income | | | | | 11,440 | | 11,440 |
| Other comprehensive income (loss): | | | | | | | |
| Unrealized gain on investment securities available for sale, net of tax effect of \$903 | | | | | | 1,409 | 1,409 |
| Unconsolidated affiliates unrecognized gain on investment securities available for sale, net of taxes recorded by the unconsolidated affiliate | | | | | | 10 | 10 |
| Comprehensive income | | | | | | | 12,859 |
| Conversion of 2,090,812 shares of preferred stock A to 1,650,489 shares of common stock | (21) | | 17 | 2 | | | (2) |
| Conversion of 169,760 shares of preferred stock B to 509,280 shares of common stock | | (2) | 5 | (3) | | | |
| Issuance of 2,875,000 shares of common stock from Initial Public Offering, net of offering costs of \$4,545 | | | 29 | 47,176 | | | 47,205 |
| Issuance of 14,617 shares of preferred stock A from exercise of stock options | | | | 2 | | | 2 |
| Net issuance of 681 shares of preferred stock B from exercise of stock options | | | | 8 | | | 8 |
| Net issuance of 47,597 shares of common stock from exercise of stock options | | | | 446 | | | 446 |
| Tax benefit from stock options exercised | | | | 187 | | | 187 |
| Share-based compensation | | | | 303 | | | 303 |
| Cash dividends Preferred Stock A, \$0.1458 per share | | | | | (303) | | (303) |
| Cash dividends Preferred Stock B, \$0.3325 per share | | | | | (56) | | (56) |

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| | | | | | |
|--|-----|---------|--------|---------|---------|
| Cash dividends Common Stock, \$0.065 per share | | | (916) | | (916) |
| Balances at September 30, 2006 (unaudited) | 172 | 194,406 | 37,496 | (6,484) | 225,590 |
| Comprehensive income (loss): | | | | | |
| Net income | | | 4,478 | | 4,478 |
| Other comprehensive income (loss): | | | | | |
| Unrealized gain on investment securities available for sale, net of tax effect of \$1,023 | | | | 1,585 | 1,585 |
| Unconsolidated affiliates unrecognized gain on investment securities available for sale, net of taxes recorded by the unconsolidated affiliate | | | | 7 | 7 |
| Comprehensive income | | | | | 6,070 |
| Issuance of 9,419 shares of common stock from exercise of stock options | | 88 | | | 88 |
| Tax benefit from stock options exercised | | 24 | | | 24 |
| Share-based compensation | | 77 | | | 77 |
| Cash dividends Common Stock, \$0.025 per share | | | (430) | | (430) |
| Balances at December 31, 2006 | 172 | 194,595 | 41,544 | (4,892) | 231,419 |
| See Condensed Notes to Consolidated Financial Statement. | | | | | |
| | 6 | | | | |

Table of Contents

Home BancShares, Inc.
Consolidated Statements of Stockholders Equity Continued

| (In thousands, except share data) | Preferred Stock A | Preferred Stock B | Common Stock | Capital Surplus | Retained Earnings | Accumulated Other Comprehensive Income (Loss) | Total |
|--|-------------------------|-------------------------|-----------------|--------------------|----------------------|---|------------|
| Comprehensive income (loss): | | | | | | | |
| Net income | | | | | 15,050 | | 15,050 |
| Other comprehensive income (loss): | | | | | | | |
| Unrealized gain on investment securities available for sale, net of tax effect of \$623 | | | | | | 966 | 966 |
| Unconsolidated affiliates unrecognized gain on investment securities available for sale, net of taxes recorded by the unconsolidated affiliate | | | | | | 31 | 31 |
| Comprehensive income | | | | | | | 16,047 |
| Net issuance of 37,387 shares of common stock from exercise of stock options | | | | 276 | | | 276 |
| Tax benefit from stock options exercised | | | | 218 | | | 218 |
| Share-based compensation | | | | 340 | | | 340 |
| Cash dividends Common Stock, \$0.10 per share | | | | | (1,723) | | (1,723) |
| Balances at September 30, 2007 | \$ | \$ | \$ 172 | \$ 95,429 | \$ 54,871 | \$ (3,895) | \$ 246,577 |

See Condensed Notes to Consolidated Financial Statements.

Table of Contents

Home BancShares, Inc.
Consolidated Statements of Cash Flows

| (In thousands) | Period Ended September 30, 2007 2006 (Unaudited) | |
|---|--|-----------|
| Operating Activities | | |
| Net income | \$ 15,050 | \$ 11,440 |
| Adjustments to reconcile net income to net cash provided by (used in) operating activities: | | |
| Depreciation | 3,342 | 3,416 |
| Amortization/Accretion | 1,378 | 1,861 |
| Share-based compensation | 340 | 303 |
| Tax benefits from stock options exercised | (218) | (187) |
| Gain on sale of assets | (232) | (443) |
| Provision for loan losses | 2,047 | 1,723 |
| Deferred income tax benefit | (1,788) | (1,121) |
| Equity in earnings of unconsolidated affiliates | 123 | 213 |
| Increase in cash value of life insurance | (1,822) | (161) |
| Originations of mortgage loans held for sale | (74,654) | (67,353) |
| Proceeds from sales of mortgage loans held for sale | 72,516 | 67,965 |
| Changes in assets and liabilities: | | |
| Accrued interest receivable | (1,450) | (2,736) |
| Other assets | (5,015) | (9,568) |
| Accrued interest payable and other liabilities | 918 | 3,916 |
| Net cash provided by operating activities | 10,535 | 9,268 |
| Investing Activities | | |
| Net (increase) decrease in federal funds sold | (2,142) | (24,026) |
| Net (increase) decrease in loans | (149,066) | (185,106) |
| Purchases of investment securities available for sale | (133,446) | (88,944) |
| Proceeds from maturities of investment securities available for sale | 218,993 | 110,725 |
| Proceeds from sales of investment securities available for sale | | 1,000 |
| Proceeds from sale of loans | 2,957 | 540 |
| Proceeds from foreclosed assets held for sale | 548 | 1,626 |
| Purchases of premises and equipment, net | (12,923) | (5,900) |
| Purchase of bank owned life insurance | (3,497) | |
| Investments in unconsolidated affiliates | (2,625) | (3,000) |
| Net cash used in investing activities | (81,201) | (193,085) |
| Financing Activities | | |
| Net increase (decrease) in deposits | (8,623) | 130,425 |
| Net increase (decrease) in securities sold under agreements to repurchase | 12,182 | 12,621 |
| Net increase (decrease) in federal funds purchased | (16,580) | (44,495) |
| Net increase (decrease) in FHLB and other borrowed funds | 74,260 | 54,063 |
| Repayment of line of credit | | (14,000) |

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| | | |
|---|-----------|-----------|
| Proceeds from initial public offering, net | | 47,205 |
| Proceeds from exercise of stock options | 276 | 456 |
| Tax benefits from stock options exercised | 218 | 187 |
| Conversion of preferred stock A fractional shares | | (2) |
| Dividends paid | (1,723) | (1,275) |
| Net cash provided by financing activities | 60,010 | 185,185 |
| Net change in cash and cash equivalents | (10,656) | 1,368 |
| Cash and cash equivalents beginning of year | 59,700 | 44,679 |
| Cash and cash equivalents end of period | \$ 49,044 | \$ 46,047 |

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 financial holding company headquartered in Conway, Arkansas. The Company is primarily engaged in providing a full range of banking services to individual and corporate customers through its five wholly owned community bank subsidiaries. Three of our bank subsidiaries are located in the central Arkansas market area, a fourth serves Stone County in north central Arkansas, and a fifth serves 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

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

Use of Estimates

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

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

Principles of Consolidation

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

Table of Contents***Investments in Unconsolidated Affiliates***

The Company had a 20.4% and 20.1% investment in White River Bancshares, Inc. (WRBI) at September 30, 2007 and December 31, 2006, respectively. The Company's investment in WRBI at September 30, 2007 and December 31, 2006 totaled \$13.7 million and \$11.1 million, respectively. The investment in WRBI is accounted for on the equity method. The Company's share of WRBI operating income included in non-interest income in the three months ended September 30, 2007 totaled \$47,000. The Company's share of WRBI operating loss included in non-interest income in the nine months ended September 30, 2007 totaled \$123,000. The Company's share of WRBI operating loss included in non-interest income in the three and nine months ended September 30, 2006 totaled \$65,000 and \$213,000, respectively. The Company's share of WRBI unrealized gain on investment securities available for sale at September 30, 2007 amounted to \$31,000. The Company's share of WRBI unrealized loss on investment securities available for sale at September 30, 2006 amounted to \$7,000. See the Acquisitions footnote related to the Company's acquisition of WRBI.

The Company has invested funds representing 100% ownership in four statutory trusts which issue trust preferred securities. The Company's investment in these trusts was \$1.3 million at September 30, 2007 and December 31, 2006, respectively. Under generally accepted accounting principles, these trusts are not consolidated.

The summarized financial information below represents an aggregation of the Company's unconsolidated affiliates as of September 30, 2007 and 2006, and for the three-month and nine-month periods then ended:

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|-------------------|---|-------------|--|-------------|
| | 2007 | 2006 | 2007 | 2006 |
| | (In thousands) | | | |
| Assets | \$ 552,126 | \$ 373,534 | \$ 552,126 | \$ 373,534 |
| Liabilities | 485,220 | 315,975 | 485,220 | 315,975 |
| Equity | 66,906 | 57,559 | 66,906 | 57,559 |
| Net income (loss) | 233 | (319) | (462) | (992) |

Interim financial information

The accompanying unaudited consolidated financial statements as of September 30, 2007 and 2006 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 2006 Form 10-K, filed with the Securities and Exchange Commission.

Table of Contents**Earnings per Share**

Basic earnings per share are computed based on the weighted average number of shares outstanding during each year. Diluted earnings per share are computed using the weighted average common shares and all potential dilutive common shares outstanding during the period. The following table sets forth the computation of basic and diluted earnings per share (EPS) for the three-month and nine-month periods ended September 30:

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|--|---|-------------|--|-------------|
| | 2007 | 2006 | 2007 | 2006 |
| | (In thousands) | | | |
| Net income available to all shareholders | \$ 5,228 | \$ 4,288 | \$ 15,050 | \$ 11,440 |
| Less: Preferred stock dividends | | (49) | | (359) |
| Income available to common shareholders | \$ 5,228 | \$ 4,239 | \$ 15,050 | \$ 11,081 |
| Average shares outstanding | 17,239 | 16,361 | 17,231 | 13,585 |
| Effect of common stock options | 298 | 192 | 290 | 134 |
| Effect of preferred stock options | | 10 | | 22 |
| Effect of preferred stock conversions | | 728 | | 1,674 |
| Diluted shares outstanding | 17,537 | 17,291 | 17,521 | 15,415 |
| Basic earnings per share | \$ 0.30 | \$ 0.26 | \$ 0.87 | \$ 0.82 |
| Diluted earnings per share | \$ 0.30 | \$ 0.25 | \$ 0.86 | \$ 0.74 |

2. Acquisitions

On August 24, 2007, HBI and Centennial Bancshares, Inc. (CBI) announced the signing of definitive agreement (the Merger Agreement) for the acquisition of CBI by HBI in exchange for stock of HBI and cash (the Merger). Immediately after the Merger, Centennial Bank, a wholly owned subsidiary of CBI, will be operated as a subsidiary bank of HBI. The CBI shareholders that are accredited investors will receive whole shares of HBI equal to the product of 16.8153 and the number of shares of CBI surrendered. The unaccredited investors, which are projected to represent a 2% ownership of CBI, will receive in the aggregate approximately \$500,000 in cash. The Merger Agreement further provides for an earn out based upon 2008 earnings of up to a maximum of \$4,000,000 which can be paid in cash or stock of HBI at the election of the accredited shareholders. Based upon the closing price of HBI stock on September 30, 2007 of \$21.79 per share the total purchase price excluding the earn out is approximately \$24.8 million. The Merger is conditioned upon regulatory approval and other customary conditions.

In January 2005, HBI purchased 20% of the common stock during the formation of White River Bancshares, Inc. of Fayetteville, Arkansas for \$9.1 million. White River Bancshares owns all of the stock of Signature Bank of Arkansas, with branch locations in the northwest Arkansas area. In January 2006, White River Bancshares issued an additional \$15.0 million of their common stock. To maintain a 20% ownership, the Company made an additional investment in White River Bancshares of \$3.0 million in January 2006. During April 2007, White River Bancshares acquired 100% of the stock of Brinkley Bancshares, Inc. in Brinkley, Arkansas. As a result, HBI made a \$2.6 million additional investment in White River Bancshares on June 29, 2007 to maintain its 20% ownership. At September 30, 2007, White River Bancshares had approximately \$507.8 million in total assets, \$411.8 million in total loans and \$424.6 million in total deposits.

Table of Contents**3. Investment Securities**

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

| | September 30, 2007 | | | Estimated Fair Value |
|---------------------------------------|---------------------------|-----------------------------|-----------------------------|-------------------------------------|
| | Available for Sale | | | |
| | Amortized | Gross Unrealized | Gross Unrealized | |
| | Cost | Gains | (Losses) | |
| | (In thousands) | | | |
| U.S. government-sponsored enterprises | \$ 148,815 | \$ 98 | \$ (2,313) | \$ 146,600 |
| Mortgage-backed securities | 191,777 | 50 | (4,501) | 187,326 |
| State and political subdivisions | 101,803 | 1,117 | (754) | 102,166 |
| Other securities | 11,893 | | (159) | 11,734 |
| Total | \$ 454,288 | \$ 1,265 | \$ (7,727) | \$ 447,826 |

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

Assets, principally investment securities, having a carrying value of approximately \$208.8 million and \$287.2 million at September 30, 2007 and December 31, 2006, 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 \$131.0 million and \$118.8 million at September 30, 2007 and December 31, 2006, respectively.

During 2007, the Company did not sell any available for sale securities. During the three months ended September 30, 2006, no available for sale securities were sold. During the nine months ended September 30, 2006, \$1.0 million in available for sale securities were sold. The gross realized gains on such sales totaled \$1,000. The income tax expense/benefit related to net security gains and losses was 39.23% of the gross amounts for the periods.

The Company evaluates all securities quarterly to determine if any unrealized losses are deemed to be other than temporary. In completing these evaluations the Company follows the requirements of paragraph 16 of SFAS No. 115, EITF 03-1, Staff Accounting Bulletin 59 and FASB Staff Position No. 115-1. Certain investment securities are valued less than their historical cost. These declines primarily resulted from recent increases in market interest rates. Based on evaluation of available evidence, management believes the declines in fair value for these securities are temporary. It is management's intent to hold these securities to recovery. Should the impairment of any of these securities become

other than temporary, the cost basis of the investment will be reduced and the resulting loss recognized in net income in the period the other than temporary impairment is identified.

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

The various categories of loans are summarized as follows:

| | September 30, 2007 | December 31, 2006 |
|---|-----------------------------------|----------------------------------|
| | (In thousands) | |
| Real estate: | | |
| Commercial real estate loans | | |
| Non-farm/non-residential | \$ 590,083 | \$ 465,306 |
| Construction/land development | 365,236 | 393,410 |
| Agricultural | 22,432 | 11,659 |
| Residential real estate loans | | |
| Residential 1-4 family | 251,057 | 229,588 |
| Multifamily residential | 38,528 | 37,440 |
| | | |
| Total real estate | 1,267,336 | 1,137,403 |
| Consumer | 45,212 | 45,056 |
| Commercial and industrial | 206,744 | 206,559 |
| Agricultural | 25,506 | 13,520 |
| Other | 15,576 | 13,757 |
| | | |
| Total loans receivable before allowance for loan losses | 1,560,374 | 1,416,295 |
| Allowance for loan losses | 28,636 | 26,111 |
| | | |
| Total loans receivable, net | \$ 1,531,738 | \$ 1,390,184 |

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

| | 2007 | 2006 |
|--|-----------------------|-------------|
| | (In thousands) | |
| Balance, beginning of year | \$ 26,111 | \$ 24,175 |
| Additions | | |
| Provision charged to expense | 2,047 | 1,723 |
| | | |
| Net (recoveries) loans charged off | | |
| Losses charged to allowance, net of recoveries of \$818 and \$1,039 for the first nine months of 2007 and 2006, respectively | (478) | (54) |
| | | |
| Balance, September 30 | \$ 28,636 | 25,952 |
| | | |
| Additions | | |
| Provision charged to expense | | 584 |
| | | |
| Net loans charged off | | |
| Losses charged to allowance, net of recoveries of \$104 for the last three months of 2006 | | 425 |

Balance, end of year \$ 26,111

At September 30, 2007 and December 31, 2006, accruing loans delinquent 90 days or more totaled \$150,000 and \$641,000, respectively. Non-accruing loans at September 30, 2007 and December 31, 2006 were \$2.6 million and \$3.9 million, respectively.

During the three-month periods ended September 30, 2007 and 2006, the Company did not sell any of the guaranteed portion of SBA loans. During the nine-month periods ended September 30, 2007 and 2006, the Company sold \$2.8 million and \$506,000, respectively, of the guaranteed portion of certain SBA loans, which resulted in gains of \$170,000 and \$34,000, respectively.

Table of Contents

Mortgage loans held for sale of approximately \$4.5 million and \$2.4 million at September 30, 2007 and December 31, 2006, 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, 2007 and December 31, 2006, impaired loans totaled \$7.9 million and \$11.2 million, respectively. As of September 30, 2007 and 2006, average impaired loans were \$11.8 million and \$6.2 million, respectively. All impaired loans had designated reserves for possible loan losses. Reserves relative to impaired loans were \$1.5 million and \$2.1 million at September 30, 2007 and December 31, 2006, respectively. Interest recognized on impaired loans during 2007 and 2006 was immaterial.

5: Goodwill and Core Deposits and Other Intangibles

Changes in the carrying amount and accumulated amortization of the Company's core deposits and other intangibles at September 30, 2007 and December 31, 2006, were as follows:

| | September 30, 2007 | December 31, 2006 |
|--------------------------|-----------------------------------|----------------------------------|
| | (In thousands) | |
| Gross carrying amount | \$ 13,457 | \$ 13,457 |
| Accumulated amortization | 5,316 | 3,999 |
| Net carrying amount | \$ 8,141 | \$ 9,458 |

Core deposit and other intangible amortization for the three months ended September 30, 2007 and 2006 was approximately \$439,000. Core deposit intangible amortization for the nine months ended September 30, 2007 and 2006 was approximately \$1.3 million. Including all of the mergers completed, HBI's estimated amortization expense of core deposits and other intangibles for each of the years 2007 through 2011 is: 2007 \$1.7 million; 2008 \$1.7 million; 2009 \$1.7 million; 2010 \$1.6 million; and 2011 \$981,000.

The carrying amount of the Company's goodwill was \$37.5 million at September 30, 2007 and December 31, 2006. Goodwill is tested annually for impairment. If the implied fair value of goodwill is lower than its carrying amount, goodwill impairment is indicated and goodwill is written down to its implied fair value. Subsequent increases in goodwill value are not recognized in the financial statements.

6: Deposits

The aggregate amount of time deposits with a minimum denomination of \$100,000 was \$432.6 million and \$486.3 million at September 30, 2007 and December 31, 2006, respectively. Interest expense applicable to certificates in excess of \$100,000 totaled \$5.9 million and \$5.0 million for the three months ended September 30, 2007 and 2006, respectively. Interest expense applicable to certificates in excess of \$100,000 totaled \$17.2 million and \$13.6 million for the nine months ended September 30, 2007 and 2006, respectively.

Deposits totaling approximately \$188.7 million and \$203.0 million at September 30, 2007 and December 31, 2006, respectively, were public funds obtained primarily from state and political subdivisions in the United States.

Table of Contents**7: FHLB Borrowed Funds**

The Company's FHLB borrowed funds were \$226.0 million and \$151.8 million at September 30, 2007 and December 31, 2006, respectively. The outstanding balance for September 30, 2007 includes \$87.0 million of short-term advances and \$139.0 million of long-term advances. The outstanding balance for December 31, 2006 includes \$5.0 million of short-term advances and \$146.8 million of long-term advances. The long-term FHLB advances mature from 2007 to 2020 with interest rates ranging from 2.019% to 5.575% and are secured by loans in the Company's loan portfolio.

8: Subordinated Debentures

Subordinated Debentures at September 30, 2007 and December 31, 2006 consisted of guaranteed payments on trust preferred securities with the following components:

| | September 30, 2007 | December 31, 2006 |
|---|-----------------------------------|----------------------------------|
| | (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, callable in 2008 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 | 3,356 | 3,424 |
| Subordinated debentures, issued in 2003, due 2033, floating rate of 3.15% above the three-month LIBOR rate, reset quarterly, callable in 2008 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 |
| Total subordinated debt | \$ 44,595 | \$ 44,663 |

As a result of the acquisition of Marine Bancorp, Inc., the Company has an interest rate swap agreement that effectively converts the floating rate on the \$5.2 million trust preferred security noted above into a fixed interest rate of 7.29%, thus reducing the impact of interest rate changes on future interest expense until the call date.

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.

Table of Contents**9: 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, | |
|----------------------------|---|-------------|--|-------------|
| | 2007 | 2006 | 2007 | 2006 |
| | (In thousands) | | | |
| Current: | | | | |
| Federal | \$ 2,568 | \$ 1,859 | \$ 7,086 | \$ 5,224 |
| State | 363 | 369 | 970 | 1,038 |
| Total current | 2,931 | 2,228 | 8,056 | 6,262 |
| Deferred: | | | | |
| Federal | (567) | (224) | (1,499) | (935) |
| State | (106) | (44) | (284) | (186) |
| Total deferred | (673) | (268) | (1,783) | (1,121) |
| Provision for income taxes | \$ 2,258 | \$ 1,960 | \$ 6,273 | \$ 5,141 |

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, | |
|--|---|-------------|--|-------------|
| | 2007 | 2006 | 2007 | 2006 |
| Statutory federal income tax rate | 35.00% | 35.00% | 35.00% | 35.00% |
| Effect of nontaxable interest income | (4.60) | (4.51) | (4.75) | (5.48) |
| Cash value of life insurance | (2.83) | (0.30) | (2.99) | (0.34) |
| State income taxes, net of federal benefit | 2.23 | 2.37 | 2.09 | 2.12 |
| Other | 0.36 | (1.19) | 0.07 | (0.29) |
| Effective income tax rate | 30.16% | 31.37% | 29.42% | 31.01% |

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, 2007 | December 31, 2006 |
|--|-----------------------------------|----------------------------------|
| | (In thousands) | |
| Deferred tax assets: | | |
| Allowance for loan losses | \$ 11,212 | \$ 10,219 |
| Deferred compensation | 341 | 244 |
| Defined benefit pension plan | | 107 |
| Stock options | 283 | 155 |
| Non-accrual interest income | 513 | 489 |
| Investment in unconsolidated subsidiary | 552 | 485 |
| Unrealized loss on securities | 2,534 | 3,179 |
| Other | 148 | 170 |
| Gross deferred tax assets | 15,583 | 15,048 |
| Deferred tax liabilities: | | |
| Accelerated depreciation on premises and equipment | 1,964 | 2,082 |
| Core deposit intangibles | 3,061 | 3,552 |
| Market value of cash flow hedge | 3 | 25 |
| FHLB dividends | 639 | 567 |
| Other | 417 | 461 |
| Gross deferred tax liabilities | 6,084 | 6,687 |
| Net deferred tax assets | \$ 9,499 | \$ 8,361 |

10: Common Stock and Stock Compensation Plans

On August 1, 2006, the Company redeemed and converted the issued and outstanding shares of Home BancShares Class A Preferred Stock and Class B Preferred Stock into Home BancShares Common Stock. The conversion of the preferred stock increased the Company's outstanding common stock by approximately 2.2 million shares.

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

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

On June 22, 2006, the Company priced its initial public offering of 2.5 million shares of common stock at \$18.00 per share. The total price to the public for the shares offered and sold by the Company was \$45.0 million. The amount of expenses incurred for the Company's account in connection with the offering includes approximately \$3.1 million of underwriting discounts and commissions and offering expenses of approximately \$1.0 million. The Company received net proceeds of approximately \$40.9 million from its sale of shares after deducting sales commissions and expenses.

On July 21, 2006, the underwriters of the Company's initial public offering exercised and completed their option to purchase an additional 375,000 shares of common stock to cover over-allotments effective July 26, 2006. The Company received net proceeds of approximately \$6.3 million from this sale of shares after deducting sales

commissions.

Table of Contents

On March 13, 2006, the Company's board of directors adopted the 2006 Stock Option and Performance Incentive Plan. The Plan was submitted to the shareholders for approval at the 2006 annual meeting of shareholders. The purpose of the Plan is to attract and retain highly qualified officers, directors, key employees, and other persons, and to motivate those persons to improve our business results. This plan which was amended at the 2007 shareholder meeting provides for the granting of incentive nonqualified options to purchase up to 1.5 million shares of common stock in the Company.

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

As of March 13, 2006, options for a total of 613,604 shares of common stock outstanding under the prior plans became subject to the Plan. Also, on that date, the Company's board of directors replaced 341,000 outstanding stock appreciation rights with 354,640 options, each with an exercise price of \$13.18. During 2005, the Company had issued 341,000 stock appreciation rights at \$12.67 for certain executive employees throughout the Company. The appreciation rights were on a five-year cliff-vesting schedule with all appreciation rights vesting on December 31, 2009. The vesting was also subject to various financial performance goals of the Company and the subsidiary banks over the five-year period ending January 1, 2010. The options issued in replacement of the stock appreciation rights are subject to achievement of the same financial goals by the Company and the bank subsidiaries over the five-year period ending January 1, 2010.

On January 1, 2006, the Company adopted the fair value recognition provisions of FASB Statement No. 123 (R), Share-Based Payment (SFAS123(R)), using the modified-prospective-transition method. Under that transition method, compensation cost is recognized beginning in 2006 includes: (a) the compensation cost for all share-based payments granted prior to, but not yet vested as of January 1, 2006, based on the grant date fair value estimated in accordance with the original provisions of FASB Statement No. 123, and (b) the compensation cost for all share-based payments granted subsequent to January 1, 2006, based on the grant-date fair value estimated in accordance with the provisions of SFAS 123 (R). Prior to January 1, 2006, the Company accounted for stock-based compensation using the intrinsic value method. 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 \$650,000 as of September 30, 2007.

As a result of adopting SFAS 123(R), the Company's income before income taxes and net income for the three months ended September 30, 2007, are \$118,000 and \$72,000 lower, respectively, than if the Company had continued to account for share-based compensation under the intrinsic method. As a result of adopting SFAS 123(R), the Company's income before income taxes and net income for the nine months ended September 30, 2007, are \$340,000 and \$207,000 lower, respectively, than if the Company had continued to account for share-based compensation under the intrinsic method. Basic and diluted earnings per share for the three months ended September 30, 2007, would have been \$0.31 and \$0.30, respectively, if the Company had not adopted Statement 123(R), compared to reported basic and diluted earnings per share of \$0.30. Basic and diluted earnings per share for the nine months ended September 30, 2007, would have been \$0.88 and \$0.87, respectively, if the Company had not adopted Statement 123(R), compared to reported basic and diluted earnings per share of \$0.87 and \$0.86, respectively. For purposes of pro forma disclosures as required by SFAS No. 123(R), the estimated fair value of stock options is amortized over the options' vesting period. The intrinsic value of the stock options outstanding and stock options vested at September 30, 2007 was \$10.1 million and \$6.7 million, respectively. The intrinsic value of the stock options exercised during the three-month and nine-month periods ended September 30, 2007 was \$62,000 and \$579,000, respectively.

Table of Contents

As a result of adopting SFAS 123(R), the Company's income before income taxes and net income for the three months ended September 30, 2006, are \$98,000 and \$67,000 lower, respectively, than if the Company had continued to account for share-based compensation under the intrinsic method. As a result of adopting SFAS 123(R), the Company's income before income taxes and net income for the nine months ended September 30, 2006, are \$303,000 and \$209,000 lower, respectively, than if the Company had continued to account for share-based compensation under the intrinsic method. Basic and diluted earnings per share were not impacted by SFAS 123(R) for the three months ended September 30, 2006. Basic and diluted earnings per share for the nine months ended September 30, 2006, would have been \$0.83 and \$0.76, respectively, if the Company had not adopted Statement 123(R), compared to reported basic and diluted earnings per share of \$0.82 and \$0.74, respectively.

The table below summarized the transactions under the Company's stock option plans at September 30, 2007 and December 31, 2006 and changes during the nine-month period and year then ended, respectively:

| | For Nine Months Ended September 30, 2007 | | For the Year Ended December 31, 2006 | |
|--|---|---|---|---|
| | Shares (000) | Weighted Average Exercisable Price | Shares (000) | Weighted Average Exercisable Price |
| Outstanding, beginning of year | 1,032 | \$ 11.39 | 630 | \$ 10.07 |
| Granted | 41 | 23.02 | 410 | 14.22 |
| Converted options of preferred stock A | | | 9 | 8.66 |
| Converted options of preferred stock B | | | 71 | 6.36 |
| Forfeited | (12) | 12.29 | (31) | 12.90 |
| Exercised | (37) | 7.40 | (57) | 9.40 |
| Outstanding, end of period | 1,024 | 12.01 | 1,032 | 11.39 |
| Exercisable, end of period | 557 | \$ 9.78 | 560 | \$ 9.27 |

For stock option awards, the fair value is estimated at the date of grant using the Black-Scholes option-pricing model. This model requires the input of highly subjective assumptions, changes to which can materially affect the fair value estimate. Additionally, there may be other factors that would otherwise have a significant effect on the value of employee stock options granted but are not considered by the model. Accordingly, while management believes that the Black-Scholes option-pricing model provides a reasonable estimate of fair value, the model does not necessarily provide the best single measure of fair value for the Company's employee stock options. The weighted-average fair value of options granted during the nine months ended September 30, 2007 and year-ended December 31, 2006, was \$5.34 and \$3.39, respectively. The fair value of each option granted is estimated on the date of grant using the Black-Scholes option-pricing model with the following weighted-average assumptions:

| | For Nine Months Ended September 30, 2007 | For the Year Ended December 31, 2006 |
|---------------------------------|---|---|
| Expected dividend yield | 0.46% | 0.59% |
| Expected stock price Volatility | 9.44% | 9.23% |
| Risk-free interest rate | 4.65% | 4.80% |
| Expected life of options | 6.1 years | 6.3 years |

Table of Contents

The following is a summary of currently outstanding and exercisable options at September 30, 2007:

| | 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 |
| \$6.14 to \$6.68 | 48 | 4.6 | \$ 6.38 | 48 | \$ 6.38 |
| \$7.33 to \$8.66 | 204 | 4.6 | 7.43 | 204 | 7.43 |
| \$9.33 to \$10.31 | 105 | 5.9 | 10.17 | 101 | 10.18 |
| \$11.34 to \$11.67 | 69 | 7.6 | 11.41 | 63 | 11.38 |
| \$12.67 to \$12.67 | 184 | 9.2 | 12.67 | 128 | 12.67 |
| \$13.18 to \$13.18 | 320 | 8.5 | 13.18 | 3 | 13.18 |
| \$19.79 to \$21.17 | 53 | 8.9 | 21.14 | 10 | 21.17 |
| \$21.89 to \$22.12 | 20 | 9.6 | 22.05 | | |
| \$23.27 to \$24.15 | 21 | 9.3 | 24.11 | | |
| | 1,024 | | | 557 | |

11. Non-Interest Expense

The table below shows the components of non-interest expense for three and nine months ended September 30, 2007 and 2006:

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|--------------------------------|-------------------------------------|----------|------------------------------------|-----------|
| | 2007 | 2006 | 2007 | 2006 |
| | (In thousands) | | | |
| Salaries and employee benefits | \$ 7,739 | \$ 7,376 | \$ 22,936 | \$ 22,123 |
| Occupancy and equipment | 2,446 | 2,223 | 6,998 | 6,351 |
| Data processing expense | 644 | 651 | 1,958 | 1,888 |
| Other operating expenses: | | | | |
| Advertising | 646 | 568 | 1,855 | 1,738 |
| Amortization of intangibles | 439 | 439 | 1,317 | 1,303 |
| Electronic banking expense | 618 | 152 | 1,803 | 430 |
| Directors' fees | 225 | 203 | 617 | 609 |
| Due from bank service charges | 55 | 91 | 162 | 245 |
| FDIC and state assessment | 266 | 142 | 757 | 394 |
| Insurance | 211 | 285 | 683 | 741 |
| Legal and accounting | 308 | 191 | 930 | 747 |
| Other professional fees | 201 | 204 | 585 | 487 |
| Operating supplies | 241 | 202 | 694 | 684 |
| Postage | 163 | 171 | 498 | 500 |
| Telephone | 227 | 251 | 688 | 755 |
| Other expense | 1,170 | 1,088 | 3,376 | 3,004 |
| Total other operating expenses | 4,770 | 3,987 | 13,965 | 11,637 |

| | | | | |
|----------------------------|-----------|-----------|-----------|-----------|
| Total non-interest expense | \$ 15,599 | \$ 14,237 | \$ 45,857 | \$ 41,999 |
|----------------------------|-----------|-----------|-----------|-----------|

Table of Contents

At its April 20, 2007 meeting, our Board of Directors approved a Chairman's Retirement Plan for John Allison our Chairman and CEO. Beginning on Mr. Allison's 65th birthday, he will receive a \$250,000 annual benefit to be paid for 10 consecutive years or until his death, whichever shall occur later. This will result in an increase of approximately \$388,000 and \$535,000 to non-interest expense for 2007 and 2008, respectively. An expense of \$130,000 and \$258,000 was accrued for the three and nine months ended September 30, 2007, respectively. This expense was accrued using an 8 percent discount factor.

12: Concentration of Credit Risks

The Company's primary market area is in central Arkansas, north central Arkansas, northwest 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.

13: 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.

14: 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, 2007 and December 31, 2006, commitments to extend credit of \$292.0 million and \$227.5 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, 2007 and December 31, 2006, is \$17.8 million and \$16.1 million, respectively.

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

Table of Contents**15: Regulatory Matters**

The Company's subsidiaries are subject to a legal limitation on dividends that can be paid to the parent company without prior approval of the applicable regulatory agencies. Arkansas bank regulators have specified that the maximum dividend limit state banks may pay to the parent company without prior approval is 75% of the current year earnings plus 75% of the retained net earnings of the preceding year. Since, the Company's Arkansas bank subsidiaries are also under supervision of the Federal Reserve, they are further limited if the total of all dividends declared in any calendar year by the Bank exceeds the Bank's net profits to date for that year combined with its retained net profits for the preceding two years. Under Florida state banking law, regulatory approval will be required if the total of all dividends declared in any calendar year by the Bank exceeds the Bank's net profits to date for that year combined with its retained net profits for the preceding two years. As the result of historical special dividends paid and leveraged capital positions, the Company's subsidiary banks do not have any significant undivided profits available for payment of dividends to the Company, without prior approval of the regulatory agencies at September 30, 2007.

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, 2007, each of the five subsidiary banks 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 was 11.40%, 13.44%, and 14.69%, respectively, as of September 30, 2007.

16: Additional Cash Flow Information

The Company paid interest and taxes during the three and nine months ended as follows:

| | Three Months Ended | | Nine Months Ended | |
|-------------------|---------------------------|-------------|--------------------------|-------------|
| | September 30, | | September 30, | |
| | 2007 | 2006 | 2007 | 2006 |
| | (In thousands) | | | |
| Interest paid | \$18,587 | \$15,528 | \$55,531 | \$42,354 |
| Income taxes paid | 1,620 | 1,100 | 7,320 | 4,520 |

17: Recent Accounting Pronouncements

In February 2007, the Financial Accounting Standards Board (FASB) issued SFAS No. 159 The Fair Value Option for Financial Assets and Financial Liabilities to provide companies with an option to report selected financial assets and liabilities at fair value. The objective is to improve financial reporting by providing entities with the opportunity to mitigate volatility in reported earnings caused by measuring related assets and liabilities differently without having to apply complex hedge accounting provisions. This statement shall be effective as of the beginning of each reporting entity's first fiscal year that begins after November 15, 2007. The Company is currently evaluating the impact of the adoption of this standard, but does not expect it to have a material effect on the Company's financial position or results of operations.

Table of Contents

In September 2006, the FASB issued SFAS No. 157, Fair Value Measurements, which defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles (GAAP), and expands disclosures about fair value measurements. This Statement applies under other accounting pronouncements that require or permit fair value measurements, FASB having previously concluded in those accounting pronouncements that fair value is the relevant measurement attribute. Accordingly, this Statement does not require any new fair value measurements. SFAS No. 157 is effective for financial statements issued for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years. The Company is currently evaluating the impact of the adoption of this standard, but does not expect it to have a material effect on the Company's financial position or results of operations.

In September 2006, the FASB Emerging Issue Task Force (EITF) issued EITF 06-4, Accounting for Deferred Compensation and Postretirement Benefit Aspects of Endorsement Split-Dollar Life Insurance Arrangements. The EITF determined that for an endorsement split-dollar life insurance arrangement within the scope of the Issue, the employer should recognize a liability for future benefits in accordance with SFAS No. 106, Employers' Accounting for Postretirement Benefits Other Than Pensions, or APB Opinion 12, Omnibus Opinion-1967, based on the substantive agreement with the employee. In March 2007, the FASB Emerging Issue Task Force (EITF) issued EITF 06-10, Accounting for Deferred Compensation and Postretirement Benefit Aspects of Collateral Assignment Split-Dollar Life Insurance Arrangements. The EITF determined that an employer should recognize a liability for the postretirement benefit related to a collateral assignment split-dollar life insurance arrangement in accordance with either Statement 106 (if, in substance, a postretirement benefit plan exists) or Opinion 12 (if the arrangement is, in substance, an individual deferred compensation contract) based on the substantive agreement with the employee. These Issues are effective for fiscal years beginning after December 15, 2007, with earlier application permitted. Entities should recognize the effects of applying EITF 06-4 through either (a) a change in accounting principle through a cumulative-effect adjustment to retained earnings or to other components of equity or net assets in the statement of financial position as of the beginning of the year of adoption or (b) a change in accounting principle through retrospective application to all prior periods. As of September 30, 2007, the Company has split-dollar life insurance arrangements with two executives of the Company that have death benefits. The Company is currently evaluating the impact that the adoption of EITF 06-4 and EITF 06-10, but does not expect it to have a material effect on the Company's financial position or results of operations.

In June 2006, the FASB issued Interpretation No. 48, Accounting for Uncertainty in Income Taxes, which provides clarification for uncertainty in income taxes recognized in an enterprise's financial statements in accordance with SFAS No. 109, Accounting for Income Taxes. This Interpretation prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. This Interpretation also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure, and transition. The Interpretation is effective for fiscal years beginning after December 31, 2006. The Company adopted the Interpretation during the first quarter of 2007 without material effect on the Company's financial position or results of operations.

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

Table of Contents

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, 2007 and the related condensed consolidated statements of income for the three-month and nine-month periods ended September 30, 2007 and 2006 and statements of stockholders' equity and cash flows for the nine-month periods ended September 30, 2007 and 2006. 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, 2006 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 15, 2007, 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, 2006 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 7, 2007

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 20, 2007, which includes the audited financial statements for the year ended December 31, 2006. *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 financial holding company headquartered in Conway, Arkansas, offering a broad array of financial services through our five wholly owned bank subsidiaries. As of September 30, 2007, we had, on a consolidated basis, total assets of \$2.27 billion, loans receivable of \$1.56 billion, total deposits of \$1.60 billion, and shareholders' equity of \$246.6 million.

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

| | Key Financial Measures | | | |
|-------------------------------------|--|-------------|--------------------------------------|-------------|
| | As of and for the Three Months | | As of and for the Nine Months | |
| | Ended September 30, | | Ended September 30, | |
| | 2007 | 2006 | 2007 | 2006 |
| | (Dollars in thousands, except per share data) | | | |
| Total assets | \$2,267,672 | \$2,113,498 | \$2,267,672 | \$2,113,498 |
| Loans receivable | 1,560,374 | 1,387,279 | 1,560,374 | 1,387,279 |
| Total deposits | 1,598,571 | 1,557,533 | 1,598,571 | 1,557,533 |
| Net income | 5,228 | 4,288 | 15,050 | 11,440 |
| Basic earnings per share | 0.30 | 0.26 | 0.87 | 0.82 |
| Diluted earnings per share | 0.30 | 0.25 | 0.86 | 0.74 |
| Diluted cash earnings per share (1) | 0.31 | 0.26 | 0.90 | 0.79 |
| Annualized net interest margin FTE | 3.55% | 3.57% | 3.49% | 3.54% |
| Efficiency ratio | 62.47 | 63.72 | 62.65 | 65.66 |
| Annualized return on average assets | 0.92 | 0.83 | 0.91 | 0.77 |
| Annualized return on average equity | 8.60 | 7.81 | 8.48 | 8.25 |

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

Overview

Our net income increased 21.9% to \$5.2 million for the three-month period ended September 30, 2007, from \$4.3 million for the same period in 2006. For the nine months ended September 30, 2007, net income increased 31.6% to \$15.1 million compared to \$11.4 million for the same period in 2006. On a diluted earnings per share basis, our net earnings increased 20.0% to \$0.30 for the three-month period ended September 30, 2007, as compared to \$0.25 for the

same period in 2006. Diluted earnings per share increased 16.2% to \$0.86 per share for the nine months ended September 30, 2007 compared to \$0.74 for the same period in 2006. The increase in earnings per share for the three and nine months ended September 30, 2007 is primarily associated with organic growth of our bank subsidiaries.

Table of Contents

Our annualized return on average assets was 0.92% and 0.91% for the three and nine months ended September 30, 2007, compared to 0.83% and 0.77% for the same periods in 2006, respectively. Our annualized return on average equity was 8.60% and 8.48% for the three and nine months ended September 30, 2007, compared to 7.81% and 8.25% for the same periods in 2006, respectively. The increases were primarily due to the improvement in net income for the three and nine months ended September 30, 2007, compared to the same periods in 2006.

Our annualized net interest margin, on a fully taxable equivalent basis, was 3.55% and 3.49% for the three and nine months ended September 30, 2007, compared to 3.57% and 3.54% for the same periods in 2006, respectively. Competitive pressures and a slightly inverted yield curve put pressure on our net interest margin causing the decline from September 30, 2006 to September 30, 2007. The current competitive pressures have eased somewhat during 2007 allowing for an improvement of our net interest margin on a linked quarter basis by achieving strong loan growth that was partially funded by maturities in the investment portfolio.

Our efficiency ratio (calculated by dividing non-interest expense less amortization of core deposit intangibles by the sum of net interest income on a tax equivalent basis and non-interest income) was 62.47% and 62.65% for three and nine months ended September 30, 2007, compared to 63.72% and 65.66% for the same periods in 2006, respectively. The improvement in our efficiency ratio for the three months ended September 30, 2007 compared to the same period in 2006 is primarily due to the continued improvement of our operations. The improvement in our efficiency ratio for the nine months ended September 30, 2007 compared to the same period in 2006 is primarily due to an increase in net interest income from the net proceeds of our initial public offering and continued improvement of our operations.

Our total assets increased \$77.0 million, an annualized growth of 4.7%, to \$2.27 billion as of September 30, 2007, from \$2.19 billion as of December 31, 2006. Our loan portfolio increased \$144.1 million, an annualized growth of 13.6%, to \$1.56 billion as of September 30, 2007, from \$1.42 billion as of December 31, 2006. Shareholders' equity increased \$15.2 million, an annualized growth of 8.8%, to \$246.6 million as of September 30, 2007, compared to \$231.4 million as of December 31, 2006. Asset and loan increases are primarily associated with organic growth of our bank subsidiaries. The increase in stockholders' equity was primarily the result of the retained earnings for the nine months.

As of September 30, 2007, our non-performing loans decreased to \$2.7 million, or 0.17%, of total loans from \$4.5 million, or 0.32%, of total loans as of December 31, 2006. The allowance for loan losses as a percent of non-performing loans increased to 1052.0% as of September 30, 2007, compared to 574.4% from December 31, 2006. These ratios reflect the continuing commitment of our management to improve and maintain sound asset quality.

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.

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.

Table of Contents

Investments. Securities available for sale are reported at fair value with unrealized holding gains and losses reported as a separate component of shareholders' equity and other comprehensive income (loss). 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 collectibility, relevant credit exposure, particular risks inherent in different kinds of lending, current collateral values and other relevant factors.

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

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

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

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.

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

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

Acquisitions and Equity Investments

On August 24, 2007, we announced the signing of a definitive agreement for the acquisition of Centennial Bancshares, Inc. in exchange for our stock and cash. Immediately after the acquisition, Centennial Bank, a wholly owned subsidiary of Centennial Bancshares, Inc., will be operated as our subsidiary bank. The Centennial Bancshares shareholders that are accredited investors will receive whole shares of our stock equal to the product of 16.8153 and the number of shares of Centennial Bancshares stock surrendered. The unaccredited investors, which are projected to represent a 2% ownership of Centennial Bancshares, will receive in the aggregate approximately \$500,000 in cash. The definitive agreement further provides for an earn out based upon 2008 earnings of up to a maximum of \$4,000,000 which can be paid in cash or our stock at the election of the accredited shareholders. Based upon the closing price of our stock on September 30, 2007 of \$21.79 per share the total purchase price excluding the earn out is approximately \$24.8 million. The acquisition is conditioned upon regulatory approval and other customary conditions.

In January 2005, we purchased 20% of the common stock during the formation of White River Bancshares, Inc. of Fayetteville, Arkansas for \$9.1 million. White River Bancshares owns all of the stock of Signature Bank of Arkansas, with branch locations in northwest Arkansas. In January 2006, White River Bancshares issued an additional \$15.0 million of common stock. To maintain our 20% ownership, we made an additional investment of \$3.0 million in January 2006. During April 2007, White River Bancshares acquired 100% of the stock of Brinkley Bancshares, Inc. in Brinkley, Arkansas. As a result, we made a \$2.6 million additional investment in White River Bancshares on June 29, 2007 to maintain our 20% ownership. At September 30, 2007, White River Bancshares had approximately \$507.8 million in total assets, \$411.8 million in total loans and \$424.6 million in total deposits.

We have offered White River Bancshares, Inc. an opportunity to repurchase our investment in their company at \$150.00 per share. Presently, this transaction is under consideration by their Board of Directors. If the transaction moves forward, it will be on terms that result in a modest accretion to the 2008 earnings and would include a one-time gain.

Table of Contents

In our continuing evaluation of our growth plans for the Company, we believe properly priced bank acquisitions can complement our organic growth and de novo branching growth strategies. The Company's acquisition focus will be to expand in its primary market areas of Arkansas and Florida. However, management was familiar with the Texas market with a prior institution and, if opportunities arise, would look to expand through a banking acquisition in the Texas market. We are continually evaluating potential bank acquisitions to determine what is in the best interest of our Company. Our goal in making these decisions is to maximize the return to our investors.

De Novo Branching

We intend to continue to open new (commonly referred to de novo) branches in our current markets and in other attractive market areas if opportunities arise. During 2007, we opened branch locations in the Arkansas communities of Quitman, Searcy (2 branches), and Bryant plus Key West and Key Largo, Florida. Also during 2007, we consolidated two of our Cabot branch locations into one new financial center. Presently, we are evaluating additional opportunities and have two pending de novo branch locations in Morrilton and Cabot, Arkansas.

Results of Operations

Our net income increased 21.9% to \$5.2 million for the three-month period ended September 30, 2007, from \$4.3 million for the same period in 2006. For the nine months ended September 30, 2007, net income increased 31.6% to \$15.1 million compared to \$11.4 million for the same period in 2006. On a diluted earnings per share basis, our net earnings increased 20.0% to \$0.30 for the three-month period ended September 30, 2007, as compared to \$0.25 for the same period in 2006. Diluted earnings per share increased 16.2% to \$0.86 per share for the nine months ended September 30, 2007 compared to \$0.74 for the same period in 2006. The increase in earnings per share is primarily associated with organic growth of our bank subsidiaries.

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

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 2004 at 1%. During 2004, the Federal Funds rate increased 125 basis points to end the year at 2.25%. Over the next 6 quarters, the Federal Funds rate increased 50 basis points in each of the six quarters until June 29, 2006 when it reached 5.25%. The rate then remained constant until September 18, 2007, when the Federal Funds rate was lowered by 50 basis points to 4.75%. Due to this occurring late in the third quarter of 2007, the impact for the quarter was minimal. Going forward, we will begin to see more of an impact of the decrease in the Federal Funds rate as our earning assets and interest-bearing liabilities begin to reprice. Average interest rates for the three and nine months ended September 30, 2007 reflect the higher interest rate environment that existed until September 18, 2007 when the Federal Funds rate was lowered.

Table of Contents

Net interest income on a fully taxable equivalent basis increased \$1.0 million, or 5.9%, to \$18.0 million for the three-month period ended September 30, 2007, from \$17.0 million for the same period in 2006. This increase in net interest income was the result of a \$4.0 million increase in interest income offset by \$3.0 million increase in interest expense. The \$4.0 million increase in interest income was primarily the result of organic growth of our bank subsidiaries combined with the repricing of our earning assets in the higher interest rate environment. The higher level of earning assets resulted in an improvement in interest income of \$3.0 million, and our earning assets repricing in the higher interest rate environment resulted in a \$1.0 million increase in interest income for the three-month period ended September 30, 2007. The \$3.0 million increase in interest expense for the three-month period ended September 30, 2007, is primarily the result of organic growth of our bank subsidiaries combined with our interest bearing liabilities repricing in the higher interest rate environment. The higher level of interest-bearing liabilities resulted in additional interest expense of \$1.6 million. The repricing of our interest bearing liabilities in the higher interest rate environment resulted in a \$1.4 million increase in interest expense for the three-month period ended September 30, 2007.

Net interest income on a fully taxable equivalent basis increased \$3.7 million, or 7.7%, to \$52.0 million for the nine-month period ended September 30, 2007, from \$48.3 million for the same period in 2006. This increase in net interest income was the result of a \$15.8 million increase in interest income offset by \$12.1 million increase in interest expense. The \$15.8 million increase in interest income was primarily the result of organic growth of our bank subsidiaries combined with the repricing of our earning assets in the higher interest rate environment. The higher level of earning assets resulted in an improvement in interest income of \$11.0 million, and our earning assets repricing in the higher interest rate environment resulted in a \$4.8 million increase in interest income for the nine-month period ended September 30, 2007. The \$12.1 million increase in interest expense for the nine-month period ended September 30, 2007, is primarily the result of organic growth of our bank subsidiaries combined with our interest bearing liabilities repricing in the higher interest rate environment. The higher level of interest-bearing liabilities resulted in additional interest expense of \$4.6 million. The repricing of our interest bearing liabilities in the higher interest rate environment resulted in a \$7.5 million increase in interest expense for the nine-month period ended September 30, 2007.

Net interest margin, on a fully taxable equivalent basis, was 3.55% and 3.49% for the three and nine months ended September 30, 2007 compared to 3.57% and 3.54% for the same periods in 2006, respectively. During 2006, competitive pressures and a slightly inverted yield curve put pressure on the Company's net interest margin. The current competitive pressures have eased somewhat during 2007, allowing the Company to improve net interest margin on a linked quarter basis by achieving strong long growth that was partially funded by maturities in the investment portfolio.

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, 2007 and 2006, as well as changes in fully taxable equivalent net interest margin for the three-month and nine-month periods ended September 30, 2007, compared to the same periods in 2006.

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

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|--|-------------------------------------|-----------|------------------------------------|-----------|
| | 2007 | 2006 | 2007 | 2006 |
| | (Dollars in thousands) | | | |
| Interest income | \$ 36,381 | \$ 32,458 | \$ 105,709 | \$ 90,078 |
| Fully taxable equivalent adjustment | 634 | 521 | 1,867 | 1,676 |
| Interest income fully taxable equivalent | 37,015 | 32,979 | 107,576 | 91,754 |
| Interest expense | 19,061 | 16,022 | 55,582 | 43,473 |
| Net interest income fully taxable equivalent | \$ 17,954 | \$ 16,957 | \$ 51,994 | \$ 48,281 |
| Yield on earning assets fully taxable equivalent | 7.31% | 6.95% | 7.23% | 6.73% |
| Cost of interest-bearing liabilities | 4.26 | 3.93 | 4.24 | 3.67 |
| Net interest spread fully taxable equivalent | 3.05 | 3.02 | 2.99 | 3.06 |
| Net interest margin fully taxable equivalent | 3.55 | 3.57 | 3.49 | 3.54 |

Table 2: Changes in Fully Taxable Equivalent Net Interest Margin

| | Three Months Ended September 30, 2007 | Nine Months Ended September 30, |
|---|--|--|
| | vs. 2006 | 2007 vs. 2006 |
| | (In thousands) | |
| Increase in interest income due to change in earning assets | \$ 3,029 | \$ 10,996 |
| Increase in interest income due to change in earning asset yields | 1,007 | 4,826 |
| Increase in interest expense due to change in interest-bearing liabilities | 1,569 | 4,599 |
| Increase in interest expense due to change in interest rates paid on interest-bearing liabilities | 1,470 | 7,510 |
| Increase in net interest income | \$ 997 | \$ 3,713 |

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, 2007 and 2006. The table also shows the average rate earned on all earning assets, the average rate expensed on all interest-bearing liabilities, the net interest spread and the net interest margin for the same periods. The analysis is presented on a fully taxable equivalent basis. Non-accrual loans were included in average loans for the purpose of calculating the rate earned on total loans.

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

| | Three Months Ended September 30, | | | | | |
|--|----------------------------------|---------------------|--|--------------------|---------------------|--------------------|
| | 2007 | | | 2006 | | |
| | Average Balance | Income / Expense | Yield / Rate (Dollars in thousands) | Average Balance | Income / Expense | Yield / Rate |
| ASSETS | | | | | | |
| Earning assets | | | | | | |
| Interest-bearing balances | | | | | | |
| due from banks | \$ 3,894 | \$ 53 | 5.40% | \$ 2,927 | \$ 38 | 5.15% |
| Federal funds sold | 2,995 | 36 | 4.77 | 3,887 | 51 | 5.21 |
| Investment securities taxable | 366,530 | 4,133 | 4.47 | 418,753 | 4,738 | 4.49 |
| Investment securities non-taxable | 87,953 | 1,614 | 7.28 | 91,931 | 1,361 | 5.87 |
| Loans receivable | 1,547,858 | 31,179 | 7.99 | 1,364,587 | 26,791 | 7.79 |
| Total interest-earning assets | 2,009,230 | 37,015 | 7.31 | 1,882,085 | 32,979 | 6.95 |
| Non-earning assets | 234,003 | | | 177,846 | | |
| Total assets | \$ 2,243,233 | | | \$ 2,059,931 | | |
| LIABILITIES AND SHAREHOLDERS EQUITY | | | | | | |
| Liabilities | | | | | | |
| Interest-bearing liabilities | | | | | | |
| Interest-bearing transaction and savings deposits | \$ 586,710 | \$ 4,375 | 2.96% | \$ 516,207 | \$ 3,358 | 2.58% |
| Time deposits | 813,676 | 10,041 | 4.90 | 769,271 | 8,652 | 4.46 |
| Total interest-bearing deposits | 1,400,386 | 14,416 | 4.08 | 1,285,478 | 12,010 | 3.71 |
| Federal funds purchased | 14,446 | 194 | 5.33 | 13,232 | 178 | 5.34 |
| Securities sold under agreement to repurchase | 125,877 | 1,267 | 3.99 | 118,796 | 1,258 | 4.20 |
| FHLB and other borrowed funds | 191,887 | 2,426 | 5.02 | 153,921 | 1,825 | 4.70 |
| Subordinated debentures | 44,609 | 758 | 6.74 | 44,699 | 751 | 6.67 |
| Total interest-bearing liabilities | 1,777,205 | 19,061 | 4.26 | 1,616,126 | 16,022 | 3.93 |
| Non-interest bearing liabilities | | | | | | |

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| | | | | |
|--|--------------|-------|--------------|-------|
| Non-interest-bearing deposits | 212,298 | | 213,682 | |
| Other liabilities | 12,577 | | 12,179 | |
| Total liabilities | 2,002,080 | | 1,841,987 | |
| Shareholders' equity | 241,153 | | 217,944 | |
| Total liabilities and shareholders' equity | \$ 2,243,233 | | \$ 2,059,931 | |
| Net interest spread | | 3.05% | | 3.02% |
| Net interest income and margin | \$ 17,954 | 3.55 | \$ 16,957 | 3.57 |

Table of Contents

| | Nine Months Ended September 30, | | | | | |
|---|---------------------------------|---------------------|--------------------|--------------------|------------------------|--------------------|
| | 2007 | | | 2006 | | |
| | Average Balance | Income / Expense | Yield / Rate | Average Balance | Income / Expense | Yield / Rate |
| | (Dollars in thousands) | | | | | |
| ASSETS | | | | | | |
| Earning assets | | | | | | |
| Interest-bearing balances due from | | | | | | |
| banks | \$ 3,336 | \$ 132 | 5.29% | \$ 2,916 | \$ 103 | 4.72% |
| Federal funds sold | 7,973 | 311 | 5.22 | 11,062 | 393 | 4.75 |
| Investment securities taxable | 382,985 | 12,992 | 4.54 | 426,549 | 14,174 | 4.44 |
| Investment securities non-taxable | 94,227 | 4,781 | 6.78 | 92,179 | 4,367 | 6.33 |
| Loans receivable | 1,501,983 | 89,360 | 7.95 | 1,289,594 | 72,717 | 7.54 |
| Total interest-earning assets | 1,990,504 | 107,576 | 7.23 | 1,822,300 | 91,754 | 6.73 |
| Non-earning assets | 227,419 | | | 173,821 | | |
| Total assets | \$ 2,217,923 | | | \$ 1,996,121 | | |
| LIABILITIES AND SHAREHOLDERS EQUITY | | | | | | |
| Liabilities | | | | | | |
| Interest-bearing liabilities | | | | | | |
| Interest-bearing transaction and savings | | | | | | |
| deposits | \$ 598,070 | \$ 13,357 | 2.99% | \$ 523,843 | \$ 9,323 | 2.38% |
| Time deposits | 805,125 | 29,283 | 4.86 | 747,782 | 23,360 | 4.18 |
| Total interest-bearing deposits | 1,403,195 | 42,640 | 4.06 | 1,271,625 | 32,683 | 3.44 |
| Federal funds purchased | 16,071 | 646 | 5.37 | 17,221 | 636 | 4.94 |
| Securities sold under agreement to repurchase | 120,451 | 3,772 | 4.19 | 107,798 | 3,122 | 3.87 |
| FHLB and other borrowed funds | 168,046 | 6,270 | 4.99 | 141,994 | 4,787 | 4.51 |
| Subordinated debentures | 44,631 | 2,254 | 6.75 | 44,722 | 2,245 | 6.71 |
| Total interest-bearing liabilities | 1,752,394 | 55,582 | 4.24 | 1,583,360 | 43,473 | 3.67 |
| Non-interest bearing liabilities | | | | | | |
| Non-interest-bearing deposits | 215,716 | | | 216,366 | | |
| Other liabilities | 12,422 | | | 10,903 | | |
| Total liabilities | 1,980,532 | | | 1,810,629 | | |
| Shareholders equity | 237,391 | | | 185,492 | | |
| Total liabilities and shareholders equity | \$ 2,217,923 | | | \$ 1,996,121 | | |

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| | | | | |
|--------------------------------|-----------|-------|-----------|-------|
| Net interest spread | | 2.99% | | 3.06% |
| Net interest income and margin | \$ 51,994 | 3.49 | \$ 48,281 | 3.54 |

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, 2007 compared to the same periods in 2006, on a fully taxable basis. The changes in interest rate and volume have been allocated to changes in average volume and changes in average rates, in proportion to the relationship of absolute dollar amounts of the changes in rates and volume.

Table of Contents**Table 4: Volume/Rate Analysis**

| | Three Months Ended September 30, 2007 over 2006 | | | Nine Months Ended September 30, 2007 over 2006 | | |
|------------------------------|--|------------|--------|---|------------|----------|
| | Volume | Yield/Rate | Total | Volume | Yield/Rate | Total |
| (In thousands) | | | | | | |
| Increase (decrease) in: | | | | | | |
| Interest income: | | | | | | |
| Interest-bearing balances | | | | | | |
| due from banks | 13 | 2 | 15 | 16 | 13 | 29 |
| Federal funds sold | (11) | (4) | (15) | (117) | 35 | (82) |
| Investment securities | | | | | | |
| taxable | (589) | (16) | (605) | (1,473) | 291 | (1,182) |
| Investment securities | | | | | | |
| non-taxable | (61) | 314 | 253 | 99 | 315 | 414 |
| Loans receivable | 3,677 | 711 | 4,388 | 12,471 | 4,172 | 16,643 |
| Total interest income | 3,029 | 1,007 | 4,036 | 10,996 | 4,826 | 15,822 |
| Interest expense: | | | | | | |
| Interest-bearing transaction | | | | | | |
| and savings deposits | 491 | 526 | 1,017 | 1,441 | 2,593 | 4,034 |
| Time deposits | 517 | 872 | 1,389 | 1,886 | 4,037 | 5,923 |
| Federal funds purchased | 16 | | 16 | (44) | 54 | 10 |
| Securities sold under | | | | | | |
| agreement to repurchase | 73 | (64) | 9 | 384 | 266 | 650 |
| FHLB and other borrowed | | | | | | |
| funds | 474 | 127 | 601 | 937 | 546 | 1,483 |
| Subordinated debentures | (2) | 9 | 7 | (5) | 14 | 9 |
| Total interest expense | 1,569 | 1,470 | 3,039 | 4,599 | 7,510 | 12,109 |
| Increase (decrease) in net | | | | | | |
| interest income | \$ 1,460 | \$ (463) | \$ 997 | \$ 6,397 | \$ (2,684) | \$ 3,713 |

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.

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

loan s assigned risk grade. Aggregate dollar volume by risk grade is monitored on an ongoing basis.

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

Table of Contents

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 decreased \$102,000, or 15.7%, to \$547,000 for the three-month period ended September 30, 2007, from \$649,000 for the same period in 2006. Our provision for loan losses increased \$300,000, or 18.8%, to \$2.0 million for the nine-month period ended September 30, 2007, from \$1.7 million for the same period in 2006. The decrease in the provision for the three months ended September 30, 2007 compared to the same period in 2006 was impacted by the lower rate of growth in the loan portfolio in the third quarter of 2007.

Non-Interest Income. Total non-interest income was \$6.3 million for the three-month period ended September 30, 2007 compared to \$4.7 million for the same period in 2006. Total non-interest income was \$19.1 million for the nine-month period ended September 30, 2007 compared to \$13.7 million for the same period in 2006. Our non-interest income includes service charges on deposit accounts, other service charges and fees, trust fees, data processing fees, mortgage banking income, insurance commissions, income from title services, increases in cash value of life insurance, dividends, equity in earnings of unconsolidated affiliates and other income.

Table 5 measures the various components of our non-interest income for the three-month and nine-month periods ended September 30, 2007 and 2006, respectively, as well as changes for the three-month and nine-month periods ended September 30, 2007 compared to the same periods in 2006.

Table 5: Non-Interest Income

| | Three Months Ended September 30, | | 2007 Change from 2006 | | Nine Months Ended September 30, | | 2007 Change from 2006 | |
|---|---|-------------|--------------------------------------|---------|--|-------------|--------------------------------------|---------|
| | 2007 | 2006 | | | 2007 | 2006 | | |
| | (Dollars in thousands) | | | | | | | |
| Service charges on deposit accounts | \$ 2,816 | \$ 2,354 | \$ 462 | 19.6% | \$ 8,073 | \$ 6,669 | \$ 1,404 | 21.1% |
| Other service charges and fees | 1,342 | 541 | 801 | 148.1 | 4,176 | 1,736 | 2,440 | 140.6 |
| Trust fees | 27 | 166 | (139) | (83.7) | 81 | 487 | (406) | (83.4) |
| Data processing fees | 192 | 215 | (23) | (10.7) | 619 | 623 | (4) | (0.6) |
| Mortgage banking income | 451 | 435 | 16 | 3.7 | 1,277 | 1,285 | (8) | (0.6) |
| Insurance commissions | 153 | 153 | | | 613 | 642 | (29) | (4.5) |
| Income from title services | 181 | 233 | (52) | (22.3) | 575 | 752 | (177) | (23.5) |
| Increase in cash value of life insurance | 607 | 55 | 552 | 1,003.6 | 1,822 | 161 | 1,661 | 1,031.7 |
| Dividends from FHLB, FRB & bankers' bank | 218 | 180 | 38 | 21.1 | 652 | 440 | 212 | 48.2 |
| Equity in earnings of unconsolidated affiliates | 47 | (65) | 112 | (172.3) | (123) | (213) | 90 | (42.3) |
| Gain on sale of SBA loans | | | | | 170 | 34 | 136 | 400.0 |

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| | | | | | | | | |
|--|----------|----------|----------|---------|-----------|-----------|----------|---------|
| Gain (loss) on sale of premises and equip, net | (31) | 129 | (160) | (124.0) | 150 | 157 | (7) | (4.5) |
| Gain on securities, net | | | | | | 1 | (1) | (100.0) |
| Other income | 309 | 302 | 7 | 2.3 | 1,015 | 924 | 91 | 9.8 |
| Total non-interest income | \$ 6,312 | \$ 4,698 | \$ 1,614 | 34.4% | \$ 19,100 | \$ 13,698 | \$ 5,402 | 39.4% |

Table of Contents

Non-interest income increased \$1.6 million, or 34.4%, to \$6.3 million for the three-month period ended September 30, 2007 from \$4.7 million for the same period in 2006. Non-interest income increased \$5.4 million, or 39.4%, to \$19.1 million for the nine-month period ended September 30, 2007 from \$13.7 million for the same period in 2006. The primary factors that resulted in the increase include:

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

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

In the fourth quarter of 2006, we made a strategic decision to enter into an agent agreement for the management of our trust services to a non-affiliated third party. This change was caused by our aspiration to improve the overall profitability of the trust efforts. The aggregate decrease in trust fees for the three-month and nine-month periods ended September 30, 2007 was primarily the result of the vendor retaining a significant portion of our trust fees. The out-sourcing of the trust management resulted in \$214,000 and \$622,000 reductions of non-interest expense for the three-month and nine-month periods ended September 30, 2007, respectively, when compared to the same periods of the previous year. This non-interest expense reduction includes \$162,000 and \$490,000 related to salaries and employee benefits for the three and nine months ended September 30, 2007, respectively.

Late in the third quarter of 2007, White River Bancshares moved their data processing services in house. This resulted in a decrease in data processing fee income of approximately \$17,000 in the third quarter of 2007. This will result in an annual reduction of our data processing fees of approximately \$300,000.

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

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

The equity in earnings of unconsolidated affiliate is related to the 20% interest in White River Bancshares that we purchased during 2005. Because the investment in White River Bancshares is accounted for on the equity method, we recorded our share of White River Bancshares' operating earnings. White River Bancshares had been operating at a loss as a result of their status as a start up company until the current quarter. The maturity of White River Bancshares and their acquisition of Brinkley Bancshares, Inc. helped to improve their earnings and should allow them to be in a profitable position going forward.

Table of Contents

The aggregate decrease in gain on sale of premises and equipment for the three months ended September 30, 2007 compared to the same period in 2006 is primarily a result of our banking subsidiary acquired in 2003 disposing of excess premises and equipment in 2006 that were no longer needed as a result of synergies achieved from the combined entities. Gain on sale of premises and equipment for the nine months ended September 30, 2007 remained constant when compared to the same period in 2006 due to a gain in the second quarter of 2007 associated with the final settlement of insurance proceeds associated with the damage incurred by the storm surge during Hurricane Wilma, which struck the Florida Keys during the fourth quarter of 2005.

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

Table 6 below sets forth a summary of non-interest expense for the three-month and nine-month periods ended September 30, 2007 and 2006, as well as changes for the three-month and nine-month periods ended September 30, 2007 compared to the same period in 2006.

Table 6: Non-Interest Expense

| | Three Months Ended September 30, | | 2007 Change from | | Nine Months Ended September 30, | | 2007 Change from | |
|--------------------------------|---|-------------|-----------------------------|--------|--|-------------|-----------------------------|--------|
| | 2007 | 2006 | 2006 | | 2007 | 2006 | 2006 | |
| | (Dollars in thousands) | | | | | | | |
| Salaries and employee benefits | \$ 7,739 | \$ 7,376 | \$ 363 | 4.9% | \$ 22,936 | \$ 22,123 | \$ 813 | 3.7% |
| Occupancy and equipment | 2,446 | 2,223 | 223 | 10.0 | 6,998 | 6,351 | 647 | 10.2 |
| Data processing expense | 644 | 651 | (7) | (1.1) | 1,958 | 1,888 | 70 | 3.7 |
| Other operating expenses: | | | | | | | | |
| Advertising | 646 | 568 | 78 | 13.7 | 1,855 | 1,738 | 117 | 6.7 |
| Amortization of intangibles | 439 | 439 | | | 1,317 | 1,303 | 14 | 1.1 |
| Electronic banking expense | 618 | 152 | 466 | 306.6 | 1,803 | 430 | 1,373 | 319.3 |
| Directors fees | 225 | 203 | 22 | 10.8 | 617 | 609 | 8 | 1.3 |
| Due from bank service charges | 55 | 91 | (36) | (39.6) | 162 | 245 | (83) | (33.9) |
| FDIC and state assessment | 266 | 142 | 124 | 87.3 | 757 | 394 | 363 | 92.1 |
| Insurance | 211 | 285 | (74) | (26.0) | 683 | 741 | (58) | (7.8) |
| Legal and accounting | 308 | 191 | 117 | 61.3 | 930 | 747 | 183 | 24.5 |
| Other professional fees | 201 | 204 | (3) | (1.5) | 585 | 487 | 98 | 20.1 |
| Operating supplies | 241 | 202 | 39 | 19.3 | 694 | 684 | 10 | 1.5 |
| Postage | 163 | 171 | (8) | (4.7) | 498 | 500 | (2) | (0.4) |
| Telephone | 227 | 251 | (24) | (9.6) | 688 | 755 | (67) | (8.9) |
| Other expense | 1,170 | 1,088 | 82 | 7.5 | 3,376 | 3,004 | 372 | 12.4 |
| | \$ 15,599 | \$ 14,237 | \$ 1,362 | 9.6% | \$ 45,857 | \$ 41,999 | \$ 3,858 | 9.2% |

Total non-interest
expense

Non-interest expense increased \$1.4 million, or 9.6%, to \$15.6 million for the three-month period ended September 30, 2007, from \$14.2 million for the same period in 2006. Non-interest expense increased \$3.9 million, or 9.2%, to \$45.9 million for the nine-month period ended September 30, 2007, from \$42.0 million for the same period in 2006. The increase is the result of the continued expansion of the Company combined with the normal increased cost of doing business. The most significant component of the increase was the \$466,000 and \$1.4 million increase in electronic banking expense for the three and nine months ended September 30, 2007. The electronic banking increase was primarily the result of additional costs associated with our ability to retain more of the interchange fee income. The remaining increases are primarily the result of the continued expansion of the Company combined with the normal increased cost of doing business. During 2007 and 2006, we have opened five de novo branch locations in Florida and six in Arkansas.

Table of Contents

At its April 20, 2007 meeting, our Board of Directors approved a Chairman's Retirement Plan for John Allison our Chairman and CEO. Beginning on Mr. Allison's 65th birthday, he will receive a \$250,000 annual benefit to be paid for 10 consecutive years or until his death, whichever shall occur later. This will result in an increase of approximately \$388,000 and \$535,000 to non-interest expense for 2007 and 2008, respectively. An expense of \$130,000 and \$258,000 was accrued for the three and nine months ended September 30, 2007, respectively. During April 2007, we purchased \$3.5 million of additional bank-owned life insurance to help offset a portion of the costs related to this retirement benefit.

Income Taxes. The provision for income taxes increased \$298,000, or 15.2%, to \$2.3 million for the three-month period ended September 30, 2007, from \$2.0 million as of September 30, 2006. The provision for income taxes increased \$1.2 million, or 22.0%, to \$6.3 million for the nine-month period ended September 30, 2007, from \$5.1 million as of September 30, 2006. The effective income tax rate was 30.16% and 29.42% for the three-month and nine-month periods ended September 30, 2007, compared to 31.37% and 31.01% for the same periods in 2006, respectively. The lower effective income tax rate for 2007 is primarily associated with our purchase of \$3.5 million and \$35 million in additional bank owned life insurance in the second quarter of 2007 and fourth quarter of 2006, respectively, which resulted in additional tax-free non-interest income.

Financial Conditions as of and for the Quarter Ended September 30, 2007 and 2006

Our total assets increased \$77.0 million, an annualized growth of 4.7%, to \$2.27 billion as of September 30, 2007, from \$2.19 billion as of December 31, 2006. Our loan portfolio increased \$144.1 million, an annualized growth of 13.6%, to \$1.56 billion as of September 30, 2007, from \$1.42 billion as of December 31, 2006. Shareholders' equity increased \$15.2 million, an annualized growth of 8.8%, to \$246.6 million as of September 30, 2007, compared to \$231.4 million as of December 31, 2006. Asset and loan increases are primarily associated with organic growth of our bank subsidiaries. The increase in stockholders' equity was primarily the result of retained earnings for the nine months.

Loan Portfolio

Our loan portfolio averaged \$1.55 billion and \$1.50 billion during the three-month and nine-month periods ended September 30, 2007. Total loans were \$1.56 billion as of September 30, 2007, compared to \$1.42 billion as of December 31, 2006. 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, southwest Florida and the Florida Keys and are generally secured by residential or commercial real estate or business or personal property within our market areas.

Certain credit markets have experienced difficult conditions and volatility during 2007. These markets continue to experience pressure including the well publicized sub-prime mortgage market. The Company does not actively market or originate subprime mortgage loans.

Table of Contents

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

Table 7: Loan Portfolio

| | As of September 30, 2007 | As of December 31, 2006 |
|---|---|--|
| | (In thousands) | |
| Real estate: | | |
| Commercial real estate loans: | | |
| Non-farm/non-residential | \$ 590,083 | \$ 465,306 |
| Construction/land development | 365,236 | 393,410 |
| Agricultural | 22,432 | 11,659 |
| Residential real estate loans: | | |
| Residential 1-4 family | 251,057 | 229,588 |
| Multifamily residential | 38,528 | 37,440 |
| Total real estate | 1,267,336 | 1,137,403 |
| Consumer | 45,212 | 45,056 |
| Commercial and industrial | 206,744 | 206,559 |
| Agricultural | 25,506 | 13,520 |
| Other | 15,576 | 13,757 |
| Total loans receivable before allowance for loan losses | 1,560,374 | 1,416,295 |
| Allowance for loan losses | 28,636 | 26,111 |
| Total loans receivable, net | \$ 1,531,738 | \$ 1,390,184 |

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, 2007, commercial real estate loans totaled \$977.8 million, or 62.7% of our loan portfolio, compared to \$870.3 million, or 61.5% of our loan portfolio, as of December 31, 2006. This increase is primarily the result of strong demand for this type of loan product which resulted in organic growth 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.

Table of Contents

As of September 30, 2007, we had \$289.6 million, or 18.6% of our loan portfolio, in residential real estate loans, compared to the \$267.0 million, or 18.9% of our loan portfolio, as of December 31, 2006. The changing market conditions have given our community banks the opportunity to retain more residential real estate loans. These loans have normal maturities of less than five years.

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

As of September 30, 2007, our installment consumer loan portfolio totaled \$45.2 million, or 2.9% of our total loan portfolio, which is comparable to the \$45.1 million, or 3.2% of our loan portfolio as of December 31, 2006.

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 five 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 90 days past due. Inventory financing will range between 50% and 60% depending on the borrower and nature of inventory. We require a first lien position for those loans.

As of September 30, 2007, commercial and industrial loans outstanding totaled \$206.7 million, or 13.2% of our loan portfolio, which is comparable to \$206.6 million, or 14.6% of our loan portfolio, as of December 31, 2006.

Non-Performing Assets

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

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

Table of Contents

Table 8 sets forth information with respect to our non-performing assets as of September 30, 2007 and December 31, 2006. As of these dates, we did not have any restructured loans within the meaning of Statement of Financial Accounting Standards No. 15.

Table 8: Non-performing Assets

| | As of September 30, 2007 | As of December 31, 2006 |
|---|---|--|
| | (Dollars in thousands) | |
| Non-accrual loans | \$ 2,572 | \$ 3,905 |
| Loans past due 90 days or more (principal or interest payments) | 150 | 641 |
| Total non-performing loans | 2,722 | 4,546 |
| Other non-performing assets | | |
| Foreclosed assets held for sale | 4,915 | 435 |
| Other non-performing assets | | 13 |
| Total other non-performing assets | 4,915 | 448 |
| Total non-performing assets | \$ 7,637 | \$ 4,994 |
| | | |
| Allowance for loan losses to non-performing loans | 1,052.02% | 574.37% |
| Non-performing loans to total loans | 0.17 | 0.32 |
| Non-performing assets to total assets | 0.34 | 0.23 |

Our non-performing loans are comprised of non-accrual loans and loans that are contractually past due 90 days. Our bank subsidiaries recognize income principally on the accrual basis of accounting. When loans are classified as non-accrual, the accrued interest is charged off and no further interest is accrued, unless the credit characteristics of the loan improves. If a loan is determined by management to be uncollectible, the portion of the loan determined to be uncollectible is then charged to the allowance for loan losses.

Total non-performing loans were \$2.7 million as of September 30, 2007, compared to \$4.5 million as of December 31, 2006 for a decrease of \$1.8 million. If the non-accrual loans had been accruing interest in accordance with the original terms of their respective agreements, interest income of approximately \$103,000 and \$117,000 for the three-month periods ended September 30, 2007 and 2006, respectively, and \$193,000 and \$374,000 for the nine months ended September 30, 2007 and 2006, respectively, would have been recorded. Interest income recognized on the non-accrual loans for the three-month and nine-month periods ended September 30, 2007 and 2006 was considered immaterial.

A loan is considered impaired when it is probable that we will not receive all amounts due according to the contracted terms of the loans. Impaired loans may include non-performing loans (loans past due 90 days or more and non-accrual loans) and certain other loans identified by management that are still performing. At September 30, 2007 and December 31, 2006, impaired loans totaled \$7.9 million and \$11.2 million, respectively. As of September 30, 2007, year-to-date average impaired loans were \$11.8 million compared to \$6.2 million as of September 30, 2006. These changes represent normal variations and are not an indication of a change in our overall asset quality.

The \$4.5 million increase in foreclosed assets held for sale is primarily the result of one credit located in the Florida Keys. This foreclosure was an owner occupied strip center. The space the proprietor occupied has subsequently been leased and the rest of the center is occupied. At this point, little or no loss is anticipated on the

foreclosure.

The appreciation of the real estate market in the Florida Keys has slowed, as a result of the sluggish economy. This has the potential to decrease the real estate values in the Keys. While we have some concerns, management believes the loans are still adequately collateralized at this time.

Table of Contents

As a result of the building boom in northwest Arkansas, this market is experiencing over-development. More specifically, the number of residential real estate lots and commercial real estate projects available exceed the current demand. For example, The Streetsmart Report published in the second quarter of 2007 by Streetsmart Data Services, reported that the current absorption rate implies that the supply of remaining lots in northwest Arkansas active subdivisions is sufficient for approximately 58 months. Management will actively monitor the status of this market as it relates to our real estate loans and make changes to the allowance for loan losses if necessary. As of September 30, 2007, we had two credits amounting to \$23.9 million in loans secured by real estate in northwest Arkansas. We anticipate no weakness in these credits as they are well-secured by substantial guarantors. At September 30, 2007, we had no loan participations in northwest Arkansas with our unconsolidated affiliate White River Bancshares Inc.

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 decreased \$38,000, or 18.1%, to \$172,000 for the three months ended September 30, 2007, compared to the same period in 2006. Total charge-offs decreased \$645,000, or 65.5%, to \$340,000 for the nine months ended September 30, 2007, compared to the same period in 2006. Total recoveries decreased \$119,000, or 44.4%, to \$149,000 for the three months ended September 30, 2007, compared to the same period in 2006. Total recoveries decreased \$221,000, or 21.3%, to \$818,000 for the nine months ended September 30, 2007, compared to the same period in 2006. The overall net recovery position for 2007 is a reflection of our thorough approach to 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, 2007 and 2006.

Table 9: Analysis of Allowance for Loan Losses

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|--|-------------------------------------|-----------|------------------------------------|-----------|
| | 2007 | 2006 | 2007 | 2006 |
| | (Dollars in thousands) | | | |
| Balance, beginning of period | \$ 28,112 | \$ 25,245 | \$ 26,111 | \$ 24,175 |
| Loans charged off | | | | |
| Real estate: | | | | |
| Commercial real estate loans: | | | | |
| Non-farm/non-residential | | 64 | | 322 |
| Construction/land development | | 43 | 8 | 45 |
| Agricultural | | 10 | | 18 |
| Residential real estate loans: | | | | |
| Residential 1-4 family | 32 | 2 | 42 | 109 |
| Multifamily residential | 6 | | 6 | |
| Total real estate | 38 | 119 | 56 | 494 |
| Consumer | 70 | 58 | 179 | 173 |
| Commercial and industrial | 64 | 29 | 105 | 281 |
| Agricultural | | | | |
| Other | | 4 | | 37 |
| Total loans charged off | 172 | 210 | 340 | 985 |
| Recoveries of loans previously charged off | | | | |
| Real estate: | | | | |
| Commercial real estate loans: | | | | |
| Non-farm/non-residential | 13 | 29 | 431 | 67 |
| Construction/land development | | 25 | 1 | 123 |
| Agricultural | 5 | | 5 | |
| Residential real estate loans: | | | | |
| Residential 1-4 family | 47 | 93 | 151 | 344 |
| Multifamily residential | 5 | 5 | 5 | 65 |
| Total real estate | 70 | 152 | 593 | 599 |
| Consumer | 18 | 14 | 94 | 45 |
| Commercial and industrial | 58 | 87 | 100 | 150 |
| Agricultural | | | | |
| Other | 3 | 15 | 31 | 245 |
| Total recoveries | 149 | 268 | 818 | 1,039 |
| Net (recoveries) loans charged off | 23 | (58) | (478) | (54) |
| Provision for loan losses | 547 | 649 | 2,047 | 1,723 |

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| | | | | |
|--|--------------|-----------|-----------|-----------|
| Balance, September 30 | \$ 28,636 | \$ 25,952 | \$ 28,636 | \$ 25,952 |
| Net (recoveries) charge-offs to average loans | 0.01% | (0.02)% | (0.04)% | (0.01)% |
| Allowance for loan losses to period-end loans | 1.84 | 1.87 | 1.84 | 1.87 |
| Allowance for loan losses to net (recoveries) charge-offs | 31,382 43 | (11,278) | (4,481) | (35,946) |

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, 2007 in the allocation of the allowance for loan losses for the individual types of loans for the most part are consistent with the changes in the outstanding loan portfolio for those products from December 31, 2006. In the opinion of management, any allocation changes not consistent with the changes in the loan portfolio product would be considered normal operating changes, not downgrading or upgrading of any one particular type of loans in the loan portfolio.

Table 10 presents the allocation of allowance for loan losses as of September 30, 2007 and December 31, 2006.

Table 10: Allocation of Allowance for Loan Losses

| | As of September 30, 2007 | | As of December 31, 2006 | |
|--------------------------------|-----------------------------|--|----------------------------|------------------|
| | Allowance Amount | % of loans(1) (Dollars in thousands) | Allowance Amount | % of loans(1) |
| Real estate: | | | | |
| Commercial real estate loans: | | | | |
| Non farm/non-residential | \$ 11,626 | 37.8% | \$ 9,130 | 32.8% |
| Construction/land development | 7,283 | 23.4 | 7,494 | 27.8 |
| Agricultural | 655 | 1.4 | 505 | 0.8 |
| Residential real estate loans: | | | | |
| Residential 1-4 family | 3,269 | 16.1 | 3,091 | 16.2 |
| Multifamily residential | 600 | 2.5 | 909 | 2.6 |
| Total real estate | 23,433 | 81.2 | 21,129 | 80.2 |
| Consumer | 864 | 2.9 | 861 | 3.2 |
| Commercial and industrial | 3,355 | 13.3 | 3,237 | 14.6 |
| Agricultural | 876 | 1.6 | 456 | 1.0 |
| Other | 18 | 1.0 | 11 | 1.0 |
| Unallocated | 90 | | 417 | |
| Total | \$ 28,636 | 100.0% | \$ 26,111 | 100.0% |

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

Investments and Securities

Our securities portfolio is the second largest component of earning assets and provides a significant source of revenue. Securities within the portfolio are classified as held-to-maturity, available-for-sale, or trading based on the intent and objective of the investment and the ability to hold to maturity. Fair values of securities are based on quoted market prices where available. If quoted market prices are not available, estimated fair values are based on quoted

market prices of comparable securities. As of September 30, 2007, we had no held-to-maturity or trading securities.

Table of Contents

Securities available-for-sale are reported at fair value with unrealized holding gains and losses reported as a separate component of shareholders' equity as other comprehensive income. Securities that are held as available-for-sale are used as a part of our asset/liability management strategy. Securities 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. Available-for-sale securities were \$447.8 million as of September 30, 2007, compared to \$531.9 million as of December 31, 2006. The estimated duration of our securities portfolio was 2.9 years as of September 30, 2007.

As of September 30, 2007, \$187.3 million, or 41.8%, of our available-for-sale securities were invested in mortgage-backed securities, compared to \$219.8 million, or 41.3%, of our available-for-sale securities as of December 31, 2006. To reduce our income tax burden, \$102.2 million, or 22.8%, of our available-for-sale securities portfolio as of September 30, 2007, was primarily invested in tax-exempt obligations of state and political subdivisions, compared to \$103.4 million, or 19.4%, of our available-for-sale securities as of December 31, 2006. Also, we had approximately \$146.6 million, or 32.7%, invested in obligations of U.S. Government-sponsored enterprises as of September 30, 2007, compared to \$196.2 million, or 36.9%, of our available-for-sale securities as of December 31, 2006.

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

Table 11 presents the carrying value and fair value of investment securities as of September 30, 2007 and December 31, 2006.

Table 11: Investment Securities

| | As of September 30, 2007 | | | Estimated Fair Value |
|---------------------------------------|--------------------------|------------------------------|---------------------------------|-------------------------|
| | Amortized Cost | Gross Unrealized Gains | Gross Unrealized (Losses) | |
| Available-for-Sale | | | | |
| U.S. government-sponsored enterprises | \$ 148,815 | \$ 98 | \$ (2,313) | \$ 146,600 |
| Mortgage-backed securities | 191,777 | 50 | (4,501) | 187,326 |
| State and political subdivisions | 101,803 | 1,117 | (754) | 102,166 |
| Other securities | 11,893 | | (159) | 11,734 |
| Total | \$ 454,288 | \$ 1,265 | \$ (7,727) | \$ 447,826 |

| | As of December 31, 2006 | | | Estimated Fair Value |
|---------------------------------------|-------------------------|------------------------------|---------------------------------|-------------------------|
| | Amortized Cost | Gross Unrealized Gains | Gross Unrealized (Losses) | |
| Available-for-Sale | | | | |
| U.S. government-sponsored enterprises | \$ 199,085 | \$ 79 | \$ (2,927) | \$ 196,237 |
| Mortgage-backed securities | 225,747 | 41 | (5,988) | 219,800 |
| State and political subdivisions | 102,536 | 1,360 | (496) | 103,400 |
| Other securities | 12,631 | | (177) | 12,454 |

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| | | | | |
|-------|------------|----------|------------|------------|
| Total | \$ 539,999 | \$ 1,480 | \$ (9,588) | \$ 531,891 |
|-------|------------|----------|------------|------------|

45

Table of Contents

Deposits

Our deposits averaged \$1.40 billion for the three-month and nine-month periods ended September 30, 2007. Total deposits decreased \$8.6 million, or an annualized decline of 0.7%, to \$1.60 billion as of September 30, 2007, from \$1.61 billion as of December 31, 2006. Deposits are our primary source of funds. We offer a variety of products designed to attract and retain deposit customers. Those products consist of checking accounts, regular savings deposits, NOW accounts, money market accounts and certificates of deposit. Deposits are gathered from individuals, partnerships and corporations in our market areas. In addition, we obtain deposits from state and local entities and, to a lesser extent, U.S. Government and other depository institutions. Our policy also permits the acceptance of brokered deposits. As of September 30, 2007 and December 31, 2006 brokered deposits were \$52.8 million and \$50.2 million, respectively.

The interest rates paid are competitively priced for each particular deposit product and structured to meet our funding requirements. We will continue to manage interest expense through deposit pricing and do not anticipate a significant change in total deposits unless our liquidity position changes. We believe that additional funds can be attracted and deposit growth can be accelerated through deposit pricing if we experience increased loan demand or other liquidity needs. The increase in interest rates paid from 2006 to 2007 is reflective of the Federal Reserve increasing the Federal Funds rate beginning in 2004 and the associated repricing of deposits during the subsequent years. On September 18, 2007, the Federal Funds rate was lowered by 50 basis points. Due to this occurring late in the third quarter of 2007, the impact for the quarter was minimal. Going forward, we will begin to see more of an impact of the decrease in the Federal Funds rate as deposits reprice. Average interest rates for the three and nine months ended September 30, 2007 reflect the higher interest rate environment that existed until September 18, 2007 when the Federal Funds rate was lowered.

Table 12 reflects the classification of the average deposits and the average rate paid on each deposit category, which is in excess of 10 percent of average total deposits, for the three-month and nine-month periods ended September 30, 2007 and 2006.

Table of Contents**Table 12: Average Deposit Balances and Rates**

| | Three Months Ended September 30, | | | |
|---|---|----------------|---------------------|----------------|
| | 2007 | | | 2006 |
| | Average | Average | Average | Average |
| | Amount | Rate | Amount | Rate |
| | (Dollars in thousands) | | | |
| Non-interest-bearing transaction accounts | \$ 212,298 | % | \$ 213,682 | % |
| Interest-bearing transaction accounts | 531,292 | 3.12 | 451,051 | 2.73 |
| Savings deposits | 55,418 | 1.38 | 65,156 | 1.55 |
| Time deposits: | | | | |
| \$100,000 or more | 468,168 | 5.00 | 432,207 | 4.68 |
| Other time deposits | 345,508 | 4.76 | 337,064 | 4.19 |
| Total | \$ 1,612,684 | 3.55% | \$ 1,499,160 | 3.18% |

| | Nine Months Ended September 30, | | | |
|---|--|----------------|---------------------|----------------|
| | 2007 | | | 2006 |
| | Average | Average | Average | Average |
| | Amount | Rate | Amount | Rate |
| | (Dollars in thousands) | | | |
| Non-interest-bearing transaction accounts | \$ 215,716 | % | \$ 216,366 | % |
| Interest-bearing transaction accounts | 540,895 | 3.15 | 448,234 | 2.51 |
| Savings deposits | 57,175 | 1.40 | 75,609 | 1.61 |
| Time deposits: | | | | |
| \$100,000 or more | 461,570 | 4.98 | 407,398 | 4.48 |
| Other time deposits | 343,555 | 4.71 | 340,384 | 3.81 |
| Total | \$ 1,618,911 | 3.52% | \$ 1,487,991 | 2.94% |

FHLB Borrowed Funds

Our FHLB borrowed funds were \$226.0 million as of September 30, 2007. The outstanding balance for September 30, 2007 consists of \$87.0 million of short-term FHLB advances and \$139.0 million of FHLB long-term advances. Our FHLB borrowings were \$151.8 million as of December 31, 2006. The outstanding balance for December 31, 2006, includes \$5.0 million of short-term advances and \$146.8 million of long-term advances. Our remaining FHLB borrowing capacity was \$205.5 million and \$323.6 million as of September 30, 2007 and December 31, 2006, respectively.

Subordinated Debentures

Subordinated debentures, which consist of guaranteed payments on trust preferred securities, were \$44.6 million and \$44.7 million as of September 30, 2007 and December 31, 2006, respectively.

Table of Contents

Table 13 reflects subordinated debentures as of September 30, 2007 and December 31, 2006, which consisted of guaranteed payments on trust preferred securities with the following components:

Table 13: Subordinated Debentures

| | As of September 30, 2007 | As of December 31, 2006 |
|---|---|--|
| | (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, callable in 2008 without penalty | \$ 20,619 | \$ 20,619 |
| Subordinated debentures, issued in 2000, due 2030, fixed at 10.60%, callable beginning in 2010 with a prepayment penalty declining from 5.30% to 0.53% depending on the year of prepayment, callable in 2020 without penalty | 3,356 | 3,424 |
| Subordinated debentures, issued in 2003, due 2033, floating rate of 3.15% above the three-month LIBOR rate, reset quarterly, callable in 2008 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 |
| Total | \$ 44,595 | \$ 44,663 |

As a result of the acquisition of Marine Bancorp, Inc., the Company has an interest rate swap agreement that effectively converts the floating rate on the \$5.2 million trust preferred security noted above into a fixed interest rate of 7.29%, thus reducing the impact of interest rate changes on future interest expense until the call date.

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

Shareholders' Equity

Stockholders' equity was \$246.6 million at September 30, 2007 compared to \$231.4 million at December 31, 2006, an annualized increase of 8.8%. As of September 30, 2007 our equity to asset ratio was 10.9%, compared to 10.6% as of December 31, 2006. Book value per common share was \$14.30 at September 30, 2007 compared to \$13.45 at December 31, 2006, an 8.4% annualized increase. The increases in stockholders' equity and book value per share were primarily the result of retained earnings during the prior nine months.

Initial Public Offering. We priced our initial public offering of 2.5 million shares of common stock at \$18.00 per share. We received net proceeds of approximately \$40.9 million from its sale of shares after deducting sales commissions and expenses. The underwriters of the Company's initial public offering exercised and completed their option to purchase an additional 375,000 shares of common stock to cover over-allotments effective July 26, 2006. We received net proceeds of approximately \$6.3 million from this sale of shares after deducting sales commissions. We have used \$16.0 million of the initial public offering proceeds to provide capital contributions to our bank subsidiaries, \$2.6 million as an additional investment in White River Bancshares to maintain our 20% ownership and

\$2.0 million to purchase a long-term investment.

Table of Contents

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

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

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

After the exercise of the over-allotment and the conversion of the preferred stock, Home BancShares outstanding common stock increased by approximately 2.5 million shares.

Cash Dividends. We declared cash dividends on our common stock of \$0.04 and \$0.025 per share for the three-month periods ended September 30, 2007 and 2006, respectively, and \$0.10 and \$0.065 per share for the nine-month periods ended September 30, 2007 and 2006, respectively. We declared cash dividends on our Class A preferred stock and Class B preferred stock of \$0.0208 and \$0.0475 per share, respectively, for the three-month period ended September 30, 2006 and \$0.14583 and \$0.3325 per share, respectively, for the nine-month period ended September 30, 2006.

Liquidity and Capital Adequacy Requirements

Risk-Based Capital. We as well as our bank subsidiaries are subject to various regulatory capital requirements administered by the federal banking agencies. Furthermore, we are deemed by federal regulators to be a source of financial strength for White River Bancshares, despite owning only 20% of its equity. Failure to meet minimum capital requirements can initiate certain mandatory and other discretionary actions by regulators that, if enforced, could have a direct material effect on our financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, we must meet specific capital guidelines that involve quantitative measures of our assets, liabilities and certain off-balance-sheet items as calculated under regulatory accounting practices. Our capital amounts and classifications are also subject to qualitative judgments by the regulators as to components, risk weightings and other factors.

Table of Contents

Quantitative measures established by regulation to ensure capital adequacy require us to maintain minimum amounts and ratios (set forth in the table below) of total and Tier 1 capital to risk-weighted assets, and of Tier 1 capital to average assets. Management believes that, as of September 30, 2007 and December 31, 2006, we met all regulatory capital adequacy requirements to which we were subject.

Table 14 presents our risk-based capital ratios as of September 30, 2007 and December 31, 2006.

Table 14: Risk-Based Capital

| | As of September 30, 2007 | As of December 31, 2006 |
|--|---|--|
| | (Dollars in thousands) | |
| Tier 1 capital | | |
| Shareholders' equity | \$ 246,577 | \$ 231,419 |
| Qualifying trust preferred securities | 43,000 | 43,000 |
| Goodwill and core deposit intangibles, net | (42,607) | (43,433) |
| Unrealized loss on available-for-sale securities | 3,895 | 4,892 |
| Total Tier 1 capital | 250,865 | 235,878 |
| | | |
| Tier 2 capital | | |
| Qualifying allowance for loan losses | 23,403 | 20,308 |
| Total Tier 2 capital | 23,403 | 20,308 |
| | | |
| Total risk-based capital | \$ 274,268 | \$ 256,186 |
| | | |
| Average total assets for leverage ratio | \$ 2,200,626 | \$ 2,089,130 |
| | | |
| Risk weighted assets | \$ 1,867,012 | \$ 1,618,849 |
| | | |
| Ratios at end of period | | |
| Leverage ratio | 11.40% | 11.29% |
| Tier 1 risk-based capital | 13.44 | 14.57 |
| Total risk-based capital | 14.69 | 15.83 |
| Minimum guidelines | | |
| Leverage ratio | 4.00% | 4.00% |
| Tier 1 risk-based capital | 4.00 | 4.00 |
| Total risk-based capital | 8.00 | 8.00 |

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

Table 15 presents actual capital amounts and ratios as of September 30, 2007 and December 31, 2006, for our bank subsidiaries and us.

Table of Contents**Table 15: Capital and Ratios**

| | Actual | | For Capital Adequacy Purposes | | To Be Well Capitalized Under Prompt Corrective Action Provision | |
|----------------------------------|-----------|--------|-------------------------------|-------|---|-------|
| | Amount | Ratio | Amount | Ratio | Amount | Ratio |
| As of September 30, 2007 | | | | | | |
| Leverage ratios: | | | | | | |
| Home BancShares | \$250,865 | 11.40% | \$ 88,023 | 4.00% | \$ N/A | N/A% |
| First State Bank | 52,306 | 8.97 | 23,325 | 4.00 | 29,156 | 5.00 |
| Community Bank | 32,376 | 9.20 | 14,077 | 4.00 | 17,596 | 5.00 |
| Twin City Bank | 59,193 | 8.66 | 27,341 | 4.00 | 34,176 | 5.00 |
| Marine Bank | 33,783 | 9.29 | 14,546 | 4.00 | 18,182 | 5.00 |
| Bank of Mountain View | 15,962 | 7.98 | 8,001 | 4.00 | 10,001 | 5.00 |
| Tier 1 capital ratios: | | | | | | |
| Home BancShares | \$250,865 | 13.44% | \$ 74,662 | 4.00% | \$ N/A | N/A% |
| First State Bank | 52,306 | 9.96 | 21,006 | 4.00 | 31,510 | 6.00 |
| Community Bank | 32,376 | 11.02 | 11,752 | 4.00 | 17,628 | 6.00 |
| Twin City Bank | 59,193 | 10.09 | 23,466 | 4.00 | 35,199 | 6.00 |
| Marine Bank | 33,783 | 10.55 | 12,809 | 4.00 | 19,213 | 6.00 |
| Bank of Mountain View | 15,962 | 13.42 | 4,758 | 4.00 | 7,137 | 6.00 |
| Total risk-based capital ratios: | | | | | | |
| Home BancShares | \$274,268 | 14.69% | \$149,363 | 8.00% | \$ N/A | N/A% |
| First State Bank | 58,893 | 11.21 | 42,029 | 8.00 | 52,536 | 10.00 |
| Community Bank | 36,104 | 12.29 | 23,501 | 8.00 | 29,377 | 10.00 |
| Twin City Bank | 66,525 | 11.34 | 46,931 | 8.00 | 58,664 | 10.00 |
| Marine Bank | 37,294 | 11.64 | 25,632 | 8.00 | 32,040 | 10.00 |
| Bank of Mountain View | 17,213 | 14.47 | 9,517 | 8.00 | 11,896 | 10.00 |
| As of December 31, 2006 | | | | | | |
| Leverage ratios: | | | | | | |
| Home BancShares | \$235,878 | 11.29% | \$ 83,571 | 4.00% | \$ N/A | N/A% |
| First State Bank | 46,811 | 8.69 | 21,547 | 4.00 | 26,934 | 5.00 |
| Community Bank | 26,235 | 7.94 | 13,217 | 4.00 | 16,521 | 5.00 |
| Twin City Bank | 50,375 | 7.51 | 26,831 | 4.00 | 33,539 | 5.00 |
| Marine Bank | 27,317 | 8.08 | 13,523 | 4.00 | 16,904 | 5.00 |
| Bank of Mountain View | 15,230 | 7.73 | 7,881 | 4.00 | 9,851 | 5.00 |
| Tier 1 capital ratios: | | | | | | |
| Home BancShares | \$235,878 | 14.57% | \$ 64,757 | 4.00% | \$ N/A | N/A% |
| First State Bank | 46,811 | 10.29 | 18,197 | 4.00 | 27,295 | 6.00 |
| Community Bank | 26,235 | 10.31 | 10,178 | 4.00 | 15,268 | 6.00 |
| Twin City Bank | 50,375 | 10.15 | 19,852 | 4.00 | 29,778 | 6.00 |
| Marine Bank | 27,317 | 9.59 | 11,394 | 4.00 | 17,091 | 6.00 |
| Bank of Mountain View | 15,230 | 14.09 | 4,324 | 4.00 | 6,485 | 6.00 |

Total risk-based capital ratios:

| | | | | | | |
|-----------------------|-----------|--------|-----------|-------|--------|-------|
| Home BancShares | \$256,186 | 15.83% | \$129,469 | 8.00% | \$ N/A | N/A% |
| First State Bank | 52,519 | 11.54 | 36,408 | 8.00 | 45,510 | 10.00 |
| Community Bank | 29,471 | 11.58 | 20,360 | 8.00 | 25,450 | 10.00 |
| Twin City Bank | 56,586 | 11.40 | 39,709 | 8.00 | 49,637 | 10.00 |
| Marine Bank | 30,582 | 10.74 | 22,780 | 8.00 | 28,475 | 10.00 |
| Bank of Mountain View | 16,316 | 15.09 | 8,650 | 8.00 | 10,812 | 10.00 |

51

Table of Contents**Non-GAAP Financial Measurements**

We had \$45.7 million, \$47.0 million, and \$47.4 million total goodwill, core deposit intangibles and other intangible assets as of September 30, 2007, December 31, 2006 and September 30, 2006, respectively. Because of our level of intangible assets and related amortization expenses, management believes diluted cash earnings per share, tangible book value per common share, cash return on average assets, cash return on average tangible equity and tangible equity to tangible assets are useful in evaluating our company. These calculations, which are similar to the GAAP calculation of diluted earnings per share, book value, return on average assets, return on average shareholders' equity, and equity to assets, are presented in Tables 16 through 20, respectively.

Table 16: Diluted Cash Earnings Per Share

| | Three Months Ended | | Nine Months Ended | |
|-----------------------------------|--|---------------------------|---------------------------|---------------------------|
| | September 30, 2007 | September 30, 2006 | September 30, 2007 | September 30, 2006 |
| | (In thousands, except per share data) | | | |
| GAAP net income | \$ 5,228 | \$ 4,288 | \$ 15,050 | \$ 11,440 |
| Intangible amortization after-tax | 267 | 267 | 801 | 792 |
| Cash earnings | \$ 5,495 | \$ 4,555 | \$ 15,851 | \$ 12,232 |
| GAAP diluted earnings per share | \$ 0.30 | \$ 0.25 | \$ 0.86 | \$ 0.74 |
| Intangible amortization after-tax | 0.01 | 0.01 | 0.04 | 0.05 |
| Diluted cash earnings per share | \$ 0.31 | \$ 0.26 | \$ 0.90 | \$ 0.79 |

Table 17: Tangible Book Value Per Common Share

| | As of | As of |
|---|--|--------------------------|
| | September 30, 2007 | December 31, 2006 |
| | (Dollars in thousands, except per share data) | |
| Book value per common share: A/B | \$ 14.30 | \$ 13.45 |
| Tangible book value per common share: (A-C-D)/B | 11.65 | 10.72 |
| (A) Total shareholders' equity | \$246,577 | \$231,419 |
| (B) Common shares outstanding | 17,243 | 17,206 |
| (C) Goodwill | 37,527 | 37,527 |
| (D) Core deposit and other intangibles | 8,141 | 9,458 |

Table of Contents**Table 18: Cash Return on Average Assets**

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|--|-------------------------------------|-----------|------------------------------------|-----------|
| | 2007 | 2006 | 2007 | 2006 |
| | (Dollars in thousands) | | | |
| Return on average assets: A/C | 0.92% | 0.83% | 0.91% | 0.77% |
| Cash return on average assets: B/(C-D) | 0.99 | 0.90 | 0.98 | 0.84 |
| (A) Net income | \$ 5,228 | \$ 4,288 | \$ 15,050 | \$ 11,440 |
| (B) Cash earnings | 5,495 | 4,555 | 15,851 | 12,232 |
| (C) Average assets | 2,243,233 | 2,059,931 | 2,217,923 | 1,996,121 |
| (D) Average goodwill, core deposits and other intangible assets | 45,887 | 47,647 | 46,323 | 48,095 |

Table 19: Cash Return on Average Tangible Equity

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|--|-------------------------------------|----------|------------------------------------|-----------|
| | 2007 | 2006 | 2007 | 2006 |
| | (Dollars in thousands) | | | |
| Return on average shareholders equity: A/C | 8.60% | 7.81% | 8.48% | 8.25% |
| Return on average tangible equity: B/(C-D) | 11.16 | 10.61 | 11.09 | 11.90 |
| (A) Net income | \$ 5,228 | \$ 4,288 | \$ 15,050 | \$ 11,440 |
| (B) Cash earnings | 5,495 | 4,555 | 15,851 | 12,232 |
| (C) Average shareholders equity | 241,153 | 217,944 | 237,391 | 185,492 |
| (D) Average goodwill, core deposits and other intangible assets | 45,887 | 47,647 | 46,323 | 48,095 |

Table 20: Tangible Equity to Tangible Assets

| | As of September 30, 2007 | As of December 31, 2006 |
|---|--------------------------------|-------------------------------|
| | (Dollars in thousands) | |
| Equity to assets: B/A | 10.87% | 10.56% |
| Tangible equity to tangible assets: (B-C-D)/(A-C-D) | 9.04 | 8.60 |
| (A) Total assets | \$2,267,672 | \$2,190,648 |
| (B) Total shareholders equity | 246,577 | 231,419 |
| (C) Goodwill | 37,527 | 37,527 |
| (D) Core deposit and other intangibles | 8,141 | 9,458 |

Table of Contents**Recent Accounting Pronouncements**

In February 2007, the Financial Accounting Standards Board (FASB) issued SFAS No. 159 The Fair Value Option for Financial Assets and Financial Liabilities to provide companies with an option to report selected financial assets and liabilities at fair value. The objective is to improve financial reporting by providing entities with the opportunity to mitigate volatility in reported earnings caused by measuring related assets and liabilities differently without having to apply complex hedge accounting provisions. This statement shall be effective as of the beginning of each reporting entity's first fiscal year that begins after November 15, 2007. The Company is currently evaluating the impact of the adoption of this standard, but does not expect it to have a material effect on the Company's financial position or results of operations.

In September 2006, the FASB issued SFAS No. 157, Fair Value Measurements, which defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles (GAAP), and expands disclosures about fair value measurements. This Statement applies under other accounting pronouncements that require or permit fair value measurements, FASB having previously concluded in those accounting pronouncements that fair value is the relevant measurement attribute. Accordingly, this Statement does not require any new fair value measurements. SFAS No. 157 is effective for financial statements issued for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years. The Company is currently evaluating the impact of the adoption of this standard, but does not expect it to have a material effect on the Company's financial position or results of operations.

In September 2006, the FASB Emerging Issue Task Force (EITF) issued EITF 06-4, Accounting for Deferred Compensation and Postretirement Benefit Aspects of Endorsement Split-Dollar Life Insurance Arrangements. The EITF determined that for an endorsement split-dollar life insurance arrangement within the scope of the Issue, the employer should recognize a liability for future benefits in accordance with SFAS No. 106, Employers' Accounting for Postretirement Benefits Other Than Pensions, or APB Opinion 12, Omnibus Opinion-1967, based on the substantive agreement with the employee. In March 2007, the FASB Emerging Issue Task Force (EITF) issued EITF 06-10, Accounting for Deferred Compensation and Postretirement Benefit Aspects of Collateral Assignment Split-Dollar Life Insurance Arrangements. The EITF determined that an employer should recognize a liability for the postretirement benefit related to a collateral assignment split-dollar life insurance arrangement in accordance with either Statement 106 (if, in substance, a postretirement benefit plan exists) or Opinion 12 (if the arrangement is, in substance, an individual deferred compensation contract) based on the substantive agreement with the employee. These Issues are effective for fiscal years beginning after December 15, 2007, with earlier application permitted. Entities should recognize the effects of applying EITF 06-4 through either (a) a change in accounting principle through a cumulative-effect adjustment to retained earnings or to other components of equity or net assets in the statement of financial position as of the beginning of the year of adoption or (b) a change in accounting principle through retrospective application to all prior periods. As of September 30, 2007, the Company has split-dollar life insurance arrangements with two executives of the Company that have death benefits. The Company is currently evaluating the impact that the adoption of EITF 06-4 and EITF 06-10, but does not expect it to have a material effect on the Company's financial position or results of operations.

In June 2006, the FASB issued Interpretation No. 48, Accounting for Uncertainty in Income Taxes, which provides clarification for uncertainty in income taxes recognized in an enterprise's financial statements in accordance with SFAS No. 109, Accounting for Income Taxes. This Interpretation prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. This Interpretation also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure, and transition. The Interpretation is effective for fiscal years beginning after December 31, 2006. The Company adopted the Interpretation during the first quarter of 2007 without material effect on the Company's financial position or results of operations.

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

Table of Contents**Item 3: QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK*****Liquidity and Market Risk Management***

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

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

Liquidity needs can be met from either assets or liabilities. On the asset side, our primary sources of liquidity include cash and due from banks, federal funds sold, available-for-sale investment securities and scheduled repayments and maturities of loans. We maintain adequate levels of cash and cash equivalents to meet our day-to-day needs. As of September 30, 2007, our cash and cash equivalents were \$49.0 million, or 2.2% of total assets, compared to \$59.7 million, or 2.7% of total assets, as of December 31, 2006. Our investment securities and federal funds sold were \$459.0 million, or 20.2% of total assets, as of September 30, 2007 and \$540.9 million, or 24.7% of total assets, as of December 31, 2006.

We may occasionally use our federal funds lines of credit in order to temporarily satisfy short-term liquidity needs. We have federal funds lines with three other financial institutions pursuant to which we could have borrowed up to \$88.2 million and \$62.1 million on an unsecured basis as of September 30, 2007 and December 31, 2006, respectively. These lines may be terminated by the respective lending institutions at any time.

We also maintain lines of credit with the Federal Home Loan Bank. Our FHLB borrowings were \$226.0 million as of September 30, 2007 and \$151.8 million as of December 31, 2006. The outstanding balance for September 30, 2007 included \$87.0 million of short-term advances and \$139.0 million of FHLB long-term advances. The outstanding balance for December 31, 2006, included \$5.0 million of short-term advances and \$146.8 million of FHLB long-term advances. Our FHLB borrowing capacity was \$205.5 million and \$323.6 million as of September 30, 2007 and December 31, 2006.

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

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

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

Table of Contents

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

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

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

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

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

Gap analysis attempts to capture the amounts and timing of balances exposed to changes in interest rates at a given point in time. As of September 30, 2007, our gap position was relatively neutral with a one-year cumulative repricing gap of -5.2%, compared to -1.1% as of December 31, 2006. During these periods, the amount of change our asset base realizes in relation to the total change in market interest rates is approximately that of the liability base. As a result, our net interest income should not have a material positive or negative affect in the current rate environment.

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

Table of Contents

Table 21 presents a summary of the repricing schedule of our interest-earning assets and interest-bearing liabilities (gap) as of September 30, 2007.

Table 21: Interest Rate Sensitivity

| | Interest Rate Sensitivity Period | | | | | | | Total |
|---|----------------------------------|---------------|----------------|-----------------|--------------|--------------|-----------------|------------|
| | 0-30 Days | 31-90 Days | 91-180 Days | 181-365 Days | 1-2 Years | 2-5 Years | Over 5 Years | |
| (Dollars in thousands) | | | | | | | | |
| Earning assets | | | | | | | | |
| Interest-bearing deposits due from banks | \$ 2,573 | \$ | \$ | \$ | \$ | \$ | \$ | \$ 2,573 |
| Federal funds sold | 11,145 | | | | | | | 11,145 |
| Investment securities | 12,752 | 40,707 | 43,822 | 50,226 | 96,251 | 93,645 | 110,423 | 447,826 |
| Loans receivable | 538,054 | 127,932 | 139,990 | 247,918 | 234,259 | 245,476 | 26,745 | 1,560,374 |
| Total earning assets | 564,524 | 168,639 | 183,812 | 298,144 | 330,510 | 339,121 | 137,168 | 2,021,918 |
| Interest-bearing liabilities | | | | | | | | |
| Interest-bearing transaction and savings deposits | 32,572 | 47,240 | 70,853 | 141,689 | 38,228 | 101,243 | 137,972 | 569,797 |
| Time deposits | 97,345 | 189,816 | 223,190 | 217,802 | 46,783 | 35,944 | 228 | 811,108 |
| Federal funds purchased | 8,690 | | | | | | | 8,690 |
| Securities sold under repurchase agreements | 103,365 | | | | 3,839 | 11,518 | 12,285 | 131,007 |
| FHLB and other borrowed funds | 87,175 | 6,080 | 41,367 | 26,531 | 5,516 | 57,783 | 1,576 | 226,028 |
| Subordinated debentures | 1 | 5,158 | 4 | 20,627 | 17 | 65 | 18,723 | 44,595 |
| Total interest-bearing liabilities | 329,148 | 248,294 | 335,414 | 406,649 | 94,383 | 206,553 | 170,784 | 1,791,225 |
| Interest rate sensitivity gap | \$ 235,376 | \$ (79,655) | \$ (151,602) | \$ (108,505) | \$ 236,127 | \$ 132,568 | \$ (33,616) | \$ 230,693 |
| Cumulative interest rate | \$ 235,376 | \$ 155,721 | \$ 4,119 | \$ (104,386) | \$ 131,741 | \$ 264,309 | \$ 230,693 | |

| | | | | | | | |
|-------------------|--------|--------|--------|-------|--------|--------|--------|
| sensitivity gap | | | | | | | |
| Cumulative rate | | | | | | | |
| sensitive assets | | | | | | | |
| to rate sensitive | | | | | | | |
| liabilities | 171.5% | 127.0% | 100.5% | 92.1% | 109.3% | 116.3% | 112.9% |
| Cumulative gap | | | | | | | |
| as a % of total | | | | | | | |
| earning assets | 11.6 | 7.7 | 0.2 | (5.2) | 6.5 | 13.1 | 11.4 |
| | | | | 57 | | | |

Table of Contents

Item 4: CONTROLS AND PROCEDURES

Evaluation of Disclosure Controls

Based on their evaluation as of the end of the period covered by this Quarterly Report on Form 10-Q, the Chief Executive Officer and Chief Financial Officer have concluded that the disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) of the Securities Exchange Act of 1934) are effective to ensure that information required to be disclosed by us in reports that we file or submit under the Securities Exchange Act of 1934 is recorded, processed, summarized and reported within the time periods specified in Securities and Exchange Commission rules and forms. Additionally, our disclosure controls and procedures were also effective in ensuring that information required to be disclosed in our Exchange Act report is accumulated and communicated to our management, including the Chief Executive Officer and Chief Financial Officer to allow timely decisions regarding required disclosures.

Changes in Internal Control Over Financial Reporting

There have not been any changes in the Company's internal controls over financial reporting during the quarter ended September 30, 2007, which have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

Table of Contents

PART II: OTHER INFORMATION

Item 1. Legal Proceedings

There are no material pending legal proceedings, other than ordinary routine litigation incidental to its business, to which Home BancShares, Inc. or any of its subsidiaries is a party or of which any of their property is the subject.

Item 1A. Risk Factors

There were no material changes from the risk factors set forth in Part I, Item 1A, Risk Factors, of our Form 10-K for the year ended December 31, 2006. See the discussion of our risk factors in the Form 10-K, as filed with the SEC. The risks described are not the only risks facing the Company. Additional risks and uncertainties not currently known to us or that we currently deem to be immaterial also may materially adversely affect our business, financial condition and/or operating results.

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

Not applicable.

Item 3: Defaults Upon Senior Securities

Not applicable.

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

Not applicable.

Item 5: Other Information

Not applicable.

Item 6: Exhibits

- 15 Awareness of Independent Registered Public Accounting Firm
- 31.1 CEO Certification Pursuant Rule 13a-14(a)/15d-14(a)
- 31.2 CFO Certification Pursuant Rule 13a-14(a)/15d-14(a)
- 32.1 CEO Certification Pursuant 18 U.S.C. Section 1350, as adopted pursuant to section 906 of the Sarbanes Oxley Act of 2002
- 32.2 CFO Certification Pursuant 18 U.S.C. Section 1350, as adopted pursuant to section 906 of the Sarbanes Oxley Act of 2002

Table of Contents

SIGNATURES

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

HOME BANCSHARES, INC.

(Registrant)

Date: October 31, 2007

/s/ John W. Allison

John W. Allison, Chief Executive Officer

Date: October 31, 2007

/s/ Randy E. Mayor

Randy E. Mayor, Chief Financial Officer

60