HOME BANCSHARES INC
Form 10-Q
May 10, 2010

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

(Mark One)

þ **Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**
For the Quarterly Period Ended March 31, 2010

or

o **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 þ No o

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes o No o

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act.

Large accelerated filer o	Accelerated filer þ	Non-accelerated filer o (Do not check if a smaller reporting company)	Smaller reporting company o

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

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

Common Stock Issued and Outstanding: 25,725,160 shares as of May 4, 2010.

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CAUTIONARY NOTE REGARDING FORWARD-LOOKING STATEMENTS

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

- the effects of future economic conditions, including inflation, deflation or a continued decrease in residential housing values;
- governmental monetary and fiscal policies, as well as legislative and regulatory changes;
- the risks of changes in interest rates or the level and composition of deposits, loan demand and the values of loan collateral, securities and interest sensitive assets and liabilities;
- the effects of terrorism and efforts to combat it;
- credit risks;
- the effects of competition from other commercial banks, thrifts, mortgage banking firms, consumer finance companies, credit unions, securities brokerage firms, insurance companies, money market and other mutual funds and other financial institutions operating in our market area and elsewhere, including institutions operating regionally, nationally and internationally, together with competitors offering banking products and services by mail, telephone and the Internet;
- the effect of any mergers, acquisitions or other transactions to which we or our subsidiaries may from time to time be a party, including our ability to successfully integrate any businesses that we acquire; and
- the failure of assumptions underlying the establishment of our allowance for loan losses.

All written or oral forward-looking statements attributable to us are expressly qualified in their entirety by this Cautionary Note. Our actual results may differ significantly from those we discuss in these forward-looking statements. For other factors, risks and uncertainties that could cause our actual results to differ materially from estimates and projections contained in these forward-looking statements, see the Risk Factors section of our Form 10-K filed with the Securities and Exchange Commission on March 5, 2010.

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PART I: FINANCIAL INFORMATION
Item 1: Financial Statements

Home BancShares, Inc.
Consolidated Balance Sheets

(In thousands, except share data)	March 31, 2010 (Unaudited)	December 31, 2009
Assets		
Cash and due from banks	$ 36,237	$ 39,970
Interest-bearing deposits with other banks	156,772	133,520
Cash and cash equivalents	193,009	173,490
Federal funds sold	11,207	11,760
Investment securities available for sale	362,710	322,115
Loans receivable not covered by loss share	1,959,666	1,950,285
Loans receivable covered by FDIC loss share	225,885	
Allowance for loan losses	(42,845)	(42,968)
Loans receivable, net	2,142,706	1,907,317
Bank premises and equipment, net	69,997	70,810
Foreclosed assets held for sale not covered by loss share	17,610	16,484
Foreclosed assets held for sale covered by FDIC loss share	8,672	
FDIC indemnification asset	88,274	
Cash value of life insurance	51,019	52,176
Investments in unconsolidated affiliates	1,424	1,424
Accrued interest receivable	14,854	13,137
Deferred tax asset, net	10,072	14,777
Goodwill	53,039	53,039
Core deposit and other intangibles	6,989	4,698
Mortgage servicing rights	872	1,090
Other assets	45,745	42,548
Total assets	$ 3,078,199	$ 2,684,865
Liabilities and Stockholders Equity		
Deposits:		
Demand and non-interest-bearing	$ 354,663	$ 302,228
Savings and interest-bearing transaction accounts	863,988	714,744
Time deposits	1,002,437	818,451
Total deposits	2,221,088	1,835,423
Federal funds purchased		
Securities sold under agreements to repurchase	55,403	62,000
FHLB borrowed funds	254,548	264,360
Accrued interest payable and other liabilities	21,360	10,625
Subordinated debentures	47,462	47,484

Total liabilities	2,599,861	2,219,892
Stockholders equity:		
Preferred stock; $0.01 par value; 5,500,000 shares authorized:		
Series A fixed rate cumulative perpetual; liquidation preference of $1,000 per share; 50,000 shares issued and outstanding at March 31, 2010 and December 31, 2009.	49,320	49,275
Common stock, par value $0.01; shares authorized 50,000,000; shares issued and outstanding 25,715,528 in 2010 and 25,690,137 in 2009	257	257
Capital surplus	363,870	363,519
Retained earnings	63,907	51,746
Accumulated other comprehensive income	984	176
Total stockholders equity	478,338	464,973
Total liabilities and stockholders equity	$ 3,078,199	$ 2,684,865

See Condensed Notes to Consolidated Financial Statements.

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Home BancShares, Inc.
Consolidated Statements of Income

(In thousands, except per share data)	Three Months Ended March 31, 2010 (Unaudited)	Three Months Ended March 31, 2009 (Unaudited)
Interest income:		
Loans	$ 29,866	$ 29,138
Investment securities		
Taxable	1,627	2,653
Tax-exempt	1,479	1,298
Deposits other banks	85	12
Federal funds sold	5	7
Total interest income	33,062	33,108
Interest expense:		
Interest on deposits	5,295	8,118
Federal funds purchased		2
FHLB borrowed funds	2,177	2,390
Securities sold under agreements to repurchase	94	111
Subordinated debentures	597	676
Total interest expense	8,163	11,297
Net interest income	24,899	21,811
Provision for loan losses	3,100	1,000
Net interest income after provision for loan losses	21,799	20,811
Non-interest income:		
Service charges on deposit accounts	3,141	3,374
Other service charges and fees	1,638	1,784
Mortgage lending income	412	880
Mortgage servicing income	160	200
Insurance commissions	347	257
Income from title services	107	140
Increase in cash value of life insurance	428	477
Dividends from FHLB, FRB & bankers bank	126	107
Gain on acquisitions	11,790	
Gain (loss) on sale of premises and equipment, net	207	7
Gain (loss) on OREO, net	159	(117)
Gain (loss) on securities, net		
Other income	586	476
Total non-interest income	19,101	7,585
Non-interest expense:		

Salaries and employee benefits	8,534	8,944
Occupancy and equipment	2,799	2,677
Data processing expense	862	777
Other operating expenses	6,360	6,864
Total non-interest expense	18,555	19,262
Income before income taxes	22,345	9,134
Income tax expense	7,971	2,889
Net income available to all stockholders	14,374	6,245
Preferred stock dividends and accretion of discount on preferred stock	670	566
Net income available to common stockholders	$ 13,704	$ 5,679
Basic earnings per common share	$ 0.53	$ 0.29
Diluted earnings per common share	$ 0.53	$ 0.28

See Condensed Notes to Consolidated Financial Statements.

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Home BancShares, Inc.
Consolidated Statements of Stockholders Equity
Three Months Ended March 31, 2010 and 2009

(In thousands, except share data)	Preferred Stock	Common Stock	Capital Surplus	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total
Balance at January 1, 2009	$	$ 199	$ 253,581	$ 32,639	$ (3,375)	$ 283,044
Comprehensive income:						
Net income				6,245		6,245
Other comprehensive income:						
Unrealized loss on investment securities available for sale, net of tax effect of $789					1,223	1,223
Comprehensive income						7,468
Issuance of 50,000 shares of preferred stock and a warrant for 144,164 shares of common stock	49,094		906			50,000
Accretion of discount on preferred stock	45			(45)		
Net issuance of 5,065 shares of common stock from exercise of stock options			39			39
Tax benefit from stock options exercised			25			25
Share-based compensation			(50)			(50)
Cash dividends Preferred Stock - 5%				(521)		(521)
Cash dividends Common Stock, $0.06 per share				(1,192)		(1,192)
Balances at March 31, 2009 (unaudited)	49,139	199	254,501	37,126	(2,152)	338,813
Comprehensive income:						
Net loss				20,561		20,561
Other comprehensive income:						
Unrealized gain on investment securities available for sale, net of tax effect of $1,503					2,328	2,328
Comprehensive income						22,889
Issuance of 5,692,500 shares of common stock from public stock offering, net of offering costs of $5,634.		57	107,284			107,341
	136			(136)		

Accretion of discount on preferred stock						
Net issuance of 122,045 shares of common stock from exercise of stock options		1	1,351			1,352
Tax benefit from stock options exercised			414			414
Share-based compensation			(31)			(31)
Cash dividends Preferred stock - 5%				(1,874)		(1,874)
Cash dividends Common Stock, $0.18 per share				(3,931)		(3,931)
Balances at December 31, 2009	49,275	257	363,519	51,746	176	464,973

See Condensed Notes to Consolidated Financial Statements.

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Home BancShares, Inc.
Consolidated Statements of Stockholders Equity Continued
Three Months Ended March 31, 2010 and 2009

(In thousands, except share data)	Preferred Stock	Common Stock	Capital Surplus	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total
Comprehensive income:						
Net income				14,374		14,374
Other comprehensive income:						
Unrealized gain on investment securities available for sale, net of tax effect of $521					808	808
Comprehensive income						15,182
Accretion of discount on preferred stock	45			(45)		
Net issuance of 8,291 shares of common stock from exercise of stock options			90			90
Disgorgement of profits			1			1
Tax benefit from stock options exercised			40			40
Share-based compensation			220			220
Cash dividend Preferred Stock - 5%				(625)		(625)
Cash dividends Common Stock, $0.06 per share				(1,543)		(1,543)
Balances at March 31, 2010 (unaudited)	$ 49,320	$ 257	$ 363,870	$ 63,907	$ 984	$ 478,338

See Condensed Notes to Consolidated Financial Statements.

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Home BancShares, Inc.
Consolidated Statements of Cash Flows

(In thousands)	Period Ended March 31, 2010	2009
	(Unaudited)	
Operating Activities		
Net income	$ 14,374	$ 6,245
Adjustments to reconcile net income to net cash provided by (used in) operating activities:		
Depreciation	1,289	1,301
Amortization/accretion	829	658
Share-based compensation	220	(50)
Tax benefits from stock options exercised	(40)	(25)
Loss on assets	(366)	110
Gain on acquisitions	(11,790)	
Provision for loan losses	3,100	1,000
Deferred income tax benefit	4,184	(1,181)
Increase in cash value of life insurance	(428)	(477)
Originations of mortgage loans held for sale	(21,307)	(59,049)
Proceeds from sales of mortgage loans held for sale	20,701	55,132
Changes in assets and liabilities:		
Accrued interest receivable	(1,717)	265
Other assets	655	(1,652)
Accrued interest payable and other liabilities	3,102	5,537
Net cash provided by operating activities	12,806	7,814
Investing Activities		
Net (increase) decrease in federal funds sold	3,632	(7,645)
Net (increase) decrease in loans net, excluding loans acquired	(15,057)	(16,410)
Purchases of investment securities available for sale	(39,552)	(11,020)
Proceeds from maturities of investment securities available for sale	30,459	33,289
Proceeds from foreclosed assets held for sale	2,213	673
Purchases of premises and equipment, net	(225)	(499)
Death benefits received	1,585	
Acquisition of Centennial Bancshares, Inc., net funds received		(3,100)
Net cash proceeds received in FDIC assisted acquisitions	71,652	
Net cash provided by (used in) investing activities	54,707	(4,712)
Financing Activities		
Net increase (decrease) in deposits, net of deposits acquired	(9,538)	(11,461)
Net increase (decrease) in securities sold under agreements to repurchase	(6,597)	(38,911)
Net increase (decrease) in federal funds purchased		
Net increase (decrease) in FHLB and other borrowed funds, net of acquired	(29,822)	(5,148)
Proceeds from exercise of stock options	90	39
Proceeds from issuance of preferred stock and common stock warrant		50,000
Disgorgement of profits	1	

Tax benefits from stock options exercised	40	25
Dividends paid on preferred stock	(625)	(201)
Dividends paid on common stock	(1,543)	(1,192)
Net cash provided by financing activities	(47,994)	(6,849)
Net change in cash and cash equivalents	19,519	(3,747)
Cash and cash equivalents beginning of year	173,490	54,168
Cash and cash equivalents end of period	$ 193,009	$ 50,421

See Condensed Notes to Consolidated Financial Statements.

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

1. Nature of Operations and Summary of Significant Accounting Policies

Nature of Operations

Home BancShares, Inc. (the Company or HBI) is a bank holding company headquartered in Conway, Arkansas. The Company is primarily engaged in providing a full range of banking services to individual and corporate customers through its wholly owned community bank subsidiary   Centennial Bank (the Bank). During 2009, the Company completed the combination of its former bank charters into a single charter, adopting Centennial Bank as the common name. The Bank has locations in central Arkansas, north central Arkansas, southern Arkansas, the Florida Keys, central Florida and southwestern Florida. The Company is subject to competition from other financial institutions. The Company also is subject to the regulation of certain federal and state agencies and undergoes periodic examinations by those regulatory authorities.

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

Operating Segments

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

Use of Estimates

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

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

Principles of Consolidation

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

Reclassifications

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

Investments in Unconsolidated Affiliates

The Company has invested funds representing 100% ownership in five statutory trusts which issue trust preferred securities. The Company s investment in these trusts was $1.4 million at March 31, 2010 and December 31, 2009. Under accounting principles generally accepted in the United States of America, these trusts are not consolidated.

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The summarized financial information below represents an aggregation of the Company s unconsolidated affiliates as of March 31, 2010 and 2009, and for the three-month period then ended:

	Three Months Ended March 31,	
	2010	**2009**
Assets	$ 47,424	$ 47,424
Liabilities	46,000	46,000
Equity	1,424	1,424
Net income		

Acquisition Accounting, Covered Loans and Related Indemnification Asset

Beginning in 2009, the Company accounts for its acquisitions under ASC Topic 805, *Business Combinations*, which requires the use of the purchase method of accounting. All identifiable assets acquired, including loans, are recorded at fair value. No allowance for loan losses related to the acquired loans is recorded on the acquisition date as the fair value of the loans acquired incorporates assumptions regarding credit risk. Loans acquired are recorded at fair value in accordance with the fair value methodology prescribed in ASC Topic 820, exclusive of the shared-loss agreements with the Federal Deposit Insurance Corporation (FDIC). The fair value estimates associated with the loans include estimates related to expected prepayments and the amount and timing of undiscounted expected principal, interest and other cash flows.

Over the life of the acquired loans, the Company continues to estimate cash flows expected to be collected on individual loans or on pools of loans sharing common risk characteristics and were treated in the aggregate when applying various valuation techniques. The Company evaluates at each balance sheet date whether the present value of its loans determined using the effective interest rates has decreased and if so, recognizes a provision for loan loss in its consolidated statement of income. For any increases in cash flows expected to be collected, the Company adjusts the amount of accretable yield recognized on a prospective basis over the loan s or pool s remaining life.

Because the FDIC will reimburse the Company for certain acquired loans should the Company experience a loss, an indemnification asset is recorded at fair value at the acquisition date. The indemnification asset is recognized at the same time as the indemnified loans, and measured on the same basis, subject to collectability or contractual limitations. The shared-loss agreements on the acquisition date reflect the reimbursements expected to be received from the FDIC, using an appropriate discount rate, which reflects counterparty credit risk and other uncertainties.

The shared-loss agreements continue to be measured on the same basis as the related indemnified loans. Because the acquired loans are subject to the accounting prescribed by ASC Topic 310, subsequent changes to the basis of the shared-loss agreements also follow that model. Deterioration in the credit quality of the loans (immediately recorded as an adjustment to the allowance for loan losses) would immediately increase the basis of the shared-loss agreements, with the offset recorded through the consolidated statement of income. Increases in the credit quality or cash flows of loans (reflected as an adjustment to yield and accreted into income over the remaining life of the loans) decrease the basis of the shared-loss agreements, with such decrease being accreted into income over 1) the same period or 2) the life of the shared-loss agreements, whichever is shorter. Loss assumptions used in the basis of the indemnified loans are consistent with the loss assumptions used to measure the indemnification asset. Fair value accounting incorporates into the fair value of the indemnification asset an element of the time value of money, which is accreted back into income over the life of the shared-loss agreements.

Upon the determination of an incurred loss the indemnification asset will be reduced by the amount owed by the FDIC. A corresponding, claim receivable is recorded until cash is received from the FDIC.

For further discussion of the Company s acquisitions and loan accounting, see Note 2 and Note 5 to the consolidated financial statements.

Interim financial information

The accompanying unaudited consolidated financial statements as of March 31, 2010 and 2009 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 2009 Form 10-K, filed with the Securities and Exchange Commission.

Earnings per Share

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

	Three Months Ended March 31,	
	2010	2009
	(In thousands)	
Net income available to common stockholders	$ 13,704	$ 5,679
Average shares outstanding	25,707	19,863
Effect of common stock options	229	256
Diluted shares outstanding	25,936	20,119
Basic earnings per common share	$ 0.53	$ 0.29
Diluted earnings per common share	$ 0.53	$ 0.28

Warrants to purchase 144,065 shares of common stock at $26.03 were outstanding at March 31, 2010 and December 31, 2009, but were not included in the computation of diluted EPS because the exercise prices were greater than the average market price of the common shares.

2. Business Combinations

Acquisition Old Southern Bank

On March 12, 2010, Centennial Bank entered into a purchase and assumption agreement (Old Southern Agreement) with the FDIC, as receiver, pursuant to which the Bank acquired certain assets and assumed substantially all of the deposits and certain liabilities of Old Southern Bank (Old Southern).

Prior to the acquisition, Old Southern operated 7 banking centers in the Orlando, Florida metropolitan area. Excluding the effects of purchase accounting adjustments, Centennial Bank acquired $335.4 million in assets and assumed approximately $328.5 million of the deposits of Old Southern. Additionally, Centennial Bank purchased loans with an estimated fair value of $179.1 million, $3.1 million of foreclosed assets and $30.4 million of investment securities.

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In connection with the Old Southern acquisition, Centennial Bank entered into a loss sharing agreement with the FDIC that covers $282.0 million of assets, based upon the seller s records, including single family residential mortgage loans, commercial real estate, commercial and industrial loans, and foreclosed assets (collectively, covered assets). Centennial Bank acquired other Old Southern assets that are not covered by the loss sharing agreement with the FDIC including interest-bearing deposits with other banks, investment securities purchased at fair market value and other tangible assets. Pursuant to the terms of the loss sharing agreement, the covered assets are subject to a stated loss threshold of $110.0 million whereby the FDIC will reimburse Centennial Bank for 80% of losses of up to $110.0 million, and 95% of losses in excess of this amount. Centennial Bank will reimburse the FDIC for its share of recoveries with respect to losses for which the FDIC paid Centennial Bank a reimbursement under the loss sharing agreement. The FDIC s obligation to reimburse Centennial Bank for losses with respect to covered assets begins with the first dollar of loss incurred.

The amounts covered by the loss sharing agreement are the pre-acquisition book values of the underlying covered assets, the contractual balance of unfunded commitments that were acquired, and certain future net direct costs. The loss sharing agreements applicable to single family residential mortgage loans provide for FDIC loss sharing and Centennial Bank reimbursement to the FDIC, in each case as described above, for ten years. The loss sharing agreements applicable to all other covered assets provide for FDIC loss sharing for five years and Centennial Bank reimbursement of recoveries to the FDIC for eight years, in each case as described above.

The loss sharing agreement is subject to certain servicing procedures as specified in agreements with the FDIC. The expected reimbursements under the loss sharing agreements were recorded as indemnification assets at their estimated fair values of $76.0 million for the Old Southern Agreement, on the acquisition date. The indemnification assets reflect the present value of the expected net cash reimbursement related to the loss sharing agreements described above.

Centennial Bank has determined that the acquisition of the net assets of Old Southern constitute a business combination as defined by the FASB ASC Topic 805, *Business Combinations*. Accordingly, the assets acquired and liabilities assumed are presented at their fair values as required. Fair values were determined based on the requirements of FASB ASC Topic 820, Fair Value Measurements. In many cases, the determination of these fair values required management to make estimates about discount rates, future expected cash flows, market conditions and other future events that are highly subjective in nature and subject to change. These fair value estimates are considered preliminary, and are subject to change for up to one year after the closing date of the acquisition as additional information relative to closing date fair values becomes available. Centennial Bank and the FDIC are engaged in on-going discussions that may impact which assets and liabilities are ultimately acquired or assumed by Centennial Bank and/or the purchase prices. In addition, the tax treatment of the FDIC assisted acquisition is complex and subject to interpretations that may result in future adjustments of deferred taxes as of the acquisition date.

Centennial Bank did not acquire the real estate, banking facilities, furniture and equipment of Old Southern as part of the purchase and assumption agreement but has the option to purchase these assets at fair market value from the FDIC. This purchase option expires 90 days after acquisition date. Fair market values for the real estate, facilities, furniture and equipment will be based on current appraisals and determined at a later date. Centennial Bank is leasing these facilities and equipment from the FDIC until current appraisals are received and a final decision is made.

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	Acquired from the FDIC	Old Southern Fair Value Adjustments (Dollars in thousands)	As Recorded by HBI
Assets			
Cash and due from banks	$ 1,759	$ 30,675	$ 32,434
Interest-bearing deposits with other banks	16,563		16,563
Investment securities	30,401		30,401
Federal funds sold	3,079		3,079
Loans receivable covered by loss share	273,166	(94,101)	179,065
Total loans receivable	273,166	(94,101)	179,065
Bank premises and equipment, net	44		44
Foreclosed assets held for sale covered by loss share	8,781	(5,821)	2,960
FDIC indemnification asset		76,000	76,000
Core deposit intangibles		2,400	2,400
Other assets	1,505	633	2,138
Total assets acquired	$ 335,298	$ 9,786	$ 345,084
Liabilities			
Deposits			
Demand and non-interest-bearing	$ 25,178	$	$ 25,178
Savings and interest-bearing transaction accounts	124,071		124,071
Time deposits	179,208		179,208
Total deposits	328,457		328,457
Accrued interest payable and other liabilities	375	6,535	6,910
Total liabilities assumed	$ 328,832	$ 6,535	$ 335,367
Gain on acquisition			$ 9,717

The following is a description of the methods used to determine the fair values of significant assets and liabilities presented above.

Cash and due from banks, interest-bearing deposits with other banks and federal funds sold The carrying amount of these assets is a reasonable estimate of fair value based on the short-term nature of these assets. The $30.7 million adjustment is the first proforma cash settlement received from the FDIC on Monday following the closing weekend.

Investment Securities Investment securities were acquired from the FDIC at fair market value.

Loans Fair values for loans were based on a discounted cash flow methodology that considered factors including the type of loan and related collateral, classification status, fixed or variable interest rate, term of loan and whether or not the loan was amortizing, and current discount rates. The discount rates used for loans are based on current market rates for new originations of comparable loans and include adjustments for liquidity concerns. The discount rate does not include a factor for credit losses as that has been included in the estimated cash flows.

Core deposit intangible This intangible asset represents the value of the relationships that Old Southern had with its deposit customers. The fair value of this intangible asset was estimated based on a discounted cash flow methodology that gave appropriate consideration to expected customer attrition rates, cost of the deposit base, and the net maintenance cost attributable to customer deposits.

Foreclosed assets held for sale These assets are presented at the estimated present values that management expects to receive when the properties are sold, net of related costs of disposal.

FDIC indemnification asset This loss sharing asset is measured separately from the related covered assets as it is not contractually embedded in the covered assets and is not transferable with the covered assets should Centennial Bank choose to dispose of them. Fair value was estimated using projected cash flows related to the loss sharing agreements based on the expected reimbursements for losses and the applicable loss sharing percentages. These cash flows were discounted to reflect the uncertainty of the timing and receipt of the loss-sharing reimbursement from the FDIC.

Deposits The fair values used for the demand and savings deposits that comprise the transaction accounts acquired, by definition equal the amount payable on demand at the acquisition date. No fair value adjustment was applied for time deposits as the Bank was able to reset deposit rates to market rates currently offered.

The Company s operating results for the period ended March 31, 2010, include the operating results of the acquired assets and assumed liabilities for the 19 days subsequent to the March 12, 2010 acquisition date. Due to the significant fair value adjustments recorded, as well as the nature of the FDIC loss sharing agreement in place, Old Southern s historical results are not believed to be relevant to the Company s results, and thus no pro forma information is presented.

Acquisition Key West Bank

On March 26, 2010, Centennial Bank, entered into separate purchase and assumption agreements (Key West Bank Agreement) with the FDIC, as receiver, pursuant to which Centennial Bank acquired certain assets and assumed substantially all of the deposits and certain liabilities of Key West Bank (Key West).

Prior to the acquisition, Key West operated one banking center located in Key West, Florida. Excluding the effects of purchase accounting adjustments, Centennial Bank acquired $96.8 million in assets and assumed approximately $66.7 million of the deposits of Key West. Additionally, Centennial Bank purchased loans with an estimated fair value of $46.9 million, $5.7 million of foreclosed assets and assumed $20.0 million of FHLB advances.

In connection with the Key West acquisition, Centennial Bank entered into loss-sharing agreements with the FDIC that collectively cover approximately $72.7 million of assets, based upon the seller s records, which include single family residential mortgage loans, commercial real estate, commercial and industrial loans and foreclosed assets (covered assets). Centennial Bank acquired other Key West assets that are not covered by loss sharing agreements with the FDIC including interest-bearing deposits with other banks and other tangible assets. Pursuant to the terms of the loss sharing agreements, the covered assets of Key West are subject to a stated loss threshold of $23.0 million whereby the FDIC will reimburse Centennial Bank for 80% of losses of up to $23.0 million, and 95% of losses in excess of this amount. Centennial Bank will reimburse the FDIC for its share of recoveries with respect to losses for which the FDIC paid Centennial Bank a reimbursement under the loss sharing agreements. The FDIC s obligation to reimburse Centennial Bank for losses with respect to covered assets begins with the first dollar of loss incurred.

The amounts covered by the loss sharing agreements are the pre-acquisition book values of the underlying covered assets, the contractual balance of unfunded commitments that were acquired, and certain future net direct costs. The loss sharing agreements applicable to single family residential mortgage loans provide for FDIC loss sharing and Centennial Bank reimbursement to the FDIC, in each case as described above, for ten years. The loss sharing agreements applicable to all other covered assets provide for FDIC loss sharing for five years and Centennial Bank reimbursement of recoveries to the FDIC for eight years, in each case as described above.

The loss sharing agreement is subject to certain servicing procedures as specified in agreements with the FDIC. The expected reimbursements under the loss sharing agreements were recorded as indemnification assets at their estimated fair values of $12.2 million for the Key West Agreement, on the acquisition date. The indemnification assets reflect the present value of the expected net cash reimbursement related to the loss sharing agreements described above.

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Centennial Bank has determined that the acquisition of the net assets of Key West constitute a business combination as defined by the FASB ASC Topic 805, *Business Combinations*. Accordingly, the assets acquired and liabilities assumed are presented at their fair values as required. Fair values were determined based on the requirements of FASB ASC Topic 820, Fair Value Measurements. In many cases, the determination of these fair values required management to make estimates about discount rates, future expected cash flows, market conditions and other future events that are highly subjective in nature and subject to change. These fair value estimates are considered preliminary, and are subject to change for up to one year after the closing date of the acquisition as additional information relative to closing date fair values becomes available. Centennial Bank and the FDIC are engaged in on-going discussions that may impact which assets and liabilities are ultimately acquired or assumed by Centennial Bank and/or the purchase prices. In addition, the tax treatment of the FDIC assisted acquisition is complex and subject to interpretations that may result in future adjustments of deferred taxes as of the acquisition date.

Centennial Bank did not acquire the real estate, banking facilities, furniture and equipment of Key West as part of the purchase and assumption agreement but has the option to purchase these assets at fair market value from the FDIC. This purchase option expires 90 days after acquisition date. Fair market values for the real estate, facilities, furniture and equipment will be based on current appraisals and determined at a later date. Centennial Bank is leasing these facilities and equipment from the FDIC until current appraisals are received and a final decision is made.

	Key West		
	Acquired from the FDIC	**Fair Value Adjustments**	**As Recorded by HBI**
		(Dollars in thousands)	
Assets			
Cash and due from banks	$ 1,592	$	$ 1,592
Interest-bearing deposits with other banks	21,063		21,063
Loans receivable covered by loss share	65,256	(18,315)	46,941
Total loans receivable	65,256	(18,315)	46,941
Foreclosed assets held for sale covered by loss share	7,412	(1,700)	5,712
FDIC indemnification asset		12,200	12,200
Core deposit intangible		370	370
Other assets	1,438	276	1,714
Total assets acquired	$ 96,761	$ (7,169)	$ 89,592
Liabilities			
Deposits			
Demand and non-interest-bearing	$ 4,357	$	$ 4,357
Savings and interest-bearing transaction accounts	5,543		5,543
Time deposits	56,846		56,846
Total deposits	66,746		66,746
FHLB borrowed funds	20,010		20,010
Accrued interest payable and other liabilities	593	170	763
Total liabilities assumed	$ 87,349	$ 170	$ 87,519

Gain on acquisition	$	2,073

The following is a description of the methods used to determine the fair values of significant assets and liabilities presented above.

Cash and due from banks and interest-bearing deposits with other banks The carrying amount of these assets is a reasonable estimate of fair value based on the short-term nature of these assets.

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Loans Fair values for loans were based on a discounted cash flow methodology that considered factors including the type of loan and related collateral, classification status, fixed or variable interest rate, term of loan and whether or not the loan was amortizing, and current discount rates. The discount rates used for loans are based on current market rates for new originations of comparable loans and include adjustments for liquidity concerns. The discount rate does not include a factor for credit losses as that has been included in the estimated cash flows.

Core deposit intangible This intangible asset represents the value of the relationships that Key West had with its deposit customers. The fair value of this intangible asset was estimated based on a discounted cash flow methodology that gave appropriate consideration to expected customer attrition rates, cost of the deposit base, and the net maintenance cost attributable to customer deposits.

Foreclosed assets held for sale These assets are presented at the estimated present values that management expects to receive when the properties are sold, net of related costs of disposal.

FDIC indemnification asset This loss sharing asset is measured separately from the related covered assets as it is not contractually embedded in the covered assets and is not transferable with the covered assets should Centennial Bank choose to dispose of them. Fair value was estimated using projected cash flows related to the loss sharing agreements based on the expected reimbursements for losses and the applicable loss sharing percentages. These cash flows were discounted to reflect the uncertainty of the timing and receipt of the loss sharing reimbursement from the FDIC.

Deposits The fair values used for the demand and savings deposits that comprise the transaction accounts acquired, by definition equal the amount payable on demand at the acquisition date. No fair value adjustment was applied for time deposits because the weighted average interest rate of Key West s CD s were at the market rates of similar funding at the time of acquisition.

The Company s operating results for the period ended March 31, 2010, include the operating results of the acquired assets and assumed liabilities for the 5 days subsequent to the March 26, 2010 acquisition date. Due to the significant fair value adjustments recorded, as well as the nature of the FDIC loss sharing agreement in place, Key West s historical results are not believed to be relevant to the Company s results, and thus no pro forma information is presented.

3. Investment Securities

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

	March 31, 2010 Available for Sale			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized (Losses)	Estimated Fair Value
	(In thousands)			
U.S. government-sponsored enterprises	$ 101,825	$ 131	$ (260)	$ 101,696
Mortgage-backed securities	105,837	2,920	(1,270)	107,487
State and political subdivisions	147,651	2,439	(1,006)	149,084
Other securities	5,778		(1,335)	4,443
Total	$ 361,091	$ 5,490	$ (3,871)	$ 362,710

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	December 31, 2009 Available for Sale			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized (Losses)	Estimated Fair Value
	(In thousands)			
U.S. government-sponsored enterprises	$ 56,439	$ 130	$ (463)	$ 56,106
Mortgage-backed securities	114,464	2,813	(1,690)	115,587
State and political subdivisions	145,086	2,224	(1,375)	145,935
Other securities	5,837		(1,350)	4,487
Total	$ 321,826	$ 5,167	$ (4,878)	$ 322,115

Assets, principally investment securities, having a carrying value of approximately $288.2 million and $231.3 million at March 31, 2010 and December 31, 2009, 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 $55.4 million and $62.0 million at March 31, 2010 and December 31, 2009, respectively.

During the three-month periods ended March 31, 2010 and 2009, no available for sale securities were sold.

The amortized cost and estimated fair value of securities at March 31, 2010, by contractual maturity, are shown below. Expected maturities will differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

	Available-for-Sale	
	Amortized Cost	Estimated Fair Value
	(In thousands)	
Due in one year or less	$ 122,359	$ 121,552
Due after one year through five years	165,537	167,959
Due after five years through ten years	46,420	46,589
Due after ten years	26,775	26,610
Total	$ 361,091	$ 362,710

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

The Company evaluates all securities quarterly to determine if any unrealized losses are deemed to be other than temporary. In completing these evaluations the Company follows the requirements of FASB ASC 320, *Investments Debt and Equity Securities.* Certain investment securities are valued less than their historical cost. These declines are primarily the result of the rate for these investments yielding less than current market rates. Based on evaluation of available evidence, management believes the declines in fair value for these securities are temporary. The Company does not intend to sell or believe it will be required to sell these investments before recovery of their amortized cost bases, which may be maturity. Should the impairment of any of these securities become other than temporary, the cost basis of the investment will be reduced and the resulting loss recognized in net income in the period the other-than-temporary impairment is identified.

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No securities were deemed by management to have other-than-temporary impairment for the three month periods ended March 31, 2010, besides securities for which impairment was taken in prior periods.

For the period ended March 31, 2010, the Company had $3.5 million in unrealized losses, which have been in continuous loss positions for more than twelve months. Included in the $3.5 million in unrealized losses are $1.3 million in unrealized losses, which were associated with government-sponsored securities and government-sponsored mortgage-back securities. Excluding impairment write downs taken in prior periods, the Company s assessments indicated that the cause of the market depreciation was primarily the change in interest rates and not the issuer s financial condition, or downgrades by rating agencies. In addition, approximately 79.7% of the Company s investment portfolio matures in five years or less. As a result, the Company has the ability and intent to hold such securities until maturity.

The following shows gross unrealized losses and estimated fair value of investment securities available for sale aggregated by investment category and length of time that individual investment securities have been in a continuous loss position as of the periods ended March 31, 2010 and December 31, 2009:

	March 31, 2010					
	Less Than 12 Months		12 Months or More		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
	(In thousands)					
U.S. Government-sponsored enterprises	$ 45,204	$ (260)	$	$	$ 45,204	$ (260)
Mortgage-backed securities	1,681	(2)	6,193	(1,268)	7,874	(1,270)
State and political subdivisions	9,903	(90)	17,180	(916)	27,083	(1,006)
Other securities			1,405	(1,335)	1,405	(1,335)
Total	$ 56,788	$ (352)	$ 24,778	$ (3,519)	$ 81,566	$ (3,871)

	December 31, 2009					
	Less Than 12 Months		12 Months or More		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
	(In thousands)					
U.S. Government-sponsored enterprises	$ 41,078	$ (463)	$	$	$ 41,078	$ (463)
Mortgage-backed securities	10,837	(205)	4,411	(1,485)	15,248	(1,690)
State and political subdivisions	10,647	(146)	17,957	(1,229)	28,604	(1,375)
Other securities			1,562	(1,350)	1,562	(1,350)
Total	$ 62,562	$ (814)	$ 23,930	$ (4,064)	$ 86,492	$ (4,878)

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4: Loans Receivable Not Covered by Loss Share and Allowance for Loan Losses

The various categories of loans not covered by loss share are summarized as follows:

	March 31, 2010	December 31, 2009
	(In thousands)	
Real estate:		
Commercial real estate loans		
Non-farm/non-residential	$ 822,252	$ 808,983
Construction/land development	363,738	368,723
Agricultural	30,943	33,699
Residential real estate loans		
Residential 1-4 family	381,451	382,504
Multifamily residential	63,602	62,609
Total real estate	1,661,986	1,656,518
Consumer	33,206	39,084
Commercial and industrial	231,867	219,847
Agricultural	12,122	10,280
Other	20,485	24,556
Loans receivable not covered by loss share	1,959,666	1,950,285

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

	2010	2009
	(In thousands)	
Balance, beginning of year	$ 42,968	$ 40,385
Additions		
Provision charged to expense	3,100	1,000
Net loans charged off		
Losses charged to allowance, net of recoveries of $497 and $452 for the first three months of 2010 and 2009, respectively	3,223	563
Balance, March 31	$ 42,845	40,822
Additions		
Provision charged to expense		10,150
Net loans charged off		
Losses charged to allowance, net of recoveries of $1,450 for the last nine months of 2009		8,004
Balance, end of year		$ 42,968

At March 31, 2010 and December 31, 2009, accruing loans not covered by loss share delinquent 90 days or more totaled $3.9 million and $2.9 million, respectively. Non-accruing loans not covered by loss share at March 31, 2010 and December 31, 2009 were $33.9 million and $37.1 million, respectively.

The Company did not sell any of the guaranteed portions of SBA loans during the first quarter of 2010 or 2009.

Mortgage loans held for sale of approximately $5.4 million and $4.8 million at March 31, 2010 and December 31, 2009, respectively, are included in residential 1-4 family loans. Mortgage loans held for sale are carried at the lower of cost or fair value, determined using an aggregate basis. Gains