

SIMMONS FIRST NATIONAL CORP  
Form 10-K  
March 12, 2013  
UNITED STATES

SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549

FORM 10-K  
(Mark One)

Annual Report Pursuant to Section 13 or 15(d) of the Exchange Act of 1934  
For the fiscal year ended: December 31, 2012

or

Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

Commission file number 0-6253

SIMMONS FIRST NATIONAL CORPORATION  
(Exact name of registrant as specified in its charter)

Arkansas  
(State or other jurisdiction of  
incorporation or organization)

71-0407808  
(I.R.S. employer  
identification No.)

501 Main Street, Pine Bluff, Arkansas  
(Address of principal executive offices)

71601  
(Zip Code)

(870) 541-1000  
(Registrant's telephone number, including area code)

Securities registered pursuant to Section 12(b) of the Act:

Common Stock, \$0.01 par value  
(Title of each class)

The NASDAQ Global Select Market®  
(Name of each exchange on which registered)

Securities registered pursuant to Section 12(g) of the Act: None

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

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

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.  Yes  No

Indicate by check mark 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  No

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or 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. (Check one):

Large accelerated filer [ ]

Accelerated filer [x]

Non-accelerated filer [ ] (Do not check if a smaller reporting company)

Smaller reporting company [ ]

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

The aggregate market value of the Registrant's Common Stock, par value \$0.01 per share, held by non-affiliates on June 30, 2012, was \$358,288,661 based upon the last trade price as reported on the NASDAQ Global Select Market® of \$23.25.

The number of shares outstanding of the Registrant's Common Stock as of February 1, 2013, was 16,504,124.

Part III is incorporated by reference from the Registrant's Proxy Statement relating to the Annual Meeting of Shareholders to be held on April 16, 2013.

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## Introduction

The Company has chosen to combine our Annual Report to Shareholders with our Form 10-K, which is a document that U.S. public companies file with the Securities and Exchange Commission every year. Many readers are familiar with “Part II” of the Form 10-K, as it contains the business information and financial statements that were included in the financial sections of our past Annual Reports. These portions include information about our business that we believe will be of interest to investors. We hope investors will find it useful to have all of this information available in a single document.

The Securities and Exchange Commission allows us to report information in the Form 10-K by “incorporated by reference” from another part of the Form 10-K, or from the proxy statement. You will see that information is “incorporated by reference” in various parts of our Form 10-K.

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## CAUTIONARY NOTE REGARDING FORWARD-LOOKING STATEMENTS

Certain statements contained in this Annual Report may not be based on historical facts and 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. These forward-looking statements may be identified by reference to a future period(s) or by the use of forward-looking terminology, such as “anticipate,” “estimate,” “expect,” “foresee,” “believe,” “may,” “might,” “will,” “would,” “could” or “intend,” future or conditional verb tenses, and variations or negatives of such terms. These forward-looking statements include, without limitation, those relating to the Company’s future growth, revenue, assets, asset quality, profitability and customer service, critical accounting policies, net interest margin, non-interest revenue, market conditions related to the Company’s stock repurchase program, allowance for loan losses, the effect of certain new accounting standards on the Company’s financial statements, income tax deductions, credit quality, the level of credit losses from lending commitments, net interest revenue, interest rate sensitivity, loan loss experience, liquidity, capital resources, market risk, earnings, effect of pending litigation, acquisition strategy, legal and regulatory limitations and compliance and competition.

These forward-looking statements involve risks and uncertainties, and may not be realized due to a variety of factors, including, without limitation: the effects of future economic conditions, governmental monetary and fiscal policies, as well as legislative and regulatory changes; the risks of changes in interest rates and their effects on the level and composition of deposits, loan demand and the values of loan collateral, securities and interest sensitive assets and liabilities; the costs of evaluating possible acquisitions and the risks inherent in integrating acquisitions; 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 such competitors offering banking products and services by mail, telephone, computer and the Internet; the failure of assumptions underlying the establishment of reserves for possible loan losses, fair value for covered loans, covered other real estate owned and FDIC indemnification asset; and those factors set forth under Item 1A. Risk-Factors of this report and other cautionary statements set forth elsewhere in this report. Many of these factors are beyond our ability to predict or control. In addition, as a result of these and other factors, our past financial performance should not be relied upon as an indication of future performance.

We believe the expectations reflected in our forward-looking statements are reasonable, based on information available to us on the date hereof. However, given the described uncertainties and risks, we cannot guarantee our future performance or results of operations and you should not place undue reliance on these forward-looking statements. We undertake no obligation to update or revise any forward-looking statements, whether as a result of new information, future events or otherwise, and all written or oral forward-looking statements attributable to us are expressly qualified in their entirety by this section.

## PART I

### ITEM 1.

### BUSINESS

#### Company Overview

Simmons First National Corporation (the “Company”) is a multi-bank financial holding company registered under the Bank Holding Company Act of 1956, as amended. The Company is headquartered in Arkansas with total assets of \$3.5 billion, loans of \$1.9 billion, deposits of \$2.9 billion and equity capital of \$406 million as of December 31, 2012. We own eight community banks that are strategically located throughout Arkansas and conduct our operations through 96 offices, of which 92 are branches, or “financial centers,” located in 55 communities in Arkansas, Missouri and Kansas.

We seek to build shareholder value by (i) focusing on strong asset quality, (ii) maintaining strong capital (iii) managing our liquidity position, (iv) improving our efficiency through specific initiatives and (v) opportunistically growing our business, both organically and through potential Federal Deposit Insurance Corporation (“FDIC”)-assisted transactions and traditional private community bank acquisitions. We believe the depth and experience of our corporate executive management team and the management teams and directors of each of our community banks has allowed us to achieve excellent asset quality, a strong capital position and increased liquidity, even in the current challenging economic climate.

### Community Bank Strategy

Our community banks feature locally based management and boards of directors, community-focused growth strategies, and flexibility in pricing of loans and deposits. Our community banks are supported by our main subsidiary bank, Simmons First National Bank (“SFNB” or “lead bank”), which allows our community banks to provide products and services, such as a bank-issued credit card, that are usually offered only by larger banks. We believe that our enterprise-wide support system enables us to “out-product” our smaller, community bank competitors while our local focus allows us to “out-service” our larger interstate bank competitors.

Our community banking business model involves some additional administrative costs as a result of maintaining multiple bank charters, but has allowed us to maintain strong management at the local level to meet the needs of local customers while ensuring good asset quality. In addition we, along with our lead bank, provide efficiencies through consolidated back office support for information systems, loan review, compliance, human resources, accounting and internal audit. Likewise, through a standardizing initiative, our banks share a common name, signage and products that enable us to maximize our branding and overall marketing strategy.

### Growth Strategy

Over the past 20 years, as we have expanded our markets and services, our growth strategy has evolved and diversified. From 1989 through 1991, in addition to our internal branching expansion, we acquired nine branches from the Resolution Trust Corporation, the federal agency that oversaw the sale or liquidation of assets of closed savings and loans institutions.

From 1995 to 2005, our strategic focus was on creating geographic diversification throughout Arkansas, driven primarily by acquisitions of other banking institutions. During this period we completed acquisitions of nine financial institutions and a total of 20 branches from five other banking institutions, some of which allowed us to enter key growth markets such as Conway, Hot Springs, Russellville, Searcy and Northwest Arkansas. In 2005, we initiated a de novo branching strategy to enter selected new Arkansas markets and to complement our presence in existing markets. From 2005 to 2008, we opened 12 new financial centers, a regional headquarters in Northwest Arkansas and a corporate office in Little Rock. We substantially completed our de novo branching strategy in 2008.

In late 2007, as we anticipated deteriorating economic conditions, we concentrated on maintaining our strong asset quality, building capital and improving our liquidity position. We intensified our focus on loan underwriting and on monitoring our loan portfolio in order to maintain asset quality, which is well above our peer group and the industry average. From late 2007 to December 31, 2009, our liquidity position (net overnight funds sold) improved by approximately \$150 million as a result of a strategic initiative to introduce deposit products that grew our core deposits in transaction and savings accounts and improved our deposit mix. Transaction and savings deposits increased from 48% of total deposits as of December 31, 2007, to 62% of total deposits as of December 31, 2009, to 63% of total deposits as of December 31, 2010, to 67% of total deposits as of December 31, 2011 and to 70% of total deposits as of December 31, 2012.

Our capital levels have remained strong during the recent economic downturn. As part of our strategic focus on building capital, we suspended our stock repurchase program in July 2008. Additionally, despite our strong capital position, in October 2008 we applied, and were one of the earliest banks approved, for funding of up to \$60 million under the U.S. Treasury’s Capital Purchase Program, referred to as the “CPP.” After careful consideration and analysis, we believed there had been considerable improvement in the economic indicators since October 2008 and we determined that participation in the CPP was not necessary nor in the best interest of our shareholders. We notified the Treasury in July 2009 that we did not intend to participate in the CPP.

On August 26, 2009, we filed a shelf registration statement with the Securities and Exchange Commission ("SEC"). The shelf registration statement will allow us to raise capital from time to time, up to an aggregate of \$175 million, through the sale of common stock, preferred stock, or a combination thereof, subject to market conditions. Specific terms and prices will be determined at the time of any offering under a separate prospectus supplement that we will be required to file with the SEC at the time of the specific offering.

In December 2009, we completed a secondary stock offering by issuing a total of 3,047,500 shares of common stock, including the over-allotment, at a price of \$24.50 per share, less underwriting discounts and commissions. The net proceeds of the offering after deducting underwriting discounts and commissions and offering expenses were approximately \$70.5 million. Subsequent to the stock offering, we have approximately \$100 million available from our shelf registration for future offerings. The excess capital positions us to continue to take advantage of unprecedented acquisition opportunity through FDIC-assisted transactions of failed banks. We continue to actively pursue the right opportunities that meet our strategic plan regarding mergers and acquisitions.

In 2010, we expanded outside the borders of Arkansas by acquiring two failed institutions through FDIC-assisted transactions. The first was a \$100 million failed bank located in Springfield, Missouri and the second was a \$400 million failed thrift located in Olathe, Kansas. On both transactions, we entered into a loss share agreement with the FDIC, which provides significant protection of 80% of covered assets. As part of the acquisitions, we recognized a pre-tax bargain purchase gain of \$3.0 million and \$18.3 million, respectively, on the Missouri and Kansas transactions.

In 2012, we acquired two additional failed institutions through FDIC-assisted transactions. The first was a \$300 million failed bank located in St. Louis, Missouri and the second was a \$200 million failed bank located in Sedalia, Missouri. On both transactions, we again entered into a loss share agreement with the FDIC to provide 80% protection of a significant portion of the assets. As part of the acquisitions, we recognized a pre-tax bargain purchase gain of \$1.1 million and \$2.3 million, respectively, on the Missouri transactions.

In September 2011, we reinstated our stock repurchase program as we continue to have one of the strongest capital positions within our peer group. A portion of our capital has been allocated for our acquisition program, and we plan to leave this portion available for this purpose. However, we plan to utilize a portion of our annual earnings to repurchase shares from time to time at prevailing market prices, through open market or unsolicited negotiated transactions, depending upon market conditions.

#### Acquisition Strategy

We believe we are strategically positioned to leverage our strong capital position to grow through acquisitions. In the near term, the disruptions in the financial markets continue to create opportunities for strong financial institutions to acquire selected assets and deposits of failed banks through FDIC-assisted transactions. We intend to continue focusing our near term acquisition strategy on such transactions. We also believe that the challenging economic environment combined with more restrictive bank regulatory reform will cause many financial institutions to seek merger partners in the intermediate future. We believe our community bank model, strong capital and successful acquisition history position us as a purchaser of choice for community banks seeking a strong partner.

We expect that our primary geographic target area for acquisitions, both FDIC-assisted and negotiated, will continue to be Arkansas and its contiguous states. Our priority will be to focus on acquisitions that would complement the footprint we have been building in the Kansas and Missouri market. The senior management teams of both our parent company and lead bank have had extensive experience during the past twenty years in acquiring banks, branches and deposits and post-acquisition integration of operations. We believe this experience positions us to successfully acquire and integrate banks on both an FDIC-assisted and unassisted basis.

With respect to FDIC-assisted transactions:

- We believe one of our key strengths is our management depth at the community bank level that will enable us to redeploy our human resources to integrate and operate an acquired institution's business with minimal disruption to our existing operations. From our management pool we have assembled an in-house acquisition team to focus on evaluating and executing FDIC-assisted transactions.
- We have retained a consultant with FDIC-assisted transaction experience that has supplemented our management's acquisition experience with additional training focused on the unique aspects of acquiring, converting and integrating banks through FDIC-assisted transactions.

With respect to negotiated community bank acquisitions:

- We have historically retained the target institution's senior management and have provided them with an appealing level of autonomy post-integration. We intend to continue to pursue negotiated community bank acquisitions and

we believe that our history with respect to such acquisitions has positioned us as an acquirer of choice for community banks.

- We encourage acquired community banks, their boards and associates to maintain their community involvement, while empowering the banks to offer a broader array of financial products and services. We believe this approach leads to enhanced profitability after the acquisition.

## Efficiency Initiatives

In 2008, we began two significant initiatives to improve our operating performance by implementing cost efficiencies and selected revenue enhancements. These initiatives have led to cost savings and revenue enhancements in 2010 through 2012 and are expected to lead to further improvements in years beyond.

Our first such initiative was an effort to leverage our corporate buying power to renegotiate our existing vendor contracts at lower prices and to maximize the return on our investment in technology. We began to benefit from operating expense savings as a result of more favorable contract terms with our vendors in 2009 with the full annualized benefits substantially realized in 2011.

Our second initiative, which was larger in scope, was to identify and implement process improvements. We have reviewed our business processes in an effort to improve our profitability while preserving the quality of our customer service. The scope of this initiative included implementing revenue enhancements, further consolidating back office processes and refining our organizational structure. We began implementing this initiative in 2010, continued throughout 2011 and finalized implementation in 2012. We have experienced significant savings and revenue enhancements through this initiative.

## Subsidiary Banks

Our lead bank, SFNB, is a national bank which has been in operation since 1903. As of December 31, 2012, SFNB had total assets of \$2.1 billion, total loans of \$1.1 billion and total deposits of \$1.7 billion. Simmons First Trust Company N.A., a wholly owned subsidiary of SFNB, performs the trust and fiduciary business operations for SFNB and for our other subsidiary banks. Simmons First Investment Group, Inc., a wholly owned subsidiary of SFNB, is a broker-dealer registered with the SEC and a member of the Financial Industry Regulatory Authority and performs the broker-dealer operations for SFNB.

The following table shows our community subsidiary banks other than the lead bank:

Subsidiary	Year Acquired	Primary Market	As of December 31, 2012		
			Assets (In thousands)	Loans	Deposits
Simmons First Bank of Northeast Arkansas	1984	Northeast Arkansas	\$351,257	\$281,147	\$299,489
Simmons First Bank of South Arkansas	1984	Southeast Arkansas	191,522	103,023	162,787
Simmons First Bank of Northwest Arkansas	1995	Northwest Arkansas	243,533	130,238	196,111
Simmons First Bank of Russellville	1997	Russellville, Arkansas	190,760	101,566	139,525
Simmons First Bank of Searcy	1997	Searcy, Arkansas	152,248	93,142	116,466
Simmons First Bank of El Dorado	1999	South central Arkansas	224,186	78,112	188,441
Simmons First Bank of Hot Springs	2004	Hot Springs, Arkansas	175,869	70,773	134,389

Our subsidiary banks provide complete banking services to individuals and businesses throughout the market areas they serve. These banks offer consumer (credit card and other consumer), real estate (construction, single family residential and other commercial) and commercial (commercial, agriculture and financial institutions) loans, checking, savings and time deposits, securities and investment services and trust and investment management services (through Simmons First Trust Company N.A.).

## Loan Risk Assessment

As part of our ongoing risk assessment, the Company has an Asset Quality Review Committee of management that meets quarterly to review the adequacy of the allowance for loan losses. The Committee reviews the status of past due, non-performing and other impaired loans, reserve ratios, and additional performance indicators for all of its subsidiary banks. The allowance for loan losses is determined based upon the aforementioned performance factors, and adjustments are made accordingly.

The Boards of Directors of each of our subsidiary banks review the adequacy of its allowance for loan losses on a monthly basis giving consideration to past due loans, non-performing loans, other impaired loans, and current economic conditions. Our loan review department monitors each of its subsidiary bank's loan information monthly. In addition, the loan review department prepares an analysis of the allowance for loan losses for each subsidiary bank twice a year, and reports the results to our Audit and Security Committee. In order to verify the accuracy of the monthly analysis of the allowance for loan losses, the loan review department performs an on-site detailed review of each subsidiary bank's loan files on a semi-annual basis. Additionally, we have instituted a Special Asset Committee for the purpose of reviewing criticized loans in regard to collateral adequacy, workout strategies and proper reserve allocations.

The SFNB Board of Directors has delegated oversight of assets covered by FDIC loss share agreements to the Loss Share Loan Committee, comprised of the Corporate CEO, President and an Executive Vice President, along with several SFNB executives. The Board authorizes the Committee to transact loan origination, renewal and workout procedures relative to FDIC-assisted acquisitions. Duties of the Committee shall be carried out in accordance with the Purchase and Assumption Agreements executed between the Bank and the FDIC.

### Competition

There is significant competition among commercial banks in our various market areas. In addition, we also compete with other providers of financial services, such as savings and loan associations, credit unions, finance companies, securities firms, insurance companies, full service brokerage firms and discount brokerage firms. Some of our competitors have greater resources and, as such, may have higher lending limits and may offer other services that we do not provide. We generally compete on the basis of customer service and responsiveness to customer needs, available loan and deposit products, the rates of interest charged on loans, the rates of interest paid for funds, and the availability and pricing of trust and brokerage services.

### Principal Offices and Available Information

Our principal executive offices are located at 501 Main Street, Pine Bluff, Arkansas 71601, and our telephone number is (870) 541-1000. We also have corporate offices in Little Rock, Arkansas. We maintain a website at <http://www.simmonsfirst.com>. On this website under the section "Investor Relations", we make our filings with the Securities and Exchange Commission available free of charge, along with other Company news and announcements.

### Employees

As of February 1, 2013, the Company and its subsidiaries had approximately 1,052 full time equivalent employees. None of the employees is represented by any union or similar groups, and we have not experienced any labor disputes or strikes arising from any such organized labor groups. We consider our relationship with our employees to be good.

### Executive Officers of the Company

The following is a list of all executive officers of the Company. The Board of Directors elects executive officers annually.

NAME	AGE	POSITION	YEARS SERVED
J. Thomas May	66	Chairman and Chief Executive Officer	26
George A. Makris, Jr. (1)	56	CEO - Elect	15
David L. Bartlett	61	President and Chief Banking Officer	16
Robert A. Fehlman	48	Senior Executive Vice President, Chief Financial Officer and Treasurer	24
Marty D. Casteel	61	Executive Vice President and Secretary	24
Robert C. Dill	69	Executive Vice President, Marketing	46
David W. Garner	43	Senior Vice President, Controller and Chief Accounting Officer	15
Kevin J. Archer	49	Senior Vice President/Credit Policy and Risk Assessment	17
Sharon K. Burdine	47	Senior Vice President and Human Resources Director	15

Tina M. Groves	43	Senior Vice President/Manager, Audit/Compliance	7
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(1) Mr. Makris was elected as CEO - Elect on August 13, 2012, effective January 1, 2013. He will succeed J. Thomas May as chairman and Chief Executive Officer upon Mr. May's retirement on December 31, 2013.

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Board of Directors of the Company

The following is a list of the Board of Directors of the Company as of December 31, 2012, along with their principal occupation.

NAME	PRINCIPAL OCCUPATION
J. Thomas May	Chairman and Chief Executive Officer Simmons First National Corporation
George A. Makris, Jr. (1)	CEO - Elect Simmons First National Corporation
David L. Bartlett (2)	President and Chief Banking Officer Simmons First National Corporation
William E. Clark, II	Chairman and Chief Executive Officer Clark Contractors, LLC
Steven A. Cossé	President and Chief Executive Officer Murphy Oil Corporation
Edward Drilling	President AT&T Arkansas
Sharon L. Gaber	Provost and Vice Chancellor for Academic Affairs University of Arkansas
Eugene Hunt	Attorney Hunt Law Firm
W. Scott McGeorge	President Pine Bluff Sand and Gravel Company
Harry L. Ryburn	Orthodontist (retired)
Robert L. Shoptaw	Chairman of the Board Arkansas Blue Cross and Blue Shield

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(1) Mr. Makris was elected as CEO – Elect on August 13, 2012, effective January 1, 2013. He will succeed J. Thomas May as chairman and Chief Executive Officer upon Mr. May’s retirement on December 31, 2013. Mr. Makris has served on the Board of Directors of the Company since 1997 and served as chairman of the Company’s Audit & Security Committee from 2007 until his resignation upon his election to CEO – Elect. Prior to his election, he served as President of M. K. Distributors, Inc.

(2) Mr. Bartlett was appointed to the Board of Directors of the Company on January 28, 2013.

SUPERVISION AND REGULATION

The Company

The Company, as a bank holding company, is subject to both federal and state regulation. Under federal law, a bank holding company generally must obtain approval from the Board of Governors of the Federal Reserve System ("FRB") before acquiring ownership or control of the assets or stock of a bank or a bank holding company. Prior to approval of any proposed acquisition, the FRB will review the effect on competition of the proposed acquisition, as well as other regulatory issues.

The federal law generally prohibits a bank holding company from directly or indirectly engaging in non-banking activities. This prohibition does not include loan servicing, liquidating activities or other activities so closely related to banking as to be a proper incident thereto. Bank holding companies, including Simmons First National Corporation, which have elected to qualify as financial holding companies, are authorized to engage in financial activities. Financial activities include any activity that is financial in nature or any activity that is incidental or complimentary to a financial activity.

As a financial holding company, we are required to file with the FRB an annual report and such additional information as may be required by law. From time to time, the FRB examines the financial condition of the Company and its subsidiaries. The FRB, through civil and criminal sanctions, is authorized to exercise enforcement powers over bank holding companies (including financial holding companies) and non-banking subsidiaries, to limit activities that represent unsafe or unsound practices or constitute violations of law.

We are subject to certain laws and regulations of the state of Arkansas applicable to financial and bank holding companies, including examination and supervision by the Arkansas Bank Commissioner. Under Arkansas law, a financial or bank holding company is prohibited from owning more than one subsidiary bank, if any subsidiary bank owned by the holding company has been chartered for less than five years and, further, requires the approval of the Arkansas Bank Commissioner for any acquisition of more than 25% of the capital stock of any other bank located in Arkansas. No bank acquisition may be approved if, after such acquisition, the holding company would control, directly or indirectly, banks having 25% of the total bank deposits in the state of Arkansas, excluding deposits of other banks and public funds.

Federal legislation allows bank holding companies (including financial holding companies) from any state to acquire banks located in any state without regard to state law, provided that the holding company (1) is adequately capitalized, (2) is adequately managed, (3) would not control more than 10% of the insured deposits in the United States or more than 30% of the insured deposits in such state, and (4) such bank has been in existence at least five years if so required by the applicable state law.

#### Subsidiary Banks

During the fourth quarter of 2010, the Company realigned the regulatory oversight for its affiliate banks in order to create efficiencies through regulatory standardization. We operate as a multi bank holding company and over the years, have acquired several banks. In accordance with the corporate strategy of leaving the bank structure unchanged, each acquired bank stayed intact as did its regulatory structure. As a result, the Company's eight affiliate banks were regulated by the Arkansas State Bank Department, the Federal Reserve, the FDIC, and/or the Office of the Comptroller of the Currency ("OCC").

Following the regulatory realignment, the lead bank remained a national bank regulated by the OCC while the other seven affiliate banks became state member banks and with the Arkansas State Bank Department as their primary regulator and the Federal Reserve as their federal regulator.

The lending powers of each of the subsidiary banks are generally subject to certain restrictions, including the amount, which may be lent to a single borrower. All of our subsidiary banks are members of the FDIC, which provides insurance on deposits of each member bank up to applicable limits by the Deposit Insurance Fund. For this protection, each bank pays a statutory assessment to the FDIC each year.

Federal law substantially restricts transactions between banks and their affiliates. As a result, our subsidiary banks are limited in making extensions of credit to the Company, investing in the stock or other securities of the Company and engaging in other financial transactions with the Company. Those transactions that are permitted must generally be undertaken on terms at least as favorable to the bank as those prevailing in comparable transactions with independent third parties.

#### Potential Enforcement Action for Bank Holding Companies and Banks

Enforcement proceedings seeking civil or criminal sanctions may be instituted against any bank, any financial or bank holding company, any director, officer, employee or agent of the bank or holding company, which is believed by the federal banking agencies to be violating any administrative pronouncement or engaged in unsafe and unsound

practices. In addition, the FDIC may terminate the insurance of accounts, upon determination that the insured institution has engaged in certain wrongful conduct or is in an unsound condition to continue operations.

#### Risk-Weighted Capital Requirements for the Company and the Subsidiary Banks

Since 1993, banking organizations (including financial holding companies, bank holding companies and banks) were required to meet a minimum ratio of Total Capital to Total Risk-Weighted Assets of 8%, of which at least 4% must be in the form of Tier 1 Capital. A well-capitalized institution is one that has at least a 10% "total risk-based capital" ratio. For a tabular summary of our risk-weighted capital ratios, see "Management's Discussion and Analysis of Financial Condition and Results of Operations – Capital" and Note 20, Stockholders' Equity, of the Notes to Consolidated Financial Statements.

A banking organization's qualifying total capital consists of two components: Tier 1 Capital and Tier 2 Capital. Tier 1 Capital is an amount equal to the sum of common shareholders' equity, hybrid capital instruments (instruments with characteristics of debt and equity) in an amount up to 25% of Tier 1 Capital, certain preferred stock and the minority interest in the equity accounts of consolidated subsidiaries. For bank holding companies and financial holding companies, goodwill (net of any deferred tax liability associated with that goodwill) may not be included in Tier 1 Capital. Identifiable intangible assets may be included in Tier 1 Capital for banking organizations, in accordance with certain further requirements. At least 50% of the banking organization's total regulatory capital must consist of Tier 1 Capital.

Tier 2 Capital is an amount equal to the sum of the qualifying portion of the allowance for loan losses, certain preferred stock not included in Tier 1, hybrid capital instruments (instruments with characteristics of debt and equity), certain long-term debt securities and eligible term subordinated debt, in an amount up to 50% of Tier 1 Capital. The eligibility of these items for inclusion as Tier 2 Capital is subject to certain additional requirements and limitations of the federal banking agencies.

Under the risk-based capital guidelines, balance sheet assets and certain off-balance sheet items, such as standby letters of credit, are assigned to one of four-risk weight categories (0%, 20%, 50%, or 100%), according to the nature of the asset, its collateral or the identity of the obligor or guarantor. The aggregate amount in each risk category is adjusted by the risk weight assigned to that category to determine weighted values, which are then added to determine the total risk-weighted assets for the banking organization. For example, an asset, such as a commercial loan, assigned to a 100% risk category, is included in risk-weighted assets at its nominal face value, but a loan secured by a one-to-four family residence is included at only 50% of its nominal face value. The applicable ratios reflect capital, as so determined, divided by risk-weighted assets, as so determined.

#### Federal Deposit Insurance Corporation Improvement Act

The Federal Deposit Insurance Corporation Improvement Act ("FDICIA"), enacted in 1991, requires the FDIC to increase assessment rates for insured banks and authorizes one or more "special assessments," as necessary for the repayment of funds borrowed by the FDIC or any other necessary purpose. As directed in FDICIA, the FDIC has adopted a transitional risk-based assessment system, under which the assessment rate for insured banks will vary according to the level of risk incurred in the bank's activities. The risk category and risk-based assessment for a bank is determined from its classification, pursuant to the regulation, as well capitalized, adequately capitalized or undercapitalized.

FDICIA substantially revised the bank regulatory provisions of the Federal Deposit Insurance Act and other federal banking statutes, requiring federal banking agencies to establish capital measures and classifications. Pursuant to the regulations issued under FDICIA, a depository institution will be deemed to be well capitalized if it significantly exceeds the minimum level required for each relevant capital measure; adequately capitalized if it meets each such measure; undercapitalized if it fails to meet any such measure; significantly undercapitalized if it is significantly below any such measure; and critically undercapitalized if it fails to meet any critical capital level set forth in regulations. The federal banking agencies must promptly mandate corrective actions by banks that fail to meet the capital and related requirements in order to minimize losses to the FDIC. The FDIC and OCC advised the Company that the subsidiary banks have been classified as well capitalized under these regulations.

The federal banking agencies are required by FDICIA to prescribe standards for banks and bank holding companies (including financial holding companies) relating to operations and management, asset quality, earnings, stock valuation and compensation. A bank or bank holding company that fails to comply with such standards will be required to submit a plan designed to achieve compliance. If no plan is submitted or the plan is not implemented, the bank or holding company would become subject to additional regulatory action or enforcement proceedings.

A variety of other provisions included in FDICIA may affect the operations of the Company and the subsidiary banks, including new reporting requirements, revised regulatory standards for real estate lending, "truth in savings" provisions, and the requirement that a depository institution give 90 days prior notice to customers and regulatory authorities before closing any branch.

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## FDIC Deposit Insurance Assessments

On October 16, 2008, in response to the problems facing the financial markets and the economy, the FDIC published a restoration plan (“Restoration Plan”) designed to replenish the Deposit Insurance Fund (“DIF”) such that the reserve ratio would return to 1.15 percent within five years. On December 16, 2008, the FDIC adopted a final rule increasing risk-based assessment rates uniformly by seven basis points, on an annual basis, for the first quarter 2009.

On February 27, 2009, the FDIC concluded that the problems facing the financial services sector and the economy at large constituted extraordinary circumstances and amended the Restoration Plan and extended the time within which the reserve ratio would return to 1.15 percent from five to seven years (“Amended Restoration Plan”). In May 2009, Congress amended the statutory provision governing establishment and implementation of a Restoration Plan to allow the FDIC eight years to bring the reserve ratio back to 1.15 percent, absent extraordinary circumstances.

On May 22, 2009, the FDIC adopted a final rule imposing a five basis point special assessment on each insured depository institution's assets minus Tier 1 capital as of June 30, 2009. The special assessment was collected on September 30, 2009.

In a final rule issued on September 29, 2009, the FDIC amended the Amended Restoration Plan as follows:

- The period of the Amended Restoration Plan was extended from seven to eight years.
- The FDIC announced that it will not impose any further special assessments under the final rule it adopted in May 2009.
- The FDIC announced plans to maintain assessment rates at their current levels through the end of 2010. The FDIC also immediately adopted a uniform three basis point increase in assessment rates effective January 1, 2011 to ensure that the DIF returns to 1.15 percent within the Amended Restoration Plan period of eight years.
  - The FDIC announced that, at least semi-annually following the adoption of the Amended Restoration Plan, it will update its loss and income projections for the DIF. The FDIC also announced that it may, if necessary, adopt a new rule prior to the end of the eight-year period to increase assessment rates in order to return the reserve ratio to 1.15 percent.

On November 12, 2009, the FDIC adopted a final rule to require insured institutions to prepay their quarterly risk-based deposit insurance assessments for the fourth quarter of 2009, and for all of 2010, 2011 and 2012, on December 30, 2009. Our payment was \$11.2 million.

The Dodd-Frank Wall Street Reform and Consumer Protection Act (“Dodd-Frank Act”), which was signed into law on July 21, 2010, changed how the FDIC will calculate future deposit insurance premiums payable by insured depository institutions. The Dodd-Frank Act directs the FDIC to amend its assessment regulations so that future assessments will generally be based upon a depository institution's average total consolidated assets minus the average tangible equity of the insured depository institution during the assessment period, whereas assessments were previously based on the amount of an institution's insured deposits. The minimum deposit insurance fund rate will increase from 1.15% to 1.35% by September 30, 2020, and the cost of the increase will be borne by depository institutions with assets of \$10 billion or more.

The Dodd-Frank Act also provides the FDIC with discretion to determine whether to pay rebates to insured depository institutions when its deposit insurance reserves exceed certain thresholds. Previously, the FDIC was required to give rebates to depository institutions equal to the excess once the reserve ratio exceeded 1.50%, and was required to rebate 50% of the excess over 1.35% but not more than 1.5% of insured deposits. The FDIC adopted a final rule on February 7, 2011 that implemented these provisions of the Dodd-Frank Act.

Dodd-Frank Wall Street Reform and Consumer Protection Act

On July 21, 2010, the President signed into law the Dodd-Frank Act, which significantly changes the regulation of financial institutions and the financial services industry. The Dodd-Frank Act includes provisions affecting large and small financial institutions alike, including several provisions that profoundly affect how community banks, thrifts, and small bank and thrift holding companies are regulated in the future. Among other things, these provisions abolish the Office of Thrift Supervision and transfer its functions to the other federal banking agencies, relax rules regarding interstate branching, allow financial institutions to pay interest on business checking accounts, and impose new capital requirements on bank and thrift holding companies.

The Dodd-Frank Act also made permanent the temporary increase in deposit insurance coverage from \$100,000 to \$250,000 that was included in the EESA, and extended until December 31, 2012 the period during which the FDIC would provide unlimited deposit insurance for "noninterest bearing transaction accounts".

The Dodd-Frank Act requires that the amount of any interchange fee charged by a debit card issuer with respect to a debit card transaction must be reasonable and proportional to the cost incurred by the issuer. Effective October 1, 2011, the FRB set the interchange rate cap at \$0.21 per transaction plus five basis points multiplied by the value of the transaction. While the restrictions on interchange fees do not apply to banks that, together with their affiliates, have assets of less than \$10 billion, the rule has affected the competitiveness of debit cards issued by smaller banks.

The Dodd-Frank Act also established the Bureau of Consumer Financial Protection (the "CFPB") as an independent entity within the Federal Reserve, which will be given the authority to promulgate consumer protection regulations applicable to all entities offering consumer financial services or products, including banks. Additionally, the Dodd-Frank Act includes a series of provisions covering mortgage loan origination standards affecting, among other things, originator compensation, minimum repayment standards, and pre-payment penalties. The Dodd-Frank Act contains numerous other provisions affecting financial institutions of all types, many of which may have an impact on our operating environment in substantial and unpredictable ways.

Because many of the regulations required to implement the Dodd-Frank Act have been only recently issued, or have not yet been issued, the statute's effect on the financial services industry in general, and on us in particular, is uncertain at this time. The Dodd-Frank Act is likely to affect our cost of doing business, however, and may limit or expand the scope of our permissible activities and affect the competitive balance within our industry and market areas. Our management continues to actively review the provisions of the Dodd-Frank Act and to assess its probable impact on our business, financial condition, and results of operations. However, given the sweeping nature of the Dodd-Frank Act and other federal government initiatives, we expect that the Company's regulatory compliance costs will increase over time.

#### Basel Committee

In June 2012, the Federal Reserve and other federal regulators published two notices of proposed rulemaking (the "2012 Capital Proposals") that would substantially revise the risk-based capital requirements applicable to bank holding companies and depository institutions compared to the current U.S. risk-based capital rules, which are based on the international capital accords of the Basel Committee on Banking Supervision (the "Basel Committee") generally referred to as Basel I.

One of the 2012 Capital Proposals (the "Basel III Proposal") deals with the components of capital and other issues affecting the numerator in banking institutions' regulatory capital ratios and would implement the Basel Committee's December 2010 framework known as Basel III for strengthening international capital standards. The other proposal (the "Standardized Approach Proposal") deals with risk weights and other issues affecting the denominator in banking institutions' regulatory capital ratios and would replace the existing Basel I-derived risk-weighting approach with a more risk-sensitive approach based, in part, on the standardized approach in the Basel Committee's 2004 Basel II capital accords. As proposed, the Basel III Proposal and the Standardized Approach Proposal were to have come into effect on January 1, 2013 and January 1, 2015, respectively.

On November 9, 2012, the Federal Reserve announced a delay of the effective date of Basel III and Standardized Approach Proposal requirements, with no announcement of a possible new effective date. Management believes that, as of December 31, 2012, the Company and each of its subsidiary banks would meet all capital adequacy requirements under the Basel III and Standardized Approach Proposals on a fully phased-in basis if such requirements were currently effective. There can be no guarantee that the Basel III and the Standardized Approach Proposals will be adopted in their current form, what changes may be made before adoption, or when ultimate adoption will occur.

Pending Legislation

Because of concerns relating to competitiveness and the safety and soundness of the banking industry, Congress often considers a number of wide-ranging proposals for altering the structure, regulation, and competitive relationships of the nation's financial institutions. We cannot predict whether or in what form any proposals will be adopted or the extent to which our business may be affected.

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ITEM 1A.

RISK FACTORS

Risks Related to Our Industry

Our business may be adversely affected by conditions in the financial markets and general economic conditions.

From 2007 through 2009, the United States was in a recession. Although there are some indicators of improvement, business activity across a wide range of industries and regions has been greatly reduced and local governments and many businesses are having difficulty due to the lack of consumer spending, the lack of liquidity in the credit markets and high unemployment.

Market conditions have also led to the failure or merger of a number of prominent financial institutions. Financial institution failures or near-failures have resulted in further losses as a consequence of defaults on securities issued by them and defaults under contracts entered into with such entities as counterparties. Furthermore, declining asset values, defaults on mortgages and consumer loans, and the lack of market and investor confidence, as well as other factors, have all combined to increase credit default swap spreads, to cause rating agencies to lower credit ratings, and to otherwise increase the cost and decrease the availability of liquidity, despite very significant declines in Federal Reserve borrowing rates and other government actions. Some banks and other lenders have suffered significant losses and have become reluctant to lend, even on a secured basis, due to the increased risk of default and the impact of declining asset values on the value of collateral. The foregoing has significantly weakened the strength and liquidity of some financial institutions worldwide.

The Company's financial performance generally, and in particular the ability of borrowers to pay interest on and repay principal of outstanding loans and the value of collateral securing those loans, is highly dependent upon the business environment in the states of Arkansas, Missouri and Kansas, and in the United States as a whole. A favorable business environment is generally characterized by, among other factors, economic growth, efficient capital markets, low inflation, high business and investor confidence and strong business earnings. Unfavorable or uncertain economic and market conditions can be caused by: declines in economic growth, business activity or investor or business confidence; limitations on the availability or increases in the cost of credit and capital; increases in inflation or interest rates; natural disasters; or a combination of these or other factors.

The business environment in Arkansas, Missouri and Kansas could continue to deteriorate. There can be no assurance that these business and economic conditions will improve in the near term. The continuation of these conditions could adversely affect the credit quality of our loans and our results of operations and financial condition.

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

In response to the financial crisis affecting the banking system and financial markets, the Dodd-Frank Act was enacted in 2010, as well as several programs that have been initiated by the U.S. Treasury, the FRB, and the FDIC to stabilize the financial system.

Some of the provisions of recent legislation and regulation that may adversely impact the Company include: the Durbin Amendment to the Dodd-Frank Act which mandates a limit to debit card interchange fees and Regulation E amendments to the EFTA regarding overdraft fees. These provisions may limit the type of products we offer, the methods by which we offer them, and the prices at which they are offered. These provisions may also increase our costs in offering these products.

The newly created CFPB has unprecedented authority over the regulation of consumer financial products and services. The CFPB has broad rule-making, supervisory and examination authority, as well as expanded data collecting and enforcement powers. The scope and impact of the CFPB's actions cannot be determined at this time, which creates significant uncertainty for the Company and the financial services industry in general.

These new laws, regulations, and changes may increase our costs of regulatory compliance. They may significantly affect the markets in which we do business, the markets for and value of our investments, and our ongoing operations, costs, and profitability. The future impact of the many provisions in the Dodd-Frank Act and other legislative and regulatory initiatives on the Company's business and results of operations will depend upon regulatory interpretation and rulemaking that will be undertaken over the next several months and years. As a result, we are unable to predict the ultimate impact of the Dodd-Frank Act or of other future legislation or regulation, including the extent to which it could increase costs or limit our ability to pursue business opportunities in an efficient manner, or otherwise adversely affect our business, financial condition and results of operations.

Difficult market conditions have adversely affected our industry.

The financial markets have continued to experience significant volatility. In some cases, the financial markets have produced downward pressure on stock prices and credit availability for certain issuers without regard to those issuers' underlying financial strength. If financial market volatility worsens, or if there are more disruptions in the financial markets, including disruptions to the United States or international banking systems, there can be no assurance that we will not experience an adverse effect, which may be material, on our ability to access capital and on our business, financial condition and results of operations.

#### Risks Related to Our Business

Our concentration of banking activities in Arkansas, Missouri and Kansas, including our real estate loan portfolio, makes us more vulnerable to adverse conditions in the particular local markets in which we operate.

Our subsidiary banks operate primarily within the states of Arkansas, Missouri and Kansas, where the majority of the buildings and properties securing our loans and the businesses of our customers are located. Our financial condition, results of operations and cash flows are subject to changes in the economic conditions in these three states, the ability of our borrowers to repay their loans, and the value of the collateral securing such loans. We largely depend on the continued growth and stability of the communities we serve for our continued success. Declines in the economies of these communities or the states of Arkansas, Missouri or Kansas, in general could adversely affect our ability to generate new loans or to receive repayments of existing loans, and our ability to attract new deposits, thus adversely affecting our net income, profitability and financial condition.

The ability of our borrowers to repay their loans could also be adversely impacted by the significant changes in market conditions in the region or by changes in local real estate markets, including deflationary effects on collateral value caused by property foreclosures. This could result in an increase in our charge-offs and provision for loan losses. Either of these events would have an adverse impact on our results of operations.

Our loan portfolio in Northwest Arkansas has been more negatively impacted than our loan portfolio comprised from other regions in our markets. This fact results primarily from the acute contraction in that region's economy and its real estate markets as compared to Arkansas as a whole. In 2010 we put an additional \$9 million in capital into our Northwest Arkansas bank. A continued deterioration of the Northwest Arkansas economy or its failure to fully participate in an economic recovery could require us to further tighten our local lending standards, inject more capital into our Northwest Arkansas bank and increase allowances for loan losses relative to loans made in the region.

A significant decline in general economic conditions caused by inflation, recession, unemployment, acts of terrorism or other factors beyond our control could also have an adverse effect on our financial condition and results of operations. In addition, because multi-family and commercial real estate loans represent the majority of our real estate loans outstanding, a decline in tenant occupancy due to such factors or for other reasons could adversely impact the ability of our borrowers to repay their loans on a timely basis, which could have a negative impact on our results of operations.

Deteriorating credit quality, particularly in our credit card portfolio, may adversely impact us.

We have a significant consumer credit card portfolio. Although we experienced a decreased amount of net charge-offs in our credit card portfolio in 2012 and 2011, the amount of net charge-offs could worsen. While we continue to experience a better performance with respect to net charge-offs than the national average in our credit card portfolio, our net charge-offs were 1.50% of our average outstanding credit card balances for the year ended December 31, 2012, compared to 2.06% of the average outstanding balances for the year ended on December 31, 2011. The current economic downturn could adversely affect consumers in a more delayed fashion compared to commercial businesses

in general. Increasing unemployment and diminished asset values may prevent our credit card customers from repaying their credit card balances which could result in an increased amount of our net charge-offs that could have a material adverse effect on our unsecured credit card portfolio.

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Changes to consumer protection laws may impede our origination or collection efforts with respect to credit card accounts, change account holder use patterns or reduce collections, any of which may result in decreased profitability of our credit card portfolio.

Credit card receivables that do not comply with consumer protection laws may not be valid or enforceable under their terms against the obligors of those credit card receivables. Federal and state consumer protection laws regulate the creation and enforcement of consumer loans, including credit card receivables. For instance, the federal Truth in Lending Act was recently amended by the “Credit Card Accountability, Responsibility and Disclosure Act of 2009,” or the “Credit CARD Act,” which, among other things:

- prevents any increases in interest rates and fees during the first year after a credit card account is opened, and increases at any time on interest rates on existing credit card balances, unless (i) the minimum payment on the related account is 60 or more days delinquent, (ii) the rate increase is due to the expiration of a promotional rate, (iii) the account holder fails to comply with a negotiated workout plan or (iv) the increase is due to an increase in the index rate for a variable rate credit card;
  - requires that any promotional rates for credit cards be effective for at least six months;
- requires 45 days notice for any change of an interest rate or any other significant changes to a credit card account;
- empowers federal bank regulators to promulgate rules to limit the amount of any penalty fees or charges for credit card accounts to amounts that are “reasonable and proportional to the related omission or violation;” and
- requires credit card companies to mail billing statements 21 calendar days before the due date for account holder payments.

As a result of the Credit CARD Act and other consumer protection laws and regulations, it may be more difficult for us to originate additional credit card accounts or to collect payments on credit card receivables, and the finance charges and other fees that we can charge on credit card account balances may be reduced. Furthermore, account holders may choose to use credit cards less as a result of these consumer protection laws. Each of these results, independently or collectively, could reduce the effective yield on revolving credit card accounts and could result in decreased profitability of our credit card portfolio.

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

We have historically employed, as important parts of our business strategy, growth through acquisition of banks and, to a lesser extent, through branch acquisitions and de novo branching. Any future acquisitions, including any FDIC-assisted transactions, in which we might engage will be accompanied by the risks commonly encountered in acquisitions. These risks include, among other risks:

- credit risk associated with the acquired bank’s loans and investments;
  - difficulty of integrating operations and personnel; and
  - potential disruption of our ongoing business.

In the current economic environment, we anticipate that in addition to opportunities to acquire other banks in privately negotiated transactions, we may also have opportunities to bid to acquire the assets and liabilities of failed banks in FDIC-assisted transactions. These acquisitions involve risks similar to acquiring existing banks. Because FDIC-assisted acquisitions are structured in a manner that would not allow us the time normally associated with due diligence investigations prior to committing to purchase the target bank or preparing for integration of an acquired bank, we may face additional risks in FDIC-assisted transactions. These risks include, among other things:

- loss of customers of the failed bank;
- strain on management resources related to collection and management of problem loans; and
  - problems related to integration of personnel and operating systems.

In addition to pursuing the acquisition of existing viable financial institutions or the acquisition of assets and liabilities of failed banks in FDIC-assisted transactions, as opportunities arise we may also continue to engage in de novo branching to further our growth strategy. De novo branching and growing through acquisition involve numerous risks, including the following:

- the inability to obtain all required regulatory approvals;
- the significant costs and potential operating losses associated with establishing a de novo branch or a new bank;
  - the inability to secure the services of qualified senior management;
- the local market may not accept the services of a new bank owned and managed by a bank holding company headquartered outside of the market area of the new bank;
  - the risk of encountering an economic downturn in the new market;
- the inability to obtain attractive locations within a new market at a reasonable cost; and
  - the additional strain on management resources and internal systems and controls.

We expect that competition for suitable acquisition candidates, whether such candidates are viable banks or are the subject of an FDIC-assisted transaction, will be significant. We may compete with other banks or financial service companies that are seeking to acquire our acquisition candidates, many of which are larger competitors and have greater financial and other resources. We cannot assure you that we will be able to successfully identify and acquire suitable acquisition targets on acceptable terms and conditions. Further, we cannot assure you that we will be successful in overcoming these risks or any other problems encountered in connection with acquisitions and de novo branching. Our inability to overcome these risks could have an adverse effect on our ability to achieve our business and growth strategy and maintain or increase our market value and profitability.

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

We may not be able to sustain our historical rate of growth or be able to expand our business. Various factors, such as economic conditions, regulatory and legislative considerations and competition, may also impede or prohibit our ability to expand our market presence. We may also be unable to identify advantageous acquisition opportunities or, once identified, enter into transactions to make such acquisitions. If we are not able to successfully grow our business, our financial condition and results of operations could be adversely affected.

Our cost of funds may increase as a result of general economic conditions, interest rates and competitive pressures.

Our cost of funds may increase as a result of general economic conditions, fluctuations in interest rates and competitive pressures. We have traditionally obtained funds principally through local deposits as we have a base of lower cost transaction deposits. Our costs of funds and our profitability and liquidity are likely to be adversely affected, if we have to rely upon higher cost borrowings from other institutional lenders or brokers to fund loan demand or liquidity needs. Also, changes in our deposit mix and growth could adversely affect our profitability and the ability to expand our loan portfolio.

We have been active in making student loans and this part of our business has been terminated by the federal government.

Our subsidiary banks historically have been active in the student loan market and our student loan portfolio has been profitable in the past. Recent interruptions in the credit markets and certain changes in the federal government programs affecting student loans, however, have decreased the marketability of student loans and increased our holding period for such loans. These events have increased our expenses associated with making and holding student loans and decreased the profitability of making such loans. The Company has terminated its student loan origination activities as a result of changes mandated by the Department of Education. These changes by the federal government eliminate banks from participating in student loan programs. Terminating our ability to originate student loans could adversely affect our profitability in the future.

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

Federal and state regulatory authorities require us and our subsidiary banks to maintain adequate levels of capital to support our operations. Many circumstances could require us to seek additional capital, such as:

- faster than anticipated growth;
  - reduced earning levels;
  - operating losses;
- changes in economic conditions;
- revisions in regulatory requirements; or

- additional acquisition opportunities.

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

Accounting standards periodically change and the application of our accounting policies and methods may require management to make estimates about matters that are uncertain.

The regulatory bodies that establish accounting standards, including, among others, the Financial Accounting Standards Board and the SEC, periodically revise or issue new financial accounting and reporting standards that govern the preparation of our consolidated financial statements. The effect of such revised or new standards on our financial statements can be difficult to predict and can materially impact how we record and report our financial condition and results of operations.

In addition, our management must exercise judgment in appropriately applying many of our accounting policies and methods so they comply with generally accepted accounting principles. In some cases, management may have to select a particular accounting policy or method from two or more alternatives. In some cases, the accounting policy or method chosen might be reasonable under the circumstances and yet might result in our reporting materially different amounts than would have been reported if we had selected a different policy or method. Accounting policies are critical to fairly presenting our financial condition and results of operations and may require management to make difficult, subjective or complex judgments about matters that are uncertain.

The Federal Reserve Board's source of strength doctrine could require that we divert capital to our subsidiary banks instead of applying available capital towards planned uses, such as engaging in acquisitions or paying dividends to shareholders.

The FRB's policies and regulations require that a bank holding company, including a financial holding company, serve as a source of financial strength to its subsidiary banks, and further provide that a bank holding company may not conduct operations in an unsafe or unsound manner. It is the FRB's policy that a bank holding company should stand ready to use available resources to provide adequate capital to its subsidiary banks during periods of financial stress or adversity, such as during periods of significant loan losses, and that such holding company should maintain the financial flexibility and capital-raising capacity to obtain additional resources for assisting its subsidiary banks if such a need were to arise.

A bank holding company's failure to meet its obligations to serve as a source of strength to its subsidiary banks will generally be considered to be an unsafe and unsound banking practice or a violation of the FRB's regulations, or both. Accordingly, if the financial condition of our subsidiary banks were to deteriorate, we could be compelled to provide financial support to our subsidiary banks at a time when, absent such FRB policy, we may not deem it advisable to provide such assistance. Under such circumstances, there is a possibility that we may not either have adequate available capital or feel sufficiently confident regarding our financial condition, to enter into acquisitions, pay dividends, or engage in other corporate activities.

We may incur environmental liabilities with respect to properties to which we take title.

A significant portion of our loan portfolio is secured by real property. In the course of our business, we may own or foreclose and take title to real estate and could become subject to environmental liabilities with respect to these properties. We may become responsible to a governmental agency or third parties for property damage, personal injury, investigation and clean-up costs incurred by those parties in connection with environmental contamination, or may be required to investigate or clean-up hazardous or toxic substances, or chemical releases at a property. The costs associated with environmental investigation or remediation activities could be substantial. If we were to become subject to significant environmental liabilities, it could have a material adverse effect on our results of operations and financial condition.

Our management has broad discretion over the use of proceeds from our recent common stock offering.

Although we have indicated our intent to use the proceeds from our recent common stock offering for general corporate purposes, including funding internal growth and selected future acquisitions, our Board of Directors retains significant discretion with respect to the use of proceeds from this offering. If we use the funds to acquire other businesses, there can be no assurance that any business we acquire will be successfully integrated into our operations or otherwise perform as expected. Likewise, other uses of the proceeds from this offering may not generate favorable returns for us.

## Risks Related to Owning Our Stock

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

We have \$20.6 million of subordinated debentures issued in connection with trust preferred securities. Payments of the principal and interest on the trust preferred securities are unconditionally guaranteed by us. The subordinated debentures are senior to our shares of common stock. As a result, we must make payments on the subordinated debentures (and the related trust preferred securities) before any dividends can be paid on our common stock and, in the event of our bankruptcy, dissolution or liquidation, the holders of the debentures must be satisfied before any distributions can be made to the holders of our common stock. We have the right to defer distributions on the subordinated debentures (and the related trust preferred securities) for up to five years, during which time no dividends may be paid to holders of our capital stock. If we elect to defer or if we default with respect to our obligations to make payments on these subordinated debentures, this would likely have a material adverse effect on the market value of our common stock. Moreover, without notice to or consent from the holders of our common stock, we may issue additional series of subordinated debt securities in the future with terms similar to those of our existing subordinated debt securities or enter into other financing agreements that limit our ability to purchase or to pay dividends or distributions on our capital stock.

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

We cannot assure you of our ability to continue to pay dividends. Our ability to pay dividends depends on the following factors, among others:

- We may not have sufficient earnings since our primary source of income, the payment of dividends to us by our subsidiary banks, is subject to federal and state laws that limit the ability of those banks to pay dividends;
- FRB policy requires bank holding companies to pay cash dividends on common stock only out of net income available over the past year and only if prospective earnings retention is consistent with the organization's expected future needs and financial condition; and
- Our Board of Directors may determine that, even though funds are available for dividend payments, retaining the funds for internal uses, such as expansion of our operations, is a better strategy.

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

There may be future sales of additional common stock or preferred stock or other dilution of our equity, which may adversely affect the value of our common stock.

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

Anti-takeover provisions could negatively impact our shareholders.

Provisions of our articles of incorporation and by-laws and federal banking laws, including regulatory approval requirements, could make it more difficult for a third party to acquire us, even if doing so would be perceived to be beneficial to our shareholders. The combination of these provisions effectively inhibits a non-negotiated merger or other business combination, which, in turn, could adversely affect the market price of our common stock. These provisions could also discourage proxy contests and make it more difficult for holders of our common stock to elect directors other than the candidates nominated by our Board of Directors.

