OPTION CARE INC/DE
Form DEF 14A
April 02, 2007

Table of Contents

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
SCHEDULE 14A

Proxy Statement Pursuant to Section 14(a) of the Securities
Exchange Act of 1934 (Amendment No.)

Filed by the Registrant þ
Filed by a Party other than the Registrant o
Check the appropriate box:

o Preliminary Proxy Statement
o **Confidential, for Use of the Commission Only (as permitted by Rule 14a-6(e)(2))**
þ Definitive Proxy Statement
o Definitive Additional Materials
o Soliciting Material Pursuant to §240.14a-12

OPTION CARE, INC.

(Name of Registrant as Specified In Its Charter)

(Name of Person(s) Filing Proxy Statement, if other than the Registrant)

Payment of Filing Fee (Check the appropriate box):

þ No fee required.
o Fee computed on table below per Exchange Act Rules 14a-6(i)(1) and 0-11.

(1) Title of each class of securities to which transaction applies:

(2) Aggregate number of securities to which transaction applies:

(3) Per unit or other underlying value of transaction computed pursuant to Exchange Act Rule 0-11 (set forth the amount on which the filing fee is calculated and state how it was determined):

(4) Proposed maximum aggregate value of transaction:

(5) Total fee paid:

o Fee paid previously with preliminary materials.

o Check box if any part of the fee is offset as provided by Exchange Act Rule 0-11(a)(2) and identify the filing for which the offsetting fee was paid previously. Identify the previous filing by registration statement number, or the Form or Schedule and the date of its filing.

(1) Amount Previously Paid:

(2) Form, Schedule or Registration Statement No.:

(3) Filing Party:

(4) Date Filed:

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485 HALF DAY ROAD
SUITE 300
BUFFALO GROVE, ILLINOIS 60089

Dear Stockholder:

You are cordially invited to the Annual Meeting of Stockholders (the Meeting) of Option Care, Inc. (Option Care or the Company). The Meeting will be held at the Company s Corporate Offices at 485 Half Day Road, Suite 300, Buffalo Grove, Illinois, on Friday, May 4, 2007, at 10:00 a.m., local time.

At the Meeting, you will be asked (a) to elect one director to hold office for a three-year term; (b) to approve the adoption of the Option Care, Inc. 2007 Incentive Plan, replacing the expiring Amended and Restated Stock Incentive Plan (1997); (c) to ratify the appointment of Ernst & Young LLP to act as independent registered public accounting firm of the Company for the fiscal year 2007; and (d) to transact any other business as may properly come before the Meeting and any adjournments or postponements of the Meeting.

Option Care s Board of Directors (the Board) unanimously recommends that you vote FOR the nominee for election as director, FOR the approval and adoption of the Option Care, Inc. 2007 Incentive Plan, and FOR appointment of Ernst & Young LLP to act as independent registered public accounting firm of the Company for the fiscal year 2007.

In the materials accompanying this letter, you will find a Notice of the Meeting, a Proxy Statement relating to the proposals you will be asked to consider and vote upon at the Meeting, and a Proxy Card. The Proxy Statement includes general information regarding Option Care as well as additional information relating to the specific proposals you will be asked to consider and vote upon at the Meeting. Also enclosed with the proxy materials is Option Care s Annual Report to Stockholders for the year ended December 31, 2006.

All stockholders are invited to attend the Meeting in person. However, whether or not you plan to attend the Meeting, please complete, sign and date the Proxy Card enclosed herewith and promptly return it to Option Care in the enclosed envelope we have provided for that purpose or follow the Internet or telephone voting instructions on the Proxy Card. If you attend the Meeting, you may vote in person if you wish, even though you have previously returned your proxy. It is important that your shares be represented and voted at the Meeting.

Sincerely,

/s/ RAJAT RAI

Rajat Rai
President and Chief Executive Officer
April 2, 2007

Table of Contents

485 HALF DAY ROAD
SUITE 300
BUFFALO GROVE, ILLINOIS 60089

NOTICE OF ANNUAL MEETING OF STOCKHOLDERS
TO BE HELD MAY 4, 2007

To the Holders of the Common Stock of
Option Care, Inc.

The Annual Meeting of Stockholders (the Meeting) of Option Care, Inc., a Delaware corporation (Option Care or the Company), will be held at the Company s Corporate Offices at 485 Half Day Road, Suite 300, Buffalo Grove, Illinois 60089 on May 4, 2007 beginning at 10:00 a.m., local time. The Company s Board of Directors has fixed the close of business on March 21, 2007 as the Record Date for the determination of stockholders entitled to receive notice of and to vote at the Meeting and any adjournments or postponements of the Meeting. At the Meeting, you will be asked to consider and vote upon the following:

1. To elect one (1) director to hold office for a term of three years or until his successor shall have been duly elected and qualified;

2. To approve the adoption of the Option Care, Inc. 2007 Incentive Plan, replacing the expiring Amended and Restated Stock Incentive Plan (1997);

3. To ratify the appointment of Ernst & Young LLP to act as independent registered public accounting firm of the Company for fiscal year 2007; and

4. To consider and act upon such other business as may properly come before the Meeting or any adjournments or postponements of the Meeting.

Each of the matters identified above are discussed in detail in the Proxy Statement attached to this Notice. We encourage you to read the Proxy Statement carefully.

It is extremely important that your shares are voted at the Meeting. To ensure that your shares are voted at the Meeting please complete, sign and date the enclosed proxy card and return it as promptly as possible in the enclosed return envelope we have provided for that purpose or by following the Internet or telephone voting instructions on the proxy card. No postage is required to return the proxy card in the enclosed envelope if mailed in the United States. You may revoke a previously given proxy in the event you change your mind after you return the proxy card to the Company. The delivery of a later dated proxy card to the Company will revoke any previously given proxy. In addition, you may revoke a previously given proxy by attending the Meeting and voting your shares in person.

By Order of the Board of Directors.

/s/ JOSEPH P. BONACCORSI

Senior Vice President, Secretary and General Counsel
April 2, 2007
Buffalo Grove, Illinois

NOTICE OF ANNUAL MEETING OF STOCKHOLDERS
TO BE HELD MAY 4, 2007

TABLE OF CONTENTS

	Page
GENERAL	1
PROPOSAL 1. ELECTION OF DIRECTOR	2
SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT	6
COMPENSATION DISCUSSION AND ANALYSIS	7
COMPENSATION DISCUSSION AND ANALYSIS	7
COMPENSATION COMMITTEE REPORT	10
EXECUTIVE COMPENSATION	10
COMPENSATION OF DIRECTORS	15
COMPENSATION COMMITTEE INTERLOCK AND INSIDER PARTICIPATION	15
REPORT OF THE AUDIT COMMITTEE OF THE BOARD OF DIRECTORS	15
PROPOSAL 2. APPROVAL OF THE OPTION CARE, INC. 2007 INCENTIVE PLAN	17
PROPOSAL 3. RATIFICATION OF APPOINTMENT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM	22
SECTION 16(a) BENEFICIAL OWNERSHIP REPORTING COMPLIANCE	23
CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS	24
RELATED PARTY TRANSACTIONS	24
INDEPENDENT DIRECTORS	24
STOCKHOLDER PROPOSALS	25
ANNUAL REPORT	25
SOLICITATION AND EXPENSES OF SOLICITATION	25
OTHER MATTERS	25

Table of Contents

485 HALF DAY ROAD
SUITE 300
BUFFALO GROVE, ILLINOIS 60089

PROXY STATEMENT

ANNUAL STOCKHOLDERS MEETING

TO BE HELD MAY 4, 2007

GENERAL

This Proxy Statement is furnished in connection with the solicitation of proxies by the Board of Directors of Option Care, Inc., a Delaware corporation (the Company), for use at the Annual Meeting of Stockholders (the Meeting) to be held on Friday, May 4, 2007, at 10:00 a.m., local time, at the Company s Corporate Offices at 485 Half Day Road, Suite 300, Buffalo Grove, Illinois, 60089 and any adjournments or postponements thereof.

The Notice of Annual Meeting to which this Proxy Statement is attached lists the matters which the Company intends to propose for consideration at the Meeting and these matters are discussed in detail later in this Proxy Statement. Other than the matters listed in the Notice of Annual Meeting and discussed herein, the Board does not currently intend, nor does it know of anyone else who intends, to present any other matter for consideration at the Meeting.

All proxies evidenced by a properly completed and returned Proxy Card will be voted in accordance with the instructions set forth in the Proxy Card. If no choice is specified, proxies will be voted FOR the election of the nominee for director proposed by the Board of Directors as set forth in Proposal 1, FOR the adoption of the Option Care, Inc. 2007 Incentive Plan, replacing the expiring Amended and Restated Stock Incentive Plan (1997) as set forth in Proposal 2 and FOR ratification of the appointment of Ernst & Young LLP to act as independent registered public accounting firm of the Company for fiscal year 2007 as set forth in Proposal 3. If any other matters properly come before the Meeting, the persons named as proxies in the Proxy Card will be authorized to vote or otherwise act on these matters using their judgment and discretion; provided, however, that proxies directing a vote against a proposal may not be voted for a proposal to adjourn the Meeting to permit further solicitation in favor of the original proposal. A stockholder who executes a proxy may revoke it at any time before it is voted by delivering to the Company another proxy bearing a later date, by submitting written notice of such revocation to the Secretary of the Company, or by personally appearing at the Meeting and casting a contrary vote. Even if you plan to attend the meeting in person, please execute, date and return the enclosed proxy promptly. Should you attend the meeting, you may revoke the proxy by voting in person. A postage-paid, return-addressed envelope is enclosed for your convenience. Your cooperation in giving this your prompt attention will be appreciated.

The representation in person or by proxy of at least a majority of the shares entitled to vote at the Meeting is necessary to constitute a quorum. Assuming the requisite numbers of shares are represented at the Meeting, each proposal will be voted on separately and the vote required to approve each proposal is described below. A plurality of the votes cast is required for the election of directors, which means that the nominee with the highest vote total will be elected as director. As a result, abstentions and broker non-votes do not have an effect on the results of the vote for the election of directors. The affirmative vote of a majority of the shares represented at the Meeting in person or by proxy is required to approve all other matters to be voted on. Abstentions are treated as votes against these matters. Broker non-votes will have no effect on the result of the vote for these matters.

1

Table of Contents

Each share of Common Stock is entitled to one vote for each of the proposals identified in this Proxy Statement. The close of business on March 21, 2007 has been fixed as the Record Date for the determination of the holders of our Common Stock entitled to notice of and to vote at the Annual Meeting. On March 21, 2007, there were 34,492,905 shares of Common Stock outstanding and entitled to vote. This Proxy Statement, together with the enclosed Notice of Meeting and Proxy Card, were mailed beginning on or about April 2, 2007 to all record owners of the Company s Common Stock as of the Record Date.

PROPOSAL 1. ELECTION OF DIRECTOR
(Proposal 1 on the Proxy Card)

In accordance with the Company s By-laws, the size of the Board of Directors has been fixed at seven members. The Board of Directors is divided into three classes, with two classes having two seats each and one class having three seats. Every year one class is elected to a three-year term. The class currently up for election contains one director and one vacancy. Despite this vacancy, you may not vote for more than one director.

The Nominating and Corporate Governance Committee recommended to the Board of Directors, and the Board of Directors approved, Jerome Sheldon as the Company s nominee for election at the meeting to a three-year term as a director of the Company. Mr. Sheldon has advised the Board of Directors that he is willing to serve if elected as a director of the Company. However, if prior to the Meeting, the Board of Directors makes a good faith determination that Mr. Sheldon is unable or unwilling to serve as a director, any proxy marked FOR this proposal will include a vote for a substitute nominee selected by the Board of Directors.

Recommendation of the Board of Directors

The Board of Directors recommends that stockholders vote FOR the Company s nominee for election as a director of the Company.

INFORMATION CONCERNING OFFICERS AND DIRECTORS

Officers and Directors

The following table identifies the nominee for election a director of the Company, each continuing director and each executive officer of the Company. The information in this table is as of March 21, 2007.

Name	Age	Positions or Offices with the Company	Has Served Continuously Since
Nominee with Term Ending in 2010			
Jerome F. Sheldon	71	Director	1991
open			
Directors with Terms Ending in 2009			
Kenneth S. Abramowitz	56	Director	2002
John N. Kapoor, Ph.D	63	Chairman of the Board of Directors	1990
Rajat Rai	40	Director, President and Chief Executive Officer	2001
Directors with Terms Ending in 2008			

Edward A. Blechschmidt	54	Director	2005
Leo Henikoff, M.D.	67	Director	2001
Executive Officers			
Joseph P. Bonaccorsi	42	Senior Vice President, Secretary and General Counsel	2002
Paul Mastrapa	42	Senior Vice President and Chief Financial Officer	2002

Table of Contents

Nominee

Jerome F. Sheldon has served as a director since November 1991. Mr. Sheldon was founder, Chairman and Chief Executive Officer of Lamar Snowboards, a manufacturer and distributor of snowboard products, from August 1991 until his retirement in July 1998. Mr. Sheldon was President and Chief Executive Officer of Medicine Shoppe International, Inc., a franchisor of retail pharmacies, from March 1980 to June 1990, and was a director of this company from March 1980 to February 1991. Mr. Sheldon has served as Chairman of the Board of First Dental Health since 1998.

Continuing Directors

Kenneth S. Abramowitz has served as a director since September 2002. Mr. Abramowitz is a Managing General Partner and co-founder of New Global Network (NGN) Capital, a $250 million worldwide healthcare venture capital fund. Mr. Abramowitz served at The Carlyle Group from 2001 to 2003 as a Managing Director for the Healthcare Team, focused on U.S. buyout opportunities in the healthcare industry. Prior to that, Mr. Abramowitz worked as an Analyst at Sanford C. Bernstein & Company where he covered the medical supply, hospital management and Health Maintenance Organization (HMO) industries for 23 years. Mr. Abramowitz currently sits on the Board of Directors of EKOS Corporation, OptiScan Biomedical Corporation, Power Medical Interventions, Inc., Sightline Technologies Ltd., and Small Bone Innovations, LLC.

John N. Kapoor, Ph.D., is the Chairman of the Company s Board of Directors, a position he has held since October 1990. Dr. Kapoor served as the Company s Chief Executive Officer from August 1993 to April 1996 and from June 2000 to March 2001. Dr. Kapoor also served as the Company s President from August 1993 through October 1993 and from January 1995 through February 1996 and as Chief Executive Officer and President from March 1991 to May 1991. Since 1990, Dr. Kapoor has served as President of EJ Financial Enterprises, Inc., a provider of funds and strategic advice and consulting services to health care companies that are in the early stages of their lifecycle and display high growth potential. Dr. Kapoor is Chairman of the Board of Directors of each of Introgen Therapeutics Inc., Akorn, Inc. and NeoPharm, Inc.

Rajat Rai has served as a director since May 2001 and as the Company s Chief Executive Officer since April 2001. Mr. Rai served as President of the Company from June 2000 through May 2003, and since June 2006. Prior to that, Mr. Rai held various positions with the Company since August 1992, including Chief Operating Officer from August 1999 to April 2001.

Edward A. Blechschmidt was appointed to the Board of Directors in November 2005. He is currently serving as acting chief executive of Novelis, having been appointed to this position Janaury 2, 2007. He has been a director of Novelis since June 2006. Mr. Blechschmidt was chairman, chief executive officer and president of Gentiva Health Services, Inc. from March 2000 until his retirement in June 2002. He remained a director until May 2005. Prior to joining Gentiva, Mr. Blechschmidt served as chief executive officer and a director of Olsten Corporation, the conglomerate from which Gentiva was spun off and taken public. He was also president of Olsten Corporation from October 1998 to March 1999. In addition, he served as president and chief executive officer of Siemens Nixdorf Americas and Siemens Pyramid Technologies from July 1996 to October 1998. Prior to these positions, Mr. Blechschmidt spent more than 20 years with Unisys Corporation, including serving as its chief financial officer. He is currently a director of HealthSouth Corp., Lionbridge Technologies, Inc., and Columbia Laboratories, Inc.

Leo Henikoff, M.D., has served as a director since November 2001. Dr. Henikoff has served as a Professor of Internal Medicine and Pediatrics at Rush-Medical College since July 1984 and President Emeritus of Rush University in Chicago, Illinois since February 2002. From July 1984 to February 2002, Dr. Henikoff served as President and Chief Executive Officer of Rush-Presbyterian-St. Luke s Medical Center in Chicago, Illinois; President and Chairman of the

Rush System of Health, a six-hospital system in the Chicago area; and President of Rush University. Dr. Henikoff is also currently a director of Harris Financial Corporation and Sentry Insurance.

Information Concerning the Board of Directors

During the year ended December 31, 2006, the Company s Board of Directors met 8 times, including four regularly scheduled meetings and four special meetings. During 2006, each director attended at least 75% of the aggregate of all meetings of the Board of Directors and all meetings of committees of which he was a member. The Company does not have a formal policy with respect to director attendance at annual meetings. All continuing directors and nominees for director attended the Company s 2006 Annual Meeting of Stockholders. The Company is actively seeking a qualified candidate to fill one remaining vacancy on the Board in the class with term to expire in 2010. At this time, the Nominating and Corporate Governance Committee has not identified a suitable candidate.

Standing Committees

To better and more efficiently discharge its fiduciary duties to stockholders, the Board has delegated special responsibility and authority with respect to various matters to committees, each of which should have a minimum of three members drawn from the full Board of Directors. The standing committees of the Board include the Audit Committee, the Compensation and Stock Incentive Committee (the Compensation Committee), and the Nominating and Corporate Governance Committee. The Board has adopted a charter for each committee. These charters are available at the Company s website, www.optioncare.com.

Audit Committee. The Audit Committee has complete authority over the selection, direction and compensation of the Company s independent registered public accounting firm. This authority extends to establishing the scope of the audit, determining compensation, approving all non-audit services and monitoring auditor independence. The Audit Committee has assumed formal responsibility for final approval of the Company s critical accounting policies and for monitoring the continued propriety of the methods employed by the Company in connection with significant estimates and accruals. The Audit Committee also participates in, oversees and has other involvement with numerous processes designed to enhance the quality of the Company s financial information, including the Company s internal controls. The Audit Committee reviews all financial disclosure documents and discusses these documents with both management and the Company s independent registered public accounting firm prior to public release. Finally, the Audit Committee monitors the Company s adherence to the Company s corporate compliance program and general corporate policies. Throughout 2006, the members of the Audit Committee were Messrs. Abramowitz and Sheldon and Dr. Henikoff. Each member of the Audit Committee is independent as that term is defined by the listing standards of the Nasdaq Stock Market, LLC. The Board has determined that Mr. Abramowitz satisfies the requirements for an audit committee financial expert under the current rules of the Securities and Exchange Commission. The Audit Committee met five times during 2006.

Compensation and Stock Incentive Committee. Although primary authority to establish and review performance standards and set compensation levels below the senior officer level has been delegated to the Company s Chief Executive Officer, his decisions remain subject to oversight and review by the Compensation and Stock Incentive Committee (Compensation Committee). The function of the Compensation Committee is to determine the annual salary, bonus and other benefits of selected senior officers of the Company and establish and review, as appropriate, performance standards under compensation programs for senior officers. The Compensation Committee also serves as administrator for the Company s Amended and Restated Stock Incentive Plan (1997) and will serve as administrator of the Option Care, Inc. 2007 Incentive Plan, if approved by the stockholders at the Meeting. Throughout 2006, the members of the Compensation Committee were Dr. Henikoff and Mr. Sheldon. In February 2006, Mr. Blechschmidt was appointed to also serve on the Compensation Committee. Each member of the Compensation Committee is an independent director as defined in the listing standards of The Nasdaq Stock Market. The Compensation Committee met a total of four times during 2006.

Nominating and Corporate Governance Committee. The members of the Nominating and Corporate Governance Committee are Messrs. Abramowitz and Sheldon and Dr. Henikoff. The purpose of the committee is to assist the Board of Directors in identifying qualified individuals to become board members, nominating directors to serve on and to chair the Board committees, periodically reviewing director compensation and

benefits, and improving the Company s corporate governance guidelines. Each member of the Nominating and Corporate Governance Committee is an independent director as defined by the listing standards of The Nasdaq Stock Market. The Nominating and Corporate Governance Committee met two times during 2006.

Director Nominee Criteria and Process

The Board of Directors is responsible for approving candidates for Board membership. The Board has delegated the screening and recruitment process to the Nominating and Corporate Governance Committee. The Nominating and Corporate Governance Committee believes that the criteria for director nominees should ensure effective corporate governance, support the Company s strategies and businesses, account for individual director attributes and the effect of the overall mix of those attributes on the Board s effectiveness, and support the successful recruitment of qualified candidates to the Board.

Qualified candidates for director are those who, in the judgment of the Nominating and Corporate Governance Committee, possess all of the personal attributes and a sufficient mix of experience as described below to assure effective service on the Board. Personal attributes of a Board candidate considered by the Nominating and Corporate Governance Committee include: leadership, personal ethics, independence, interpersonal skills and effectiveness. The experience of a Board candidate considered by the Nominating and Corporate Governance Committee include: financial acumen, general business experience, industry knowledge, diversity of view points, special business experience and expertise.

The Nominating and Corporate Governance Committee may receive recommendations for Board candidates from various sources, including recommendations from directors, executive officers and stockholders. A stockholder wishing to nominate a candidate for election to the Board at the annual meeting is required to give written notice to the Secretary of the Company of his or her intention to make a nomination. To be considered timely, such notice shall be delivered to or mailed to and received by the Secretary not less than 60 days and not more than 90 days before the first anniversary of the preceding year s annual meeting, provided, however, in the event that the date of the annual meeting is more than 30 days before or more than 60 days after such anniversary date, notice by the stockholder to be timely must be delivered not earlier than the close of business on the 90th day prior to such annual meeting and not later than the close of business on the later of the 60th day prior to such annual meeting or the close of business on the 10th day following the day on which public announcement of the date of such meeting is first made by the Company. A stockholder s notice to the Secretary shall contain, for each person nominated for election or reelection as director, all information relating to such person that is required to be disclosed in solicitations of proxies for election of directors pursuant to Regulation 14A under the Securities Exchange Act of 1934, as amended. Such information shall include, but not be limited to, the nominee s name, age and qualifications for serving as director, including relevant experience and education background, and the nominee s written consent to being named in the proxy statements as a nominee and to serving as a director if elected. In addition, the stockholder giving notice must provide his or her name and address, and the name and address of such beneficial owner, if any, on whose behalf the proposal is made, as well as the number of shares of the Company s common stock that are owned beneficially and of record by such stockholder and such beneficial owner.

Stockholder Communications to Directors

Any stockholder interested in communicating with the Board of Directors as a group, or an individual member of the Board of Directors, may do so by writing c/o Joseph P. Bonaccorsi, Senior Vice President, Secretary and General Counsel, Option Care, Inc., 485 Half Day Road, Suite 300, Buffalo Grove, Illinois 60089. All communications to the Board of Directors or a specified individual director will be provided to the Board of Directors, or the specified individual director, at the next Board meeting following receipt of the communication. However, if the Secretary determines the nature of the communication requires the immediate attention of the Board of Directors or the specified

individual director, the communication will be provided as soon as reasonably possible. Such correspondence will not be screened and will be forwarded in its entirety.

Table of Contents

Executive Officers

Joseph P. Bonaccorsi joined Option Care in January 2002 as Senior Vice President, Secretary and General Counsel. Prior to joining Option Care, Mr. Bonaccorsi was a partner at the Chicago law firm of Sanchez & Daniels, where he practiced from 1993 to 2001.

Paul Mastrapa rejoined Option Care, Inc. as a Senior Vice President and Chief Financial Officer in February 2002. Previously, Mr. Mastrapa held key senior level positions responsible for the financial management, business development, and operations of several healthcare service companies. Mr. Mastrapa founded and served as Chief Executive Officer for AdvoLife, a venture capital-backed provider of private pay chronic care management services to seniors, leading the company to profitability. In 1991, Mr. Mastrapa joined Option Care, where he supported the IPO process, acquisitions, and financial management needs of the company during the early 1990 s. He began his career at Ernst & Young LLP in Chicago.

SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT

The table below sets forth information regarding the amount of Common Stock beneficially owned, as of March 21, 2007, by (i) each director of the Company, (ii) each nominee for election as a director of the Company, (iii) each named executive officer, (iv) all directors and executive officers of the Company as a group and (v) any person who is known by us to beneficially own 5% or more of our Common Stock.

Name and Address(1)	Number of Shares Beneficially Owned(2)	Percent of Outstanding Common Stock Beneficially Owned(3)
Rao Akella(4)	4,263,878	11.9%
FMR Corporation(5)	3,415,694	9.5%
John N. Kapoor, Ph.D.(6)	3,305,173	9.2%
Wellington Management Company, LLP(7)	3,151,275	8.8%
Lord Abbett & Co., LLC(8)	2,888,488	8.0%
Mellon Financial Corporation(9)	2,540,184	7.1%
Fiduciary Management, Inc.(10)	2,335,950	6.5%
Rajat Rai	975,580	2.7%
Kenneth S. Abramowitz	105,563	*
Edward A. Blechschmidt	65,000	*
Joseph P. Bonaccorsi	81,340	*
Leo Henikoff, M.D.	118,126	*
Paul Mastrapa	195,917	*
Jerome F. Sheldon	73,125	*
All directors and executive officers as a group (8 persons)	4,919,824	13.7%

* Less than 1%

(1)

Except as otherwise indicated, each individual has sole voting and investment power over the shares listed beside his or her name. The address for each person is 485 Half Day Road, Suite 300, Buffalo Grove, Illinois, 60089.

(2) Includes the following shares that such persons may acquire upon the exercise of options exercisable within 60 days of March 21, 2007: Mr. Abramowitz 104,063 shares; Mr. Blechschmidt 60,000 shares; Mr. Bonaccorsi 70,313 shares; Dr. Henikoff 118,126 shares; Mr. Mastrapa 194,766 shares; Mr. Rai 884,246 shares; Mr. Sheldon 30,000 shares; and all directors and executive officers as a group 1,461,514 shares.

(3) The percentage calculations for beneficial ownership are based upon 34,492,905 shares of Common Stock issued and outstanding as of March 21, 2007 plus for each person or group, the number of shares of Common Stock subject to options exercisable currently or within 60 days after March 21, 2007 by such person or group.

(4) Consists of shares controlled by Rao Akella as sole trustee for various trusts created for members of the John N. Kapoor family. Rao Akella is serving as third party trustee administering matters related to the trusts, and John N. Kapoor, Ph.D. has no voting or dispositive control over the shares of Common Stock held by the trusts. The address of this person is c/o E.J. Financial Enterprises, Inc., 225 East Deerpath, Suite 250, Lake Forest, IL 60045. This information was derived solely from a Schedule 13G filed with the Securities and Exchange Commission by such trustee dated July 31, 2006.

(5) The address of FMR Corporation is 82 Devonshire Street, Boston, Massachusetts, 02109. This information was derived from a Schedule 13G/A filed with the Securities and Exchange Commission by such holder to disclose its beneficial ownership of the Company s common stock as of December 31, 2006.

(6) Includes: 1,905,213 shares owned by E.J. Financial/OCI Management, L.P., of which Pharma Nevada, Inc., a company for which Dr. Kapoor is the sole director and president, is the general partner; 952,381 shares owned by the Kapoor Family Partnership, L.P., of which Dr. Kapoor is the sole general partner; and 447,579 shares owned by the John N. Kapoor Trust dated September 20, 1989, of which Dr. Kapoor is the sole trustee and sole current beneficiary.

(7) The address of Wellington Management Company, LLP is 75 State Street, Boston, Massachusetts, 02109. This information was derived from a Schedule 13G filed with the Securities and Exchange Commission by such holder to disclose its beneficial ownership of the Company s common stock as of December 31, 2006.

(8) The address of Lord, Abbett & Co., LLC is 90 Hudson Street, 11th Floor, Jersey City, New Jersey, 07302. This information was derived from a Schedule 13G filed with the Securities and Exchange Commission by such holder to disclose its beneficial ownership of the Company s common stock as of December 31, 2006.

(9) The address of Mellon Financial Corporation is One Mellon Bank Center, 500 Grant Street, Pittsburgh, Pennsylvania, 15258. This information was derived from a Schedule 13G filed with the Securities and Exchange Commission by such holder to disclose its beneficial ownership of the Company s common stock as of December 31, 2006.

(10) The address of Fiduciary Management, Inc. is 100 East Wisconsin Avenue, Suite 2200, Milwaukee, Wisconsin, 53202. This information was derived from a Schedule 13G filed with the Securities and Exchange Commission by such holder to disclose its beneficial ownership of the Company s common stock as of December 31, 2006.

COMPENSATION DISCUSSION AND ANALYSIS

Compensation Discussion and Analysis

Compensation Governance

The Compensation and Stock Incentive Plan Committee of our Board of Directors (the Committee or Compensation Committee) is responsible for guiding and overseeing the formulation and application of the compensation and benefit program for our executive officers. The purposes of the Committee are (i) to discharge the responsibilities of the Board of Directors relating to compensation of the Company s Chief Executive Officer and other executives, (ii) to produce and annual report on executive compensation for discussion and analysis for inclusion in the Company s annual proxy statement and (iii) to oversee and advise the Board on the adoption of policies that govern the Company s compensation programs, including stock incentive plans. The Committee is also responsible for administering the Company s Amended and Restated Stock Incentive Plan (1997).

General Philosophy

The goal of the Company s executive compensation policy is to ensure that an appropriate relationship exists between executive pay and the creation of stockholder value. We seek to attract and retain talent and knowledge in the organization, specific to our industry, while rewarding key employees for contributions in the achievement of corporate and individual goals. To achieve this goal, we compensate our senior

management through a mix of base salary, cash bonus and equity compensation designed to be competitive with comparable employers and to align management s incentives with the long-term interests of our stockholders.

For our executive officers, participation in an incentive compensation plan (cash bonus and stock options) is designed to reward company-wide performance, as well as individual contributions. Measurement of company-wide performance is primarily based on the Company s internal targets and benchmarked against industry performance levels. Accordingly, in years in which performance targets and company performance levels are achieved or exceeded, executive compensation may be higher than in years in which performance is below expectations.

Targeted Overall Compensation

In evaluating actual compensation levels for executive officers, the Committee reviews all elements of the program salary, bonuses (cash and stock) and stock options in total rather than any one element in isolation. Base annual salary and bonus are considered the short-term incentive of overall compensation, whereas the awarding of stock options is viewed as a long-term incentive. Severance and Change of Control benefits are not factored into the decision regarding overall compensation plans. The Committee compares these compensation components to those that it establishes as its peer group for these purposes. The peer group consists of similar-sized and geographically positioned companies that have business operations in the healthcare industry including home health care infusion and specialty pharmacy operations. Overall compensation of each executive officer is evaluated against that of similarly situated executives in the peer group, considering the overall scope of the executive s individual and geographic responsibilities. This evaluation is conducted using a software database from the Economic Research Institute, which inputs a variety of surveys, proxy information and other sources outlining the market for various positions (including CEO, CFO, and Chief Legal Counsel) within the industry within specific geographic and revenue parameters. In making compensation determinations for executive officers, the Committee also considers recommendations of the Chief Executive Officer (other than with respect to his own compensation). Individual compensation of our executive officers is comprised of three elements: base salary, cash bonus and stock options.

Base salary. Base salary provides the opportunity for our executive officers to earn a portion of their compensation without being subject to the risk of Company performance. Base salary for each executive officer is determined by the Committee annually by evaluating the executive s length of service, as well as his level of position, at the Company. The Committee may change base salary year-to-year as a result of promotions, individual performance, peer group trend changes, competitive conditions and internal considerations such a changes in the executive s overall responsibility.

In July 2006, as part of an overall review, the position and performance of our President and Chief Executive Officer (CEO), Chief Financial Officer (CFO) and Senior Vice President, Secretary and General Counsel (SVP/GC) was conducted. The position of the CEO was evaluated and compared peers of like companies and an adjustment to his yearly base salary was made from $360,000 to $400,000, effective July 2006. Mr. Rai s compensation for this period was based on his overall scope of financial and operational responsibilities and his past and anticipated future performance in meeting overall business objectives of the Company, particularly in the areas of executing the short term and long range business strategy. His base salary is below midpoint in comparison to other CEO s of similarly sized healthcare companies in the peer group.

Our Chief Financial Officer (CFO) is responsible for the overall financial structure of the organization, as well as to assist with raising working capital for the organization. Evaluation of our CFO s individual accomplishments and responsibilities was conducted in July 2006, resulting in the Committee raising his annual base salary from $250,000 to $275,000, which falls at approximately midpoint in comparison of other peers in like industries. Finally, our Senior Vice President/Chief General Counsel (SVP/GC) is responsible for guiding management in identifying the critical legal issues and identifying the greatest opportunity for minimizing risks and maximizing profits in business

transactions and contract negotiations. He was evaluated for his accomplishments and responsibilities in assisting in achieving the organizational goals, resulting in

raising his annual base salary from $244,000 to $265,000. Again, his base salary is at or below midpoint in comparison to peers in like industries.

Bonuses. The Committee believes that a significant portion of each executive officer s annual compensation should be paid in the form of cash bonuses that are tied to performance objectives set for the Company and the individual. Bonuses are paid as a percentage of base salary and weighted on achievement of Company and individual objectives to drive achievement within each area. Although performance goals are typically the primary consideration in determining bonuses, from time-to-time we have used and will use other goals as well.

When setting the maximum level of bonus compensation available for an executive officer, the Committee considers the level of position at the Company, as well as other competitive information. For 2006, the Committee established maximums and payouts for the named executive officers as follows:

Named Executive Officer	Bonus as a % of Salary	Final Payout is Based Upon: Company Objectives	Individual Objectives
Rajat Rai	60%	50%	50%
Joe Bonaccorsi	40%	50%	50%
Paul Mastrapa	40%	50%	50%

If the weighted average result relative to Company objectives is less than 75%, the maximum bonus payout an executive can receive is 50% of the target bonus, even if all individual objectives are met.

For 2006, company and individual objectives for our CEO, CFO, SVP/GC included:

1. Secure and implement the Specialty Pharmacy Services Agreement with Blue Cross/Blue Shield of Michigan and the Blue Cross network.

2. Complete the targeted acquisitions, resulting in geographic expansion and market consolidation.

3. Achieve revenue, net income and operating cash flow targets.

4. Achieve an increase in shareholder return.

The compensation committee gave consideration to these achievements in determining executive compensation for 2006. Taking into account the recommendation of the Compensation Committee, the independent directors of our Board of Directors made the final determination regarding bonuses to be paid under the 2006 bonus program in 2007. For 2006 the CEO, CFO and SVP/GC were determined to have achieved 90% of their individual objectives. The bonuses paid to the executives are outlined in the Summary Compensation Table.

For 2007, In evaluating annual bonuses, the Committee will examine earnings per share, sales growth and operating results as well as subjective factors relating to performance of management objectives. The committee recognizes the achievement of these objectives, will lead to the increase in shareholder value. The earnings factors are compared with designated Company performance goals, prior years performance and performance of other companies in the industry. Accordingly, the Company believes it is important that its performance be compared to that of overall industry growth metrics in order to demonstrate the impact of management s objectives and performance.

Stock options. Where base salaries and cash bonuses typically focus on short-term compensation and performance, stock options and other equity incentives encourage executive officer retention and provide long-term incentives for executives to create shareholder value. Historically, the primary form of equity compensation that we have awarded consists of non-qualified stock options. Long term incentives are considered as part of total compensation and are awarded based upon the level of position within the organization and upon the assumption of the growth of the organization or division within the Company. Stock options may be granted to executive officers on an annual basis, coinciding with their regular annual compensation review, in order to enhance the link between shareholder value creation and executive pay. The exercise price of stock options is

Table of Contents

set at the Company s closing stock price on the date of grant. Accordingly, stock options have value only if the stock price appreciates following the date the options are granted.

The 2006 stock option grants to named executive officers have a seven year life expiration with a four year vesting schedule. This approach focuses the executive on the creation of shareholder value over the long term and encourages equity ownership in the Company.

At present there is no specific targeted policy mix between current and long term compensation using stock options as an incentive. From time to time; the Company may elect to utilize the grant of stock options based upon overall Company performance and/or in lieu of cash bonuses.

Compensation Committee Report

The Compensation Committee of the Board of Directors has reviewed and discussed the Compensation Discussion and Analysis for the fiscal year ended December 31, 2006 with the Company s management. Based on this review and discussions, the Compensation Committee has recommended to the Board of Directors that the Compensation Discussion and Analysis be included in the Company s 2007 Proxy Statement.

Submitted by the Compensation Committee:

Edward A. Blechschmidt (Chairman)
Leo Henikoff, M.D.
Jerome F. Sheldon

Executive Compensation

The following table presents summary information concerning 2006 compensation awarded or paid to, or earned by, (i) the Company s President and Chief Executive Officer, (ii) the Company s Chief Financial Officer and (iii) the other most highly compensated executive officers for the year 2006.

Summary Compensation Table

Name and Principal Positions	Year	Salary ($)	Bonus ($)	Stock Awards ($)	Option Awards ($)(*)	All Other Compensation ($) (1)	Total ($)
Rajat Rai President and Chief Executive Officer	2006	$ 380,000	$ 108,000	$ 0	$ 266,481	$ 14,805	$ 769,286
Joseph P. Bonaccorsi Senior Vice President, Secretary and General Counsel	2006	$ 254,500	$ 45,000	$ 0	$ 144,129	$ 11,756	$ 455,385
Paul Mastrapa	2006	$ 262,500	$ 50,000	$ 0	$ 177,333	$ 11,916	$ 501,249

Senior Vice President and Chief Financial Officer							
Richard M. Smith, President and Chief Operating Officer	2006	$ 153,910	$ 0	$ 0	$ 0	$ 47,750	$ 201,660

* Valuation of Stock Options is determined assuming fully vested options utilizing the Black Scholes calculation.

The only form of Stock Awards is stock options, which are included in the above table (Summary Compensation Table).

(1) Other compensation for Mr. Rai, Mr. Bonaccorsi and Mr. Mastrapa consists of the employer match on the 401K and car allowance. Other compensation for Mr. Smith consists of car allowance through May 31, 2006 and payment for providing consulting services after his transition from the company. See also Employment Agreements and Severance Benefits below for a description of our employment agreements with Mr. Rai, Mr. Mastrapa, Mr. Bonaccorsi and Mr. Smith.

Table of Contents

The following table sets forth certain information about outstanding equity awards held at December 31, 2006 by the executive officers named in the Summary Compensation Table.

Outstanding Equity Awards at Fiscal 2006 Year-End

			Option Awards Equity Incentive Plan Awards:			
Name	**Number of Securities Underlying Unexercised Options (#) Exercisable**	**Number of Securities Underlying Unexercised Options (#) Unexercisable**	**Number of Securities Underlying Unexercised Unearned Options (#)**		**Option Exercise Price ($)**	**Option Expiration Date**
Rajat Rai	126,747	0	0	$	0.40	10/12/2008
	46,875	0	0	$	2.97	1/20/210
	140,625	0	0	$	2.93	7/28/2010
	112.500	0	0	$	3.80	3/9/2011
	168,750	0	0	$	6.87	5/11/2011
	187,500	0	0	$	8.61	8/3//2011
	101,250	0	0	$	8.22	6/4/2012
	0	75,000	0	$	11.17	6/23/2013
Joseph P. Bonaccorsi	23,438	0	0	$	9.03	3/21/2012
	14,062	14,063	0	$	5.23	2/28/2013
	9,375	18,750	0	$	8.65	5/11/2014
	0	40,000	0	$	11.17	6/23/2013
Paul Mastrapa	157,500	0	0	$	9.02	3/21/2012
	0	37,500	0	$	5.23	2/28/2013
	0	50,000	0	$	11.17	6/23/2013
Richard M. Smith	0	0	0	$	0.00	0

Vesting for Options is twenty-five percent (25%) per year over a four year schedule.

The following table sets forth certain information concerning stock option exercises and the vesting of restricted stock units during 2006 by the executive officers named in the Summary Compensation Table.

Option Exercises and Stock Vested

Name	Option Awards Number of Shares Acquired on Exercise (#)	Value Realized On Exercise ($)
Rajat Rai	55,786	$ 747,901
Joseph P. Bonaccorsi	82,812	$ 509,687
Paul Mastrapa	67,500	$ 438,906
Richard M. Smith	112,500	$ 547,785

Table of Contents

Equity Compensation Plans

The following table gives information about the Company s common stock that may be issued upon exercise of options, warrants and rights under the Company s equity compensation plans as of December 31, 2006 (security amounts in thousands of shares).

Plan Category	Number of securities to be issued upon exercise of outstanding options, warrants and rights (in thousands)		Weighted-average price of outstanding options, warrants and rights	Number of securities remaining available for future issuance under equity compensation plans
Equity compensation plans approved by security holders:(1)	3,256	$	8.77	2,122
Equity compensation plans not approved by security holders				
Total	3,256	$	8.77	2,122

Employment Agreements and Severance Benefits.

We believe that Option Care should provide severance benefits to certain employees. With respect to senior management, these severance benefits should reflect the fact that it may be difficult for employees to find comparable employment within a short period of time. While it is possible to provide a lump sum salary to an employee and would separate the employee from the Company as soon a practicable, we prefer to reduce the cash flow burden a lump-sum severance payment has on the organization and prefer to pay on a salary continuation basis.

Option Care provides termination related payments for two different termination events: involuntary termination without cause and involuntary termination without cause following a change in control. These agreements are entered into on an individual basis. The Company believes that providing for such income continuity results in greater management stability and minimized costs to address unwanted management turnover.

Mr. Rai signed a two-year Employment Agreement with the Company on May 11, 2004. The term of the agreement automatically renews for successive one year terms beginning on May 11, 2006, unless either the Company or Mr. Rai gives the other written notice at least forty-five days before the renewal date of its or his desire to not renew the agreement. Mr. Rai s employment agreement entitles him to receive twenty-four months severance if his employment is terminated by the Company without cause or by Mr. Rai upon a change in control of the Company or other good reason defined blow.

Mr. Bonaccorsi has an Executive Severance Agreement with the Company that entitles Mr. Bonaccorsi to receive twelve months severance in the event of any termination by the Company without cause or upon Mr. Bonaccorsi s election to leave the Company voluntarily upon a change in control of the Company or other good reason, defined below.

Mr. Mastrapa has an Executive Severance Agreement with the Company that entitles Mr. Mastrapa to receive twelve months severance in the event of any termination by the Company without cause or upon Mr. Mastrapa s election to leave the Company voluntarily upon a change in control of the Company or other good reason, defined below.

In each of the foregoing Employment and Executive Severance Agreements described above, good reason is defined as:

i. A change in the principal location at which the executive provides services to the Company, without prior written consent.

ii. Failure of the board to appoint the executive into their role as an Officer of the company, or removal of the executive from their position or as an Officer of the Company.

12

Table of Contents

iii. An adverse change in the executive s duties, authority or responsibilities of the Company which causes the position with the Company to become of less responsibility or authority than the position provided previously.

iv. The assignment of duties not commensurate or consistent with the position named.

v. A reduction in compensation or other benefits.

vi. A change of control of the Company.

vii. Failure of the Company to obtain the assumption of Employment or Severance Agreement.

Mr. Smith signed a one-year Employment Agreement upon joining the Company on May 9, 2003 as the Company s President and Chief Operating Officer. Under the terms of this agreement, Mr. Smith received an initial annual salary of $300,000, to be reviewed periodically but not less than annually, plus bonus opportunities. The agreement also specified the immediate grant of 300,000 stock options to Mr. Smith. (The grant was pro forma adjusted to 450,000 options to reflect the 3-for-2 stock split effective March 31, 2005 for stockholders of record on March 17, 2005.) On each anniversary of the date of the agreement, Mr. Smith s employment agreement automatically renewed for additional one-year terms, unless either the Company or Mr. Smith submits written notice to the other, at least 45 days prior to the anniversary date, of its or his desire to not renew the agreement. Mr. Smith s employment agreement contained a provision that entitles him to receive twelve months severance if terminated by the Company without cause or upon Mr. Smith s election to leave the Company voluntarily upon a change in control of the Company or other good reason, as defined in the agreement. Effective May 31, 2006, Mr. Smith resigned as President and Chief Operating Officer and his employment agreement terminated. Following his resignation, Mr. Smith provided consulting services to the organization for a fee of $45,000.

Severance agreements for our executives provide for the payment of 100% of then-current base salary plus continuation of health insurance and other benefits. Based upon a hypothetical termination date of December 31, 2006, the severance benefits for our CEO, CFO, and SVP/GC would have been as follows:

	Salary Continuation			Fringe Benefits Continuation			Equity Acceleration			Total
	Duration (Months)	Cost	Bonus	Duration (Months)	Cost	Employer Match on 401K	on Stock Option Grants	Excise Tax	Out placement	Cost of Terminati Benefits
t Rai										
h/Disability	0	$ 0	$ 0	24	$ 48,512	$ 0	$ 0	$ 0	$ 0	$ 48,
Cause	0	Accrued Obligations	$ 0	0	$ 0	$ 0	$ 0	$ 0	$ 0	Accr Obligati
out Cause/For d Reason	24	$ 800,000	$ 0	12	$ 24,256	$ 0	$ 0	$ 0	$ 10,000	$ 834,
to Change of rol	24	$ 800,000	$ 240,000	12	$ 24,256	$ 12,000	$ 0	$ 0	$ 10,000	$ 1,086,
Mastrapa										

h/Disability	0	$ 0	$ 0	12	$ 23,135	$ 0	$ 0	$ 0	$ 0	$ 23,
Cause	0	Accrued Obligations	$ 0	0	$ 0	$ 0	$ 0	$ 0	$ 0	Accr Obligati
out Cause/For d Reason	12	$ 275,000	$ 0	12	$ 23,135	$ 0	$ 0	$ 0	$ 10,000	$ 308,
to Change of rol	12	$ 275,000	$ 110,000	12	$ 23,135	$ 7,950	$ 338,250	$ 0	$ 10,000	$ 764,
ph Bonaccorsi										
h/Disability	0	$ 0	$ 0	12	$ 17,135	$ 0	$ 0	$ 0	$ 0	$ 17,
Cause	0	Accrued Obligations	$ 0	0	$ 0	$ 0	$ 0	$ 0	$ 0	Accr Obligati
out Cause/For d Reason	12	$ 265,000	$ 0	12	$ 23,135	$ 0	$ 0	$ 0	$ 10,000	$ 298,
to Change of rol	12	$ 265,000	$ 106,000	12	$ 23,135	$ 8,950	$ 231,848	$ 0	$ 10,000	$ 644,

Table of Contents

Accrued Obligations include the following payments: unused accrued sick time, unused accrued vacation, car allowance due for the pay period and time worked that has not been paid as of the termination date. This information is determined as of the termination date.

Bonus payments are made should there be a termination for good reason or change of control.

Fringe Benefit Continuation includes: All medical, dental, life, short-term disability, long-term disability, AD&D, monthly car allowance.

401(k) is the maximum employer match based upon the current contribution rate of the executive.

Perquisites and Other Benefits.

We annually review the perquisites and benefits that senior management receives. We provide benefits programs to executive officers and to other employees. The following table generally identifies such benefit plans and identifies those employees who may be eligible to participate.

Benefit	Executive Officers	Certain Management	Full-Time Employees	Part-Time Employees
401(k)	ü	ü	ü	ü
Deferred Compensation Plan	Not Offered	Not Offered	Not Offered	Not Offered
Supplemental Early Retirement Plan	Not Offered	Not Offered	Not Offered	Not Offered
Employee Stock Purchase Plan (15% Reduction)	ü	ü	ü	ü
Medical/Dental/Vision	ü	ü	ü	ü
E-Care Health Screening	ü	ü	ü	Not Offered
Life Insurance up to $500,000	ü	ü	ü	ü
Short Term Disability up to $1,000/Week	Not Offered	ü	ü	ü
Short Term Disability up to $1,500/Week	ü	ü	Not Offered	Not Offered
Long Term Disability up to $10,000/Month	ü	ü	ü	ü
Accidental Death & Dismemberment up to $300,000	ü	ü	ü	ü
Family Medical Leave(2)	Not Offered	ü	ü	Not Offered
Severance Plans/Change in Control	ü	Not Offered	Not Offered	Not Offered
Auto Allowance	ü	ü	Not Offered	Not Offered
Auto Reimbursement for Mileage	ü	ü	ü	ü
Country Club Membership	Not Offered	Not Offered	Not Offered	Not Offered
Voluntary Legal Services	ü	ü	ü	Not Offered
Voluntary Spousal Life Insurance up to $250,000	ü	ü	ü	ü
Voluntary Dependant Life Insurance up to $10,000	ü	ü	ü	ü
Voluntary Employee Whole Life Insurance	ü	ü	ü	ü
Voluntary Spousal Whole Life Insurance	ü	ü	ü	ü
Voluntary Dependant Whole Life Insurance	ü	ü	ü	ü
Voluntary Grandchild Whole Life Insurance	ü	ü	ü	ü
Voluntary Critical Illness	ü	ü	ü	ü
Voluntary Accident Insurance	ü	ü	ü	ü

(1) A six (6) month lease under the company name may be secured for executives relocating to a given area, allowing for transition to new dwellings. Relocation benefits are reimbursed but are individually negotiated when they occur.

(2) In consideration of the need for an executive to be present and able to lead the organization, per Family Medical Leave Act exemption, an Executive may be denied 12 weeks of Family Medical Leave Act guarantee.

Table of Contents

Compensation of Directors

The following table provides certain information about compensation to directors during 2006 who are not employees.

Director Compensation

Name	Fees Earned or Paid in Cash ($)	Stock Awards ($)	Option Awards ($)	Non-Equity Incentive Plan Compensation ($)	Change in Pension Value and Nonqualified Deferred Compensation Earnings ($)	All Other Compensation ($)	Total ($)
Kenneth S. Abramowitz	$ 30,000	$ 0	$ 57,000	$ 0	$ 0	$ 0	$ 87,000
Edward A. Blechschmidt	$ 30,000	$ 0	$ 57,000	$ 0	$ 0	$ 0	$ 87,000
Leo Henikoff, M.D.	$ 30,000	$ 0	$ 57,000	$ 0	$ 0	$ 0	$ 87,000
John N. Kapoor, Ph.D.	$ 100,000	$ 0	$ 0	$ 0	$ 0	$ 0	$ 100,000
Jerome F. Sheldon	$ 30,000	$ 0	$ 57,000	$ 0	$ 0	$ 0	$ 87,000

In 2006, non-employee directors received $7,500 in compensation for attendance at each regular meeting of the Board of Directors. Directors are also reimbursed for out-of-pocket expenses incurred in connection with attendance at Board of Directors and committee meetings. John Kapoor, in each of the years 2006, 2005, 2004 and 2003, received $100,000 for services rendered as Chairman of the Board.

In 2007, non-employee Directors will receive $50,000 for services rendered, paid in quarterly installments; the Chairman of the Board will receive additional compensation in the amount of $50,000 in the year 2007, paid in quarterly installments; the Chairman of the Audit Committee of the Board will receive additional compensation in the amount of $10,000 in the year 2007, paid in quarterly installments; the Chairman of the Compensation Committee of the Board will receive additional compensation in the amount of $6,000 in the year 2007, paid in quarterly installments. Directors are also reimbursed for out-of-pocket expenses incurred in connection with attendance at Board of Directors and committee meetings.

Further effective 2007, upon election or appointment to the Board of Directors, each non-employee director receives an option to purchase 45,000 shares of the Company s common stock (Common Stock) at an exercise price equal to the closing market price on the date of grant. Prior to 2007, such formulary grants were available only to independent directors. These options are generally exercisable immediately upon issuance. After the director s first year of service to the Board, at the beginning of each additional year of service, each non-employee director is granted an option to purchase 15,000 shares of Common Stock at an exercise price equal to the market price on the date of grant. Each such annual grant generally becomes vested in full on the one-year anniversary of the grant date.

Compensation Committee Interlock and Insider Participation

During 2006, the members of the Compensation Committee of the Board of Directors were Dr. Henikoff, Mr. Sheldon, and Edward Blechschmidt. None of these individuals and none of our executive officers have had a relationship that would constitute an interlocking relationship with executive officers or directors of another entity or insider participation in compensation decisions.

Report of the Audit Committee of the Board of Directors

The Audit Committee has assumed its expanded responsibilities following the passage of the Sarbanes-Oxley Act of 2002. The Audit Committee believes that the procedures it currently has in place are sufficient to establish meaningful, independent oversight of the Company s financial reporting, the core goal of Sarbanes-Oxley and other reform-oriented corporate governance initiatives. Nevertheless, the Audit Committee will continue to seek ways in which it can further enhance the quality, timeliness and transparency of the Company s financial disclosures.

The basic responsibilities relating to the Company s financial statements have not changed. The Audit Committee is not responsible for either preparing or expressing an opinion on the Company s financial statements. Management is responsible for the preparation of the Company s financial statements as well as the design, implementation and functioning of the Company s financial reporting processes, including its system of internal controls. The Company s auditors are responsible for performing an audit of the books and records of the Company and expressing an opinion as to whether the Company s annual financial statements have been prepared in conformity with U.S. generally accepted accounting principles and are free of material misstatement, as well as expressing an opinion on management s assessment of the effectiveness of internal control over financial reporting and the effectiveness of internal control over financial reporting.

While the basic responsibilities have not changed, changes in the relationships among the parties create a significant increase in the Audit Committee s ability to oversee and evaluate the performance of both the Company s management and its independent registered public accounting firm. The most significant change in this regard is the clear articulation of the Audit Committee s right to control the Company s relationship with its independent registered public accounting firm. The involvement of the Audit Committee in the process is expected to enhance the process because the members of the Audit Committee are independent (as determined in accordance with applicable standards) of both active participants in the process, the Company and Ernst & Young LLP.

To fulfill its obligations to monitor and oversee the performance of management and the independent registered public accounting firm, the Audit Committee meets with management and the independent registered public accounting firm, both jointly and individually. In meetings with management, the Audit Committee has inquired into the quality, not just the acceptability, of the decisions made by management in preparing the financial statements. An emphasis has been placed on assessing the reasonableness of any material judgments made by management in the preparation of the financial statements, which includes significant estimates and accruals. The Audit Committee has also pressed management on various contingencies, such as regulatory changes, which could have a significant impact on the Company.

The Audit Committee has reviewed the report of management contained in the Company s Annual Report on Form 10-K for the fiscal year ended December 31, 2006 filed with the Securities and Exchange Commission, as well as Ernst & Young LLP s Report on Form 10-K related to its audit of (i) the consolidated financial statements and financial statement schedule, (ii) management s assessment of the effectiveness of internal control over financial reporting and (iii) the effectiveness of internal control over financial reporting. The Audit Committee continues to oversee the Company s efforts related to its internal control over financial reporting and management s preparations for the evaluation in fiscal 2006.

The Audit Committee has also met with the independent registered public accounting firm both individually and with management present. At these meetings, the Audit Committee has considered the scope of and procedures for the Company s annual audit. The Audit Committee also discussed with the independent registered public accounting firm the results of the independent registered public accounting firm s examination of the Company. During such discussions, the Audit Committee received the independent registered public accounting firm s evaluation of the Company s system of internal controls and the overall quality of the Company s financial reporting. In particular, the Audit Committee has reassessed the Company s position on applicable critical accounting policies, including obtaining guidance on the probable effects of adopting other potentially acceptable policies. The Audit Committee has also reviewed with the independent registered public accounting firm the quality of decisions made by management in the preparation of the financial statements and such other matters as either the Audit Committee or independent registered public accounting firm deemed necessary or appropriate for both parties to discharge their respective duties, which included a discussion of the matters identified in Statement of Accounting Standards 61 and PCAOB Auditing Standard No. 2 regarding the assessment of internal control over financial reporting. The Audit Committee obtained

from the independent registered public accounting firm a formal written statement describing all relationships between the auditors and the Company that might bear on the auditors independence consistent with the Independence Standards Board Standard No. 1, Independence Discussions with Audit Committees, discussed with the auditors any relationships that may impact their objectivity and independence and satisfied itself as to the auditors independence.

The Audit Committee reviewed and discussed the audited financial statements of the Company as of and for the fiscal year ended December 31, 2006 with management and the independent registered public accounting firm. Based on this review and discussions with management and the independent registered public accounting firm and the report of the independent registered public accounting firm, the Audit Committee recommended to the Board that the Company s audited financial statements be included in its Annual Report on Form 10-K for the fiscal year ended December 31, 2006, for filing with the Securities and Exchange Commission. The Audit Committee also has selected and recommended to the stockholders for ratification the reappointment of Ernst & Young LLP as the independent registered public accounting firm to audit the consolidated financial statements of the Company for 2007.

THE AUDIT COMMITTEE OF THE BOARD OF DIRECTORS
KENNETH S. ABRAMOWITZ JEROME F. SHELDON LEO HENIKOFF

PROPOSAL 2. APPROVAL OF THE OPTION CARE, INC. 2007 INCENTIVE PLAN
(Proposal 2 on the Proxy Card)

The Board recommends that shareholders approve the Option Care, Inc. 2007 Incentive Plan (the Plan). The Board approved the Plan on March 28, 2007. The Board believes that it is in the best interest of the Company and its shareholders to adopt a new incentive plan. The purposes of the Plan are to increase shareholder value and to advance the interests of Option Care and its subsidiaries by providing a variety of economic incentives designed to motivate, retain and attract employees, directors and others persons providing services to Option Care and its subsidiaries. A summary of the material terms of the Plan is contained below. This summary should be read with and is subject to the specific provisions of the Plan, the full text of which is set forth as Appendix A to this Proxy Statement.

The Plan is intended to replace the Amended and Restated Incentive Plan (1997), which expires on April 11, 2007. As of December 31, 2006, 868,305 shares of Option Care s common stock remained available for grant under the existing plan. For further information on our current equity compensation plans, please refer to the Equity Compensation Plan Information on page 12 of this Proxy Statement.

The specific individuals who will be granted awards under the Plan and the type and amount of any such awards will be determined by the Committee (as defined below). Accordingly, future awards to be received by or allocated to particular individuals under the Plan are not presently determinable.

2007 Incentive Plan

General

A maximum of 3.75 million shares of the Company s common stock will be available for grants of all equity awards under the Plan. The Plan is administered by a committee of the Board of Directors (the Committee) that, unless otherwise determined by the Board, consists of no fewer than two directors, each of whom is (i) a non-employee director within the meaning of Rule 16b-3 of the Securities Exchange Act of 1934, as amended (the Exchange Act), (ii) an outside director within the meaning of Section 162(m) of the Internal Revenue Code of 1986, as amended (the Code), and (iii) an independent director for purposes of the rules and regulations of the Nasdaq Stock Market. The Board has designed the Compensation Committee to act as the Committee under the Plan. The Committee may make discretionary grants of incentive awards, stock options, stock appreciation rights, restricted stock and restricted stock units, or combinations thereof, to directors, officers and other employees of the Company and its subsidiaries and other persons who provide services to the Company and its subsidiaries (vendors). As of December 31, 2006, there were four independent directors, three executive officers, 3044 employees and no vendors eligible to participate in the Plan.

All grants and awards under the Plan will be evidenced by written agreements between the Company and the participants and no grant or award will be valid until evidenced by a written agreement. The Committee may interpret the Plan and establish rules and regulations for the administration of the Plan, including, without limitation, the imposition of conditions with respect to competitive employment and provisions accelerating

vesting or exercisability. All rules, regulations, and interpretations relating to the Plan adopted by the Committee are conclusive and binding on the Company and the participants.

Appropriate adjustments may be made by the Committee to the maximum number of shares to be issued under the Plan, the maximum number of shares to be issued pursuant to incentive awards and the number of shares subject to any option grant to give effect to any stock splits, stock dividends and other relevant changes in capitalization occurring after the effective date of the Plan.

Unless otherwise provided in the written agreement evidencing a grant or award, upon a change of control (as defined below) any vesting period will end and all otherwise unvested awards will become immediately exercisable. In addition, the Committee may authorize the issuance or assumption of benefits under the Plan in connection with a change of control. In the event of any change of control, the Committee or the Board may cause any award outstanding as of the effective date of the change of control to be cancelled in consideration of a cash payment or alternate award made to the holder of the cancelled award equal in value to the fair market value of the cancelled award, provided that there is no repricing, replacing or regranting of option or stock appreciation rights or violation of the provisions of Section 409A of the Code. For these purposes, unless the Committee determines otherwise as necessary to avoid the imposition of additional tax and/or interest under Section 409A of the Code, a change of control means the occurrence of any of the following events: (i) a merger, consolidation or reorganization involving the Company, (ii) a sale of all or substantially all of the assets of the Company, (iii) the date on which the individuals who are members of the Board as of the effective date of the Plan cease for any reason to constitute a majority of the Board, unless the election, or nomination for election by the Company s stockholders, of any new director(s) was approved by a vote of the majority of the Board; (iv) a spin-off or split up involving the Company; or (v) any transaction similar to the foregoing that in the determination of the Committee results in a change of control of the Company.

Incentive Awards

Incentive awards, whether performance awards or fixed awards (each as described below), may be made to participants in the form of cash, restricted stock units, restricted stock or any combination of the foregoing.

Performance awards may be made in terms of a stated potential maximum dollar amount, percentage of compensation or number of units or shares, with the actual amount, number or percentage to be determined by reference to the level of achievement of specific objectives over a performance period of one year to five years, as determined by the Committee.

Fixed awards may be made that are not contingent on the performance of objectives, but are contingent on the recipient s continuing in the Company s employ for a period to be specified in the award, which period shall be not more than ten years from the date of the award. Fixed awards may generally consist of cash, restricted stock, restricted stock units, or other property.

Stock Options

Options granted pursuant to discretionary grants may be non-qualified stock options or incentive stock options within the meaning of Section 422 of the Code. The selection of participants, allotment of shares, determination of price and other conditions of purchase of such options are determined by the Committee, in its sole discretion. Options granted under discretionary grants are exercisable for a period of up to ten years, except that incentive stock options granted to participants who, at the time the option is granted, own stock representing greater than 10% of the voting power of all classes or series of stock of Option Care, are exercisable for a period of up to five years. The per share exercise price of incentive stock options granted pursuant to discretionary grants must be no less than 100% of the fair market value

of the common stock on the date of grant, except that the per share exercise price of incentive stock options granted to participants who, at the time the option is granted, own stock representing greater than 10% of the voting power of all classes of stock of Option Care, must be no less than 110% of the fair market value of the common stock.

Options may be exercised during the participant s continued employment with, or in the case of a vendor, engagement by, the Company or service on the Board, as the case may be, and for a period of 90 days following termination of such employment, engagement or service on the Board, or such other period of time provided in a relevant employment or severance agreement between the participant and the Company; provided, however, that if employment or engagement of the participant by the Company or service on the Board, as the case may be, shall have terminated by reason of retirement at or after age 65 or total and permanent disability, then the option may be exercised for a period of one year following termination of employment, engagement or service on the Board, or such other period of time provided in a relevant employment or severance agreement between the participant and the Company, but in any event not after the expiration of the term of the option.

Each option will be evidenced by an option agreement containing such terms and conditions consistent with the Plan that are approved by the Committee. Option agreements may provide for the exercise of an option in whole or in part from time to time during the term of the option, or in such installments and at such times as the Committee may determine. Options granted under the Plan are non-transferable, except in the event of death of a participant (i) during employment, engagement or service on the Board, (ii) within one year after the retirement of the employee at or after age 65 or the employee s total and permanent disability or (iii) within ninety days after termination of employment, engagement or service on the Board for any other reason in which case outstanding options may be exercised by the participant s representative during the remainder of the period during which the participant could have exercised the options had he or she survived, but not less than ninety days after the participant s death. No option may be exercised after the expiration of its term. The option exercise price is payable in full upon exercise of an option. No participant has any of the rights or privileges of a stockholder of the Company with respect to shares issuable upon exercise of an option until certificates representing such shares have been issued and delivered to the participant.

Stock Appreciation Rights

Rights entitling the grantee to receive cash or shares of common stock having a fair market value equal to the appreciation in market value of a stated number of shares of common stock from the date of grant, or in the case of rights granted in tandem with or by reference to a stock option granted prior to the grant of such rights from the date of grant of the related stock option to the date of exercise, may be granted to such eligible directors, officers and other employees and vendors as may be selected by the Committee and approved by the Board. Stock appreciation rights are not exercisable unless they have been outstanding for at least six months, and may not be exercised more than ten years after the date of grant. Stock appreciation rights may be exercised during the individual s continued employment with, or engagement by, the Company or service on the Board, as the case may be, and for a period of ninety days following termination of employment or engagement or service, or such other period of time provided in a relevant employment or severance agreement between the individual and the Company, and only within the original term of the grant. Upon exercise of a right, the grantee shall be paid the excess of the then fair market value of the number of shares to which the right relates over the fair market value of such number of shares as of the date of the grant of the right or of the related stock option, as the case may be. Such excess will be paid in cash or shares of common stock having a fair market value equal to such excess or in such combination thereof as the Committee shall determine.

Restricted Stock and Restricted Stock Units.

The Committee may award restricted stock or restricted stock units. Restricted stock awards consist of shares that are transferred to the participant subject to restrictions that may result in forfeiture if specified conditions are not satisfied. Restricted stock unit awards result in the transfer of shares to the participant only after specified conditions are satisfied. A holder of restricted stock is generally treated as a current stockholder (subject to the restrictions), whereas the holder of a restricted stock unit award is treated as a stockholder with respect to the award only when the shares of common stock are delivered in the future. The Committee will determine the restrictions and conditions applicable to

each award of restricted stock or restricted stock units. Each restricted stock and restricted stock unit grant will be evidenced by a written agreement between the

Company and the participant that will specify the period(s) of restriction, number share of restricted stock or the restricted stock units granted, and such other provisions as the Committee may determine. The Committee may provide that an award of restricted stock is conditioned upon the participant making an election under Section 83(b) of the Code.

Performance Measures.

Certain awards granted under the Plan may be granted in a manner to qualify such awards as performance-based compensation exempt from the deduction limitation imposed by Section 162(m) of the Code. The Committee will have complete discretion in determining the number, amount and timing of performance awards granted to participants. Performance awards will be earned only if performance goals over performance periods established by or under the direction of the Committee are met. The performance goals may vary from participant to participant, group to group and period to period. The performance goals for awards that are intended to constitute qualified performance-based compensation will be based upon one or more of the following: (i) net earnings or net income (before or after taxes); (ii) earnings per share; (iii) net sales growth; (iv) net operating profit; (v) return measures (including, but not limited to, return on assets, capital, invested capital, equity, or sales); (vi) cash flow (including, but not limited to, operating cash flow, free cash flow, and cash flow return on equity); (vii) earnings before or after taxes, interest, depreciation, and/or amortization; (viii) gross or operating margins; (ix) productivity ratios; and (x) share price (including, but not limited to, growth measures and total stockholder return).

The Committee will determine whether the performance targets or goals that have been chosen for a particular performance award have been met and may provide in an award that any evaluation of performance may include or exclude any of the following: asset write-downs; litigation; claims, judgments, or settlements; the effect of changes in tax laws, accounting principles, or other laws or provisions affecting reporting results; any reorganization and restructuring programs; extraordinary nonrecurring items as described in Accounting Principles Board Opinion No. 30 and/or in management s discussion and analysis of financial condition and results of operations appearing in our annual report to stockholders for the applicable year; acquisitions or divestitures; and foreign exchange gains and losses.

Awards that are designed to qualify as performance-based compensation may not be adjusted upward. However, the Committee has the discretion to adjust these awards downward. In addition, the Committee has the discretion to make awards that do not qualify as performance-based compensation. Awards may be paid in the form of cash, shares, or in any combination, as determined by the Committee.

Amendment and Termination

The Board, in its sole discretion, may terminate, amend, change or modify the Plan in any manner as the Board shall deem advisable, except that no amendment may be made without stockholder approval if such amendment would cause the Plan to fail to comply with Rule 16b-3 under the Exchange Act, Section 422 of the Code or any other requirement of applicable law or regulation. In addition, the Committee may make an amendment or modification to any award granted under the Plan without the consent of the holder of the award as necessary to avoid the imposition of additional tax and/or interest under Section 409A of the Code. Without the prior approval of the stockholders, options or stock appreciation rights issued under the Plan will not be repriced, replaced, or regranted through cancellation, or by lowering the exercise price of a previously granted option or the grant price of a previously granted stock appreciation right.

The Plan will terminate on the tenth anniversary of stockholder approval of the Plan, unless terminated earlier by action of the Board. No further grants will be made under the Plan after termination, but termination will not affect the rights of any participant under any grants made prior to termination.

Summary of Federal Income Tax Consequences of the Plan

The following discussion summarizes the material federal income tax consequences of participation in the Plan. This discussion is general in nature and does not address issues related to the tax circumstances of any particular employee. The discussion is based on federal income tax laws in effect on the date of this Proxy

Table of Contents

Statement and is, therefore, subject to possible changes in the law, some of which may have a retroactive effect. This discussion does not address state, local or foreign tax consequences.

Incentive Stock Options. An optionee will not recognize any income upon either grant or exercise of an incentive stock option, although the exercise may subject the optionee to alternative minimum tax liability in the year of exercise because the excess of the fair market value of the shares at the time of exercise over the option price of the shares is included in income for purposes of the alternative minimum tax. The treatment of any gain realized upon sale or other disposition of the Company s common stock received upon exercise of an incentive stock option will depend on the holding period. If the optionee does not dispose of the stock received within either one year after the exercise of the incentive stock option or two years after grant, any gain realized upon disposition will be characterized as long-term capital gain. If this holding period requirement is not satisfied, such disposition will be a disqualifying disposition. In such a case, the portion of the gain realized on disposition equal to the excess of the fair market value of the shares at the time the incentive stock option was exercised over the option price will be ordinary income taxable as compensation in the year of disposition. The balance, if any, of the gain will be capital gain.

The Company is entitled to a deduction with respect to an incentive stock option only in the taxable year of the Company in which a disqualifying disposition occurs. In that event, the deduction would be equal to the ordinary income, if any, recognized by the optionee upon disposition of the shares, provided that the deduction is not otherwise disallowed under the Code.

Nonqualified Stock Options. An optionee will not recognize any income upon either grant or vesting of a nonqualified stock option. Upon exercise of any part of a nonqualified stock option, the optionee will recognize ordinary income in an amount equal to the difference between the option price and the then fair market value of the shares acquired, assuming the shares are freely transferable or are not subject to a substantial risk of forfeiture. If the shares are not freely transferable and are subject to a substantial risk of forfeiture, the shares will be considered restricted stock. An optionee who receives restricted stock on exercise of a nonqualified stock option will not be subject to tax on exercise unless the recipient makes an election under Section 83(b) of the Code. Instead, such recipient will be subject to tax at ordinary income rates at the time of the expiration or earlier termination of a restriction period in an amount equal to the excess of the fair market value of the restricted stock at the time that the restriction period lapses or terminates over the option price. Any further gain on sale of the stock would be capital gain. If a holder makes an election under Section 83(b) of the Code, the holder will be subject to tax at ordinary income rates in an amount equal to the excess of the fair market value of the restricted stock at the date of option exercise over the option price. Any further gain on sale of the stock would be capital gain.

In general, upon a subsequent disposition of stock, the optionee s basis for determining taxable gain or loss would be the amount paid for such shares plus the amount that was includable in the optionee s income. Any gain recognized on such disposition would generally be taxed as long-term or short-term capital gain depending on the length of time the optionee is deemed to have held these shares and the holding period in effect at the time.

The Company will be entitled to a deduction for federal income tax purposes upon exercise of a nonqualified stock option in an amount equal to the ordinary income recognized by the optionee, provided that the deduction is not otherwise disallowed under the Code. The Company must withhold taxes from the optionee s compensation with respect to the ordinary income recognized by the optionee upon exercise.

Stock Appreciation Rights. The treatment of stock appreciation rights is essentially the same as the treatment of the related options granted under the Plan.

Restricted Stock. The recipient of restricted stock will not be subject to tax upon its grant, unless the recipient makes an election under Section 83(b) of the Code. Assuming no election under Section 83(b) is made, the holder will be

subject to tax at ordinary income rates at the time of the expiration or earlier termination of the restriction period in an amount equal to the excess of the fair market value of the restricted stock at the time that the restriction period lapses or terminates over the amount paid for the stock. Any further gain on sale of the stock will be capital gain. If a holder makes an election under Section 83(b) of the

Table of Contents

Code, the holder will be subject to tax at ordinary income rates based on the fair market value of the restricted stock at the date of grant. Any further gain on sale of the stock would be capital gain.

The Company must withhold taxes and will be entitled to a deduction with respect to the amount of ordinary income recognized by the employee, unless otherwise disallowed under the Code.

Other Awards. In the case of an exercise of a stock appreciation right or an award of restricted share units, performance awards or fixed awards, the participant would generally recognize ordinary income in an amount equal to any cash received and the fair market value of any shares received on the date of payment. In that taxable year, Option Care would receive a federal income tax deduction in an amount equal to the ordinary income that the participant has recognized.

Cap on Company Deductions for Certain Compensation. Under Section 162(m) of the Code, certain compensation payments in excess of $1 million are subject to a cap on deductibility for the Company. The limitation on deductibility applies with respect to that portion of a compensation payment for a taxable year in excess of $1 million to either the chief executive officer of the Company or any one of the other four highest paid executives. Certain performance-based compensation is not subject to the cap on deductibility. Stock options can qualify for this performance-based exception, but only if they are granted by the Compensation Committee, they are granted at fair market value, the total number of shares that can be granted to an executive for any period is stated, and stockholder and Board approval is obtained. The Company intends to administer the incentive stock option and nonqualified stock option portions of the Plan to comply with these performance-based criteria.

Restricted stock, restricted stock units, performance awards or fixed awards do not satisfy the definition of performance-based compensation unless the granting or vesting of such awards are based upon the attainment of specified performance goals.

Compliance With Deferred Compensation Provisions of American Jobs Creation Act. Section 409A of the Code imposes penalty taxes and interest charges on employees who receive certain deferred compensation that does not meet the requirements of Section 409A. Option Care intends that awards under the Plan will meet the requirements of Section 409A, but no assurance can be made in this regard.

Withholding Taxes. Awards made to participants under the Plan may be subject to federal, state and local income tax and employment tax withholding obligations, and Option care will comply with any requirements to withhold such taxes.

PROPOSAL 3. RATIFICATION OF APPOINTMENT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM
(Proposal 3 on the Proxy Card)

The Audit Committee has selected the accounting firm of Ernst & Young LLP as the Company s independent registered public accounting firm with respect to the fiscal year ending December 31, 2007. Ernst & Young LLP has served as the Company s independent registered public accounting firm since January 1998. Although the Company is not required to submit this selection to a vote of stockholders, the Audit Committee believes it appropriate as a matter of policy. If the stockholders do not ratify this appointment, the Audit Committee will investigate the reasons for the rejection and consider other independent registered public accounting firms. Even if the appointment is ratified, the Audit Committee in its discretion may appoint a different independent registered public accounting firm at any time during the year if it determines that such a change would be appropriate.

Representatives of Ernst & Young LLP will be present at the annual meeting. They will have the opportunity to make a statement and will be available to respond to appropriate questions from stockholders.

Table of Contents

Audit and Related Fees

The following table shows the fees paid by the Company to Ernst & Young LLP for audit services for the fiscal years ended December 31, 2005 and 2006:

	2006	2005
Audit Fees	$ 579,000	$ 521,000
Audit-Related Fees	$ 49,000	79,000
Total	$ 628,000	$ 600,000

Audit Fees. This category includes the annual audit of the Company s financial statements and review of the financial statements in the Company s quarterly reports. Audit fees also include the audit of management s report on the effectiveness of the Company s internal control over financial reporting, as required by Section 404 of the Sarbanes-Oxley Act of 2002.

Audit-Related Fees. This category consists primarily of fees for the audits of the Company s 401(k) plan and fees related to registration statements filed by the Company during 2006 and 2005.

Tax Fees. Tax services were not provided by Ernst & Young LLP to the Company in 2005 or 2006.

Audit Committee pre-approval policies and procedures.

Under the Sarbanes-Oxley Act of 2002, the audit committee is responsible for the appointment, compensation and oversight of the work of the independent registered public accounting firm. As part of this responsibility, the Audit Committee is required to pre-approve the audit and non-audit services preformed by the independent registered public accounting firm in order to assure that the performance of such services does not impair the registered public accounting firm independence from the Company. The Audit Committee may pre-approve non-audit services up to predetermined cost limits without consideration of specific case-by-case services; or may require specific, case-by-case pre-approval; or may utilize a combination of the two approaches. Audit services will be subject to specific pre-approval of the Audit Committee. The Audit Committee will monitor the audit services engagement as necessary, but no less than on a quarterly basis, and will also approve, if necessary, any changes in terms, conditions and fees resulting from changes in audit scope, Company structure or other items. Audit-related services may be pre-approved generally or on a specific case-by-case basis, as deemed appropriate by the Audit Committee. Tax services, such as tax compliance and tax advice, may be pre-approved if determined to not impair the auditor s independence or constitute prohibited non-audit services as defined by the Securities and Exchange Commission. Tax services may be pre-approved generally to the extent that such services conform to the historical tax services provided by the independent registered public accounting firm. Increases in the scope of such tax services would require specific, case-by-case pre-approval by the Audit Committee. Any other services provided by the independent registered public accounting firm will be subject to specific, case-by-case pre-approval and will be evaluated to ensure that they do not constitute prohibited non-audit services or otherwise impair auditor independence.

The Audit Committee reviewed and pre-approved all audit services and non-audit services performed by the independent registered public accounting firm during the years ended December 31, 2006 and 2005.

Recommendation of the Board of Directors

The Board of Directors recommends that the stockholders vote FOR the proposal to ratify Ernst & Young LLP as the Company s independent registered public accounting firm with respect to the fiscal year ending December 31, 2007.

SECTION 16(a) BENEFICIAL OWNERSHIP REPORTING COMPLIANCE

Section 16(a) of the Securities Exchange Act of 1934, as amended, requires that the Company s officers and directors, and persons who own more than ten percent of the Company s outstanding stock, file reports of ownership and changes in ownership with the Securities and Exchange Commission. To the knowledge of the

Table of Contents

Company, all Section 16(a) reports required to be filed its officers, directors and greater than ten percent beneficial owners were timely filed during the year ended December 31, 2006.

CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS

Related Party Transactions

The Company s Board of Directors, having responsibility for the Company s overall affairs and dealings abides by a policy that the Audit Committee reviews related party transactions involving executive officers directors or director nominees. The related party transaction may be entered into or continued if the Board of Directors determines that the related party transaction in question is in, or is not inconsistent with, the best interests of the Company and its stockholders. Related parties include executive officers, directors, director nominees, beneficial owners of more than 5% of the Company s voting securities, immediate family members of any of the foregoing persons, and any firm, corporation or other entity in which any of the foregoing persons is employed and in which such person has 5% or greater beneficial ownership interest.

We engage in transactions with EJ Financial Enterprises, Inc., a company controlled by the Chairman of our Board of Directors. For the years ended December 31, 2006, 2005 and 2004, we purchased strategic consulting services of $175,000, $175,000 and $176,000.

We have obtained legal services from firms for which the spouse of our Senior Vice President, Secretary and General Counsel is serving, or has served, as a partner. During 2006, 2005 and 2004, we obtained legal services from such firms totaling $800,000, $1.6 million and $600,000, respectively.

We provide management services to our joint venture in Portland, Oregon in accordance with a management agreement executed as of October 1, 2005. This management agreement is a renewable, three-year agreement and is terminable only with the majority consent of the members of the joint venture, of which we own a 50% financial and voting interest. We also provide management services to our joint venture investment in Columbus, Ohio in accordance with a management agreement executed as of November 1, 2005. This management agreement is a renewable, ten-year agreement and is terminable only with the majority consent of the members of the joint venture, of which we own a 50% financial and voting interest. The management services provided in both of these agreements includes such services as legal and accounting in addition to day-to-day managerial support of the ongoing operations of the businesses. See also Note 5, *Investments in Joint Ventures*, in our Annual Report on Form 10-K for the fiscal year ended December 31, 2006.

We entered into a $1.0 million revolving note agreement with the Columbus, Ohio joint venture on November 1, 2005. The note bears interest at 9.25% and is due and payable on October 31, 2008. The principal balance due under this note was $1.0 million as of December 31, 2006 and $100,000 as of December 31, 2005. The Columbus, Ohio joint venture also owes us $800,000 over and above the $1.0 million note balance, representing additional working capital advances that we have made to them. To address this issue, the promissory note is in the process of being amended to increase the maximum loan balance.

As of December 31, 2006 and 2005, we had additional amounts due from our joint ventures of approximately $200,000, and $1.0 million, respectively. These receivables were included in Other current assets on our Consolidated Balance Sheets as of those dates. This balance primarily relates to certain specialty drugs purchased by Option Care on behalf of the joint ventures.

Independent Directors

A director is considered independent if the Board makes an affirmative determination after a review of all the relevant information that the director has no material relationship with the Company. Annually, the Board reviews financial and other relationships between the directors and the Company as part of the assessment of director independence. In determining independence, the Board considers whether a director or nominee or immediate family member, has had any material interest, or proposes to have in the future, in any transactions or series of similar transactions (including employment relationships), which exceeds $60,000 and to which the Company or any subsidiary was or is to be a party. The Board of Directors has determined that each of

Table of Contents

our continuing directors and nominee other than Dr. Kapoor and Mr. Rai qualify as independent in accordance with the listing standards of The Nasdaq Stock Market. Dr. Kapoor is not considered independent because of the Company s relationship with EJ Financial Enterprises, Inc., of which Dr. Kapoor is the sole owner, and from which we purchase strategic consulting services. Mr. Rai is not considered independent because he is an officer of the Company.

STOCKHOLDER PROPOSALS

Proposals that stockholders intend to present at the 2007 Annual Meeting of Stockholders are due by January 31, 2008 for inclusion in the Company s Proxy Statement relating to that meeting. Upon receipt of any such proposal, the Company will determine whether or not to include such proposal in the Proxy Statement in accordance with regulations governing the solicitation of proxies. The Company s By-laws provide that stockholder proposals that do not appear in the Proxy Statement may be considered at a meeting of stockholders only if written notice of the proposal is received by the Secretary of the Company not less than 60 days and not more than 90 days before the anniversary of the prior years Annual Meeting; provided, however, that, in the event the date of the Annual Meeting is more than 30 days before or more than 60 days after such anniversary date, notice by the stockholder to be timely must be delivered not earlier than the close of business on the 90th day prior to such annual meeting and not later than the 60th day prior to such annual meeting or the close of business on the 10th day following the day on which public announcement of the date of such meeting is first made by the Company. Any such notice of a stockholder proposal by a stockholder to the Secretary of the Company must be accompanied by (a) a brief description of the business desired to be brought before the Annual Meeting and the reasons for conducting such business at the Annual Meeting, (b) the name and address of the stockholder who intends to present the proposal for a vote, (c) the class and number of shares of the Company s common stock which are beneficially owned by the stockholder, and (d) a description of any material interest of the stockholder in such business.

ANNUAL REPORT

The Annual Report to Stockholders for the year ended December 31, 2006 has been mailed simultaneously to the stockholders of the Company. This Annual Report includes a copy of the Company s Annual Report on Form 10-K for the year ended December 31, 2006, as filed with the Securities and Exchange Commission (excluding certain exhibits).

Additional copies of the Company s Annual Report on Form 10-K for the year ended December 31, 2006, as filed with the Securities and Exchange Commission (excluding exhibits), may be obtained by any stockholder, without charge, upon written request to Paul Mastrapa, Senior Vice President and Chief Financial Officer, Option Care, Inc., 485 Half Day Road, Suite 300, Buffalo Grove, Illinois 60089. The Company s Annual Report on Form 10-K for the year ended December 31, 2006 is also available through the Company s web site, www.optioncare.com.

SOLICITATION AND EXPENSES OF SOLICITATION

The Company will bear the cost of solicitation of proxies. Proxies will be solicited by mail. Proxies may also be solicited by officers and regular employees of the Company and its subsidiaries, personally or by telephone or facsimile, but such persons will not be specifically compensated for such services. Brokerage houses, custodians, nominees and fiduciaries will be requested to forward the soliciting material to the beneficial owners of stock held of record by such persons and will be reimbursed by the Company for their reasonable expenses incurred in connection therewith.

OTHER MATTERS

Management knows of no business to be brought before the Annual Meeting of Stockholders other than that set forth herein. Should any other matters properly come before the meeting, the persons named in the proxy intend to vote such proxy in accordance with their judgment on such matters.

Table of Contents

Delivery of Documents to Security Holders Sharing an Address

The Securities and Exchange Commission permits companies and intermediaries, such as brokers and banks, to satisfy delivery requirements for proxy statements with respect to two or more stockholders sharing the same address by delivering a single proxy statements and annual report to those stockholders. This method of delivery, often referred to as householding, is meant to reduce the amount of duplicate information that stockholders receive and lower printing and mailing costs for companies. We are not householding proxy materials for our stockholders of record in connection with the Annual Meeting, but we have been notified that certain intermediaries may household proxy materials. If you hold your shares of our common stock through a broker or bank that has determined to household proxy materials:

Only one proxy statement and 2006 Annual Report to Stockholders will be delivered to multiple stockholders sharing an address unless you notify your broker or bank to the contrary;

We will promptly deliver to you a separate copy of the proxy statement and 2006 Annual Report to Stockholders if you so request by calling us at (847) 465-2100, or by writing to our Secretary at Option Care, 485 Half Day Road, Suite 300, Buffalo Grove, Illinois, 60089. You may also contact your bank or broker to make a similar request; and

If your household is receiving multiple copies of our proxy statement and annual report, you can request delivery from your bank or broker of only a single copy of our proxy statement and annual report.

By Order of the Board of Directors
Joseph P. Bonaccorsi
Senior Vice President, Secretary and General Counsel

April 2, 2007
Buffalo Grove, Illinois

26

Table of Contents

Appendix A

OPTION CARE, INC.
2007 INCENTIVE PLAN

I. GENERAL

1. *Plan.* To provide incentives to employees of Option Care, Inc., a Delaware Corporation (the Company), or its subsidiary corporations, members of the Board of Directors of the Company (the Board) and other persons who provide services to the Company or its subsidiary corporations on a regular and substantial basis (vendors) through rewards based upon the ownership and performance of the common stock of the Company, the Company hereby establishes an incentive compensation plan to be known as the 2007 Incentive Plan (the Plan), as set forth in this document. The Plan permits the Committee, hereinafter designated, to grant incentive awards, stock options, stock appreciation rights, restricted stock or combinations thereof, to eligible directors, officers and other employees and vendors on the terms and subject to the conditions stated in this Plan. References hereinafter to employment by or the provision of services to the Company shall include references to its subsidiary corporations within the meaning of section 424(f) of the Internal Revenue Code of 1986, as amended (the Code). All directors, officers and other employees and vendors who receive grants or awards under this Plan shall be collectively referred to herein as participants.

2. *Eligibility.* Directors, officers and other employees of the Company and its subsidiaries and vendors, shall, upon selection by the Committee, be eligible to receive incentive awards, stock options, stock appreciation rights or restricted stock, either singly or in combination, as the Committee, in its discretion, shall determine.

3. *Shares to be Issued.* The maximum number of shares of common stock, par value $0.01 per share of the Company (Common Stock), to be issued pursuant to all grants made under the Plan shall be three million seven hundred fifty thousand (3.75 million). Shares covered by an award shall only be counted as used to the extent they are actually issued. Shares awarded pursuant to grants which, by reason of the expiration, cancellation or other termination of the grants prior to issuance (including awards that are settled in cash in lieu of shares), are not issued, shall again be available for future grants. Shares of Common Stock to be issued may be authorized and unissued shares, treasury stock or a combination thereof.

4. *Administration of the Plan.* The Plan shall be administered by a committee designated by the Board (the Committee) that, unless otherwise determined by the Board, consists of now fewer than two directors, each of whom is (i) a non-employee director within the meaning of Rule 16b-3 of the Securities Exchange Act of 1934, as amended (the Exchange Act), (ii) an outside director within the meaning of Section 162(m) of the Code and (iii) an independent director for purposes of the rules and regulations of the Nasdaq Stock Market. The Committee shall, subject to the terms of the Plan, establish selection guidelines, select directors, officers and other employees, and vendors for participation, and determine the form of grant, either as an incentive award, stock option, stock appreciation rights, restricted stock or combination thereof, determine the form of stock option, the number of shares subject to the grant, the fair market value of the Common Stock when necessary, the time and conditions of vesting or exercise, and all other terms and conditions of the grant. All grants and awards under this Plan shall be evidenced by written agreements (Award Agreements) between the Company and the participants and no such grant or award shall be valid until so evidenced. The Committee may interpret the Plan and establish rules and regulations for the administration of the Plan, including without limitation, the imposition of conditions with respect to competitive employment and provisions accelerating vesting or exercisability, not inconsistent with or conflicting with the terms of the Plan. All such rules, regulations, and interpretations relating to the Plan adopted by the Committee shall be conclusive and binding on all parties.

5. *Adjustments for Changes in Capitalization.* Appropriate adjustments shall be made by the Committee in the maximum number of shares to be issued under the Plan, the maximum number of shares to be issued pursuant to incentive awards, the number of shares the subject of any award, the exercise price of any option and the grant price of any stock appreciation right, to give effect to any stock splits, stock dividends

and other relevant changes in capitalization occurring after the effective date of the Plan, as necessary to prevent the dilution or enlargement of participants rights under the Plan.

6. *Effective Date and Term of Plan.* The Plan shall be submitted to the stockholders of the Company for approval and, if approved within 12 months from the date of approval by the Board of Directors, shall become effective on the date of stockholder approval (the Effective Date). The Plan shall terminate ten years thereafter, unless terminated earlier by action of the Board. No further grants shall be made under the Plan after termination, but termination shall not affect the rights of any participant under any grants made prior to termination.

7. *Amendments and Termination.* The Board, in its sole discretion, may terminate, amend, change or modify this Plan in such respects as the Board shall deem advisable, provided, however, that no amendment may be made without stockholder approval if such amendment would cause the Plan to fail to comply with Rule 16b-3 under the Exchange Act (as such Rule 16b-3 may be amended or applicable from time to time), Section 422 of the Code or any other requirement of applicable law or regulation (collectively, Applicable Law). In addition, the Committee may make such amendments or modifications to any award granted under the Plan without the consent of the holder thereof as necessary to avoid the imposition of additional tax and/or interest under section 409A of the Code.

Notwithstanding the foregoing, without the prior approval of the Company s stockholders, options or stock appreciation rights issued under the Plan will not be repriced, replaced, or regranted through cancellation, or by lowering the exercise price of a previously granted option or the grant price of a previously granted stock appreciation right.

8. *Change of Control.* Unless otherwise provided in the Award Agreement, upon a Change of Control, any vesting period shall end and all otherwise unvested awards shall become immediately exercisable. In addition, the Committee may authorize the issuance or assumption of benefits under this Plan in connection with any Change in Control. Without limiting the foregoing, in the event of any Change of Control, the Committee or the Board may cause any award outstanding as of the effective date of the Change in Control to be cancelled in consideration of a cash payment or alternate award made to the holder of such cancelled award equal in value to the fair market value of such cancelled award; provided, however, that nothing in this Section 8 shall permit the repricing, replacing or regranting of options or stock appreciation rights or violate the provisions of Section 409A of the Code. For these purposes, unless the Committee determines otherwise as necessary to avoid the imposition of additional tax and/or interest under section 409A of the Code, a Change of Control shall mean the occurrence of any of the following events:

(a) a merger, consolidation or reorganization of or involving the Company;

(b) a sale of all or substantially all of the assets of the Company;

(c) the date on which the individuals who are members of the Board as of the Effective Date cease for any reason to constitute a majority of the Board, unless the election, or nomination for election by the Company s stockholders, of any new director or directors was approved by a vote of a majority of the Board, in which case such new director or directors shall, for purposes of this Plan, be considered a member or members of the Board;

(d) a spin-off or split up involving the Company; or

(e) any transaction similar to the foregoing which in the determination of the Committee results in a change of control of the Company.

9. *No Rights as a Stockholder.* No stock option or award granted under this Plan shall entitle the participant to any dividend, voting or other right of a stockholder unless and until (i) the date of issuance of the shares that are the subject of such option or award, free of all applicable restrictions or (ii) the date on which such shares vest in accordance with their terms.

10. *Continued Employment or Services.* None of the Plan, participation in the Plan or any action by the Board or Committee taken under the Plan shall be construed as giving any person any right to be retained in

Table of Contents

the employ of the Company or limit the Company s right to terminate the employment or services of any person.

11. *Withholding.* The Company shall have the right to withhold from a participant (or a permitted assignee thereof), or otherwise require such participant or assignee to pay, any federal, state, local or foreign income taxes, withholding taxes, or employment taxes required to be withheld by law or regulations (Withholding Taxes) arising as a result of the grant of any award, exercise of an option or stock appreciation right, lapse of restrictions with respect to restricted stock or restricted stock units, or any other taxable event occurring pursuant to this Plan or any Award Agreement. If the participant (or a permitted assignee thereof) shall fail to make such tax payments as are required, the Company (or its affiliates or subsidiaries) shall, to the extent permitted by law, have the right to deduct any such Withholding Taxes from any payment of any kind otherwise due to such participant or to take such other action as may be necessary to satisfy such Withholding Taxes. In satisfaction of the requirement to pay Withholding Taxes, the participant (or permitted assignee) may make a written election which may be accepted or rejected in the discretion of the Committee, (i) to have withheld a portion of any shares or other payments then issuable to the participant (or permitted assignee) pursuant to any award, or (ii) to tender other shares to the Company (either by actual delivery or attestation, in the sole discretion of the Committee, provided that, except as otherwise determined by the Committee, the shares that are tendered must have been held by the participant for at least six months prior to their tender to satisfy the option price or have been purchased on the open market), in either case having an aggregate Fair Market Value (as defined in Article II, Section 1 hereof) equal to the Withholding Taxes.

12. *Additional Provisions.*

(a) *Additional Option and/or Award Provisions.* The Board or Committee may, in its sole discretion, include additional provisions in any option or award granted under the Plan, including, without limitation, restrictions on transfer, repurchase rights, or commitments (i) to pay cash bonuses, (ii) to make, arrange for or guaranty loans to employees (other than officers) or vendors, or (iii) to transfer other property to optionees upon exercise of options, or such other provisions as shall be determined by the Board or Committee; provided that such additional provisions shall not be inconsistent with any other term or condition of the Plan.

(b) *Acceleration.* The Board or Committee may, in its sole discretion, (i) accelerate the date or dates on which all or any particular option or options granted under the Plan may be exercised; or (ii) extend the dates during which all or any particular option or options granted under the Plan may be exercised; provided, however, that no such extension shall be permitted if (A) it would cause the Plan to fail to comply with Applicable Law or (B), unless consent is obtained from the relevant participant, such extension would cause the compensation payable pursuant to such option(s) to be subject to Code Section 409A.

(c) *Amendment to Comply with Applicable Law.* It is intended that no award granted under this Plan shall be subject to any interest or additional tax under Section 409A of the Code. In the event Code Section 409A is amended after the date hereof, or regulations or other guidance is promulgated after the date hereof that would make an award under the Plan subject to the provisions of Code Section 409A, then the terms and conditions of this Plan shall be interpreted and applied, to the extent possible, in a manner to avoid the imposition of the provisions of Code Section 409A.

(d) *Governing Law.* The Plan and each Award Agreement shall be governed by the laws of the State of Delaware, excluding any conflicts or choice of law rule or principle that might otherwise refer construction or interpretation of the Plan to the substantive law of another jurisdiction. Unless otherwise provided in the Award Agreement, recipients of an Award under the Plan are deemed to submit to the exclusive jurisdiction and venue of the federal or state courts of Delaware, to resolve any and all issues that may arise out of or relate to the Plan or any related Award Agreement.

29

II. INCENTIVE AWARDS

1. *Form of Award.* Incentive awards, whether performance awards or fixed awards (as described below), may be made to participants in the form of (i) cash, whether in an absolute amount or as a percentage of compensation, (ii) restricted stock units, without power to vote and without the entitlement to current dividends, (iii) shares of Common Stock issued to the participant but forfeitable and with restrictions on transfer in any form as hereinafter provided (restricted stock) or (iv) any combination of the foregoing. In addition, in the Committee s discretion, the Company may satisfy all or any part of its obligation under an incentive award payable in cash by delivering shares of Common Stock with a then Fair Market Value (as determined in accordance with the remainder of this Section 1) equal to the amount of such obligation or such part thereof. If the Common Stock is listed on an established stock exchange such as the Nasdaq Stock Market, then Fair Market Value means the average of the high and low per share sales prices for the Common Stock as reported by such stock exchange for the day preceding the date in question. If there is no such reported price for the Common Stock for the date in question, then such price on the last preceding date for which such price exists shall be determinative of the Fair Market Value.

2. *Performance Awards.* Performance awards may be made in terms of a stated potential maximum dollar amount, percentage or compensation, or number of units or shares, with such actual amount, percentage and number to be determined by reference to the level of achievement of corporate, group, division, individual or other specific objectives over a performance period of not less than one year nor more than five years, as determined by the Committee. No rights or interests of any kind shall be vested in an individual receiving a performance award until the conclusion of the performance period and the determination of the level of achievement specified in the award. The vesting period, if any, for a performance award shall be as specified in the applicable Award Agreement. Notwithstanding the foregoing, performance awards to be made to Covered Employees (as such term is defined in Article VI, below) shall only be made in accordance with the requirements set forth in Article VI, below, unless the Committee determines otherwise.

3. *Fixed awards.* Fixed awards may be made which are not contingent on the performance of objectives, but are contingent on the recipient s continuing in the Company s employ for a period to be specified in the award, which period shall be not more than ten years from the date of award. Fixed awards may generally consist of awards of cash, restricted stock, restricted stock units or other property.

III. STOCK OPTIONS FOR OFFICERS, OTHER EMPLOYEES, VENDORS AND DIRECTORS

1. *Grants of Options.* The Board or Committee shall have the authority, in its sole discretion, to determine the type or types of awards to be made under the Plan. Such awards may consist of incentive stock options and/or nonqualified stock options. Options may be granted singly or in combination. Notwithstanding the foregoing, no participant may receive in any single calendar year, an option grant to purchase more than six hundred thousand (600,000) shares of Common Stock.

2. *Terms of Options.*

(a) No option shall be exercisable more than ten years after the date of grant. Subject to the preceding sentence, the exercisability of an option may be conditioned upon the achievement of performance goals established by the Committee.

(b) (i) The per share option exercise price shall be not less than 100% of the Fair Market Value of a share of Common Stock at the time the option is granted, provided, however, that if at the time an option designated

as and intended to be an incentive stock option is otherwise to be granted pursuant to the Plan, the optionee owns directly or indirectly (within the meaning of Section 424(d) of the Code) shares of Common Stock of the Company possessing more than ten percent (10%) of the total combined voting power of all classes of stock of the Company or its parent or subsidiary corporations, if any within the meaning of Section 422(b) of the Code), then the option exercise price shall be not less than 110% of the Fair Market Value of the Common Stock as of the date the

Table of Contents

option is granted, and such option by its terms shall not be exercisable after the expiration of five (5) years from the date the option is granted.

(i) To the extent the aggregate Fair Market Value (determined as of the date of grant) of Common Stock with respect to which incentive stock options are exercisable for the first time during any calendar year (under the Plan and all other stock option plans of the Company) exceeds $100,000, such portion in excess of $100,000 shall be treated as a nonqualified stock option. In the event the participant holds two or more such options that become exercisable for the first time in the same calendar year, such limitation shall be applied on the basis of the order in which such options are granted.

(ii) Individuals who are not employees of the Company or one of its parent corporations or subsidiary corporations may not be granted incentive stock options. For purposes of this section, parent corporation and subsidiary corporation shall have the meanings attributed to those terms for purposes of Section 422 of the Code.

(iii) To qualify for incentive stock option tax treatment, an option designated as an incentive stock option must be exercised within 90 days after termination of employment for reasons other than death, except that, in the case of termination of employment due to disability, such option must be exercised within one year after such termination. Employment shall not be deemed to continue beyond the first 90 days of a leave of absence unless the recipient s reemployment rights are guaranteed by statute or contract. Total and permanent disability shall mean a mental or physical impairment of the participant that is expected to result in death or that has lasted or is expected to last for a continuous period of 12 months or more and that causes the participant to be unable, in the opinion of the Company and two independent physicians, to perform his or her duties for the Company and to be engaged in any substantial gainful activity. Total and permanent disability shall be deemed to have occurred on the first day after the Company and the two independent physicians have furnished their opinion of total disability to the Board or Committee.

(iv) In order to obtain certain tax benefits afforded to incentive stock options under Section 422 of the Code, the participant must hold the shares issued upon the exercise of an incentive stock option for two years after the date of grant of the incentive stock option and one year from the date of exercise. A participant may be subject to the alternative minimum tax at the time of exercise of an incentive stock option. The Board or Committee may require a participant to give the Company prompt notice of any disposition of shares acquired by the exercise of an incentive stock option prior to the expiration of such holding periods.

(c) The Board or Committee shall establish and set forth in each instrument that evidences an option the time at which or the installments in which the option shall vest and become exercisable, which provisions may be waived by the Board or Committee at any time. To the extent that the right to purchase shares has accrued thereunder, an option may be exercised from time to time by written notice to the Company, in accordance with procedures established by the Board or Committee, setting forth the number of shares with respect to which the option is being exercised and accompanied by payment in full as described in subsection (d) below. The Board or Committee may determine at any time that an option may not be exercised as to less than 100 shares at any one time (or the lesser number of remaining shares covered by the Option).

(d) The exercise price for shares purchased under an option shall be paid in full to the Company by delivery of cash equal to the product of the option exercise price and the number of shares purchased. Unless the Board or Committee in its sole discretion determines otherwise, in lieu of cash, a participant may deliver a properly

executed exercise notice, together with irrevocable instructions, to (i) a brokerage firm designated by the Company to deliver promptly to the Company the aggregate amount of sale proceeds to pay the option exercise price and any withholding tax obligations that may arise in connection with the exercise and (ii) the Company to deliver the certificates for such purchased shares directly to such brokerage firm, all in accordance with the

regulations of the Federal Reserve Board and all other Applicable Laws. In addition, the exercise price for shares purchased under an option may be paid, either singly or in combination with one or more of the alternative forms of payment authorized by this section, by such other consideration as the Board or Committee may permit.

(e) Options may be exercised during the individual s continued employment with, or in the case of a vendor, engagement by, the Company or service on the Board, as the case may be, and for a period of 90 days following termination of such employment, engagement or service on the Board (or such other period of time provided in a relevant employment or severance agreement between the optionee and the Company) and only within the original term of that option; provided, however, that if employment of the optionee by the Company or service on the Board, as the case may be, shall have terminated by reason of retirement at or after age 65 (Retirement) or total and permanent disability, then the option may be exercised for a period not in excess of one year following such termination of employment or service on the Board (or such other period of time provided in a relevant employment or severance agreement between the optionee and the Company), but in any event not after the expiration of the term of the option. If and to the extent the Committee may, in its discretion, determine the change in an option holder s status from an employee to a vendor, or the transfer of an individual from the employment or engagement or vice versa, the Company or its subsidiaries to the employment or engagement of any affiliate of the Company shall not be treated as a termination of employment or engagement by the Company. The status of another entity as an affiliate of the Company shall be determined by the Committee in its sole discretion.

(f) Options shall not be transferable, except with the prior express written consent of the Committee, and except that in the event of the death of an optionee (i) during employment, engagement or service on the Board, as the case may be, (ii) within a period not in excess of one year after termination of employment or service on the Board, as the case may be, by reason of Retirement or total and permanent disability or (iii) within 90 days after termination of employment, engagement or service on the Board, as the case may be, for any other reason, outstanding options may be exercised by the executor, administrator or personal representative at such deceased optionee during the remainder of the period during which the optionee could have exercised the option had he survived, but not less than 90 days after the death of such optionee.

IV. STOCK APPRECIATION RIGHTS

1. *Grants.* Rights entitling the grantee to receive cash or shares of Common Stock having a Fair Market Value equal to the appreciation in market value of a stated number of shares of Common Stock from the date of grant, or in the case of rights granted in tandem with or by reference to a stock option granted prior to the grant of such rights, from the date of grant of the related stock option to the date of exercise, may be granted to such eligible directors officers and other employees, and vendors as may be selected by the Committee and approved by the Board.

2. *Terms of Grant.* Such rights may be granted in tandem with or with reference to a related stock option, in which event the grantee may elect to exercise either the option or the right, but not both, as to the same shares of Common Stock subject to the option and the right, or the right may be granted independently of a related stock option. In either event, the right shall not be exercisable unless it shall have been outstanding for at least 6 months nor shall such right be exercisable more than ten years after the date of grant. Stock appreciation rights shall not be transferable, except that in the event of the death of a grantee such right shall be exercisable by the same persons and for the same period of time as the related option. Stock appreciation rights may be exercised during the individual s continued employment with the Company and for a period of 90 days following termination of employment or engagement (or such other period of time provided in a relevant employment or severance agreement between the optionee and the Company), as the case may be, and only within the original term of that grant; provided, however, that if employment of the grantee by the Company and its subsidiaries shall have terminated by reason of the grantee s death, Retirement or total and

permanent disability, or if the grantee dies after termination of employment on account of such retirement or disability, then such right shall be exercisable by the same persons and for the same period of time as the

related option. If and to the extent the Committee may, in its discretion, determine the change in an option holder s status from an employee to a vendor, or the transfer of an individual from the employment or engagement or vice versa, the Company or its subsidiaries to the employment or engagement of any affiliate of the Company shall not be treated as a termination of employment or engagement by the Company. The status of another entity as an affiliate of the Company shall be determined by the Committee.

3. *Payment on Exercise.* Upon exercise of a right, the grantee shall be paid the excess of the then fair market value of the number of shares to which the right relates over the fair market value of such number of shares at the date of grant of the right or of the related stock option, as the case may be. Such excess shall be paid in cash or in shares of Common Stock having a Fair Market Value equal to such excess or in such combination thereof as the Committee shall determine.

V. RESTRICTED STOCK AND RESTRICTED STOCK UNITS

1. *Grant of Restricted Stock or Restricted Stock Units.* Subject to the terms and provisions of the Plan, the Committee, at any time and from time to time, may grant restricted stock and/or restricted stock units to participants in such amounts as the Committee shall determine. Restricted stock units shall be similar to restricted stock except that no shares are actually awarded to the participant on the date of grant.

2. *Restricted Stock or Restricted Stock Unit Agreement.* Each restricted stock and/or restricted stock unit grant shall be evidenced by an Award Agreement that shall specify the period(s) of restriction, the number of restricted stock or the number of restricted stock units granted, and such other provisions as the Committee shall determine. Notwithstanding anything in this Article V to the contrary, delivery of Shares pursuant to an award of restricted stock units (or an award of restricted stock) shall be made no later than 2-1/2 months after the close of the Company s first taxable year in which such Shares are no longer subject to a risk of forfeiture (within the meaning of Section 409A of the Code).

3. *Transferability.* Except as provided in this Plan or an Award Agreement, the restricted stock and/or restricted stock units granted herein may not be sold, transferred, pledged, assigned, or otherwise alienated or hypothecated until the end of the applicable period of restriction established by the Committee and specified in the Award Agreement (and in the case of restricted stock units until the date of delivery or other payment), or upon earlier satisfaction of any other conditions, as specified by the Committee, in its sole discretion, and set forth in the Award Agreement or otherwise at any time by the Committee. All rights with respect to the restricted stock and/or restricted stock units granted to a participant under the Plan shall be available during his lifetime only to such participant, except as otherwise provided in an Award Agreement or at any time by the Committee.

4. *Other Restrictions.* The Committee shall impose such other conditions and/or restrictions on any restricted stock or restricted stock units granted pursuant to the Plan as it may deem advisable including, without limitation, a requirement that participants pay a stipulated purchase price for each restricted stock or each restricted stock unit, restrictions based upon the achievement of specific performance goals, time-based restrictions on vesting following the attainment of the performance goals, time-based restrictions, and/or restrictions under applicable laws or under the requirements of any stock exchange or market upon which such shares are listed or traded, or holding requirements or sale restrictions placed on the shares by the Company upon vesting of such restricted stock or restricted stock units.

To the extent deemed appropriate by the Committee, the Company may retain the certificates representing restricted stock in the Company s possession until such time as all conditions and/or restrictions applicable to such shares have been satisfied or lapse.

Except as otherwise provided in this Article V, restricted stock covered by each restricted stock award shall become freely transferable by the participant after all conditions and restrictions applicable to such Shares have been satisfied or lapse (including satisfaction of any applicable tax withholding obligations), and restricted stock units shall be paid in cash, Shares, or a combination of cash and Shares as the Committee, in its sole discretion shall determine.

5. *Certificate Legend.* Each certificate representing restricted stock granted pursuant to the Plan may bear a legend such as the following or as otherwise determined by the Committee in its sole discretion:

The sale or transfer of Shares of stock represented by this certificate, whether voluntary, involuntary, or by operation of law, is subject to certain restrictions on transfer as set forth in the Option Care, Inc. 2007 Incentive Plan, and in the associated Award Agreement. A copy of the Plan and such Award Agreement may be obtained from Option Care, Inc.

6. *Voting Rights.* Unless otherwise determined by the Committee and set forth in a participant s Award Agreement, to the extent permitted or required by law, as determined by the Committee, participants holding restricted stock granted hereunder may be granted the right to exercise full voting rights with respect to those shares during the period of restriction. A participant shall have no voting rights with respect to any restricted stock units granted hereunder.

7. *Dividend Rights.* Participants who hold restricted stock shall receive all dividends from the date of issuance, unless and until forfeited. If restricted stock units are credited to a recipient, amounts equal to dividends otherwise payable on a like number of shares of Common Stock after crediting of the units shall be credited to an account for the recipient and held until the award is forfeited or paid out. Interest shall be credited on the account annually at a rate equal to the return on five year U.S. treasury obligations.

8. *Termination of Employment.* Each Award Agreement shall set forth the extent to which the participant shall have the right to retain restricted stock and/or restricted stock units following termination of the participant s employment with or provision of services to the Company, its affiliates, and/or its subsidiaries, as the case may be. Such provisions shall be determined in the sole discretion of the Committee, shall be included in the Award Agreement entered into with each participant, need not be uniform among all restricted stock or restricted stock units issued pursuant to the Plan, and may reflect distinctions based on the reasons for termination.

9. *Section 83(b) Election.* The Committee may provide in an Award Agreement that the award of restricted stock is conditioned upon the participant making or refraining from making an election with respect to the award under Section 83(b) of the Code. If a participant makes an election pursuant to Section 83(b) of the Code concerning a restricted stock award, the participant shall be required to file promptly a copy of such election with the Company.

VI. PERFORMANCE MEASURES

1. *General.* (a) Certain awards granted under the Plan may be granted in a manner such that the awards qualify as performance-based compensation exempt from the deduction limitation imposed by Section 162(m) of the Code (Performance-Based Compensation). Awards shall only qualify as Performance-Based Compensation if, among other things, at the time of grant the Committee is comprised solely of two or more outside directors (as such term is used in Section 162(m) of the Code and the Treasury Regulations thereunder).

(b) Awards intended to qualify as Performance-Based Compensation may be granted to participants who are or may be covered employees, as defined in Code Section 162(m) and the Treasury Regulations promulgated thereunder (Covered Employees) at any time and from time to time, as shall be determined by the Committee. The Committee shall have complete discretion in determining the number, amount and timing of awards granted to each Covered Employee.

(c) The Committee shall set performance goals at its discretion which, depending on the extent to which they are met, will determine the number and/or value of awards intended to qualify as Performance-Based Compensation that will be paid out to the Covered Employees, and may attach to such Performance-Based Compensation one or more restrictions.

2. *Other awards.* Either the granting or vesting of awards intended to qualify as Performance-Based Compensation (other than options and stock appreciation rights) granted under the Plan shall be subject to the achievement of a performance target or targets, as determined by the Committee in its sole discretion, based

on one or more of the performance measures specified below. With respect to such Performance-Based Compensation:

(a) the Committee shall establish in writing (x) the objective performance-based goals applicable to a given period and (y) the individual Covered Employees or class of Covered Employees to which such performance-based goals apply no later than 90 days after the commencement of such period (but in no event after 25 percent of such period has elapsed);

(b) no Performance-Based Compensation shall be payable to or vest with respect to, as the case may be, any Covered Employee for a given period until the Committee certifies in writing that the objective performance goals (and any other material terms) applicable to such period have been satisfied; and

(c) after the establishment of a performance goal, the Committee shall not revise such performance goal or increase the amount of compensation payable thereunder (as determined in accordance with Section 162(m) of the Code) upon the attainment of such performance goal.

3. *Performance Measures.* Unless and until the Committee proposes for shareholder vote and the shareholders approve a change in the general Performance Measures set forth in this Article VI, the performance goals upon which the payment or vesting of an award to a Covered Employee that is intended to qualify as Performance-Based Compensation shall be limited to the following performance measures:

(a) Net earnings or net income (before or after taxes);

(b) Earnings per share;

(c) Net sales growth;

(d) Net operating profit;

(e) Return measures (including, but not limited to, return on assets, capital, invested capital, equity, or sales);

(f) Cash flow (including, but not limited to, operating cash flow, free cash flow, and cash flow return on capital);

(g) Earnings before or after taxes, interest, depreciation, and/or amortization;

(h) Gross or operating margins;

(i) Productivity ratios; and

(j) Share price (including, but not limited to, growth measures and total shareholder return).

Any Performance Measure(s) may be used to measure the performance of the Company, any subsidiary and/or any affiliate thereof as a whole or any business unit of the Company, such subsidiary and/or affiliate, or any combination thereof, as the Committee may deem appropriate, or any of the above performance measures as compared to the performance of a group of peer companies, or published or special index that the Committee, in its sole discretion, deems appropriate, or the Company may select performance measure (j) above as compared to various stock market indices.

4. *Evaluation of Performance.* The Committee may provide in any such award that any evaluation of performance may include or exclude any of the following events that occurs during a Performance Period: (a) asset write-downs, (b) litigation or claim judgments or settlements, (c) the effect of changes in tax laws, accounting principles, or other laws or provisions affecting reported results, (d) any reorganization and restructuring programs, (e) extraordinary nonrecurring items as described in Accounting Principles Board Opinion No. 30 and/or in management s discussion and analysis of financial condition and results of operations appearing in the Company s annual report to shareholders for the applicable year, (f) acquisitions or divestitures, and (g) foreign exchange gains and losses. To the extent such inclusions or exclusions affect awards to Covered Employees, they shall be prescribed in a form that meets the requirements of Code Section 162(m) for deductibility.

5. *Adjustment of Performance-Based Compensation.* Awards intended to qualify as Performance-Based Compensation may not be adjusted upward. The Committee shall retain the discretion to adjust such awards downward, either on a formula or discretionary basis or any combination, as the Committee determines.

6. *Committee Discretion.* In the event that applicable tax and/or securities laws change to permit Committee discretion to alter the governing Performance Measures without obtaining shareholder approval of such changes, the Committee shall have sole discretion to make such changes without obtaining shareholder approval. In addition, in the event that the Committee determines that it is advisable to grant awards that shall not qualify as Performance-Based Compensation, the Committee may make such grants without satisfying the requirements of Code Section 162(m) and base vesting on Performance Measures other than those set forth in this Article VI.

Table of Contents

OPTION CARE, INC.
PLEASE RETURN YOUR COMPLETED
PROXY CARD BY MAIL

Mark, sign and date your proxy card.

Detach your proxy card.

Return your proxy card in the postage paid envelope provided.

6 DETACH PROXY CARD HERE 6

The Board of Directors HAS PROPOSED AND recommends a vote for THE FOLLOWING:

1. ELECTION OF DIRECTOR

o **FOR** the nominee listed below o **WITHHOLD AUTHORITY** to vote for the nominee listed below

(INSTRUCTIONS: To withhold authority to vote for any individual nominee, strike a line through the nominee s name in the list below.)

FOR TERM EXPIRING IN 2010:

Nominee: 01 Jerome F. Sheldon

2. PROPOSAL TO RATIFY AND APPROVE THE OPTION CARE, INC. 2007 INCENTIVE PLAN.

o **FOR** o **AGAINST** o **ABSTAIN**

3. PROPOSAL TO RATIFY THE APPOINTMENT OF ERNST & YOUNG LLP TO ACT AS INDEPENDENT AUDITOR OF OPTION CARE FOR THE FISCAL YEAR 2007.

o **FOR** o **AGAINST** o **ABSTAIN**

This proxy, when properly executed, will be voted in the manner directed herein by the undersigned stockholder. If no direction is made, this proxy will be voted FOR THE NAMED NOMINEE FOR DIRECTOR and FOR all other proposals or otherwise in accordance with the recommendation of the Board of Directors.

The undersigned acknowledges receipt of the 2006 Annual Report of the Stockholders, the Notice of the 2007 Annual Meeting and the Proxy Statement.

Dated: , 2007

Signature [Please sign exactly as name appears hereon.]

Signature [Please sign exactly as name appears hereon.]

Joint owners should each sign personally. If stockholder is a corporation, please sign full corporate name by the President or other authorized officer and, if a partnership, please sign full partnership name by an authorized partner or other authorized person. Executors, trustees, officers, etc., should indicate their titles when signing.

YOUR VOTE IS IMPORTANT.
Please Detach Here
6 **You Must Detach This Portion of the Proxy Card** 6
Before Returning it in the Enclosed Envelope

Table of Contents

PROXY

OPTION CARE, INC.
This Proxy is Solicited on Behalf of the Board of Directors
For the Annual Meeting of Stockholders to be held May 4, 2007

The undersigned stockholder of Option Care, Inc. hereby appoints Rajat Rai and Joseph Bonaccorsi proxies, with full authority, which may be exercised by either one or both of them, with power of substitution to vote all shares of the common stock of Option Care which the undersigned is entitled to vote at the Annual Meeting of Stockholders of Option Care to be held at the **Company s Corporate Offices, 485 Half Day Road, Suite 300, Buffalo Grove, Illinois, 60089 at 10:00 a.m., local time, on Friday, May 4, 2007** (the Meeting), and at any adjournment or postponement thereof as follows:

A. as directed herein with respect to each of the proposals identified below; and

B. in their discretion with respect to any other business that may properly come before the Meeting.

By delivery of this proxy, the undersigned stockholder hereby revokes all proxies previously given by the undersigned with respect to the shares of common stock covered hereby.

A STOCKHOLDER WISHING TO VOTE IN ACCORDANCE WITH THE RECOMMENDATIONS OF THE BOARD OF DIRECTORS NEED ONLY SIGN AND DATE THIS PROXY ON THE REVERSE SIDE AND RETURN IT IN THE ENCLOSED ENVELOPE.

LAY: inline; FONT-FAMILY: times new roman; FONT-SIZE: 10pt">

Return on average assets	0.77%	1.19%	0.85%	0.94%	1.03%
Return on average equity	6.25%	9.69%	8.26%	9.54%	10.26%
Return on average tangible equity (non-GAAP) (2) (4)	7.54%	11.71%	10.61%	12.54%	13.78%
Net interest margin (5)	3.85%	3.78%	3.78%	3.75%	3.96%
Efficiency ratio (6)	67.86%	65.28%	65.69%	66.84%	64.94%
Balance sheet ratios: (7)					
Nonperforming assets as a percentage of period-end assets	1.18%	1.12%	1.12%	0.64%	0.51%
Nonperforming loans as a percentage of period-end loans	1.02%	0.83%	1.35%	0.81%	0.60%
Nonperforming assets as a percentage of period-end loans & OREO	2.44%	2.18%	1.83%	0.96%	0.75%
Allowance/to nonperforming loans	186.14%	190.17%	98.81%	165.12%	226.10%
Allowance for loan losses as a percentage of period-end loans	1.91%	1.57%	1.33%	1.34%	1.37%
Net (recoveries) charge-offs as a percentage of average loans	0.49%	0.71%	0.58%	0.43%	0.23%
Other data					
Number of financial centers					

	84	85	84	84	83
Number of full time equivalent employees	1,083	1,075	1,091	1,123	1,128

(1)Diluted core earnings (net income excluding nonrecurring items) is a non-GAAP measure. The following nonrecurring items were excluded in the calculation of diluted core earnings per share (non-GAAP). In 2011, the Company recorded a $0.04 increase in EPS from the sale of MasterCard stock. Also in 2011, the Company recorded a $0.01 decrease in EPS from the closing cost of a branch and a $0.01 EPS decrease from merger related costs from an FDIC-assisted acquisition. In 2010, the Company recorded a net $0.65 increase in EPS from FDIC-assisted acquisitions (bargain purchase gains, merger related costs, gains from disposition of investment securities and costs from disposition of FHLB borrowings). Also in 2010, the Company recorded a $0.01 decrease in EPS from costs to close nine branches. In 2008, the Company recorded a $0.13 increase in EPS from the cash proceeds on a mandatory Visa stock redemption and a $0.05 increase in EPS from the reversal of Visa, Inc.'s litigation expense recorded in 2007. In 2007, the Company recorded a $0.05 reduction in EPS from litigation expense associated with the recognition of certain contingent liabilities related to Visa, Inc.'s litigation.

(2)Because of our significant level of intangible assets, total goodwill and core deposit premiums, management believes a useful calculation for investors in their analysis of our Company is tangible book value per share (non-GAAP). This non-GAAP calculation eliminates the effect of goodwill and acquisition related intangible assets and is calculated by subtracting goodwill and intangible assets from total stockholders' equity, and dividing the resulting number by the common stock outstanding at period end. The following table reflects the reconciliation of this non-GAAP measure to the GAAP presentation of book value for the periods presented above:

	Years Ended December 31				
($ in thousands, except per share data)	2011	2010	2009	2008	2007
Stockholders' equity	$407,911	$397,371	$371,247	$288,792	$272,406
Less: Intangible assets					
Goodwill	60,605	60,605	60,605	60,605	60,605
Other intangibles	1,579	2,463	1,769	2,575	3,382
Tangible stockholders' equity (non-GAAP)	$345,727	$334,303	$308,873	$225,612	$208,419
Book value per share	$23.70	$23.01	$21.72	$20.69	$19.57
Tangible book value per share (non-GAAP)	$20.09	$19.36	$18.07	$16.16	$14.97
Shares outstanding	17,212,317	17,271,594	17,093,931	13,960,680	13,918,368

(3)Tangible common equity to tangible assets ratio is tangible stockholders' equity (non-GAAP) divided by total assets less goodwill and other intangible assets as and for the periods ended presented above.

(4)Return on average tangible equity is a non-GAAP measure that removes the effect of goodwill and intangible assets, as well as the amortization of intangibles, from the return on average equity. This non-GAAP measure is calculated as net income, adjusted for the tax-effected effect of intangibles, divided by average tangible equity.

(5)Fully taxable equivalent (assuming an income tax rate of 39.225%).

(6)The efficiency ratio is total non-interest expense less foreclosure expense and amortization of intangibles, divided by the sum of net interest income on a fully taxable equivalent basis plus total non-interest income less security gains, net of tax. For the year ended December 31, 2011, this calculation excludes the $1.1 million gain on sale of MasterCard stock. For the year ended December 31, 2010, this calculation excludes the gain on FDIC-assisted transactions of $21.3 million from total non-interest income. For the year ended December 31, 2009, this calculation excludes the FDIC special assessment of $1.4 million from total non-interest expense. For the year ended December 31, 2008, this calculation adds the VISA litigation expense reversal of $1.2 million to total non-interest expense and excludes gain on partial redemption of Visa shares of $3.0 million from total non-interest

income. For the year ended December 31, 2007, this calculation excludes VISA litigation expense of $1.2 million from total non-interest expense.

(7)Excludes assets covered by FDIC loss share agreements, except for their inclusion in total assets.

ITEM 7.MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIALCONDITION AND RESULTS OF OPERATIONS

Critical Accounting Policies

Overview

We follow accounting and reporting policies that conform, in all material respects, to generally accepted accounting principles and to general practices within the financial services industry. The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. While we base estimates on historical experience, current information and other factors deemed to be relevant, actual results could differ from those estimates.

We consider accounting estimates to be critical to reported financial results if (i) the accounting estimate requires management to make assumptions about matters that are highly uncertain and (ii) different estimates that management reasonably could have used for the accounting estimate in the current period, or changes in the accounting estimate that are reasonably likely to occur from period to period, could have a material impact on our financial statements.

The accounting policies that we view as critical to us are those relating to estimates and judgments regarding (a) the determination of the adequacy of the allowance for loan losses, (b) acquisition accounting, (c) the valuation of goodwill and the useful lives applied to intangible assets, (d) the valuation of employee benefit plans and (e) income taxes.

Allowance for Loan Losses on Loans Not Covered by Loss Share

The allowance for loan losses is established as losses are estimated to have occurred through a provision for loan losses charged to income. Loan losses are charged against the allowance when management believes the uncollectability of a loan balance is confirmed. Subsequent recoveries, if any, are credited to the allowance.

The allowance is maintained at a level considered appropriate to provide for potential loan losses related to specifically identified loans as well as probable credit losses inherent in the remainder of the loan portfolio as of period end and at a level considered appropriate in relation to the estimated risk inherent in the loan portfolio. This estimate is based on management's evaluation of the loan portfolio, as well as on prevailing and anticipated economic conditions and historical losses by loan category. General reserves have been established, based upon the aforementioned factors and allocated to the individual loan categories. Allowances are accrued on specific loans evaluated for impairment for which the basis of each loan, including accrued interest, exceeds the discounted amount of expected future collections of interest and principal or, alternatively, the fair value of loan collateral. The unallocated reserve generally serves to compensate for the uncertainty in estimating loan losses, including the possibility of changes in risk ratings and specific reserve allocations in the loan portfolio as a result of our ongoing risk management system.

A loan is considered impaired when it is probable that we will not receive all amounts due according to the contractual terms of the loan. This includes loans that are delinquent 90 days or more, nonaccrual loans and certain other loans identified by management. Certain other loans identified by management consist of performing loans with specific allocations of the allowance for loan losses. Specific allocations are applied when quantifiable factors are present requiring an allocation other than that we established based on our analysis of historical losses for each loan category. Accrual of interest is discontinued and interest accrued and unpaid is removed at the time such amounts are

delinquent 90 days unless management is aware of circumstances which warrant continuing the interest accrual. Interest is recognized for nonaccrual loans only upon receipt and only after all principal amounts are current according to the terms of the contract.

Acquisition Accounting, Covered Loans and Related Indemnification Asset

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

Because the FDIC will reimburse the Company for losses incurred on certain acquired loans, 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.

Goodwill and Intangible Assets

Goodwill represents the excess of the cost of an acquisition over the fair value of the net assets acquired. Other intangible assets represent purchased assets that also lack physical substance but can be separately distinguished from goodwill because of contractual or other legal rights or because the asset is capable of being sold or exchanged either on its own or in combination with a related contract, asset or liability. We perform an annual goodwill impairment test, and more frequently if circumstances warrant, in accordance with ASC Topic 350, Intangibles – Goodwill and Other. ASC Topic 350 requires that goodwill and intangible assets that have indefinite lives be reviewed for impairment annually, or more frequently if certain conditions occur. Impairment losses on recorded goodwill, if any, will be recorded as operating expenses.

Employee Benefit Plans

We have adopted various stock-based compensation plans. The plans provide for the grant of incentive stock options, nonqualified stock options, stock appreciation rights and bonus stock awards. Pursuant to the plans, shares are reserved for future issuance by the Company upon exercise of stock options or awarding of bonus shares granted to directors, officers and other key employees.

In accordance with ASC Topic 718, Compensation – Stock Compensation, the fair value of each option award is estimated on the date of grant using the Black-Scholes option-pricing model that uses various assumptions. This model requires the input of highly subjective assumptions, changes to which can materially affect the fair value estimate. For additional information, see Note 12, Employee Benefit Plans, in the accompanying Notes to Consolidated Financial Statements included elsewhere in this report.

Income Taxes

We are subject to the federal income tax laws of the United States and the tax laws of the states and other jurisdictions where we conduct business. Due to the complexity of these laws, taxpayers and the taxing authorities may subject these laws to different interpretations. Management must make conclusions and estimates about the application of these innately intricate laws, related regulations, and case law. When preparing the Company's income tax returns, management attempts to make reasonable interpretations of the tax laws. Taxing authorities have the ability to challenge management's analysis of the tax law or any reinterpretation management makes in its ongoing assessment of facts and the developing case law. Management assesses the reasonableness of its effective tax rate quarterly based on its current estimate of net income and the applicable taxes expected for the full year. On a quarterly basis, management also reviews circumstances and developments in tax law affecting the reasonableness of deferred tax assets and liabilities and reserves for contingent tax liabilities.

2011 Overview

Our net income for the year ended December 31, 2011, was $25.4 million, or $1.47 diluted earnings per share, compared to $37.1 million, or $2.15 diluted earnings per share in 2010. Net income in 2009 was $25.2 million, or $1.74 diluted earnings per share.

Net income for both 2011 and 2010 included several significant nonrecurring items that impacted net income, mostly related to our FDIC-assisted acquisitions. Excluding all nonrecurring items, core earnings for the year ended December 31, 2011, were $25.0 million, or $1.45 diluted core earnings per share, compared to $26.0 million, or $1.51 diluted core earnings per share in 2010. See Reconciliation of Non-GAAP Measures and Table 21 – Reconciliation of Core Earnings (non-GAAP) for additional discussion of non-GAAP measures.

During the first half of 2011, we recorded a pre-tax gain of $1.1 million on the sale of MasterCard stock. We also recorded pre-tax merger related costs of $0.4 million and branch right sizing expenses of $0.1 million. After-taxes, the combined 2011 nonrecurring items contributed $0.4 million to net income, or $0.02 to diluted earnings per share.

On October 15, 2010, we announced that our wholly-owned bank subsidiary, Simmons First National Bank ("SFNB" or the "lead bank"), entered into a purchase and assumption agreement with loss share arrangements with the FDIC to purchase substantially all of the assets and to assume substantially all of the deposits and certain other liabilities of Security Savings Bank, FSB ("SSB") in Olathe, Kansas. The Company recognized a pre-tax bargain purchase gain of $18.3 million on this transaction and incurred pre-tax merger related costs of $2.0 million. As part of our acquisition strategy, the investment portfolio was liquidated resulting in a pre-tax gain of $317,000. Additionally, in order to utilize some of the Company's excess liquidity, $58.4 million in FHLB advances were paid off, which resulted in a one-time pre-payment expense of $594,000. After taxes, the combined fourth quarter 2010 nonrecurring items

contributed $9.7 million to net income, or $0.56 to diluted earnings per share, for the year ended December 31, 2010.

On May 14, 2010, we announced that our wholly-owned bank subsidiary, SFNB, entered into a purchase and assumption agreement with loss share arrangements with the FDIC to purchase substantially all of the assets and to assume substantially all of the deposits and certain other liabilities of Southwest Community Bank ("SWCB") in Springfield, Missouri. The Company recognized a pre-tax bargain purchase gain of $3.0 million on this transaction and incurred pre-tax merger related costs of $0.4 million. After taxes, these nonrecurring items contributed $1.6 million to net income, or $0.09 to diluted earnings per share, for the year ended December 31, 2010. Also, during the second quarter of 2010, as a result of our branch right sizing initiative, we recorded a one-time, nonrecurring charge of $0.01 to diluted earnings per share. See Efficiency Initiatives below for more information on branch right sizing.

Stockholders' equity as of December 31, 2011, was $407.9 million, an increase of $10.5 million, or approximately 2.65%, from December 31, 2010. Book value per share was $23.70 and tangible book value per share was $20.09. Our ratio of stockholders' equity to total assets was 12.3% and the ratio of tangible stockholders' equity to tangible assets was 10.6% at December 30, 2011. The Company's Tier I leverage ratio of 11.86%, as well as our other regulatory capital ratios, remain significantly above the "well capitalized" levels. See Table 18 – Risk-Based Capital for regulatory capital ratios. Our excess capital positions us to continue to take advantage of unprecedented acquisition opportunities through FDIC-assisted transactions of failed banks. We continue to actively pursue the right opportunities that meet our strategic plan regarding mergers and acquisitions. As with our history, we will continue to be very deliberate and disciplined in these acquisition opportunities.

Total loans, including loans covered by FDIC loss share agreements, were $1.7 billion at December 31, 2011, a decrease of $177 million, or 9.3%, from the same period in 2010. In our legacy portfolio, we experienced a decrease of $104 million, or 6.2%, compared to December 31, 2010. Additionally, like the rest of the industry, we continue to experience weak loan demand as a result of the overall general economic environment. We believe loan demand is likely to remain soft through the first quarter of 2012, but we are becoming more optimistic relative to improved loan demand in the last half of 2012. Loans covered by FDIC loss share agreements, which provide 80% Government guaranteed protection against credit risk on those covered assets, were $158 million at December 31, 2011, compared to $232 million at December 31, 2010.

Although the general state of the national economy has shown signs of improvement, it remains somewhat unsettled. Also, despite continued challenges in the Northwest Arkansas region, overall, we continue to have good asset quality, compared to the rest of the industry. The allowance for loan losses as a percent of total loans was 1.91% at December 31, 2011. Non-performing loans equaled 1.02% of total loans. Non-performing assets were 1.18% of total assets. The allowance for loan losses was 186.14% of non-performing loans. The Company's net charge-offs for 2011 were 0.49% of total loans. Excluding credit cards, net charge-offs for 2011 were 0.30% of total loans.

Total assets at December 31, 2011, were $3.3 billion, an increase of $3.7 million, or 0.11%, over the period ended December 31, 2010.

Simmons First National Corporation is an Arkansas based financial holding company with $3.3 billion in assets and eight community banks in Pine Bluff, Lake Village, Jonesboro, Rogers, Searcy, Russellville, El Dorado and Hot Springs, Arkansas. Including one office in Missouri and nine offices in Kansas acquired in 2010 through FDIC-assisted transactions, our eight subsidiary banks conduct financial operations from 88 offices, of which 84 are financial centers, in 47 communities in Arkansas, Missouri and Kansas.

Efficiency Initiatives

We previously reported that we hired a consultant to help us identify and implement revenue enhancements, process improvements and branch staff level adjustments. We are in the final stages of implementation and expect to be fully complete in 2012. We estimate a total annual benefit from the efficiency initiative of approximately $5 million before tax, with a phase-in period from 2010 through 2012. A portion of the benefit is projected from revenue enhancements, with the remainder from non-interest expense savings. We assured our associates that no one would lose their job as a result of this initiative, as all positions impacted are being eliminated through attrition.

During June 2010, as scheduled as part of our branch right sizing initiative, and after much deliberation and analysis, we closed or consolidated nine financial centers, primarily smaller branches in rural areas. During June 2011, we closed another small branch. We believe most of the customers have been absorbed into other Simmons locations in close proximity to the closed branches. After the closings, we now have 74 financial centers in Arkansas, still one of the best footprints in the state. As a result of these closings, we recorded a one-time, nonrecurring pre-tax charge of

$372,000, or $0.01 to diluted earnings per share in 2010, and $141,000 in 2011. Again, staff reductions are being realized through attrition and associates at the affected branches have been reassigned to other locations. Our branch right sizing initiative has been under way for some time. Over the last several years we have added numerous new financial centers, closed several and relocated others. We will continue our efforts to manage our product delivery system in the most efficient manner possible.

Both our efficiency and branch right sizing initiatives resulted in significant cost savings and staff reductions. Since the beginning of both projects in early 2009, our staffing levels are down 144 headcount. As mentioned earlier, all of the staffing reduction is being realized through attrition, and no associate has lost their job.

Net Interest Income

Net interest income, our principal source of earnings, is the difference between the interest income generated by earning assets and the total interest cost of the deposits and borrowings obtained to fund those assets. Factors that determine the level of net interest income include the volume of earning assets and interest bearing liabilities, yields earned and rates paid, the level of non-performing loans and the amount of non-interest bearing liabilities supporting earning assets. Net interest income is analyzed in the discussion and tables below on a fully taxable equivalent basis. The adjustment to convert certain income to a fully taxable equivalent basis consists of dividing tax-exempt income by one minus the combined federal and state income tax rate of 39.225%.

The Federal Reserve Board sets various benchmark rates, including the Federal Funds rate, and thereby influences the general market rates of interest, including the deposit and loan rates offered by financial institutions. Our loan portfolio is significantly affected by changes in the prime interest rate. The prime interest rate, which is the rate offered on loans to borrowers with strong credit, began 2008 at 7.25% and decreased 200 basis points in the first quarter, 25 basis points in the second quarter and another 175 basis points in the fourth quarter to end the year at 3.25%. The prime interest rate has remained unchanged at 3.25% since December 16, 2008.

The Federal Funds rate, which is the cost to banks of immediately available overnight funds, began 2008 at 4.25%. During 2008, the Federal Funds rate decreased 200 basis points in the first quarter, 25 basis points in the second quarter and another 175-200 basis points in the fourth quarter to end the year at 0.00% - 0.25%. The Federal Funds rate has remained unchanged since December 16, 2008.

Our practice is to limit exposure to interest rate movements by maintaining a significant portion of earning assets and interest bearing liabilities in short-term repricing. Historically, approximately 70% of our loan portfolio and approximately 80% of our time deposits have repriced in one year or less. These historical percentages are consistent with our current interest rate sensitivity.

For the year ended December 31, 2011, net interest income on a fully taxable equivalent basis was $113.6 million, an increase of $6.7 million, or 6.2%, from the same period in 2010. The increase in net interest income was the result of a $6.6 million decrease in interest expense and a $0.1 million increase in interest income.

The $6.6 million decrease in interest expense for 2011 was primarily the result of a 29 basis point decrease in cost of funds due to competitive repricing during a low interest rate environment, coupled with a shift in our mix of interest bearing deposits. The lower interest rates accounted for an $5.9 million decrease in interest expense. The most significant component of this decrease was the $3.1 million decrease associated with the repricing of our time deposits that resulted from time deposits that matured during the period or were tied to a rate that fluctuated with changes in market rates. Historically, approximately 80% of our time deposits reprice in one year or less. As a result, the average rate paid on time deposits decreased 34 basis points from 1.58% to 1.24%. Lower rates on interest bearing transaction and savings accounts resulted in an additional $1.8 million decrease in interest expense, with the average rate decreasing by 14 basis points from 0.44% to 0.30%. Another $1.5 million decrease in interest expense resulted from the 2011 conversion of $10.3 million in trust preferred securities from a fixed rate of 6.97% to a floating rate of 2.80% above the three month LIBOR rate. Another decrease for 2011 resulted from a $0.6 million one-time pre-payment expense recorded in 2010 from the pay-off of $58.4 million in FHLB advances related to the SSB FDIC-assisted transaction. As part of our acquisition strategy, we decided to pay-off these advances in order to utilize some of the Company’s excess liquidity. Additional scheduled payoffs of FHLB borrowings caused a $0.8 million decrease in interest expense, with a $0.2 million increase due to deposit growth.

The $0.1 million increase in interest income for 2011 can be attributed to our FDIC-assisted acquisitions in 2010, as the acquired covered loans generated an additional $12.9 million of interest income in 2011 over 2010. The declining balance of the legacy loan portfolio, which excludes loans covered by FDIC loss share agreements, caused a $10.6 million decrease in interest income. Another $2.4 million decrease in interest income resulted from a 35 basis point decline in the yield on investment securities.

Of the $12.9 million increase in interest income from covered loans, $8.6 million was due to higher average balances in 2011 over 2010, as the majority of the covered loans were acquired during the fourth quarter of 2010. The remaining $4.3 million increase in interest income was the result of higher average yields on the covered loans in 2011. The average yield on covered loans increased from 5.26% in 2010 to 8.90% in 2011. A portion of the yield increase was due to additional yield accretion recognized in conjunction with the fair value of the loan pools acquired in the 2010 FDIC-assisted transactions as discussed in Note 2 and Note 5 of the Notes to Consolidated Financial Statements. Each quarter, we estimate the cash flows expected to be collected from the acquired loan pools. During the fourth quarter of 2011, this cash flows estimate increased based on the payment histories and reduced loss expectations of the loan pools, resulting in a total of $23.7 million of adjustments to be spread on a level-yield basis over the remaining expected lives of the loan pools. The increases in expected cash flows also reduced the amount of expected reimbursements under the loss sharing agreements with the FDIC, which are recorded as indemnification assets. The expected indemnification assets have also been reduced during the fourth quarter of 2011, resulting in a total of $20.9 million of adjustments to be amortized on a level-yield basis over the remainder of the loss sharing agreements or the remaining expected life of the loan pools, whichever is shorter.

For the year ended December 31, 2011, the adjustments increased interest income by $1.1 million and decreased non-interest income by $1.0 million. The net impact to pre-tax income was $146,000 for 2011. Because these adjustments will be recognized over the estimated remaining lives of the loan pools and the remainder of the loss sharing agreements, respectively, they will impact future periods as well. The current estimate of the remaining accretable yield adjustment that will positively impact interest income is $22.6 million and the remaining adjustment to the indemnification assets that will reduce non-interest income is $19.9 million. Of the remaining adjustments, we expect to recognize $11.0 million of interest income and a $9.7 million reduction of non-interest income during 2012. The accretable yield adjustments recorded in future periods will change as we continue to evaluate expected cash flows from the acquired loan pools.

Our net interest margin was 3.85% for the year ended December 31, 2011, up 7 basis points from 2010. Although we have seen an increase in margin from 2010, our margin remains compacted primarily due to two factors. First, while keeping us prepared to benefit from rising interest rates, our high levels of liquidity are holding the margin down. Also, margin is impacted by our drop in legacy loan balances. The increase in margin in 2011 was primarily due to covered loans acquired through acquisitions. The accretable yield adjustment discussed above accounted for 4 basis points of the increase, while the remainder of the increase was due to a higher yield on acquired covered loans compared to the yield on loans in our legacy portfolio. Based on our current interest rate risk pricing model, we anticipate a slight margin expansion in 2012 due to the impact of our FDIC-assisted acquisitions.

Our net interest margin was 3.78% for the year ended December 31, 2010, unchanged from same period in 2009.

Tables 1 and 2 reflect an analysis of net interest income on a fully taxable equivalent basis for the years ended December 31, 2011, 2010 and 2009, respectively, as well as changes in fully taxable equivalent net interest margin for the years 2011 versus 2010 and 2010 versus 2009.

Table 1:Analysis of Net Interest Income
(FTE =Fully Taxable Equivalent)

(In thousands)	Years Ended December 31 2011	2010	2009
Interest income	$129,056	$128,955	$136,533
FTE adjustment	4,970	5,012	4,935
Interest income - FTE	134,026	133,967	141,468
Interest expense	20,396	27,006	38,806
Net interest income - FTE	$113,630	$106,961	$102,662
Yield on earning assets - FTE	4.54 %	4.74 %	5.21 %
Cost of interest bearing liabilities	0.86 %	1.15 %	1.69 %
Net interest spread - FTE	3.68 %	3.59 %	3.52 %
Net interest margin - FTE	3.85 %	3.78 %	3.78 %

Table 2: Changes in Fully Taxable Equivalent Net Interest Margin

(In thousands)	2011 vs. 2010	2010 vs. 2009
Decrease due to change in earning assets	$ (1,877)	$ (2,062)
Increase (decrease) due to change in earning asset yields	1,936	(5,439)
Increase due to change in interest rates paid on interest bearing liabilities	5,946	11,013
Increase due to change in interest bearing liabilities	664	787
Increase in net interest income	$ 6,669	$ 4,299

Table 3 shows, for each major category of earning assets and interest bearing liabilities, the average (computed on a daily basis) amount outstanding, the interest earned or expensed on such amount and the average rate earned or expensed for each of the years in the three-year period ended December 31, 2011. The table also shows the average rate earned on all earning assets, the average rate expensed on all interest bearing liabilities, the net interest spread and the net interest margin for the same periods. The analysis is presented on a fully taxable equivalent basis. Nonaccrual loans were included in average loans for the purpose of calculating the rate earned on total loans.

Table 3: Average Balance Sheets and Net Interest Income Analysis

	Years Ended December 31								
	2011			2010			2009		
(In thousands)	Average Balance	Income/ Expense	Yield/ Rate(%)	Average Balance	Income/ Expense	Yield/ Rate(%)	Average Balance	Income/ Expense	Yield/ Rate(%)
ASSETS									
Earning Assets									
Interest bearing balances due from banks	$486,274	$1,100	0.23	$273,001	$721	0.26	$120,763	$439	0.36
Federal funds sold	886	6	0.68	1,686	15	0.89	4,271	27	0.63
Investment securities - taxable	426,226	6,719	1.58	440,379	8,951	2.03	448,918	13,896	3.10
Investment securities - non-taxable	207,929	12,784	6.15	206,832	13,211	6.39	196,446	12,632	6.43
Mortgage loans held for sale	11,953	503	4.21	16,762	715	4.27	12,428	608	4.89
Assets held in trading accounts	7,466	33	0.44	7,278	30	0.41	6,187	20	0.32
Loans not covered by loss share agreements	1,621,251	95,763	5.91	1,800,868	106,120	5.89	1,924,317	113,846	5.92
Loans covered by FDIC loss share agreements	192,300	17,118	8.90	79,912	4,204	5.26	--	--	--
Total interest earning assets	2,954,285	134,026	4.54	2,826,718	133,967	4.74	2,713,330	141,468	5.21
Non-earning assets	330,342			307,143			251,282		
Total assets	$3,284,627			$3,133,861			$2,964,612		
LIABILITIES AND									

STOCKHOLDERS’ EQUITY

Liabilities									
Interest bearing liabilities									
Interest bearing transaction and savings deposits	$1,217,218	$3,611	0.30	$1,181,597	$5,227	0.44	$ 1,091,960	$ 8,252	0.76
Time deposits	913,009	11,314	1.24	907,146	14,310	1.58	939,358	22,794	2.43
Total interest bearing deposits	2,130,227	14,925	0.70	2,088,743	19,537	0.94	2,031,318	31,046	1.53
Federal funds purchased and securities sold under agreements to repurchase	103,557	450	0.43	101,918	532	0.52	107,975	769	0.71
Other borrowed funds									
Short-term debt (1)	667	51	7.65	3,135	58	1.85	2,583	33	1.28
Long-term debt	127,577	4,970	3.90	147,042	6,879	4.68	160,963	6,958	4.32
Total interest bearing liabilities	2,362,028	20,396	0.86	2,340,838	27,006	1.15	2,302,839	38,806	1.69
Non-interest bearing liabilities									
Non-interest bearing deposits	482,651			375,941			332,998		
Other liabilities	33,855			33,941			23,565		
Total liabilities	2,878,534			2,750,720			2,659,402		
Stockholders’ equity	406,093			383,141			305,210		
Total liabilities and stockholders’ equity	$3,284,627			$3,133,861			$ 2,964,612		
Net interest spread			3.68			3.59			3.52
Net interest margin		$113,630	3.85		$106,961	3.78		$ 102,662	3.78

(1) Interest expense on short-term debt includes fees related to an open line of credit from the FHLB. Because the average balance of short-term debt was so low in 2011, the fees caused a significant increase to the 2011 rate.

29

Table 4: Volume/Rate Analysis

(In thousands, on a fully taxable equivalent basis)	Years Ended December 31 2011 over 2010 Volume	Yield/ Rate	Total	2010 over 2009 Volume	Yield/ Rate	Total
Increase (decrease) in						
Interest income						
Interest bearing balances due from banks	$ 495	$ (116)	$ 379	$ 429	$ (147)	$ 282
Federal funds sold	(6)	(3)	(9)	(20)	8	(12)
Investment securities - taxable	(280)	(1,952)	(2,232)	(259)	(4,686)	(4,945)
Investment securities - non-taxable	70	(497)	(427)	664	(85)	579
Mortgage loans held for sale	(202)	(10)	(212)	192	(85)	107
Assets held in trading accounts	1	2	3	4	6	10
Loans not covered by loss share	(10,609)	252	(10,357)	(7,276)	(450)	(7,726)
Loans covered by FDIC loss share agreements	8,654	4,260	12,914	4,204	--	4,204
Total	(1,877)	1,936	59	(2,062)	(5,439)	(7,501)
Interest expense						
Interest bearing transaction and savings accounts	154	(1,770)	(1,616)	631	(3,656)	(3,025)
Time deposits	91	(3,087)	(2,996)	(758)	(7,726)	(8,484)
Federal funds purchased and securities sold under agreements to repurchase	9	(91)	(82)	(41)	(196)	(237)
Other borrowed funds						
Short-term debt	(75)	68	(7)	8	17	25
Long-term debt	(843)	(1,066)	(1,909)	(627)	548	(79)
Total	(664)	(5,946)	(6,610)	(787)	(11,013)	(11,800)
Increase (decrease) in net interest income	$ (1,213)	$ 7,882	$ 6,669	$ (1,275)	$ 5,574	$ 4,299

Provision for Loan Losses

The provision for loan losses represents management's determination of the amount necessary to be charged against the current period's earnings in order to maintain the allowance for loan losses at a level considered appropriate in relation to the estimated risk inherent in the loan portfolio. The level of provision to the allowance is based on management's judgment, with consideration given to the composition, maturity and other qualitative characteristics of the portfolio, historical loan loss experience, assessment of current economic conditions, past due and non-performing loans and net loan loss experience. It is management's practice to review the allowance on at least a quarterly basis, but generally on a monthly basis, and, after considering the factors previously noted, to determine the level of provision made to the allowance.

The provision for loan losses for 2011, 2010 and 2009, was $11.7 million, $14.1 million and $10.3 million, respectively. During 2011, we decreased our provision by approximately $2.5 million, primarily due to a decrease from 2010 in net loan charge-offs. However, we did add a special $500,000 provision during the second quarter of 2011, as we believe there remain many economic and financial factors, including the many uncertainties related to our

national debt, spending and taxes that have recently consumed the news, that necessitate the need for a higher level of unallocated reserve, resulting in a higher level of provision. See Allowance for Loan Losses section for additional information.

During 2010, we increased our provision by approximately $3.8 million, primarily due to an increase in net loan charge-offs. Management also determined that there were several economic and environmental factors that necessitated the need for a higher level of unallocated reserve, resulting in a higher level of provision.

30

Non-Interest Income

Total non-interest income was $53.5 million in 2011, compared to $77.9 million in 2010 and $52.7 million in 2009. Non-interest income for 2011 decreased $24.4 million, or 31.3%, from 2010. The most significant factor for the decrease was the nonrecurring $21.3 million gain on the FDIC-assisted transactions in 2010. Another nonrecurring item was the $317,000 gain on sale of securities related from the liquidation of the SSB investment portfolio. See 2011 Overview section for more discussion of the FDIC-assisted transactions. The decrease in non-interest income was partially offset by a nonrecurring $1.1 million gain from the sale of MasterCard stock in the second quarter of 2011 (see further discussion below). Normalizing for these nonrecurring items, core non-interest income for 2011 was down 6.9% from 2010.

Non-interest income is principally derived from recurring fee income, which includes service charges, trust fees and credit card fees. Non-interest income also includes income on the sale of mortgage loans, investment banking income, premiums on sale of student loans, income from the increase in cash surrender values of bank owned life insurance, gains (losses) from sales of securities and gains (losses) related to FDIC-assisted transactions and covered assets.

Table 5 shows non-interest income for the years ended December 31, 2011, 2010 and 2009, respectively, as well as changes in 2011 from 2010 and in 2010 from 2009.

Table 5: Non-Interest Income

(In thousands)	Years Ended December 31 2011	2010	2009	2011 Change from 2010		2010 Change from 2009	
Trust income	$ 5,375	$ 5,179	$ 5,227	$ 196	3.78 %	$ (48)	-0.92 %
Service charges on deposit accounts	16,808	17,700	17,944	(892)	-5.04	(244)	-1.36
Other service charges and fees	2,980	2,812	2,668	168	5.97	144	5.40
Income on sale of mortgage loans, net of commissions	4,188	4,810	4,032	(622)	-12.93	778	19.30
Income on investment banking, net of commissions	1,478	2,236	2,153	(758)	-33.90	83	3.86
Credit card fees	16,828	16,140	14,392	688	4.26	1,748	12.15
Premiums on sale of student loans	--	2,524	2,333	(2,524)	-100.00	191	8.19
Bank owned life insurance income	1,481	1,670	1,270	(189)	-11.32	400	31.50
Gain on FDIC-assisted transactions	--	21,314	--	(21,314)	-100.00	21,314	--
Net gain (loss) on assets covered by FDIC loss share agreements	154	318	--	(164)	-51.57	318	100.00
Other income	4,173	2,854	2,548	1,319	46.22	306	12.01
Gain on sale of securities, net	--	317	144	(317)	-100.00	173	120.14

Total non-interest income	$ 53,465	$ 77,874	$ 52,711	$ (24,409)	-31.34 %	$ 25,163	47.74 %

Recurring fee income for 2011 was $42.0 million, an increase of $160,000, or 0.4%, when compared with the 2010 amounts. Service charges on deposits accounts decreased by $892,000 primarily due to a significant decline in fee income as a result of recent regulatory changes related to overdrafts on point-of-sale transactions. Credit card fees increased $688,000 due primarily to a higher volume of credit and debit card transactions. In July, the Federal Reserve released final rules regarding debit card fee income under the Durbin amendment. While the Durbin amendment only applies to banks of $10 billion or more in size, we have consistently indicated that we believe all banks will ultimately be negatively impacted. In fact, we continue to estimate the potential negative impact to our institution, going forward, to be approximately $600,000 annually.

Recurring fee income for 2010 was $41.8 million, an increase of $1.6 million, or 4.0%, when compared with the 2009 amounts. Credit card fees increased $1.7 million, primarily due to a higher volume of credit and debit card transactions, with the credit card volume increase a direct result of the addition of new credit card accounts in 2007 through 2009.

Income on sale of mortgage loans decreased by $622,000, or 12.9%, in 2011 compared to 2010 , due to the significant industry-wide slowdown of financing and refinancing. Income on sale of mortgage loans increased by $778,000, or 19.3%, in 2010 compared to 2009. The majority of the increase resulted from the sale of mortgage loans in Kansas from our SSB transaction, with the remainder primarily due to lower mortgage rates producing an increase in residential refinancing volume.

Income on investment banking decreased by $758,000, or 33.9%, in 2011 compared to 2010, due in part to an industry-wide decline in dealer-bank activities. Another factor in the decrease was a favorable mark-to-market adjustment on trading investment during 2010, with unfavorable adjustments in 2011.

As expected, premiums on sale of student loans decreased by $2.5 million, or 100.0%, for the year ended December 31, 2011, compared to 2010. U.S. government legislation has eliminated the private sector from providing student loans after the 2009-2010 school year. Therefore, we had no student loan sales during 2011. Premiums on sale of student loans increased by $191,000, or 8.2%, for the year ended December 31, 2010, compared to 2009. The increase was due to a higher volume of loan sales in 2010. During the second and third quarters of 2010, we sold the balance of our loans that were originated for the 2009-2010 school year, approximately $65 million of student loans, to the government, resulting in premiums of approximately $2.5 million.

We currently plan to continue servicing the remaining student loans internally until the loans pay off, we find a suitable buyer or the students consolidate their loans. Unless we do find a suitable buyer, we do not expect to receive income from premiums on sale of student loans during 2012 or thereafter. See Loan Portfolio section for additional information on student loans.

Net gain (loss) on assets covered by FDIC loss share agreements decreased by $164,000 in 2011 compared to 2010. Although the amount of the net change is not significant, there are considerable changes from 2010 to 2011 in the components. First, we recognized $1.2 million of income from the accretion of the FDIC indemnification assets, net of amortization of the FDIC true-up liability, during 2011, compared to $0.3 million during 2010. Because the SSB acquisition came in October 2010, only a small amount of income was recorded in 2010, with a full year of accretion in 2011. Also, 2011 included $40,000 of gains from the sale of covered foreclosed assets, with no gains in 2010.

Finally, as described in Note 5 of the Notes to Consolidated Financial Statements, due to the increase in cash flows expected to be collected from the FDIC-covered loan portfolios, $978,000 of amortization, a reduction of non-interest income, was recorded in 2011 relating to reductions of expected reimbursements under the loss sharing agreements with the FDIC, which are recorded as indemnification assets. There was no amortization adjustment recorded in 2010 relating to reductions of expected reimbursements under the loss sharing agreements with the FDIC.

Other non-interest income for 2011 increased by $1.3 million over 2010, primarily due to a $1.1 million gain from the sale of MasterCard stock in the second quarter of 2011. On May 31, 2006, MasterCard Incorporated completed its Initial Public Offering (“IPO”). As a part of the IPO, approximately 41% of the equity was issued to member-banks as Class B common stock. Conversion of Class B shares to Class A shares was restricted as to the timing and number of shares eligible until the fourth anniversary of the IPO. As a member-bank the Company received 4,077 shares of MasterCard Class B stock. As there was no market or readily ascertainable fair market value for the class B shares, they were recorded with no basis value. On May 31, 2010, restrictions on the conversion of the Class B shares to Class A shares expired, permitting Class B stockholders to convert Class B shares into an equal number of Class A shares for prompt disposition to the public. On May 13, 2011, the Company applied for conversion of its Class B shares to Class A common stock and recorded a $1.1 million pre-tax gain upon conversion approval by MasterCard Incorporated and immediately sold the Class A shares.

We recorded no gains or losses on sale of securities during 2011. As part of our acquisition strategy related to SSB, we liquidated the acquired investment portfolio, resulting in net realized gain of $317,000 in 2010. We recorded $144,000 of securities gains in 2009.

Non-Interest Expense

Non-interest expense consists of salaries and employee benefits, occupancy, equipment, foreclosure losses and other expenses necessary for the operation of the Company. Management remains committed to controlling the level of non-interest expense through the continued use of expense control measures that have been installed. We utilize an extensive profit planning and reporting system involving all subsidiaries. Based on a needs assessment of the business plan for the upcoming year, monthly and annual profit plans are developed, including manpower and capital expenditure budgets. These profit plans are subject to extensive initial reviews and monitored by management on a monthly basis. Variances from the plan are reviewed monthly and, when required, management takes corrective action intended to ensure financial goals are met. We also regularly monitor staffing levels at each affiliate to ensure productivity and overhead are in line with existing workload requirements.

Non-interest expense for 2011 was $114.7 million, an increase of $3.4 million or 3.0%, from 2010. This increase includes approximately $5.7 million of incremental normal operating expenses in 2011 for our FDIC-assisted acquisitions of 2010. Also included in non-interest expense are merger related costs of $0.4 million and $2.6 million in 2011 and 2010, respectively. Normalizing for these incremental operating expenses, merger related costs and other nonrecurring items, non-interest expense decreased by 0.2% in 2011 from 2010. This decrease is the result of the implementation of our efficiency initiatives. See the Reconciliation of Non-GAAP Measures section for details of the nonrecurring items. Also see the section titled Efficiency Initiatives in the 2011 Overview for additional information.

Non-interest expense for 2010 was $111.3 million, an increase of $6.6 million or 6.3%, from 2009. This increase includes $2.6 million of merger related costs and approximately $3.0 million of normal operating expense at our two new FDIC-assisted acquisitions. Normalizing for these expenses, as well as for $372,000 of one-time nonrecurring costs associated with our branch closings in 2010, non-interest expense increased by 0.6% in 2010 over 2009. This modest increase was the result of the implementation of our efficiency initiatives. See the section titled Efficiency Initiatives in the 2010 Overview for additional information.

Deposit insurance expense during 2011 decreased to $2.4 million from $3.8 million in 2010, a decrease of $1.4 million, or 37.4%. The decrease was primarily due to a decrease in deposit insurance premiums resulting from changes in the FDIC’s assessment base and rates.

Deposit insurance expense during 2010 decreased to $3.8 million from $4.6 million in 2009, a decrease of $829,000, or 17.9%. The decrease in deposit insurance expense was due to the June 30, 2009, FDIC special assessment, partially offset by increases in the fee assessment rates during 2010.

In May 2009, the FDIC issued a final rule which levied a special assessment applicable to all insured depository institutions totaling 5 basis points of each institution’s total assets less Tier 1 capital as of June 30, 2009. The special assessment, collected by the FDIC on September 30, 2009, is part of the FDIC’s efforts to rebuild the Deposit Insurance Fund (“DIF”). Deposit insurance expense during 2009 included $1.5 million related to the special assessment.

Fees paid for professional services increased by $98,000, or 2.2%, in 2011 over 2010, as we were in the second of three years of increased professional fees related to our ongoing efficiency initiatives. Fees paid for professional services increased by $833,000, or 22.9%, in 2010 over 2009. The increase in professional services, which consist of audit, accounting, legal and consulting fees, was primarily due to costs associated with our ongoing efficiency initiatives, which began to positively impact earnings in 2010 and 2011, and we expect to produce significant savings and revenue enhancements in 2012 and beyond. See Item 1. Business – Efficiency Initiatives for additional information on our efficiency initiatives.

Credit card expense for 2011 increased $726,000, or 12.4%, from 2010, following an increase of $788,000, or 15.6%, in 2010. These increases were primarily due to increased card usage, interchange fees and other related expense resulting from initiatives we have taken to grow our credit card portfolio. See Loan Portfolio section for additional information on our credit card portfolio.

Core deposit premium amortization expense recorded for the years ended December 31, 2011, 2010 and 2009, was $884,000, $786,000 and $805,000, respectively. The Company’s estimated amortization expense for each of the following five years is: 2012 – $295,000; 2013 – $261,000; 2014 – $157,000; 2015 – $151,000; and 2016 – $148,000. The estimated amortization expense decreases as core deposit premiums fully amortize in future years.

Table 6 below shows non-interest expense for the years ended December 31, 2011, 2010 and 2009, respectively, as well as changes in 2011 from 2010 and in 2010 from 2009.

Table 6: Non-Interest Expense

(In thousands)	Years Ended December 31 2011	2010	2009	2011 Change from 2010		2010 Change from 2009	
Salaries and employee benefits	$ 65,058	$ 60,731	$ 58,317	$ 4,327	7.12 %	$ 2,414	4.14 %
Occupancy expense, net	8,443	7,808	7,457	635	8.13	351	4.71
Furniture and equipment expense	6,633	6,093	6,195	540	8.86	(102)	-1.65
Other real estate and foreclosure expense	678	974	453	(296)	-30.39	521	115.01
Deposit insurance	2,387	3,813	4,642	(1,426)	-37.40	(829)	-17.86
Merger related costs	357	2,611	--	(2,254)	-86.33	2,611	--
Other operating expenses							
Professional services	4,574	4,476	3,643	98	2.19	833	22.87
Postage	2,486	2,465	2,409	21	0.85	56	2.32
Telephone	2,480	2,328	2,113	152	6.53	215	10.18
Credit card expense	6,565	5,839	5,051	726	12.43	788	15.60
Operating supplies	1,653	1,403	1,470	250	17.82	(67)	-4.56
Amortization of core deposits	884	786	805	98	12.47	(19)	-2.36
Other expense	12,452	11,936	12,167	516	4.32	(231)	-1.90
Total non-interest expense	$ 114,650	$ 111,263	$ 104,722	$ 3,387	3.04 %	$ 6,541	6.25 %

Income Taxes

The provision for income taxes for 2011 was $10.4 million, compared to $17.3 million in 2010 and $10.2 million in 2009. The effective income tax rates for the years ended 2011, 2010 and 2009 were 29.1%, 31.8% and 28.8%, respectively.

Loan Portfolio

Our loan portfolio, excluding loans covered by FDIC loss share arrangements, averaged $1.621 billion during 2011 and $1.801 billion during 2010. As of December 31, 2011, total loans, excluding loans covered by FDIC loss share arrangements, were $1.580 billion, compared to $1.684 billion on December 31, 2010. The most significant components of the loan portfolio were loans to businesses (commercial loans, commercial real estate loans and agricultural loans) and individuals (consumer loans, credit card loans and single-family residential real estate loans).

We seek to manage our credit risk by diversifying the loan portfolio, determining that borrowers have adequate sources of cash flow for loan repayment without liquidation of collateral, obtaining and monitoring collateral, providing an appropriate allowance for loan losses and regularly reviewing loans through the internal loan review

process. The loan portfolio is diversified by borrower, purpose and industry and, in the case of credit card loans, which are unsecured, by geographic region. We seek to use diversification within the loan portfolio to reduce credit risk, thereby minimizing the adverse impact on the portfolio, if weaknesses develop in either the economy or a particular segment of borrowers. Collateral requirements are based on credit assessments of borrowers and may be used to recover the debt in case of default. We use the allowance for loan losses as a method to value the loan portfolio at its estimated collectable amount. Loans are regularly reviewed to facilitate the identification and monitoring of deteriorating credits.

Consumer loans consist of credit card loans, student loans and other consumer loans. Consumer loans were $346.6 million at December 31, 2011, or 21.9% of total loans, compared to $370.2 million, or 22.0% of total loans at December 31, 2010. The $23.6 million consumer loan decrease from 2010 to 2011 is primarily due to a $13.9 million decrease in our student loan portfolio, as expected. The balance of our consumer loan portfolio decreased by $9.7 million, with declines in both our direct and indirect lending areas.

The student loan portfolio balance at December 31, 2011 was $47.4 million, a decrease of $13.9 million, or 22.7%, from December 31, 2010. Student loans were 3.0% of total loans at December 31, 2011, compared with 3.6% at December 31, 2010 and 6.1% at December 31, 2009.

Simmons First had been in the student loan business since 1966, and we believe that the banking industry had been very efficient in serving the students and the schools in Arkansas. However, U.S. government legislation finalized during the first quarter of 2010 has eliminated the private sector from providing student loans after the 2009-2010 school year. Therefore, as of June 30, 2010, the Company and the banking industry were no longer providers of student loans.

As for our current student loan portfolio, we have sold the loans we originated during the 2009-2010 school year under the program established in 2008 in which the government will purchase the loans at par plus a premium. Sales of these loans during the third quarter of 2010 left approximately $61.3 million of student loans in our portfolio that will not qualify for the government purchase program, down $53.0 million, or 46.4%, from December 31, 2009. Payoffs and consolidations have left approximately $47.4 million of student loans in our portfolio at December 31, 2011. We currently plan to continue servicing the remaining student loans internally until the loans pay off, we find a suitable buyer or the students consolidate their loans. See Non-Interest Income section for additional information on student loans.

The credit card portfolio balance at December 31, 2011, decreased by $359,000, or 0.2%, when compared to the same period in 2010. After several years of significant growth, including a $19.5 million, or 11.5% increase during 2009, growth in the credit card portfolio stabilized during 2010 and 2011. After five consecutive years of growth, we did not see a large increase in net new accounts in 2010 or 2011, due primarily to increased competition from the large credit card banks.

The growth in outstanding credit card balances in recent years through 2009 was primarily the result of an increase in net new accounts. We added over 15,000 net new accounts in 2009 and over 5,000 net new accounts in 2008. We believe the increase in outstanding balances and the addition of new accounts were the result of the introduction of several initiatives over the past few years to make our credit card products more competitive, while maintaining extremely high underwriting standards.

Real estate loans consist of construction loans, single family residential loans and commercial loans. Real estate loans were $1.001 billion at December 31, 2011, or 63.4% of total loans, compared to $1.067 billion, or 63.4% of total loans at December 31, 2010, a decrease of $65.3 million, or 6.1%. Our construction and development ("C&D") loans decreased by $43.9 million, with loans either migrating to our commercial real estate ("CRE") portfolio or being liquidated or refinanced elsewhere. Single family residential loans decreased by $9.3 million and CRE loans decreased by $12.0 million. Considering the continuing challenges in the economy, we believe it is important to note that we have no significant concentrations in our real estate loan portfolio mix. Our C&D loans represent only 7.0% of our loan portfolio and CRE loans (excluding C&D) represent 34.0% of our loan portfolio, both of which compare very favorably to our peers.

Commercial loans consist of commercial loans and agricultural loans. Commercial loans were $227.2 million at December 31, 2011, or 14.4% of total loans, compared to the $236.7 million, or 14.1% of total loans at December 31, 2010. This $9.5 million decrease in commercial loans is primarily due to weak loan demand throughout Arkansas, Kansas and southern Missouri.

The balances of loans outstanding, excluding loans covered by FDIC loss share agreements, at the indicated dates are reflected in table 7, according to type of loan.

Table 7: Loan Portfolio

	Years Ended December 31				
(In thousands)	2011	2010	2009	2008	2007
Consumer					
Credit cards	$189,970	$190,329	$189,154	$169,615	$166,044
Student loans	47,419	61,305	114,296	111,584	76,277
Other consumer	109,211	118,581	139,647	138,145	137,624
Total consumer	346,600	370,215	443,097	419,344	379,945
Real Estate					
Construction	109,825	153,772	180,759	224,924	260,924
Single family residential	355,094	364,442	392,208	409,540	382,676
Other commercial	536,372	548,360	596,517	584,843	542,184
Total real estate	1,001,291	1,066,574	1,169,484	1,219,307	1,185,784
Commercial					
Commercial	141,422	150,501	172,091	195,967	200,531
Agricultural	85,728	86,171	84,866	88,233	73,470
Total commercial	227,150	236,672	256,957	284,200	274,001
Other	4,728	10,003	5,451	10,223	10,724
Total loans	$1,579,769	$1,683,464	$1,874,989	$1,933,074	$1,850,454

Table 8 reflects the remaining maturities and interest rate sensitivity of loans, excluding loans covered by FDIC loss share agreements, at December 31, 2011.

Table 8: Maturity and Interest Rate Sensitivity of Loans

(In thousands)	1 year or less	Over 1 year through 5 years	Over 5 years	Total
Consumer	$299,346	$47,184	$70	$346,600
Real estate	635,863	357,704	7,725	1,001,292
Commercial	178,519	48,246	385	227,150
Other	4,032	552	143	4,727
Total	$1,117,760	$453,686	$8,323	$1,579,769
Predetermined rate	$603,030	$412,895	$4,004	$1,019,929
Floating rate	514,730	40,791	4,319	559,840
Total	$1,117,760	$453,686	$8,323	$1,579,769

Covered Assets

On May 14, 2010, the Company acquired substantially all of the assets and assumed substantially all of the deposits and certain other liabilities of SWCB in an FDIC-assisted transaction that generated a pre-tax bargain-purchase gain of $3.0 million. On October 15, 2010, the Company acquired substantially all of the assets and assumed substantially all of the deposits and certain other liabilities of SSB in an FDIC-assisted transaction that generated a pre-tax bargain-purchase gain of $18.3 million. Loans comprise the majority of the assets acquired and are subject to loss share agreements with the FDIC whereby SFNB is indemnified against 80% of losses. The loans acquired from the former SWCB and the former SSB, as well as the acquired other real estate owned and the related indemnification asset from the FDIC, are presented as covered assets in the accompanying consolidated financial statements.

A summary of assets covered by FDIC loss share agreements is as follows.

Table 9:	Covered Assets	
(In thousands)	December 31, 2011	
Loans, net of discount	$	158,075
Foreclosed assets held for sale		11,685
FDIC indemnification asset		47,683
Total covered assets	$	217,443

We evaluated loans purchased in conjunction with the acquisitions of SWCB and SSB for impairment in accordance with the provisions of ASC Topic 310-30, Loans and Debt Securities Acquired with Deteriorated Credit Quality. Purchased covered loans are considered impaired if there is evidence of credit deterioration since origination and if it is probable that not all contractually required payments will be collected. All loans acquired in these two transactions were deemed to be covered impaired loans. These loans were not classified as nonperforming assets at December 31, 2011, or December 31, 2010, as the loans are accounted for on a pooled basis and the pools are considered to be performing. Therefore, interest income, through accretion of the difference between the carrying amount of the loans and the expected cash flows, is being recognized on all purchased impaired loans. See Note 2 and Note 5 of the Notes to Consolidated Financial Statements for further discussion of assets covered by FDIC loss share agreements.

Asset Quality

A loan is considered impaired when it is probable that we will not receive all amounts due according to the contractual terms of the loans. Impaired loans include non-performing loans (loans past due 90 days or more and nonaccrual loans) and certain other loans identified by management that are still performing.

Non-performing loans are comprised of (a) nonaccrual loans, (b) loans that are contractually past due 90 days and (c) other loans for which terms have been restructured to provide a reduction or deferral of interest or principal, because of deterioration in the financial position of the borrower. The subsidiary banks recognize income principally on the accrual basis of accounting. When loans are classified as nonaccrual, generally, the accrued interest is charged off and no further interest is accrued. Loans, excluding credit card loans, are placed on a nonaccrual basis either: (1) when there are serious doubts regarding the collectability of principal or interest, or (2) when payment of interest or principal is 90 days or more past due and either (i) not fully secured or (ii) not in the process of collection. If a loan is determined by management to be uncollectible, the portion of the loan determined to be uncollectible is then charged to the allowance for loan losses.

Credit card loans are classified as impaired when payment of interest or principal is 90 days past due. Litigation accounts are placed on nonaccrual until such time as deemed uncollectible. Credit card loans are generally charged off when payment of interest or principal exceeds 180 days past due, but are turned over to the credit card recovery department, to be pursued until such time as they are determined, on a case-by-case basis, to be uncollectible.

Historically, we have sold our student loans into the secondary market before they reached payout status, thus requiring no servicing by the Company. Currently, since the government takeover of the student loan origination business in 2010, there is no secondary market for student loans; therefore, we are now required to service loans that have converted to a payout basis. Student loans are classified as impaired when payment of interest or principal is 90 days past due. Approximately $2.5 million of government guaranteed student loans were over 90 days past due as of December 31, 2011. Under existing rules, when these loans exceed 270 days past due, the Department of Education

will purchase them at 97% of principal and accrued interest. Although these student loans remain guaranteed by the federal government, because they are over 90 days past due they are included in our non-performing assets.

Foreclosed assets held for sale, excluding other real estate covered by FDIC loss share agreements, decreased by $0.3 million from December 31, 2010, to December 31, 2011, as we continue to aggressively manage our non-performing assets. During 2011, we moved two classified credits, previously reported as performing troubled debt restructurings ("TDRs"), to nonaccrual status. We were also able to rid ourselves of several significant non-performing assets through liquidation or customer refinancing at other financial institutions. As a result of these credit reclassifications and dispositions, non-performing assets, including TDRs, as a percent of total assets decreased to 1.52% at December 31, 2011, compared to 1.71% at December 31, 2010. We remain aggressive in the identification, quantification and resolution of problem loans.

37

Foreclosed assets held for sale, excluding other real estate covered by FDIC loss share agreements, increased by $14.0 million from December 31, 2009, to December 31, 2010, as we continued to aggressively manage our non-performing assets. The majority of the increase was attributable to our acceptance of a deed in lieu of foreclosure for an $8.1 million motel loan in the Northwest Arkansas region, previously in nonaccrual status. We recorded the property at $6.7 million, with the difference charged-off through our allowance for loan losses. This transaction is also the primary reason our nonaccrual loans decreased by $10.9 million from the previous year. Total non-performing assets increased $2.7 million from December 31, 2009.

Given current economic conditions, borrowers of all types are experiencing declines in income and cash flow. As a result, many borrowers are seeking to reduce contractual cash outlays, the most prominent being debt payments. In an effort to preserve our net interest margin and earning assets, we are open to working with existing customers in order to maximize the collectability of the debt.

When we restructure a loan to a borrower that is experiencing financial difficulty and grant a concession that we would not otherwise consider, a troubled debt restructuring (“TDR”) results and the Company classifies the loan as a TDR. The Company grants various types of concessions, primarily interest rate reduction and/or payment modifications or extensions, with an occasional forgiveness of principal.

Under ASC Topic 310-10-35, Subsequent Measurement, a TDR is considered to be impaired, and an impairment analysis must be performed. We assess the exposure for each modification, either by collateral discounting or by calculation of the present value of future cash flows, and determine if a specific allocation to the allowance for loan losses is needed.

Once an obligation has been restructured because of such credit problems, it continues to be considered a TDR until paid in full; or, if an obligation yields a market interest rate and no longer has any concession regarding payment amount or amortization, then it is not considered a TDR at the beginning of the calendar year after the year in which the improvement takes place. We had TDRs totaling $16.5 million and $21.6 million at December 31, 2011, and December 31, 2010, respectively. The majority of performing and non-performing TDRs are in our CRE portfolio.

We return TDRs to accrual status only if (1) all contractual amounts due can reasonably be expected to be repaid within a prudent period, and (2) repayment has been in accordance with the contract for a sustained period, typically at least six months.

Although the general state of the national economy remains volatile, and despite the challenges in housing and commercial real estate markets, we continue to maintain good asset quality, compared to the industry. The allowance for loan losses as a percent of total loans was 1.91% as of December 31, 2011. Non-performing loans equaled 1.02% of total loans. Non-performing assets were 1.18% of total assets. The allowance for loan losses was 186% of non-performing loans. Our net charge-offs to total loans for 2011 were 0.49%. Excluding credit cards, the net charge-offs to total loans were 0.30%. Net credit card charge-offs to total credit card loans for 2011 were 2.06%, compared to 2.37% in 2010, and more than 400 basis points better than the industry average charge-off ratio as reported by Moody’s Investors Service for the same period.

We do not own any securities backed by subprime mortgage assets, and offer no mortgage loan products that target subprime borrowers.

Table 10 presents information concerning non-performing assets, including nonaccrual and restructured loans and other real estate owned (excluding loans and other real estate covered by FDIC loss share agreements).

Table 10: Non-performing Assets

	Years Ended December 31				
(In thousands, except ratios)	2011	2010	2009	2008	2007
Nonaccrual loans (1)	$ 12,907	$ 11,186	$ 21,994	$ 14,358	$ 9,909
Loans past due 90 days or more (principal or interest payments):					
Government guaranteed student loans (2)	2,483	1,736	1,939	--	--
Other loans	785	969	1,383	1,292	1,282
Total loans past due 90 days or more	3,268	2,705	3,322	1,292	1,282
Total non-performing loans	16,175	13,891	25,316	15,650	11,191
Other non-performing assets:					
Foreclosed assets held for sale	22,887	23,204	9,179	2,995	2,629
Other non-performing assets	--	109	20	12	17
Total other non-performing assets	22,887	23,313	9,199	3,007	2,646
Total non-performing assets	$ 39,062	$ 37,204	$ 34,515	$ 18,657	$ 13,837
Performing TDRs	$ 11,391	$ 19,426	$ 12,718	$ --	$ --
Allowance for loan losses to non-performing loans (3)	186.14 %	190.17 %	98.81 %	165.12 %	226.10 %
Non-performing loans to total loans (3)	1.02	0.83	1.35	0.81	0.60
Non-performing loans to total loans (excluding government guaranteed student loans) (2) (3)	0.87	0.72	1.25	0.81	0.60
Non-performing assets to total assets (3)	1.18	1.12	1.12	0.64	0.51
Non-performing assets to total assets (excluding government guaranteed student loans) (2) (3)	1.10	1.07	1.05	0.64	0.51

(1) Includes nonaccrual TDRs of approximately $5.2 million at December 31, 2011, and $2.1 million at December 31, 2010.

(2) Student loans past due 90 days or more are included in non-performing loans. Student loans are guaranteed by the federal government and will be purchased at 97% of principal and accrued interest when they exceed 270 days past due; therefore, non-performing ratios have been calculated excluding these loans.

(3) Excludes assets covered by FDIC loss share agreements, except for their inclusion in total assets.

There was no interest income on the nonaccrual loans recorded for the years ended December 31, 2011, 2010 and 2009.

At December 31, 2011, impaired loans, net of government guarantees, excluding loans covered by FDIC loss share agreements, were $40.1 million compared to $50.6 million at December 31, 2010. Impaired loans at December 31,

2011 and 2010, includes government guaranteed student loans of $2.5 million and $1.7 million, respectively. During 2010, some large commercial real estate loan relationships in the Northwest Arkansas region were downgraded and considered impaired. However, individual impairment testing on these loans, based on current appraisals, revealed the need for specific reserves that were actually smaller for these relationships than had previously been applied based on our model. On an ongoing basis, management evaluates the underlying collateral on all impaired loans and allocates specific reserves, where appropriate, in order to absorb potential losses if the collateral were ultimately foreclosed.

Allowance for Loan Losses

Overview

The Company maintains an allowance for loan losses. This allowance is created through charges to income and maintained at a sufficient level to absorb expected losses in our loan portfolio. The allowance for loan losses is determined monthly based on management's assessment of several factors such as (1) historical loss experience based on volumes and types, (2) reviews or evaluations of the loan portfolio and allowance for loan losses, (3) trends in volume, maturity and composition, (4) off balance sheet credit risk, (5) volume and trends in delinquencies and non-accruals, (6) lending policies and procedures including those for loan losses, collections and recoveries, (7) national, state and local economic trends and conditions, (8) concentrations of credit that might affect loss experience across one or more components of the loan portfolio, (9) the experience, ability and depth of lending management and staff and (10) other factors and trends that will affect specific loans and categories of loans.

As we evaluate the allowance for loan losses, it is categorized as follows: (1) specific allocations, (2) allocations for classified assets with no specific allocation, (3) general allocations for each major loan category and (4) unallocated portion.

Specific Allocations

Specific allocations are made when factors are present requiring a greater reserve than would be required when using the assigned risk rating allocation. As a general rule, if a specific allocation is warranted, it is the result of an analysis of a previously classified credit or relationship. Our evaluation process in specific allocations includes a review of appraisals or other collateral analysis. These values are compared to the remaining outstanding principal balance. If a loss is determined to be reasonably possible, the possible loss is identified as a specific allocation. If the loan is not collateral dependent, the measurement of loss is based on the expected future cash flows of the loan.

Allocations for Classified Assets with No Specific Allocation

We establish allocations for loans rated "watch" through "doubtful" based upon analysis of historical loss experience by category. A percentage rate is applied to each of these loan categories to determine the level of dollar allocation. During the second quarter of 2009, we made adjustments to our methodology in the evaluation of the collectability of loans, which added quantitative factors to the internal and external influences used in determining the credit quality of loans and the allocation of the allowance. This adjustment in methodology resulted in an addition to impaired loans from classified loans and a redistribution of allocated and unallocated reserves.

It is likely that the methodology will continue to evolve over time. Allocated reserves are presented in table 12 below detailing the components of the allowance for loan losses.

General Allocations

We establish general allocations for each major loan category. This section also includes allocations to loans which are collectively evaluated for loss such as credit cards, one-to-four family owner occupied residential real estate loans and other consumer loans. The allocations in this section are based on an analysis of historical losses for each loan category. We give consideration to trends, changes in loan mix, delinquencies, prior losses and other related information.

Unallocated Portion

Allowance allocations other than specific, classified and general are included in the unallocated portion. While allocations are made for loans based upon historical loss analysis, the unallocated portion is designed to cover the uncertainty of how current economic conditions and other uncertainties may impact the existing loan portfolio. Factors to consider include national and state economic conditions such as increases in unemployment, the recent real estate lending crisis, the volatility in the stock market and the unknown impact of the various government stimulus programs. Various Federal Reserve articles and reports indicate the economy is in a moderate recovery, but questions remain about the durability of growth and whether it can be sustained by private demand. While the recession may be over, production, income, sales and employment are at very low levels. With moderate economic growth, it is possible the recovery could take years. The unemployment rate seems likely to remain elevated for several years. In addition, there is now much uncertainty related to the potential impact of the current debt and budget crisis, as well as the uncertainties that come in times leading up to a national election. The unallocated reserve addresses inherent probable losses not included elsewhere in the allowance for loan losses. While calculating allocated reserve, the unallocated reserve supports uncertainties within the loan portfolio.

40

Reserve for Unfunded Commitments

In addition to the allowance for loan losses, we have established a reserve for unfunded commitments, classified in other liabilities. This reserve is maintained at a level sufficient to absorb losses arising from unfunded loan commitments. The adequacy of the reserve for unfunded commitments is determined monthly based on methodology similar to our methodology for determining the allowance for loan losses. Net adjustments to the reserve for unfunded commitments are included in other non-interest expense.

An analysis of the allowance for loan losses for the last five years is shown in table 11.

Table 11: Allowance for Loan Losses

(In thousands)	2011	2010	2009	2008	2007
Balance, beginning of year	$26,416	$25,016	$25,841	$25,303	$25,385
Loans charged off					
Credit card	4,703	5,321	5,336	3,760	2,663
Other consumer	1,890	2,471	2,758	2,105	1,538
Real estate	3,165	9,564	4,814	2,987	1,916
Commercial	1,411	1,246	1,920	1,394	715
Total loans charged off	11,169	18,602	14,828	10,246	6,832
Recoveries of loans previously charged off					
Credit card	979	1,035	920	883	1,024
Other consumer	604	884	673	519	483
Real estate	981	3,657	1,393	207	648
Commercial	621	297	701	529	414
Total recoveries	3,185	5,873	3,687	2,138	2,569
Net loans charged off	7,984	12,729	11,141	8,108	4,263
Provision for loan losses	11,676	14,129	10,316	8,646	4,181
Balance, end of year	$30,108	$26,416	$25,016	$25,841	$25,303
Net charge-offs to average loans (1)	0.49 %	0.71 %	0.58 %	0.43 %	0.23 %
Allowance for loan losses to period-end loans (1)	1.91 %	1.57 %	1.33 %	1.34 %	1.37 %
Allowance for loan losses to net charge-offs (1)	377.10 %	207.53 %	224.54 %	318.71 %	593.55 %

(1)Excludes loans covered by FDIC loss share agreements.

Provision for Loan Losses

The amount of provision to the allowance each year was based on management's judgment, with consideration given to the composition of the portfolio, historical loan loss experience, assessment of current economic conditions, past due and non-performing loans and net loss experience. It is management's practice to review the allowance on at least a quarterly basis, but generally on a monthly basis, and after considering the factors previously noted, to determine the level of provision made to the allowance.

41

Allocated Allowance for Loan Losses

We utilize a consistent methodology in the calculation and application of the allowance for loan losses. Because there are portions of the portfolio that have not matured to the degree necessary to obtain reliable loss statistics from which to calculate estimated losses, the unallocated portion of the allowance is an integral component of the total allowance. Although unassigned to a particular credit relationship or product segment, this portion of the allowance is vital to safeguard against the uncertainty and imprecision inherent when estimating credit losses, especially when trying to determine the impact the current and unprecedented economic crisis will have on the existing loan portfolios.

Accordingly, several factors in the national economy, including the continuing high unemployment rates, the continuing credit crisis, the mortgage crisis, the uncertainty in the residential and commercial real estate markets and other loan sectors which may be exhibiting weaknesses and the unknown impact of various current and future federal government economic stimulus programs influence our determination of the size of unallocated reserves. In addition, there is now much uncertainty related to the potential impact of the current debt and budget crisis, including a debt crisis in several other countries.

During 2010, management determined that there were several economic and environmental factors that necessitated the need for a higher level of unallocated reserve. Due to these factors, along with an increase in net loan charge-offs, we increased our provision by approximately $3.8 million over 2009, resulting in the higher level of allowance at December 31, 2010. Management continued to believe that these same factors necessitated the need for an even higher level of unallocated allowance in 2011. Although the provision for loan losses was reduced by $2.4 million in 2011, a decrease in net loans charge-offs resulted in an increase in the allowance for loan losses of approximately $3.7 million from December 31, 2010.

In late 2006, the economy in Northwest Arkansas, particularly in the residential real estate market, started showing signs of deterioration which caused concerns over the full recoverability of this portion of our loan portfolio. We continued to monitor the Northwest Arkansas economy and, beginning in the third quarter of 2007, specific credit relationships deteriorated to a level requiring increased general and specific reserves. These credit relationships continued to deteriorate, and others were identified, prompting special loan loss provisions each quarter, beginning with the second quarter of 2008, resulting in an increase to the allowance allocation for real estate loans through December 31, 2008.

As the economic downturn continued through 2009, additional problem loans were identified and specific allocations were applied, resulting in a significant decrease in the unallocated portion of the allowance for loan losses. Although several non-performing loans with large specific allocations were charged off during 2009, the identification of other non-performing loans with specific allocations late in 2009 resulted in a relatively small decrease in the total allocation to real estate loans as of December 31, 2009. During 2010, we moved some significant credits from non-performing loans to foreclosed assets held for sale, resulting in a lower allocation in the real estate portfolio. However, the real estate related portfolios could still be adversely impacted by the overall economic downturn and the regional market saturation in Northwest Arkansas.

Our allocation of the allowance for loan losses to credit card loans, as well as credit card balances, remained relatively unchanged from December 31, 2010, to December 31, 2011. Annualized net credit card charge-offs to credit card loans decreased from 2.37% at December 31, 2010, to 2.06% at December 31, 2011. Although we continue to have minimal credit card losses compared to the industry, credit card loans are unsecured loans. The current economic downturn could adversely affect consumers in a more delayed fashion compared to commercial business in general. Increasing unemployment and diminished asset values could 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 significant adverse effect on our unsecured credit card portfolio.

The unallocated allowance for loan losses is based on our concerns over the uncertainty of the national economy and the economy in Arkansas, Missouri and Kansas. The impact of market pricing in the poultry, timber and catfish industries in Arkansas remains uncertain. We are also cautious regarding the continued softening of the real estate market, specifically in the Northwest Arkansas region. The housing industry remains one of the weakest links for economic recovery. Although the unemployment rate in Arkansas, Missouri and Kansas is lagging behind the national average, it remains at historically high levels. We actively monitor the status of these industries and economic factors as they relate to our loan portfolio and make changes to the allowance for loan losses as necessary. Based on our analysis of loans and external uncertainties, we believe the allowance for loan losses is appropriate for the year ended December 31, 2011.

We allocate the allowance for loan losses according to the amount deemed to be reasonably necessary to provide for losses incurred within the categories of loans set forth in table 12.

Table 12: Allocation of Allowance for Loan Losses

	December 31														
	2011			2010			2009			2008			2007		
	Allowance	% of		Allowance	% of		Allowance	% of		Allowance	% of		Allowance	% of	
(In thousands)	Amount	loans(1)		Amount	loans(1)		Amount	loans(1)		Amount	loans(1)		Amount	loans(1)	
Credit cards	$5,513	12.0	%	$5,549	11.3	%	$5,808	10.1	%	$3,957	8.8	%	$3,841	9.0	%
Other consumer	1,638	9.9	%	1,703	10.7	%	1,719	13.5	%	1,325	12.9	%	1,501	11.5	%
Real estate	10,117	63.4	%	9,692	63.4	%	11,164	62.4	%	11,695	63.1	%	10,157	64.1	%
Commercial	2,063	14.4	%	2,277	14.1	%	2,451	13.7	%	2,255	14.7	%	2,528	14.8	%
Other	209	0.3	%	255	0.5	%	161	0.3	%	209	0.5	%	187	0.6	%
Unallocated	10,568			6,940			3,713			6,400			7,089		
Total	$30,108	100.0	%	$26,416	100.0	%	$25,016	100.0	%	$25,841	100.00	%	$25,303	100.0	%

(1) Percentage of loans in each category to total loans not covered by FDIC loss share.

Investments and Securities

Our securities portfolio is the second largest component of earning assets and provides a significant source of revenue. Securities within the portfolio are classified as either held-to-maturity, available-for-sale or trading.

Held-to-maturity securities, which include any security for which management has the positive intent and ability to hold until maturity, are carried at historical cost, adjusted for amortization of premiums and accretion of discounts. Premiums and discounts are amortized and accreted, respectively, to interest income using the constant yield method over the period to maturity. Interest and dividends on investments in debt and equity securities are included in income when earned.

Available-for-sale securities, which include any security for which management has no immediate plans to sell, but which may be sold in the future, are carried at fair value. Realized gains and losses, based on amortized cost of the specific security, are included in other income. Unrealized gains and losses are recorded, net of related income tax effects, in stockholders' equity. Premiums and discounts are amortized and accreted, respectively, to interest income, using the constant yield method over the period to maturity. Interest and dividends on investments in debt and equity securities are included in income when earned.

Our philosophy regarding investments is conservative based on investment type and maturity. Investments in the portfolio primarily include U.S. Treasury securities, U.S. Government agencies, mortgage-backed securities and municipal securities. Our general policy is not to invest in derivative type investments or high-risk securities, except for collateralized mortgage-backed securities for which collection of principal and interest is not subordinated to significant superior rights held by others.

Held-to-maturity and available-for-sale investment securities were $525.4 million and $172.2 million, respectively, at December 31, 2011, compared to the held-to-maturity amount of $465.2 million and available-for-sale amount of $148.5 million at December 31, 2010. During 2009, we made a decision to change our portfolio targets from 75% available-for-sale to 25% available-for-sale. We chose this strategy due to our level of pledging and our history of holding securities to maturity.

As of December 31, 2011, $312.8 million, or 59.5%, of the held-to-maturity securities were invested in U.S. Treasury securities and obligations of U.S. government agencies, 60.0% of which will mature in less than five years. In the available-for-sale securities, $153.6 million, or 89.2%, were in U.S. Treasury and U.S. government agency securities, 47.8% of which will mature in less than five years.

In order to reduce our income tax burden, $211.7 million, or 40.3%, of the held-to-maturity securities portfolio, as of December 31, 2011, was invested in tax-exempt obligations of state and political subdivisions. In the available-for-sale securities, there was none invested in tax-exempt obligations of state and political subdivisions. Most of the state and political subdivision debt obligations are non-rated bonds and represent relatively small, Arkansas issues, which are evaluated on an ongoing basis. There are no securities of any one state or political subdivision issuer exceeding ten percent of our stockholders' equity at December 31, 2011.

We have approximately $62,000 in mortgaged-backed securities in the held-to-maturity portfolio at December 31, 2011. In the available-for-sale securities, approximately $2.6 million, or 1.5% were invested in mortgaged-backed securities. Securities with limited marketability, such as stock in the Federal Reserve Bank and the Federal Home Loan Bank, are carried at cost and are reported as other available for sale securities.

As of December 31, 2011, the held-to-maturity investment portfolio had gross unrealized gains of $7.1 million and gross unrealized losses of $0.3 million.

We had no gross realized gains or losses during 2011. We had gross realized gains of $467,000 and gross realized losses of $150,000 during the year ended December 31, 2010, from the sale and/or calls securities. As part of our acquisition strategy related to SSB, we liquidated the acquired investment portfolio, resulting in net realized gain of $317,000 in 2010. We had gross realized gains of $144,000 and no realized losses during 2009 from the sales and/or calls of securities.

Trading securities, which include any security held primarily for near-term sale, are carried at fair value. Gains and losses on trading securities are included in other income. Our trading account is established and maintained for the benefit of investment banking. The trading account is typically used to provide inventory for resale and is not used to take advantage of short-term price movements.

Declines in the fair value of held-to-maturity and available-for-sale securities below their cost that are deemed to be other than temporary are reflected in earnings as realized losses. In estimating other-than-temporary impairment losses, management considers, among other things, (i) the length of time and the extent to which the fair value has been less than cost, (ii) the financial condition and near-term prospects of the issuer and (iii) the intent and ability of the Company to retain its investment in the issuer for a period of time sufficient to allow for any anticipated recovery in fair value.

The unrealized losses on our investment securities were caused by interest rate increases. The contractual terms of those investments do not permit the issuer to settle the securities at a price less than the amortized cost bases of the investments. Because we do not intend to sell the investments and it is not more likely than not the we will be required to sell the investments before recovery of their amortized cost bases, which may be maturity, we do not consider those investments to be other-than-temporarily impaired at December 31, 2011.

Management has the ability and intent to hold the securities classified as held to maturity until they mature, at which time we expect to receive full value for the securities. Furthermore, as of December 31, 2011, management also had the ability and intent to hold the securities classified as available-for-sale for a period of time sufficient for a recovery of cost. The unrealized losses are largely due to increases in market interest rates over the yields available at the time the underlying securities were purchased. The fair value is expected to recover as the bonds approach their maturity date or repricing date or if market yields for such investments decline. Management does not believe any of the securities are impaired due to reasons of credit quality. Accordingly, as of December 31, 2011, management believes the impairments detailed in the table below are temporary.

Table 13 presents the carrying value and fair value of investment securities for each of the years indicated.

Table 13: Investment Securities

	Years Ended December 31							
	2011				2010			
(In thousands)	Amortized Cost	Gross Unrealized Gains	Gross Unrealized (Losses)	Estimated Fair Value	Amortized Cost	Gross Unrealized Gains	Gross Unrealized (Losses)	Estimated Fair Value
Held-to-Maturity								
U.S. Treasury	$4,000	$ 14	$ --	$4,014	$4,000	$ 28	$ --	$4,028
U.S. Government agencies	308,779	712	(154)	309,337	249,844	1,764	(507)	251,101
Mortgage-backed securities	62	1	--	63	78	4	--	82
State and political subdivisions	211,673	6,333	(144)	217,862	210,331	2,280	(1,845)	210,766
Other securities	930	--	--	930	930	--	--	930
Total	$525,444	$ 7,060	$ (298)	$532,206	$465,183	$ 4,076	$ (2,352)	$466,907
Available-for-Sale								
U.S. Government agencies	$153,560	$ 295	$ (228)	$153,627	$125,175	$ 577	$ (283)	$125,469

Mortgage-backed securities	2,280	277	--	2,557	2,647	143	(1)	2,789
State and political subdivisions	--	--	--	--	--	--	--	--
Other securities	15,648	384	(5)	16,027	19,814	411	(4)	20,221
Total	$ 171,488	$ 956	$ (233)	$ 172,211	$ 147,636	$ 1,131	$ (288)	$ 148,479

45

Table 14 reflects the amortized cost and estimated fair value of securities at December 31, 2011, by contractual maturity and the weighted average yields (for tax-exempt obligations on a fully taxable equivalent basis, assuming a 39.225% tax rate) of such securities. Expected maturities will differ from contractual maturities because borrowers may have the right to call or prepay obligations, with or without call or prepayment penalties.

Table 14: Maturity Distribution of Investment Securities

	December 31, 2011							
(In thousands)	1 year or less	Over 1 year through 5 years	Over 5 years through 10 years	Over 10 years	No fixed maturity	Total Amortized Cost	Par Value	Fair Value
Held-to-Maturity								
U.S. Treasury	$4,000	$--	$--	$--	$--	$4,000	$4,000	$4,014
U.S. Government agencies	18,000	165,779	125,000	--	--	308,779	308,785	309,337
Mortgage-backed securities	--	3	42	17	--	62	62	63
State and political subdivisions	14,695	55,143	56,632	85,203	--	211,673	211,961	217,862
Other securities	--	--	--	930	--	930	930	930
Total	$36,695	$220,925	$181,674	$86,150	$--	$525,444	$525,738	$532,206
Percentage of total	7.0 %	42.0 %	34.6 %	16.4 %	0.0 %	100.0 %		
Weighted average yield	1.8 %	2.0 %	3.4 %	4.0 %	0.0 %	2.8 %		
Available-for-Sale								
U.S. Government agencies	$300	$80,498	$72,763	$--	$--	$153,561	$153,520	$153,627
Mortgage-backed securities	--	1,432	844	3	--	2,279	2,303	2,558
Other securities	--	--	--	--	15,648	15,648	15,648	16,027
Total	$300	$81,930	$73,607	$3	$15,648	$171,488	$171,471	$172,212
Percentage of total	0.2 %	47.8 %	42.9 %	0.0 %	9.1 %	100.0 %		
Weighted average yield	0.0 %	0.9 %	3.2 %	3.1 %	2.8 %	2.1 %		

Deposits

Deposits are our primary source of funding for earning assets and are primarily developed through our network of 84 financial centers. We offer a variety of products designed to attract and retain customers with a continuing focus on developing core deposits. Our core deposits consist of all deposits excluding time deposits of $100,000 or more

and brokered deposits. As of December 31, 2011, core deposits comprised 86.5% of our total deposits.

We continually monitor the funding requirements at each subsidiary bank along with competitive interest rates in the markets it serves. Because of our community banking philosophy, subsidiary bank executives in the local markets establish the interest rates offered on both core and non-core deposits. This approach ensures that the interest rates being paid are competitively priced for each particular deposit product and structured to meet the funding requirements. We believe we are paying a competitive rate when compared with pricing in those markets.

We manage our interest expense through deposit pricing and do not anticipate a significant change in total deposits. We believe that additional funds can be attracted and deposit growth can be accelerated through deposit pricing if it experiences increased loan demand or other liquidity needs. We also utilize brokered deposits as an additional source of funding to meet liquidity needs.

Our total deposits as of December 31, 2011 were $2.650 billion, an increase of $41.6 million, or 1.6%, from $2.609 billion at December 31, 2010. We have continued our strategy to move more volatile time deposits to less expensive, revenue enhancing transaction accounts throughout 2011. Non-interest bearing transaction accounts increased $103.5 million to $532.3 million at December 31, 2011, compared to $428.8 million at December 31, 2010. Interest bearing transaction and savings accounts were $1.240 billion at December 31, 2011, a $19.4 million increase compared to $1.220 billion on December 31, 2010. Total time deposits decreased approximately $81.3 million to $878.6 million at December 31, 2011, from $959.9 million at December 31, 2010. In an attempt to utilize some of our excess liquidity, we have priced deposits in a manner to encourage a reduction in non-relationship time deposits. We had $20.6 million and $21.5 million of brokered deposits at December 31, 2011 and 2010, respectively.

Table 15 reflects the classification of the average deposits and the average rate paid on each deposit category which is in excess of 10 percent of average total deposits for the three years ended December 31, 2011.

Table 15: Average Deposit Balances and Rates

	December 31					
	2011		2010		2009	
(In thousands)	Average Amount	Average Rate Paid	Average Amount	Average Rate Paid	Average Amount	Average Rate Paid
Non-interest bearing transaction accounts	$482,651	--	$375,941	--	$332,998	--
Interest bearing transaction and savings deposits	1,217,218	0.30 %	1,181,597	0.44 %	1,091,960	0.76 %
Time deposits $100,000 or more	380,362	1.24 %	381,432	1.62 %	406,924	2.43 %
Other time deposits	532,647	1.24 %	525,714	1.55 %	532,434	2.42 %
Total	$2,612,878	0.57 %	$2,464,684	0.79 %	$2,364,316	1.31 %

The Company's maturities of large denomination time deposits at December 31, 2011 and 2010 are presented in table 16.

Table 16: Maturities of Large Denomination Time Deposits

	Time Certificates of Deposit ($100,000 or more)			
	December 31			
	2011		2010	
(In thousands)	Balance	Percent	Balance	Percent
Maturing				
Three months or less	$109,974	29.0 %	$114,891	31.9 %
Over 3 months to 6 months	96,214	25.4 %	90,141	25.0 %
Over 6 months to 12 months	101,862	26.9 %	107,658	29.9 %
Over 12 months	70,775	18.7 %	47,659	13.2 %
Total	$378,825	100.00 %	$360,349	100.00 %

47

Short-Term Debt

Federal funds purchased and securities sold under agreements to repurchase were $114.8 million at December 31, 2011, as compared to $109.1 million at December 31, 2010. Other short-term borrowings, consisting of U.S. TT&L Notes and short-term FHLB borrowings, were $272,000 at December 31, 2011, as compared to $1.0 million at December 31, 2010.

We have historically funded our growth in earning assets through the use of core deposits, large certificates of deposits from local markets, FHLB borrowings and Federal funds purchased. Management anticipates that these sources will provide necessary funding in the foreseeable future.

Long-Term Debt

Our long-term debt was $120.8 million and $164.3 million at December 31, 2011 and 2010, respectively. The outstanding long-term debt balance for December 31, 2011, includes $89.9 million in FHLB long-term advances and $30.9 million of trust preferred securities. The outstanding balance for December 31, 2010, includes $133.4 million in FHLB long-term advances and $30.9 million of trust preferred securities.

During the year ended December 31, 2011, we reduced long-term debt by $43.5 million, or 26.5%, from December 31, 2010, through scheduled payoffs of FHLB advances.

Aggregate annual maturities of long-term debt at December 31, 2011 are presented in table 17.

Table 17: Maturities of Long-Term Debt

(In thousands)	Year	Annual Maturities
	2012	$ 7,370
	2013	22,275
	2014	5,977
	2015	9,699
	2016	8,002
	Thereafter	67,505
	Total	$ 120,828

Capital

Overview

At December 31, 2011, total capital reached $407.9 million. Capital represents shareholder ownership in the Company – the book value of assets in excess of liabilities. At December 31, 2011, our equity to asset ratio was 12.3% compared to 12.0% at year-end 2010.

Capital Stock

On February 27, 2009, at a special meeting, our shareholders approved an amendment to the Articles of Incorporation to establish 40,040,000 authorized shares of preferred stock, $0.01 par value. The aggregate liquidation preference of all shares of preferred stock cannot exceed $80,000,000. As of December 31, 2011, no preferred stock has been issued.

On August 26, 2009, we filed a shelf registration statement with the Securities and Exchange Commission ("SEC"). The shelf registration statement, which was declared effective on September 9, 2009, 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.

48

In November 2009, the Company raised common equity through an underwritten public offering by issuing 2,650,000 shares of common stock 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 $61.3 million. In December 2009, the underwriters of our stock offering exercised and completed their option to purchase an additional 397,500 shares of common stock at $24.50 to cover over-allotments. The net proceeds of the exercise of the over-allotment option after deducting underwriting discounts and commissions were $9.2 million. The total net proceeds of the offering after deducting underwriting discounts and commissions and offering expenses were approximately $70.5 million.

Stock Repurchase

On November 28, 2007, we announced the adoption by the Board of Directors of a stock repurchase program. The program authorizes the repurchase of up to 700,000 shares of Class A common stock, or approximately 5% of the outstanding common stock. Under the repurchase program, there is no time limit for the stock repurchases, nor is there a minimum number of shares we intend to repurchase. We may discontinue purchases at any time that management determines additional purchases are not warranted. As part of its strategic focus on building capital, management suspended the Company's stock repurchase program in July 2008.

On September 27, 2011, we announced that reinstatement of the existing stock repurchase program. Prior to the suspension of the program, we had repurchased 54,328 shares, thereby leaving authority to repurchase 645,672 shares under the program. The shares are to be purchased from time to time at prevailing market prices, through open market or unsolicited negotiated transactions, depending upon market conditions. We intend to use the repurchased shares to satisfy stock option exercises, for payment of future stock dividends and for general corporate purposes.

During 2011, after announcing the reinstatement of the program, we repurchased 137,144 shares of stock with a weighted average repurchase price of $23.98 per share. Under the current stock repurchase plan, we can repurchase an additional 508,528 shares.

Cash Dividends

We declared cash dividends on our common stock of $0.76 per share for the twelve months ended December 31, 2011, compared to $0.76 per share for the twelve months ended December 31, 2010. The timing and amount of future dividends are at the discretion of our Board of Directors and will depend upon our consolidated earnings, financial condition, liquidity and capital requirements, the amount of cash dividends paid to us by our subsidiaries, applicable government regulations and policies and other factors considered relevant by our Board of Directors. Our Board of Directors anticipates that we will continue to pay quarterly dividends in amounts determined based on the factors discussed above. However, there can be no assurance that we will continue to pay dividends on our common stock at the current levels or at all. See Item 5, Market for Registrant's Common Equity and Related Stockholder Matters, for additional information regarding cash dividends.

Parent Company Liquidity

The primary liquidity needs of the Parent Company are the payment of dividends to shareholders, the funding of debt obligations and the share repurchase plan. The primary sources for meeting these liquidity needs are the current cash on hand at the parent company and the future dividends received from the eight affiliate banks. Payment of dividends by the eight subsidiary banks is subject to various regulatory limitations. See Item 7A, Liquidity and Qualitative Disclosures About Market Risk, for additional information regarding the parent company's liquidity.

Risk-Based Capital

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

Quantitative measures established by regulation to ensure capital adequacy require us to maintain minimum amounts and ratios (set forth in the table below) of total and Tier 1 capital (as defined in the regulations) to risk-weighted assets (as defined) and of Tier 1 capital (as defined) to average assets (as defined). Management believes that, as of December 31, 2011, we meet all capital adequacy requirements to which we are subject.

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

Our risk-based capital ratios at December 31, 2011 and 2010, are presented in table 18 below:

Table 18: Risk-Based Capital

(In thousands, except ratios)	December 31 2011	2010
Tier 1 capital		
Stockholders' equity	$407,911	$397,371
Trust preferred securities	30,000	30,000
Goodwill and core deposit premiums	(47,889)	(49,953)
Unrealized gain on available-for-sale securities, net of income taxes	(439)	(512)
Total Tier 1 capital	389,583	376,906
Tier 2 capital		
Qualifying unrealized gain on available-for-sale equity securities	9	7
Qualifying allowance for loan losses	22,682	23,553
Total Tier 2 capital	22,691	23,560
Total risk-based capital	$412,274	$400,466
Risk weighted assets	$1,805,585	$1,879,832
Ratios at end of year		
Leverage ratio	11.86 %	11.33 %
Tier 1 capital	21.58 %	20.05 %
Total risk-based capital	22.83 %	21.30 %
Minimum guidelines		
Leverage ratio	4.00 %	4.00 %
Tier 1 capital	4.00 %	4.00 %
Total risk-based capital	8.00 %	8.00 %

Off-Balance Sheet Arrangements and Aggregate Contractual Obligations

In the normal course of business, the Company enters into a number of financial commitments. Examples of these commitments include but are not limited to long-term debt financing, operating lease obligations, unfunded loan commitments and letters of credit.

Our long-term debt at December 31, 2011, includes notes payable, FHLB long-term advances and trust preferred securities, all of which we are contractually obligated to repay in future periods.

Operating lease obligations entered into by the Company are generally associated with the operation of a few of our financial centers located throughout the states of Arkansas and Kansas. Our financial obligation on these locations is considered immaterial due to the limited number of financial centers that operate under an agreement of this type.

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

50

The funding requirements of the Company's most significant financial commitments, at December 31, 2011, are shown in table 19.

Table 19: Funding Requirements of Financial Commitments

(In thousands)	Payments due by period Less than 1 Year	1-3 Years	3-5 Years	Greater than 5 Years	Total
Long-term debt	$7,370	$28,252	$17,701	$ 67,505	$120,828
Credit card loan commitments	343,400	--	--	--	343,400
Other loan commitments	285,487	--	--	--	285,487
Letters of credit	9,269	--	--	--	9,269

Reconciliation of Non-GAAP Measures

We have $62.2 million and $63.1 million total goodwill and core deposit premiums for the periods ended December 31, 2011 and December 31, 2010, respectively. Because of our high level of these two intangible assets, management believes a useful calculation is return on tangible equity (non-GAAP). This non-GAAP calculation for the twelve months ended December 31, 2011, 2010, 2009, 2008, and 2007, which is similar to the GAAP calculation of return on average stockholders' equity, is presented in table 20.

Table 20: Return on Tangible Equity

(In thousands, except ratios)	2011		2010		2009		2008		2007	
Twelve months ended										
Return on average stockholders' equity: (A/C)	6.25	%	9.69	%	8.26	%	9.54	%	10.26	%
Return on tangible equity (non-GAAP): (A+B)/(C-D)	7.54	%	11.71	%	10.61	%	12.54	%	13.78	%
(A) Net income	$25,374		$37,117		$25,210		$26,910		$27,360	
(B) Amortization of intangibles, net of taxes	537		478		503		504		511	
(C) Average stockholders' equity	406,093		383,141		305,210		282,186		266,628	
(D) Average goodwill and core deposits, net	62,631		62,125		62,789		63,600		64,409	

The table below presents computations of core earnings (net income excluding nonrecurring items {Visa litigation expense reversal, gain from the cash proceeds on mandatory Visa stock redemption, gain from the sale of MasterCard stock, gains on FDIC-assisted transactions and the related merger costs, liquidation gains and losses from FDIC-assisted transactions and the one-time costs of branch right sizing}) and diluted core earnings per share (non-GAAP). Nonrecurring items are included in financial results presented in accordance with generally accepted accounting principles (GAAP).

We believe the exclusion of these nonrecurring items in expressing earnings and certain other financial measures, including "core earnings," provides a meaningful base for period-to-period and company-to-company comparisons, which management believes will assist investors and analysts in analyzing the core financial measures of the Company and predicting future performance. This non-GAAP financial measure is also used by management to assess the performance of the Company's business because management does not consider these nonrecurring items to be

relevant to ongoing financial performance. Management and the Board of Directors utilize "core earnings" (non-GAAP) for the following purposes:

- Preparation of the Company's operating budgets
- Monthly financial performance reporting
- Monthly "flash" reporting of consolidated results (management only)
- Investor presentations of Company performance

We believe the presentation of "core earnings" on a diluted per share basis, "diluted core earnings per share" (non-GAAP), provides a meaningful base for period-to-period and company-to-company comparisons, which management believes will assist investors and analysts in analyzing the core financial measures of the Company and predicting future performance. This non-GAAP financial measure is also used by management to assess the performance of the Company's business, because management does not consider these nonrecurring items to be relevant to ongoing financial performance on a per share basis. Management and the Board of Directors utilize "diluted core earnings per share" (non-GAAP) for the following purposes:

- Calculation of annual performance-based incentives for certain executives
- Calculation of long-term performance-based incentives for certain executives
- Investor presentations of Company performance

We believe that presenting these non-GAAP financial measures will permit investors and analysts to assess the performance of the Company on the same basis as that applied by management and the Board of Directors.

"Core earnings" and "diluted core earnings per share" (non-GAAP) have inherent limitations and are not required to be uniformly applied and are not audited. To mitigate these limitations, we have procedures in place to identify and approve each item that qualifies as nonrecurring to ensure that the Company's "core" results are properly reflected for period-to-period comparisons. Although these non-GAAP financial measures are frequently used by stakeholders in the evaluation of a company, they have limitations as analytical tools and should not be considered in isolation or as a substitute for analyses of results as reported under GAAP. In particular, a measure of earnings that excludes nonrecurring items does not represent the amount that effectively accrues directly to stockholders (i.e., nonrecurring items are included in earnings and stockholders' equity).

During the second quarter of 2011, we recorded an after tax gain of $688,000 on the sale of MasterCard stock, contributing $0.04 to diluted earnings per share. Also during the second quarter, as a result of our right sizing initiative, we recorded a nonrecurring charge of $0.01 to diluted earnings per share.

During the first and second quarters of 2011, we recorded after-tax merger related costs of $217,000 on the FDIC-assisted acquisition of SSB, resulting in a nonrecurring charge of $0.01 to diluted earnings per share.

During the fourth quarter of 2010, we recorded an after tax bargain purchase gain of $18.3 million on the FDIC-assisted acquisition of SSB, along with merger related costs of $2.0 million. Also, as part of our acquisition strategy, the investment portfolio was liquidated resulting in an after tax gain of $193,000, and FHLB advances were paid off resulting in a $361,000 pre-payment expense, after tax. These nonrecurring items related to SSB contributed $0.56 to diluted earnings per share.

During the second quarter of 2010, we recorded an after tax bargain purchase gain of $1.8 million on the FDIC-assisted acquisition of SWCB, along with merger related costs of $351,000. These nonrecurring items related to SWCB contributed $0.09 to diluted earnings per share. Also during the second quarter of 2010, as a result of our branch right sizing initiative, we recorded a nonrecurring charge of $0.01 to diluted earnings per share.

See table 21 below for the reconciliation of non-GAAP financial measures, which exclude nonrecurring items for the periods presented.

Table 21: Reconciliation of Core Earnings (non-GAAP)

(In thousands, except share data)	2011	2010	2009	2008	2007
Twelve months ended					
Net Income	$25,374	$37,117	$25,210	$26,910	$27,360
Nonrecurring items					
Mandatory stock redemption gain (Visa)	--	--	--	(2,973)	--
Litigation liability expense/reversal (Visa)	--	--	--	(1,220)	1,220
Gain on sale of MasterCard stock	(1,132)	--	--	--	--
Gain on FDIC-assisted transactions	--	(21,314)	--	--	--
Merger related costs	357	2,611	--	--	--
Gains from sale of securities	--	(317)	--	--	--
FHLB prepayment penalties	--	594	--	--	--
Branch right sizing	141	372	--	--	--
Tax effect (39.225%) (1)	248	6,978	--	1,635	(476)
Net nonrecurring items	(386)	(11,076)	--	(2,558)	744
Core earnings (non-GAAP)	$24,988	$26,041	$25,210	$24,352	$28,104
Diluted earnings per share	$1.47	$2.15	$1.74	$1.91	$1.92
Nonrecurring items					
Mandatory stock redemption gain (Visa)	--	--	--	(0.21)	--
Litigation liability expense/reversal (Visa)	--	--	--	(0.09)	0.09
Gain on sale of MasterCard stock	(0.07)	--	--	--	--
Gain on FDIC-assisted transactions	--	(1.23)	--	--	--
Merger related costs	0.02	0.15	--	--	--
Gain from sale of securities	--	(0.02)	--	--	--
FHLB prepayment penalties	--	0.03	--	--	--
Branch right sizing	0.01	0.02	--	--	--
Tax effect (39.225%) (1)	0.02	0.41	--	0.12	(0.04)
Net nonrecurring items	(0.02)	(0.64)	--	(0.18)	0.05
Diluted core earnings per share (non-GAAP)	$1.45	$1.51	$1.74	$1.73	$1.97

(1) For 2010, effective tax rate of 39.225%, adjusted for additional fair value deduction related to the donation of a closed branch with a fair value significantly higher than its book value.

53

Quarterly Results

Selected unaudited quarterly financial information for the last eight quarters is shown in table 22.

Table 22: Quarterly Results

(In thousands, except per share data)	Quarter First	Second	Third	Fourth	Total
2011					
Net interest income	$26,834	$27,250	$27,279	$27,297	$108,660
Provision for loan losses	2,675	3,328	2,842	2,831	11,676
Non-interest income	12,632	14,364	13,722	12,747	53,465
Non-interest expense	29,975	28,692	27,633	28,350	114,650
Net income	5,066	6,746	7,257	6,305	25,374
Basic earnings per share	0.29	0.39	0.42	0.37	1.47
Diluted earnings per share	0.29	0.39	0.42	0.37	1.47
2010					
Net interest income	$24,412	$25,205	$26,056	$26,276	$101,949
Provision for loan losses	3,231	3,758	3,407	3,733	14,129
Non-interest income	12,200	17,248	14,822	33,604	77,874
Non-interest expense	26,796	27,276	26,758	30,433	111,263
Net income	4,956	7,981	7,620	16,560	37,117
Basic earnings per share	0.29	0.46	0.45	0.96	2.16
Diluted earnings per share	0.29	0.46	0.44	0.96	2.15

ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Liquidity and Market Risk Management

Parent Company

The Company has leveraged its investment in subsidiary banks and depends upon the dividends paid to it, as the sole shareholder of the subsidiary banks, as a principal source of funds for dividends to shareholders, stock repurchases and debt service requirements. At December 31, 2011, undivided profits of the Company's subsidiary banks were approximately $189.4 million, of which approximately $18.7 million was available for the payment of dividends to the Company without regulatory approval. In addition to dividends, other sources of liquidity for the Company are the sale of equity securities and the borrowing of funds.

Subsidiary Banks

Generally speaking, the Company's subsidiary banks rely upon net inflows of cash from financing activities, supplemented by net inflows of cash from operating activities, to provide cash used in investing activities. Typical of most banking companies, significant financing activities include: deposit gathering; use of short-term borrowing facilities, such as federal funds purchased and repurchase agreements; and the issuance of long-term debt. The subsidiary banks' primary investing activities include loan originations and purchases of investment securities, offset by loan payoffs and investment maturities.

Liquidity represents an institution's ability to provide funds to satisfy demands from depositors and borrowers by either converting assets into cash or accessing new or existing sources of incremental funds. A major responsibility of management is to maximize net interest income within prudent liquidity constraints. Internal corporate guidelines have been established to constantly measure liquid assets as well as relevant ratios concerning earning asset levels and purchased funds. The management and board of directors of each subsidiary bank monitor these same indicators and make adjustments as needed.

In response to tightening credit markets in 2007 and anticipating potential liquidity pressures in 2008, the Company’s management strategically planned to enhance the liquidity of each of its subsidiary banks during 2008 and 2009. We grew core deposits through various initiatives, and built additional liquidity in each of our subsidiary banks by securing additional long-term funding from FHLB borrowings. At December 31, 2011, each subsidiary bank was within established guidelines and total corporate liquidity remains strong. At December 31, 2011, cash and cash equivalents, trading and available-for-sale securities and mortgage loans held for sale were 23.1% of total assets, as compared to 18.6% at December 31, 2010.

Liquidity Management

The objective of our liquidity management is to access adequate sources of funding to ensure that cash flow requirements of depositors and borrowers are met in an orderly and timely manner. Sources of liquidity are managed so that reliance on any one funding source is kept to a minimum. Our liquidity sources are prioritized for both availability and time to activation.

Our liquidity is a primary consideration in determining funding needs and is an integral part of asset/liability management. Pricing of the liability side is a major component of interest margin and spread management. Adequate liquidity is a necessity in addressing this critical task. There are five primary and secondary sources of liquidity available to the Company. The particular liquidity need and timeframe determine the use of these sources.

The first source of liquidity available to the Company is Federal funds. Federal funds, primarily from downstream correspondent banks, are available on a daily basis and are used to meet the normal fluctuations of a dynamic balance sheet. In addition, the Company and its subsidiary banks have approximately $91 million in Federal funds lines of credit from upstream correspondent banks that can be accessed, when needed. In order to ensure availability of these upstream funds, we have a plan for rotating the usage of the funds among the upstream correspondent banks, thereby providing approximately $40 million in funds on a given day. Historical monitoring of these funds has made it possible for us to project seasonal fluctuations and structure our funding requirements on a month-to-month basis.

A second source of liquidity is the retail deposits available through our network of subsidiary banks throughout Arkansas. Although this method can be a somewhat more expensive alternative to supplying liquidity, this source can be used to meet intermediate term liquidity needs.

Third, our subsidiary banks have lines of credits available with the Federal Home Loan Bank. While we use portions of those lines to match off longer-term mortgage loans, we also use those lines to meet liquidity needs. Approximately $333 million of these lines of credit are currently available, if needed.

Fourth, we use a laddered investment portfolio that ensures there is a steady source of intermediate term liquidity. These funds can be used to meet seasonal loan patterns and other intermediate term balance sheet fluctuations. Approximately 25% of the investment portfolio is classified as available-for-sale. We also use securities held in the securities portfolio to pledge when obtaining public funds.

Finally, we have the ability to access large deposits from both the public and private sector to fund short-term liquidity needs.

We believe the various sources available are ample liquidity for short-term, intermediate-term and long-term liquidity.

Market Risk Management

Market risk arises from changes in interest rates. We have risk management policies to monitor and limit exposure to market risk. In asset and liability management activities, policies designed to minimize structural interest rate risk are in place. The measurement of market risk associated with financial instruments is meaningful only when all related and offsetting on- and off-balance-sheet transactions are aggregated, and the resulting net positions are identified.

Interest Rate Sensitivity

Interest rate risk represents the potential impact of interest rate changes on net income and capital resulting from mismatches in repricing opportunities of assets and liabilities over a period of time. A number of tools are used to

monitor and manage interest rate risk, including simulation models and interest sensitivity gap analysis. Management uses simulation models to estimate the effects of changing interest rates and various balance sheet strategies on the level of the Company's net income and capital. As a means of limiting interest rate risk to an acceptable level, management may alter the mix of floating and fixed-rate assets and liabilities, change pricing schedules and manage investment maturities during future security purchases.

The simulation model incorporates management's assumptions regarding the level of interest rates or balance changes for indeterminate maturity deposits for a given level of market rate changes. These assumptions have been developed through anticipated pricing behavior. Key assumptions in the simulation models include the relative timing of prepayments, cash flows and maturities. These assumptions are inherently uncertain and, as a result, the model cannot precisely estimate net interest income or precisely predict the impact of a change in interest rates on net income or capital. Actual results will differ from simulated results due to the timing, magnitude and frequency of interest rate changes and changes in market conditions and management strategies, among other factors.

The table below presents our interest rate sensitivity position at December 31, 2011. This analysis is based on a point in time and may not be meaningful because assets and liabilities are categorized according to contractual maturities, repricing periods and expected cash flows rather than estimating more realistic behaviors as is done in the simulation models. Also, this analysis does not consider subsequent changes in interest rate level or spreads between asset and liability categories.

Table: 23 Interest Rate Sensitivity

	Interest Rate Sensitivity Period							
	0-30	31-90	91-180	181-365	1-2	2-5	Over 5	
(In thousands, except ratios)	Days	Days	Days	Days	Years	Years	Years	Total
Earning assets								
Short-term investments	$ 535,119	$ —	$ —	$ —	$ —	$ —	$ —	$ 535,119
Assets held in trading accounts	3,547	—	—		3,994	—	—	7,541
Investment securities	121,819	108,170	75,223	113,153	82,576	78,736	117,979	697,656
Mortgage loans held for sale	22,976	—	—	—	—	—	—	22,976
Loans	587,246	117,220	182,741	222,055	237,673	216,013	16,821	1,579,769
Covered Loans	74,893	6,515	13,448	14,544	16,786	34,507	(2,618)	158,075
Total earning assets	1,345,600	231,905	271,412	349,752	341,029	329,256	132,182	3,001,136
Interest bearing liabilities								
Interest bearing transaction and savings deposits	710,336	—	—	—	105,834	317,501	105,834	1,239,504
Time deposits	103,263	150,863	207,284	235,062	93,690	88,402	70	878,634

Short-term debt	115,038	—	—	—	—	—	—	115,038
Long-term debt	21,137	1,038	2,398	3,611	21,581	20,381	50,682	120,828
Total interest bearing liabilities	949,774	151,901	209,682	238,673	221,105	426,284	156,586	2,354,004
Interest rate sensitivity Gap	$ 395,826	$ 80,004	$ 61,730	$ 111,079	$ 119,924	$ (97,028)	$ (24,404)	$ 647,132
Cumulative interest rate sensitivity Gap	$ 395,826	$ 475,830	$ 537,560	$ 648,639	$ 768,564	$ 671,536	$ 647,132	
Cumulative rate sensitive assets to rate sensitive liabilities	141.7%	143.2%	141.0%	141.8%	143.4%	130.6%	127.5%	
Cumulative Gap as a % of earning assets	13.2%	15.9%	17.9%	21.6%	25.6%	22.4%	21.6%	

56

ITEM 8. CONSOLIDATED FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

INDEX

Management's Report on Internal Control Over Financial Reporting	58
Report of Independent Registered Public Accounting Firm	
Report on Internal Control Over Financial Reporting	59
Report on Consolidated Financial Statements	60
Consolidated Balance Sheets, December 31, 2011 and 2010	61
Consolidated Statements of Income, Years Ended December 31, 2011, 2010 and 2009	62
Consolidated Statements of Cash Flows, Years Ended December 31, 2011, 2010 and 2009	63
Consolidated Statements of Stockholders' Equity, Years Ended December 31, 2011, 2010 and 2009	64
Notes to Consolidated Financial Statements, December 31, 2011, 2010 and 2009	65

Note: Supplementary Data may be found in Item 7 "Management's Discussion and Analysis of Financial Condition and Results of Operations – Quarterly Results" on page 54 hereof.

Management's Report on Internal Control Over Financial Reporting

The management of Simmons First National Corporation (the "Company") is responsible for establishing and maintaining adequate internal control over financial reporting. The Company's internal control over financial reporting is a process designed under the supervision of the Company's Chief Executive Officer and Chief Financial Officer to provide reasonable assurance regarding the reliability of financial reporting and the preparation of the Company's financial statements for external purposes in accordance with generally accepted accounting principles.

As of December 31, 2011, management assessed the effectiveness of the Company's internal control over financial reporting based on the criteria for effective internal control over financial reporting established in Internal Control - Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Based on this assessment, management determined that the Company maintained effective internal control over financial reporting as of December 31, 2011, based on the specified criteria.

BKD, LLP, the independent registered public accounting firm that audited the consolidated financial statements of the Company included in this Annual Report on Form 10-K, has issued an attestation report on the effectiveness of the Company's internal control over financial reporting as of December 31, 2011. The report, which expresses an unqualified opinion on the effectiveness of the Company's internal control over financial reporting as of December 31, 2011, immediately follows.

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

Audit Committee, Board of Directors and Stockholders
Simmons First National Corporation
Pine Bluff, Arkansas

We have audited Simmons First National Corporation's internal control over financial reporting as of December 31, 2011, based on criteria established in Internal Control-Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). The Company's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Management's Report on Internal Control over Financial Reporting. Our responsibility is to express an opinion on the Company's internal control over financial reporting based on our audit.

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

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

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

In our opinion, Simmons First National Corporation maintained, in all material respects, effective internal control over financial reporting as of December 31, 2011, based on criteria established in Internal Control-Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO).

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated financial statements of Simmons First National Corporation and our report dated March 7, 2012, expressed an unqualified opinion thereon.

BKD, LLP

/s/ BKD, LLP

Pine Bluff, Arkansas
March 7, 2012

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

Audit Committee, Board of Directors and Stockholders
Simmons First National Corporation
Pine Bluff, Arkansas

We have audited the accompanying consolidated balance sheets of Simmons First National Corporation as of December 31, 2011, and 2010, and the related consolidated statements of income, cash flows, and stockholders' equity for each of the years in the three-year period ended December 31, 2011. The Company's management is responsible for these financial statements. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Simmons First National Corporation as of December 31, 2011, and 2010, and the results of its operations and its cash flows for each of the years in the three-year period ended December 31, 2011, in conformity with accounting principles generally accepted in the United States of America.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), Simmons First National Corporation's internal control over financial reporting as of December 31, 2011, based on criteria established in Internal Control-Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) and our report dated March 7, 2012, expressed an unqualified opinion on the effectiveness of the Company's internal control over financial reporting.

BKD, LLP

/s/ BKD, LLP

Pine Bluff, Arkansas
March 7, 2012

Simmons First National Corporation
Consolidated Balance Sheets
December 31, 2011 and 2010

(In thousands, except share data)	2011	2010
ASSETS		
Cash and non-interest bearing balances due from banks	$ 35,087	$ 33,717
Interest bearing balances due from banks	535,119	418,343
Cash and cash equivalents	570,206	452,060
Investment securities	697,656	613,662
Mortgage loans held for sale	22,976	17,237
Assets held in trading accounts	7,541	7,577
Loans not covered by loss share agreements	1,579,769	1,683,464
Loans covered by FDIC loss share agreements	158,075	231,600
Allowance for loan losses	(30,108)	(26,416)
Net loans	1,707,736	1,888,648
FDIC indemnification asset	47,683	60,235
Premises and equipment	86,486	77,199
Foreclosed assets not covered by loss share agreements	22,887	23,204
Foreclosed assets covered by FDIC loss share agreements	11,685	8,717
Interest receivable	15,126	17,363
Bank owned life insurance	50,579	49,072
Goodwill	60,605	60,605
Core deposit premiums	1,579	2,463
Other assets	17,384	38,390
Total assets	$ 3,320,129	$ 3,316,432
LIABILITIES AND STOCKHOLDERS’ EQUITY		
Deposits:		
Non-interest bearing transaction accounts	$ 532,259	$ 428,750
Interest bearing transaction accounts and savings deposits	1,239,504	1,220,133
Time deposits	878,634	959,886
Total deposits	2,650,397	2,608,769
Federal funds purchased and securities sold under agreements to repurchase	114,766	109,139
Short-term debt	272	1,033
Long-term debt	120,828	164,324
Accrued interest and other liabilities	25,955	35,796
Total liabilities	2,912,218	2,919,061
Stockholders’ equity:		
Preferred stock, $0.01 par value; 40,040,000 shares authorized and unissued at December 31, 2011 and 2010	—	—
Common stock, Class A, $0.01 par value; 60,000,000 shares authorized; 17,212,317 and 17,271,594 shares issued and outstanding at December 31, 2011 and 2010, respectively	172	173
Surplus	112,436	114,040
Undivided profits	294,864	282,646
Accumulated other comprehensive income		
Unrealized appreciation on available-for-sale securities, net of income taxes of $283 and $331 at December 31, 2011 and 2010, respectively	439	512
Total stockholders’ equity	407,911	397,371
Total liabilities and stockholders’ equity	$ 3,320,129	$ 3,316,432

See Notes to Consolidated Financial Statements.

Simmons First National Corporation
Consolidated Statements of Income
Years Ended December 31, 2011, 2010 and 2009

(In thousands, except per share data)	2011	2010	2009
INTEREST INCOME			
Loans not covered by loss share agreements	$ 95,713	$ 106,062	$ 113,648
Loans covered by FDIC loss share agreements	17,118	4,204	—
Federal funds sold	6	15	27
Investment securities	14,583	17,208	21,791
Mortgage loans held for sale	503	715	608
Assets held in trading accounts	33	30	20
Interest bearing balances due from banks	1,100	721	439
TOTAL INTEREST INCOME	129,056	128,955	136,533
INTEREST EXPENSE			
Deposits	14,925	19,537	31,046
Federal funds purchased and securities sold under agreements to repurchase	450	532	769
Short-term debt	51	58	33
Long-term debt	4,970	6,879	6,958
TOTAL INTEREST EXPENSE	20,396	27,006	38,806
NET INTEREST INCOME	108,660	101,949	97,727
Provision for loan losses	11,676	14,129	10,316
NET INTEREST INCOME AFTER PROVISION FOR LOAN LOSSES	96,984	87,820	87,411
NON-INTEREST INCOME			
Trust income	5,375	5,179	5,227
Service charges on deposit accounts	16,808	17,700	17,944
Other service charges and fees	2,980	2,812	2,668
Income on sale of mortgage loans, net of commissions	4,188	4,810	4,032
Income on investment banking, net of commissions	1,478	2,236	2,153
Credit card fees	16,828	16,140	14,392
Premiums on sale of student loans	—	2,524	2,333
Bank owned life insurance income	1,481	1,670	1,270
Gain on sale of securities, net	—	317	144
Gain on FDIC-assisted transactions	—	21,314	—
Net gain (loss) on assets covered by FDIC loss share agreements	154	318	—
Other income	4,173	2,854	2,548
TOTAL NON-INTEREST INCOME	53,465	77,874	52,711
NON-INTEREST EXPENSE			
Salaries and employee benefits	65,058	60,731	58,317
Occupancy expense, net	8,443	7,808	7,457
Furniture and equipment expense	6,633	6,093	6,195
Other real estate and foreclosure expense	678	974	453
Deposit insurance	2,387	3,813	4,642
Merger related costs	357	2,611	—
Other operating expenses	31,094	29,233	27,658
TOTAL NON-INTEREST EXPENSE	114,650	111,263	104,722
INCOME BEFORE INCOME TAXES	35,799	54,431	35,400
Provision for income taxes	10,425	17,314	10,190
NET INCOME	$ 25,374	$ 37,117	$ 25,210
BASIC EARNINGS PER SHARE	$ 1.47	$ 2.16	$ 1.75

DILUTED EARNINGS PER SHARE	$ 1.47	$ 2.15	$ 1.74

See Notes to Consolidated Financial Statements.

62

Simmons First National Corporation
Consolidated Statements of Cash Flows
Years Ended December 31, 2011, 2010 and 2009

(In thousands)	2011	2010	2009
OPERATING ACTIVITIES			
Net income	$ 25,374	$ 37,117	$ 25,210
Items not requiring (providing) cash			
Depreciation and amortization	6,067	5,724	5,841
Provision for loan losses	11,676	14,129	10,316
Gain on sale of investment securities	—	(317)	(144)
Net accretion of investment securities	(51)	(7)	(48)
Stock-based compensation expense	1,204	974	627
Net (accretion) amortization on assets covered by FDIC loss share agreements	(4,448)	(595)	—
Gain on FDIC-assisted transactions	—	(21,314)	—
Deferred income taxes	(3,571)	8,428	1,613
Bank owned life insurance income	(1,481)	(1,670)	(1,270)
Changes in			
Interest receivable	2,237	518	3,049
Mortgage loans held for sale	(5,739)	(8,840)	1,939
Assets held in trading accounts	36	(691)	(1,132)
Other assets	4,742	3,660	(12,417)
Accrued interest and other liabilities	(2,847)	2,282	(5,387)
Income taxes payable	(3,642)	(291)	1,552
Net cash provided by operating activities	29,557	39,107	29,749
INVESTING ACTIVITIES			
Net collections of loans	75,516	128,451	36,621
Net collections of covered loans	66,967	26,046	—
Purchases of premises and equipment, net	(14,470)	(4,001)	(4,257)
Proceeds from sale of covered other real estate owned	8,200	4,284	—
Proceeds from sale of foreclosed assets held for sale	20,512	37,310	4,139
Net (purchases) sales of short-term investment securities	—	(1)	84,033
Proceeds from sale of available-for-sale securities	5,350	75,948	361
Proceeds from maturities of available-for-sale securities	302,438	520,883	573,604
Purchases of available-for-sale securities	(331,583)	(461,904)	(384,080)
Proceeds from maturities of held-to-maturity securities	228,284	331,527	281,986
Purchases of held-to-maturity securities	(288,505)	(332,655)	(558,921)
Purchases of bank owned life insurance	(25)	(6,482)	(33)
Net cash proceeds received in FDIC-assisted transactions	—	99,677	—
Cash received on FDIC loss share	28,872	3,751	—
Net cash provided by investing activities	101,556	422,834	33,453
FINANCING ACTIVITIES			
Net change in deposits	41,628	(258,980)	95,839
Net change in short-term debt	(761)	(4,822)	2,528
Dividends paid	(13,156)	(13,091)	(11,245)
Proceeds from issuance of long-term debt	4,835	6,278	9,166
Repayment of long-term debt	(48,331)	(97,454)	(8,014)
Net change in Federal funds purchased and securities sold under agreements to repurchase	5,627	3,229	(9,539)
Shares issued from public stock offering, net of offering costs of $4,178	—	—	70,486

Net shares issued under stock compensation plans	474	1,374	1,626
Repurchase of common stock	(3,283)	—	—
Net cash (used in) provided by financing activities	(12,967)	(363,466)	150,847
INCREASE IN CASH EQUIVALENTS	118,146	98,475	214,049
CASH AND CASH EQUIVALENTS, BEGINNING OF YEAR	452,060	353,585	139,536
CASH AND CASH EQUIVALENTS, END OF YEAR	$ 570,206	$ 452,060	$ 353,585

See Notes to Consolidated Financial Statements.

Simmons First National Corporation
Consolidated Statements of Stockholders' Equity
Years Ended December 31, 2011, 2010 and 2009

(In thousands, except share data)	Common Stock	Surplus	Accumulated Other Comprehensive Income (Loss)	Undivided Profits	Total
Balance, December 31, 2008	$ 140	$ 40,807	$ 3,190	$ 244,655	$ 288,792
Comprehensive income:					
Net income	—	—	—	25,210	25,210
Change in unrealized appreciation on available-for-sale securities, net of income taxes of ($1,456)	—	—	(2,428)	—	(2,428)
Comprehensive income					22,782
Stock issued from public stock offering, net of offering costs of $4,178	30	70,456	—	—	70,486
Stock issued as bonus shares – 27,915 shares	—	702	—	—	702
Cancelled bonus shares – 1,113 shares	—	29	—	—	29
Non-vested bonus shares	—	(1,208)	—	—	(1,208)
Stock issued for employee stock purchase plan – 5,823 shares	—	141	—	—	141
Exercise of stock options – 56,700 shares	1	689	—	—	690
Stock granted under stock-based compensation plans	—	180	—	—	180
Securities exchanged under stock option plan	—	(102)	—	—	(102)
Cash dividends – $0.76 per share	—	—	—	(11,245)	(11,245)
Balance, December 31, 2009	171	111,694	762	258,620	371,247
Comprehensive income:					
Net income	—	—	—	37,117	37,117
Change in unrealized appreciation on available-for-sale securities, net of income taxes of ($161)	—	—	(250)	—	(250)
Comprehensive income					36,867
Stock issued as bonus shares – 83,245 shares	1	203	—	—	204
Vesting bonus shares	—	801	—	—	801
Stock issued for employee stock purchase plan – 4,947 shares	—	131	—	—	131
Exercise of stock options – 108,604 shares	1	1,460	—	—	1,461
Stock granted under stock-based compensation plans	—	173	—	—	173
Securities exchanged under stock option plan	—	(422)	—	—	(422)
Cash dividends – $0.76 per share	—	—	—	(13,091)	(13,091)
Balance, December 31, 2010	173	114,040	512	282,646	397,371
Comprehensive income:					
Net income	—	—	—	25,374	25,374
Change in unrealized appreciation on available-for-sale securities, net of income taxes of ($47)	—	—	(73)	—	(73)
Comprehensive income					25,301
Stock issued as bonus shares – 47,995 shares		98	—	—	98
Vesting bonus shares	—	1,066	—	—	1,066

Stock issued for employee stock purchase plan – 4,805 shares	—	127	—	—	127
Exercise of stock options – 30,319 shares	—	385	—	—	385
Stock granted under stock-based compensation plans	—	138	—	—	138
Securities exchanged under stock option plan – (5,252 shares)	—	(136)	—	—	(136)
Repurchase of common stock – (137,144 shares)	(1)	(3,282)	—	—	(3,283)
Cash dividends – $0.76 per share	—	—	—	(13,156)	(13,156)
Balance, December 31, 2011	$ 172	$ 112,436	$ 439	$ 294,864	$ 407,911

See Notes to Consolidated Financial Statements.

Simmons First National Corporation
Notes to Consolidated Financial Statements

NOTE 1: NATURE OF OPERATIONS AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Nature of Operations

Simmons First National Corporation (the "Company") is primarily engaged in providing a full range of banking services to individual and corporate customers through its subsidiaries and their branch banks with offices in Arkansas, Missouri and Kansas. The Company is subject to competition from other financial institutions. The Company also is subject to the regulation of certain federal and state agencies and undergoes periodic examinations by those regulatory authorities.

Operating Segments

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

Use of Estimates

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

Material estimates that are particularly susceptible to significant change relate to the determination of the allowance for loan losses, the valuation of real estate acquired in connection with foreclosures or in satisfaction of loans and the valuation of covered loans and related indemnification asset. 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 Simmons First National Corporation and its subsidiaries. Significant intercompany accounts and transactions have been eliminated in consolidation.

Reclassifications

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

Cash Equivalents

The Company considers all liquid investments with original maturities of three months or less to be cash equivalents. For purposes of the consolidated statements of cash flows, cash and cash equivalents are considered to include cash and non-interest bearing balances due from banks, interest bearing balances due from banks and federal

funds sold and securities purchased under agreements to resell.

Interest Bearing Deposits in Banks

Interest bearing balances due from banks mature within one year and are carried at cost.

Investment Securities

Held-to-maturity securities, which include any security for which the Company has the positive intent and ability to hold until maturity, are carried at historical cost adjusted for amortization of premiums and accretion of discounts. Premiums and discounts are amortized and accreted, respectively, to interest income using the constant yield method over the period to maturity.

Available-for-sale securities, which include any security for which the Company has no immediate plan to sell but which may be sold in the future, are carried at fair value. Realized gains and losses, based on specifically identified amortized cost of the individual security, are included in other income. Unrealized gains and losses are recorded, net of related income tax effects, in stockholders' equity. Premiums and discounts are amortized and accreted, respectively, to interest income using the constant yield method over the period to maturity.

Trading securities, which include any security held primarily for near-term sale, are carried at fair value. Gains and losses on trading securities are included in other income.

Effective April 1, 2009, the Company adopted new accounting guidance related to recognition and presentation of other-than-temporary impairment, ASC Topic 320-10. When the Company does not intend to sell a debt security, and it is more likely than not, the Company will not have to sell the security before recovery of its cost basis, it recognizes the credit component of an other-than-temporary impairment of a debt security in earnings and the remaining portion in other comprehensive income. For held-to-maturity debt securities, the amount of an other-than-temporary impairment recorded in other comprehensive income for the noncredit portion of a previous other-than-temporary impairment is amortized prospectively over the remaining life of the security on the basis of the timing of future estimated cash flows of the security.

As a result of this guidance, the Company’s consolidated statements of income as of December 31, 2011 and 2010 reflect the full impairment (that is, the difference between the security’s amortized cost basis and fair value) on debt securities that the Company intends to sell or would more likely than not be required to sell before the expected recovery of the amortized cost basis. For available-for-sale and held-to-maturity debt securities that management has no intent to sell and believes that it more likely than not will not be required to sell prior to recovery, only the credit loss component of the impairment is recognized in earnings, while the noncredit loss is recognized in accumulated other comprehensive income. The credit loss component recognized in earnings is identified as the amount of principal cash flows not expected to be received over the remaining term of the security as projected based on cash flow projections. Prior to the adoption of this accounting guidance on April 1, 2009, management considered, in determining whether other-than-temporary impairment exists, (1) the length of time and the extent to which the fair value has been less than cost, (2) the financial condition and near-term prospects of the issuer and (3) the intent and ability of the Company to retain its investment in the issuer for a period of time sufficient to allow for any anticipated recovery in fair value.

Mortgage Loans Held For Sale

Mortgage loans held for sale are carried at the lower of cost or fair value, determined using an aggregate basis. Write-downs to fair value are recognized as a charge to earnings at the time the decline in value occurs. Forward commitments to sell mortgage loans are acquired to reduce market risk on mortgage loans in the process of origination and mortgage loans held for sale. The forward commitments acquired by the Company for mortgage loans in process of origination are not mandatory forward commitments. These commitments are structured

on a best efforts basis; therefore, the Company is not required to substitute another loan or to buy back the commitment if the original loan does not fund. Typically, the Company delivers the mortgage loans within a few days after the loans are funded. These commitments are derivative instruments and their fair values at December 31, 2011 and 2010 are not material. Gains and losses resulting from sales of mortgage loans are recognized when the respective loans are sold to investors. Gains and losses are determined by the difference between the selling price and the carrying amount of the loans sold, net of discounts collected or paid. Fees received from borrowers to guarantee the funding of mortgage loans held for sale are recognized as income or expense when the loans are sold or when it becomes evident that the commitment will not be used.

Loans

Loans that management has the intent and ability to hold for the foreseeable future or until maturity or pay-offs are reported at their outstanding principal adjusted for any loans charged off, the allowance for loan losses and any unamortized deferred fees or costs on originated loans and unamortized premiums or discounts on purchased loans.

For loans amortized at cost, interest income is accrued based on the unpaid principal balance. Loan origination fees, net of certain direct origination costs, as well as premiums and discounts, are deferred and amortized as a level yield adjustment over the respective term of the loan.

The accrual of interest on loans, except on certain government guaranteed loans, is discontinued at the time the loan is 90 days past due unless the credit is well-secured and in process of collection. Past due status is based on contractual terms of the loan. In all cases, loans are placed on nonaccrual or charged off at an earlier date if collection of principal or interest is considered doubtful.

Discounts and premiums on purchased residential real estate loans are amortized to income using the interest method over the remaining period to contractual maturity, adjusted for anticipated prepayments. Discounts and premiums on purchased consumer loans are recognized over the expected lives of the loans using methods that approximate the interest method.

Allowance for Loan Losses

The allowance for loan losses is established as losses are estimated to have occurred through a provision for loan losses charged to income. Loan losses are charged against the allowance when management believes the uncollectability of a loan balance is confirmed. Subsequent recoveries, if any, are credited to the allowance.

The allowance is maintained at a level considered appropriate to provide for potential loan losses related to specifically identified loans as well as probable credit losses inherent in the remainder of the loan portfolio as of period end. This estimate is based on management's evaluation of the loan portfolio, as well as on prevailing and anticipated economic conditions and historical losses by loan category. General reserves have been established, based upon the aforementioned factors and allocated to the individual loan categories. Allowances are accrued on specific loans evaluated for impairment for which the basis of each loan, including accrued interest, exceeds the discounted amount of expected future collections of interest and principal or, alternatively, the fair value of loan collateral. The unallocated reserve generally serves to compensate for the uncertainty in estimating loan losses, including the possibility of changes in risk ratings and specific reserve allocations in the loan portfolio as a result of the Company’s ongoing risk management system.

A loan is considered impaired when it is probable that the Company will not receive all amounts due according to the contractual terms of the loan. This includes loans that are delinquent 90 days or more, nonaccrual loans and certain other loans identified by management. Certain other loans identified by management consist of performing loans with specific allocations of the allowance for loan losses. Specific allocations are applied when quantifiable factors are present requiring a greater allocation than that established by the Company based on its analysis of historical losses for each loan category. Accrual of interest is discontinued and interest accrued and unpaid is removed at the time such amounts are delinquent 90 days unless management is aware of circumstances which warrant continuing the interest accrual. Interest is recognized for nonaccrual loans only upon receipt and only after all principal amounts are current according to the terms of the contract.

Acquisition Accounting, Covered Loans and Related Indemnification Asset

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 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 losses incurred on certain acquired loans, 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 acquisition and loan accounting, see Note 2 and Note 5 to the consolidated financial statements.

Premises and Equipment

Depreciable assets are stated at cost less accumulated depreciation. Depreciation is charged to expense using the straight-line method over the estimated useful lives of the assets. Leasehold improvements are capitalized and amortized by the straight-line method over the terms of the respective leases or the estimated useful lives of the improvements, whichever is shorter.

Foreclosed Assets Held For Sale

Assets acquired by foreclosure or in settlement of debt and held for sale are valued at estimated fair value as of the date of foreclosure, and a related valuation allowance is provided for estimated costs to sell the assets. Management

evaluates the value of foreclosed assets held for sale periodically and increases the valuation allowance for any subsequent declines in fair value. Changes in the valuation allowance are charged or credited to other expense.

68

Goodwill and Intangible Assets

Goodwill represents the excess of the cost of an acquisition over the fair value of the net assets acquired. Other intangible assets represent purchased assets that also lack physical substance but can be separately distinguished from goodwill because of contractual or other legal rights or because the asset is capable of being sold or exchanged either on its own or in combination with a related contract, asset or liability. The Company performs an annual goodwill impairment test, and more frequently if circumstances warrant, in accordance with ASC Topic 350, Intangibles – Goodwill and Other. ASC Topic 350 requires that goodwill and intangible assets that have indefinite lives be reviewed for impairment annually, or more frequently if certain conditions occur. Impairment losses on recorded goodwill, if any, will be recorded as operating expenses.

Derivative Financial Instruments

The Company may enter into derivative contracts for the purposes of managing exposure to interest rate risk to meet the financing needs of its customers. The Company records all derivatives on the balance sheet at fair value. Historically, the Company's policy has been not to invest in derivative type investments, but, in an effort to meet the financing needs of its customers, the Company has entered into one fair value hedge. Fair value hedges include interest rate swap agreements on fixed rate loans. For derivatives designated as hedging the exposure to changes in the fair value of the hedged item, the gain or loss is recognized in earnings in the period of change together with the offsetting loss or gain of the hedging instrument. The fair value hedge is considered to be highly effective and any hedge ineffectiveness was deemed not material. The notional amount of the loan being hedged was $1.5 million at December 31, 2011, and $1.6 million at December 31, 2010.

Securities Sold Under Agreements to Repurchase

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

Bankcard Fee Income

Periodic bankcard fees, net of direct origination costs, are recognized as revenue on a straight-line basis over the period the fee entitles the cardholder to use the card.

Income Taxes

The Company accounts for income taxes in accordance with income tax accounting guidance in ASC Topic 740, Income Taxes. The income tax accounting guidance results in two components of income tax expense: current and deferred. Current income tax expense reflects taxes to be paid or refunded for the current period by applying the provisions of the enacted tax law to the taxable income or excess of deductions over revenues. The Company determines deferred income taxes using the liability (or balance sheet) method. Under this method, the net deferred tax asset or liability is based on the tax effects of the differences between the book and tax bases of assets and liabilities, and enacted changes in tax rates and laws are recognized in the period in which they occur.

69

Deferred income tax expense results from changes in deferred tax assets and liabilities between periods. Deferred tax assets are recognized if it is more likely than not, based on the technical merits, that the tax position will be realized or sustained upon examination. The term more likely than not means a likelihood of more than 50 percent; the terms examined and upon examination also include resolution of the related appeals or litigation processes, if any. A tax position that meets the more-likely-than-not recognition threshold is initially and subsequently measured as the largest amount of tax benefit that has a greater than 50 percent likelihood of being realized upon settlement with a taxing authority that has full knowledge of all relevant information. The determination of whether or not a tax position has met the more-likely-than-not recognition threshold considers the facts, circumstances and information available at the reporting date and is subject to management's judgment. Deferred tax assets are reduced by a valuation allowance if, based on the weight of evidence available, it is more likely than not that some portion or all of a deferred tax asset will not be realized.

The Company files consolidated income tax returns with its subsidiaries.

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 computation of per share earnings is as follows:

(In thousands, except per share data)	2011	2010	2009
Net Income	$ 25,374	$ 37,117	$ 25,210
Average common shares outstanding	17,309	17,204	14,375
Average common share stock options outstanding	9	61	90
Average diluted common shares	17,318	17,265	14,465
Basic earnings per share	$ 1.47	$ 2.16	$ 1.75
Diluted earnings per share	$ 1.47	$ 2.15	$ 1.74

Stock options to purchase 147,470, 95,770 and 100,290 shares, respectively, for the years ended December 31, 2011, 2010 and 2009, were not included in the earnings per share calculation because the exercise price exceeded the average market price.

Stock-Based Compensation

The Company has adopted various stock-based compensation plans. The plans provide for the grant of incentive stock options, nonqualified stock options, stock appreciation rights and bonus stock awards. Pursuant to the plans, shares are reserved for future issuance by the Company, upon exercise of stock options or awarding of bonus shares granted to directors, officers and other key employees.

In accordance with ASC Topic 718, Compensation – Stock Compensation, the fair value of each option award is estimated on the date of grant using the Black-Scholes option-pricing model that uses various assumptions. This model requires the input of highly subjective assumptions, changes to which can materially affect the fair value estimate. For additional information, see Note 12, Employee Benefit Plans.

NOTE 2: ACQUISITIONS

On May 14, 2010, the Company, through its wholly-owned subsidiary, Simmons First National Bank ("SFNB" or "lead bank"), entered into a purchase and assumption agreement with loss share arrangements with the FDIC pursuant to which it acquired substantially all of the assets and assumed substantially all of the deposits and certain other liabilities of Southwest Community Bank ("SWCB") in Springfield, Missouri. As a result of this acquisition, the Company expanded its footprint outside the Arkansas borders for the first time. The Company recognized a pre-tax gain of $3.0 million on this transaction and incurred pre-tax merger related costs of $0.4 million.

On October 15, 2010, the Company, through the lead bank, entered into a purchase and assumption agreement with loss share arrangements with the FDIC to purchase substantially all of the assets and to assume substantially all of the deposits and certain other liabilities of Security Savings Bank, FSB ("SSB") with nine offices in Kansas, including three in Salina, two each in Olathe and Wichita and one each in Overland Park and Leawood. This acquisition marked the Company's second expansion outside the State of Arkansas. The Company recognized a pre-tax gain of $18.3 million on this transaction and incurred pre-tax merger related costs of $2.0 million.

A summary, at fair value, of the assets acquired and liabilities assumed in the SWCB and SSB transactions, as of acquisition dates, is as follows:

(In thousands)	SWCB	SSB	Total
Assets Acquired			
Cash and due from banks	$ 7,414	$ 11,063	$ 18,477
Cash received from FDIC	10,000	71,200	81,200
Receivable from FDIC	653	1,856	2,509
Investment securities	24,850	75,621	100,471
Loans not covered by loss share agreements	—	991	991
Loans covered by FDIC loss share agreements	40,177	219,158	259,335
Foreclosed assets covered by FDIC loss share agreements	4,646	6,363	11,009
FDIC indemnification asset	13,783	68,330	82,113
Core deposit premium	—	1,480	1,480
Other assets	467	1,577	2,044
Total assets acquired	101,990	457,639	559,629
Liabilities Assumed			
Deposits:			
Non-interest bearing transaction accounts	5,063	82,614	87,677
Interest bearing transaction accounts and savings deposits	103	8,624	8,727
Time deposits	92,174	246,999	339,173
Total deposits	97,340	338,237	435,577
Repurchase agreements	—	2,215	2,215
FHLB borrowings	—	95,676	95,676
Accrued interest and other liabilities	1,613	3,234	4,847
Total liabilities assumed	98,953	439,362	538,315
Pre-tax gains on FDIC-assisted transactions	$ 3,037	$ 18,277	$ 21,314

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, cash received from FDIC and receivable from FDIC – The carrying amount of these assets is a reasonable estimate of fair value based on the short-term nature of these assets. The $10.0 million cash received from the FDIC for SWCB and $71.2 million for SSB is the first pro-forma cash settlement received from the FDIC on Monday following the closing weekend. The $0.7 million receivable from the FDIC for SWCB and $1.9 million for SSB is the remaining amount due from the settlement.

Investment securities – Investment securities were acquired from the FDIC at fair market value. The fair values provided by the FDIC were reviewed and considered reasonable based on SFNB's understanding of the market conditions.

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. Loans were grouped together according to similar characteristics and were treated in the aggregate when applying various valuation techniques.

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 SFNB 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.

Core deposit premium – This intangible asset represents the value of the relationships that SWCB and SSB had with their 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. Based on the valuation methodologies used in the analysis, the estimated fair value of the core deposit premium at SWCB was immaterial.

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. Even though deposit rates were above market, because SFNB reset deposit rates to current market rates, there was no fair value adjustment recorded for time deposits.

FHLB borrowings – The fair value of Federal Home Loan Bank ("FHLB") borrowings is estimated based on borrowing rates currently available to the Company for borrowings with similar terms and maturities. Included in the SSB acquisition were FHLB borrowed funds with a fair value totaling $95.7 million. The Company did not need these advances to meet its liquidity needs, and redeemed approximately $60.8 million of the advances during the fourth quarter of 2010. The FHLB borrowings are secured by mortgage loans. The remaining borrowings are being held to maturity to match loans with similar maturities.

FDIC True-Up Provision – The purchase and assumption agreements for SWCB and SSB allow for the FDIC to recover a portion of the loss share funds previously paid out under the indemnification agreement in the event losses fail to reach the expected loss level under a claw back provision ("true-up provision"). A true-up is scheduled to occur in the calendar month in which the tenth anniversary of the respective closing occurs. If the threshold is not met, the assuming institution is required to pay the FDIC 50 percent of the excess, if any, within 45 days following the true-up.

The value of the true-up provision liability is calculated as the present value of the estimated payment to the FDIC in the tenth year using the formula provided in the agreements. The result of the calculation is based on the net present value of expected future cash payments to be made by SFNB to the FDIC at the conclusion of the loss share agreements. The discount rate used was based on current market rates. The expected cash flows were calculated in accordance with the loss share agreements and are based primarily on the expected losses on the covered assets. The

value of the true-up provision was $3.4 million and $3.2 million at December 31, 2011 and 2010, respectively, and was included in accrued interest and other liabilities on the balance sheet.

In connection with the SWBC and SSB acquisitions, SFNB and the FDIC will share in the losses on assets covered under the loss share agreements. The FDIC will reimburse SFNB for 80% of all losses on covered assets. The loss sharing agreements entered into by SFNB and the FDIC in conjunction with the purchase and assumption agreements require that SFNB follow certain servicing procedures as specified in the loss share agreements or risk losing FDIC reimbursement of covered asset losses. Additionally, to the extent that actual losses incurred by SFNB under the loss share agreements are less than expected, SFNB may be required to reimburse the FDIC under the clawback provisions of the loss share agreements. At December 31, 2011, the covered loans and covered other real estate owned and the related FDIC indemnification asset (collectively, the "covered assets") and the FDIC true-up provision were reported at the net present value of expected future amounts to be paid or received.

Purchased loans acquired in a business combination, including loans purchased in the SWCB and SSB acquisitions, are recorded at estimated fair value on their purchase date with no carryover of the related allowance for loan and lease losses. Purchased loans are accounted for in accordance with ASC Topic 310-30, Loans and Debt Securities Acquired with Deteriorated Credit Quality accounting guidance for certain loans or debt securities acquired in a transfer, when the loans have evidence of credit deterioration since origination and it is probable at the date of acquisition that the acquirer will not collect all contractually required principal and interest payments. The difference between contractually required payments and the cash flows expected to be collected at acquisition is referred to as the non-accretable difference. Subsequent decreases to the expected cash flows will generally result in a provision for loan and lease losses. Subsequent increases in cash flows result in a reversal of the provision for loan and lease losses to the extent of prior charges and an adjustment in accretable yield, recognized on a prospective basis over the loan's or pool's remaining life, which will have a positive impact on interest income.

The Company has finalized its analysis of the acquired loans along with the other acquired assets and assumed liabilities in these transactions. No significant adjustments to the estimated amounts and carrying values were required as of the dates of acquisition. See Note 5 for discussion regarding subsequent evaluation of future cash flows.

During 2010, SFNB acquired the real estate (building and land) for the Springfield, Missouri location (formerly SWCB) for a total of $1.1 million. During 2011, SFNB acquired the real estate for four of the Kansas locations previously owned by SSB related entities for a total of $6.2 million. Also, during 2011, SFNB acquired three additional Kansas locations upon final settlement of SSB with the FDIC for a total of $4.4 million. Two other locations are leased from third parties and SFNB will continue to lease these facilities.

NOTE 3: INVESTMENT SECURITIES

The amortized cost and fair value of investment securities that are classified as held-to-maturity and available-for-sale are as follows:

	Years Ended December 31							
	2011				2010			
(In thousands)	Amortized Cost	Gross Unrealized Gains	Gross Unrealized (Losses)	Estimated Fair Value	Amortized Cost	Gross Unrealized Gains	Gross Unrealized (Losses)	Estimated Fair Value
Held-to-Maturity								
U.S. Treasury	$ 4,000	$ 14	$ —	$ 4,014	$ 4,000	$ 28	$ —	$ 4,028
U.S. Government agencies	308,779	712	(154)	309,337	249,844	1,764	(507)	251,101
Mortgage-backed securities	62	1	—	63	78	4	—	82
State and political subdivisions	211,673	6,333	(144)	217,862	210,331	2,280	(1,845)	210,766
Other securities	930	—	—	930	930	—	—	930
Total	$ 525,444	$ 7,060	$ (298)	$ 532,206	$ 465,183	$ 4,076	$ (2,352)	$ 466,907
Available-for-Sale								
U.S. Government agencies	$ 153,560	$ 295	$ (228)	$ 153,627	$ 125,175	$ 577	$ (283)	$ 125,469
Mortgage-backed securities	2,280	277	—	2,557	2,647	143	(1)	2,789
State and political subdivisions	—	—	—	—	—	—	—	—
Other securities	15,649	384	(5)	16,028	19,814	411	(4)	20,221
Total	$ 171,489	$ 956	$ (233)	$ 172,212	$ 147,636	$ 1,131	$ (288)	$ 148,479

Securities with limited marketability, such as stock in the Federal Reserve Bank and the Federal Home Loan Bank, are carried at cost and are reported as other available-for-sale securities in the table above.

Certain investment securities are valued at less than their historical cost. Total fair value of these investments at December 31, 2011 and 2010, was $196.3 million and $229.6 million, which is approximately 27.9% and 37.3%, respectively, of the Company's available-for-sale and held-to-maturity investment portfolio.

The following table shows the gross unrealized losses and fair value of the Company's investments with unrealized losses, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position at December 31:

	Less Than 12 Months		12 Months or More		Total	
(In thousands)	Estimated Fair Value	Gross Unrealized Losses	Estimated Fair Value	Gross Unrealized Losses	Estimated Fair Value	Gross Unrealized Losses
December 31, 2011						
Held-to-Maturity						
U.S. Government agencies	$ 83,128	$ 154	$ —	$ —	$ 83,128	$ 154
State and political subdivisions	4,673	11	1,226	133	5,899	144
Total	$ 87,801	$ 165	$ 1,226	$ 133	$ 89,027	$ 298
Available-for-Sale						
U.S. Government agencies	$ 106,097	$ 201	$ 1,166	$ 27	$ 107,263	$ 228
Mortgage-backed securities	—	—	35	—	35	—
Other securities	1	5	—	—	1	5
Total	$ 106,098	$ 206	$ 1,201	$ 27	$ 107,299	$ 233
December 31, 2010						
Held-to-Maturity						
U.S. Government agencies	$ 97,437	$ 507	$ —	$ —	$ 97,437	$ 507
State and political subdivisions	62,807	1,735	1,837	110	64,644	1,845
Total	$ 160,244	$ 2,242	$ 1,837	$ 110	$ 162,081	$ 2,352
Available-for-Sale						
U.S. Government agencies	$ 67,203	$ 283	$ —	$ —	$ 67,203	$ 283
Mortgage-backed securities	207	—	110	1	317	1
Other securities	1	4	—	—	1	4
Total	$ 67,411	$ 287	$ 110	$ 1	$ 67,521	$ 288

U.S. Government Agencies

The unrealized losses on the Company's investments in direct obligations of U.S. government agencies were caused by interest rate increases. The contractual terms of those investments do not permit the issuer to settle the securities at a price less than the amortized cost bases of the investments. Because the Company does not intend to sell the investments and it is not more likely than not the Company will be required to sell the investments before recovery of their amortized cost bases, which may be maturity, the Company does not consider those investments to be other-than-temporarily impaired at December 31, 2011.

State and Political Subdivisions

The unrealized losses on the Company's investments in securities of state and political subdivisions were caused by interest rate increases. The contractual terms of those investments do not permit the issuer to settle the securities at a price less than the amortized cost bases of the investments. Because the Company does not intend to sell the investments and it is not more likely than not the Company will be required to sell the investments before recovery of their amortized cost bases, which may be maturity, the Company does not consider those investments to be other-than-temporarily impaired at December 31, 2011.

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.

Management has the ability and intent to hold the securities classified as held to maturity until they mature, at which time the Company expects to receive full value for the securities. Furthermore, as of December 31, 2011, management also had the ability and intent to hold the securities classified as available-for-sale for a period of time sufficient for a recovery of cost. The unrealized losses are largely due to increases in market interest rates over the yields available at the time the underlying securities were purchased. The fair value is expected to recover as the bonds approach their maturity date or repricing date or if market yields for such investments decline. Management does not believe any of the securities are impaired due to reasons of credit quality. Accordingly, as of December 31, 2011, management believes the impairments detailed in the table above are temporary.

Income earned on the above securities for the years ended December 31, 2011, 2010 and 2009, is as follows:

(In thousands)	2011	2010	2009
Taxable			
Held-to-maturity	$ 4,229	$ 4,615	$ 2,880
Available-for-sale	2,490	4,336	11,016
Non-taxable			
Held-to-maturity	7,864	8,257	7,874
Available-for-sale	—	—	21
Total	$ 14,583	$ 17,208	$ 21,791

The Statement of Stockholders' Equity includes other comprehensive income. Other comprehensive income for the Company includes the change in the unrealized appreciation on available-for-sale securities. The changes in the unrealized appreciation on available-for-sale securities for the years ended December 31, 2011, 2010 and 2009, are as follows:

(In thousands)	2011	2010	2009
Unrealized holding gains (losses) arising during the period	$ (120)	$ (94)	$ (3,740)
Gains realized in net income	—	317	144
	(120)	(411)	(3,884)
Income tax expense (benefit)	(47)	(161)	(1,456)
Net change in unrealized appreciation on available-for-sale securities	$ (73)	$ (250)	$ (2,428)

The amortized cost and estimated fair value by maturity of securities are shown in the following table. Securities are classified according to their contractual maturities without consideration of principal amortization, potential prepayments or call options. Accordingly, actual maturities may differ from contractual maturities.

	Held-to-Maturity		Available-for-Sale	
	Amortized	Fair	Amortized	Fair
(In thousands)	Cost	Value	Cost	Value
One year or less	$ 36,695	$ 36,890	$ 300	$ 300
After one through five years	220,925	222,012	81,929	81,965
After five through ten years	181,674	183,745	73,607	73,915
After ten years	86,150	89,559	4	4
Other securities	—	—	15,649	16,028
Total	$ 525,444	$ 532,206	$ 171,489	$ 172,212

The carrying value, which approximates the fair value, of securities pledged as collateral, to secure public deposits and for other purposes, amounted to $410,702,000 at December 31, 2011 and $435,635,000 at December 31, 2010.

The book value of securities sold under agreements to repurchase amounted to $83,556,000 and $75,774,000 for December 31, 2011 and 2010, respectively.

There were no gross realized gains or losses from the sale of available for sale securities during the year ended December 31, 2011. The Company had gross realized gains of $467,000 and gross realized losses of $150,000 during the year ended December 31, 2010, from the sale of available for sale securities. As part of its acquisition strategy related to SSB, the Company liquidated the acquired investment portfolio, resulting in the entire net realized gain of $317,000 in 2010. The Company had gross realized gains of $144,000 and no realized losses during the year ended December 31, 2009. The income tax expense/benefit related to security gains/losses was 39.225% of the gross amounts.

The state and political subdivision debt obligations are primarily non-rated bonds and represent small, Arkansas issues, which are evaluated on an ongoing basis.

NOTE 4: LOANS AND ALLOWANCE FOR LOAN LOSSES

At December 31, 2011, the Company's loan portfolio was $1.74 billion, compared to $1.92 billion at December 31, 2010. The various categories of loans are summarized as follows:

(In thousands)	2011	2010
Consumer:		
Credit cards	$ 189,970	$ 190,329
Student loans	47,419	61,305
Other consumer	109,211	118,581
Total consumer	346,600	370,215
Real estate:		
Construction	109,825	153,772
Single family residential	355,094	364,442
Other commercial	536,372	548,360
Total real estate	1,001,291	1,066,574
Commercial:		
Commercial	141,422	150,501
Agricultural	85,728	86,171
Total commercial	227,150	236,672
Other	4,728	10,003
Loans not covered by loss share agreements	1,579,769	1,683,464
Loans covered by FDIC loss share agreements	158,075	231,600
Total loans before allowance for loan losses	$ 1,737,844	$ 1,915,064

Loan Origination/Risk Management – The Company seeks to manage its credit risk by diversifying its loan portfolio, determining that borrowers have adequate sources of cash flow for loan repayment without liquidation of collateral; obtaining and monitoring collateral; providing an appropriate allowance for loans losses by regularly reviewing loans through the internal loan review process. The loan portfolio is diversified by borrower, purpose and industry. The Company seeks to use diversification within the loan portfolio to reduce its credit risk, thereby minimizing the adverse impact on the portfolio, if weaknesses develop in either the economy or a particular segment of borrowers. Collateral requirements are based on credit assessments of borrowers and may be used to recover the debt in case of default. Furthermore, factors that influenced the Company's judgment regarding the allowance for loan losses consists of a three-year historical loss average segregated by each primary loan sector. On an annual basis, historical loss rates are calculated for each sector.

Consumer – The consumer loan portfolio consists of credit card loans, student loans and other consumer loans. The Company no longer originates student loans, and the current portfolio is guaranteed by the Department of Education at 97% of principal and interest. Credit card loans are diversified by geographic region to reduce credit risk and minimize any adverse impact on the portfolio. Although they are regularly reviewed to facilitate the identification and monitoring of creditworthiness, credit card loans are unsecured loans, making them more susceptible to be impacted by economic downturns resulting in increasing unemployment. Other consumer loans include direct and indirect installment loans and overdrafts. Loans in this portfolio segment are sensitive to unemployment and other key consumer economic measures.

Real estate – The real estate loan portfolio consists of construction loans, single family residential loans and commercial loans. Construction and development loans ("C&D") and commercial real estate loans ("CRE") can be particularly sensitive to valuation of real estate. Commercial real estate cycles are inevitable. The long planning and production process for new properties and rapid shifts in business conditions and employment create an inherent tension between supply and demand for commercial properties. While general economic trends often move individual

markets in the same direction over time, the timing and magnitude of changes are determined by other forces unique to each market. CRE cycles tend to be local in nature and longer than other credit cycles. Factors influencing the CRE market are traditionally different from those affecting residential real estate markets; thereby making predictions for one market based on the other difficult. Additionally, submarkets within commercial real estate – such as office, industrial, apartment, retail and hotel – also experience different cycles, providing an opportunity to lower the overall risk through diversification across types of CRE loans. Management realizes that local demand and supply conditions will also mean that different geographic areas will experience cycles of different amplitude and length. The Company monitors these loans closely and has no significant concentrations in its real estate loan portfolio.

Commercial – The commercial loan portfolio includes commercial and agricultural loans, representing loans to commercial customers and farmers for use in normal business or farming operations to finance working capital needs, equipment purchase or other expansion projects. Collection risk in this portfolio is driven by the creditworthiness of the underlying borrowers, particularly cash flow from customers' business or farming operations. The Company continues its efforts to keep loan terms short, reducing the negative impact of upward movement in interest rates. Term loans are generally set up with a one or three year balloon, and the Company has recently instituted a pricing index for commercial loans. It is standard practice to require personal guaranties on all commercial loans, particularly as they relate to closely-held or limited liability entities.

Nonaccrual and Past Due Loans – Loans are considered past due if the required principal and interest payments have not been received as of the date such payments were due. Loans are placed on nonaccrual status when, in management's opinion, the borrower may be unable to meet payment obligations as they become due, as well as when required by regulatory provisions. Loans may be placed on nonaccrual status regardless of whether or not such loans are considered past due. When interest accrual is discontinued, all unpaid accrued interest is reversed. Interest income is subsequently recognized only to the extent cash payments are received in excess of principal due. Loans are returned to accrual status when all the principal and interest amounts contractually due are brought current and future payments are reasonably assured.

Nonaccrual loans, excluding loans covered by FDIC loss share agreements, at December 31, 2011 and 2010, segregated by class of loans, are as follows:

(In thousands)	2011	2010
Consumer:		
Credit cards	$ 305	$ 295
Student loans	—	—
Other consumer	839	963
Total consumer	1,144	1,258
Real estate:		
Construction	121	804
Single family residential	3,198	3,470
Other commercial	7,233	4,340
Total real estate	10,552	8,614
Commercial:		
Commercial	757	972
Agricultural	454	342
Total commercial	1,211	1,314
Other	—	—
Total	$ 12,907	$ 11,186

An age analysis of past due loans, excluding loans covered by FDIC loss share agreements, segregated by class of loans, at December 31, 2011 and 2010, is as follows:

(In thousands)	Gross 30-89 Days Past Due	90 Days or More Past Due	Total Past Due	Current	Total Loans	90 Days Past Due & Accruing
December 31, 2011						
Consumer:						
Credit cards	$ 820	$ 605	$ 1,425	$ 188,545	$ 189,970	$ 300
Student loans	1,894	2,483	4,377	43,042	47,419	2,483
Other consumer	1,398	664	2,062	107,149	109,211	335
Total consumer	4,112	3,752	7,864	338,736	346,600	3,118
Real estate:						
Construction	548	121	669	109,156	109,825	—
Single family residential	3,581	2,262	5,843	349,251	355,094	121
Other commercial	806	6,240	7,046	529,326	536,372	15
Total real estate	4,935	8,623	13,558	987,733	1,001,291	136
Commercial:						
Commercial	467	467	934	140,488	141,422	9
Agricultural	103	312	415	85,313	85,728	5
Total commercial	570	779	1,349	225,801	227,150	14
Other	—	—	—	4,728	4,728	—
Total	$ 9,617	$ 13,154	$ 22,771	$ 1,556,998	$ 1,579,769	$ 3,268
December 31, 2010						
Consumer:						
Credit cards	$ 971	$ 911	$ 1,882	$ 188,447	$ 190,329	$ 615
Student loans	1,505	1,736	3,241	58,064	61,305	1,736
Other consumer	2,016	448	2,464	116,117	118,581	155
Total consumer	4,492	3,095	7,587	362,628	370,215	2,506
Real estate:						
Construction	691	498	1,189	152,583	153,772	—
Single family residential	1,877	2,155	4,032	360,410	364,442	122
Other commercial	7,312	2,229	9,541	538,819	548,360	—
Total real estate	9,880	4,882	14,762	1,051,812	1,066,574	122
Commercial:						
Commercial	1,002	500	1,502	148,999	150,501	77
Agricultural	25	185	210	85,961	86,171	—
Total commercial	1,027	685	1,712	234,960	236,672	77
Other	—	—	—	10,003	10,003	—
Total	$ 15,399	$ 8,662	$ 24,061	$ 1,659,403	$ 1,683,464	$ 2,705

Impaired Loans – A loan is considered impaired when it is probable that the Company will not receive all amounts due according to the contractual terms of the loans, including scheduled principal and interest payments. This includes loans that are delinquent 90 days or more, nonaccrual loans and certain other loans identified by management. Certain other loans identified by management consist of performing loans with specific allocations of the allowance for loan losses. Impaired loans are carried at the present value of estimated future cash flows using the loan's existing rate, or the fair value of the collateral if the loan is collateral dependent. Specific allocations are applied when quantifiable factors are present requiring a greater allocation than that established by the Company based on its analysis of historical losses for each loan category.

Impairment is evaluated in total for smaller-balance loans of a similar nature and on an individual loan basis for other loans. Impaired loans, or portions thereof, are charged-off when deemed uncollectible.

Impaired loans, net of government guarantees and excluding loans covered by FDIC loss share agreements, segregated by class of loans, at December 31, 2011 and 2010, are as follows:

(In thousands)	Unpaid Contractual Principal Balance	Recorded Investment With No Allowance	Recorded Investment With Allowance	Total Recorded Investment	Related Allowance	Average Investment in Impaired Loans	Interest Income Recognized
December 31, 2011							
Consumer:							
Credit cards	$ 605	$ 605	$ —	$ 605	$ 91	$ 715	$ 44
Student loans	—	—	—	—	—	—	—
Other consumer	1,359	1,203	128	1,331	266	1,298	57
Total consumer	1,964	1,808	128	1,936	357	2,013	101
Real estate:							
Construction	5,324	3,783	1,498	5,281	415	6,758	298
Single family residential	5,152	4,243	589	4,832	402	5,978	264
Other commercial	28,538	13,642	13,100	26,742	1,942	30,160	1,332
Total real estate	39,014	21,668	15,187	36,855	2,759	42,896	1,894
Commercial:							
Commercial	949	569	312	881	214	1,223	54
Agricultural	572	332	104	436	153	538	24
Total commercial	1,521	901	416	1,317	367	1,761	78
Other	—	—	—	—	—	—	—
Total	$ 42,499	$ 24,377	$ 15,731	$ 40,108	$ 3,483	$ 46,670	$ 2,073
December 31, 2010							
Consumer:							
Credit cards	$ 911	$ —	$ 911	$ 911	$ 159		
Student loans	—	—	—	—	—		
Other consumer	1,431	92	1,270	1,362	368		
Total consumer	2,342	92	2,181	2,273	527		
Real estate:							
Construction	9,690	5,878	2,591	8,469	804		
Single family residential	6,590	3,002	3,366	6,368	792		
Other commercial	32,547	3,843	27,531	31,374	2,342		
Total real estate	48,827	12,723	33,488	46,211	3,938		
Commercial:							
Commercial	1,567	704	655	1,359	626		
Agricultural	703	318	454	772	144		
Total commercial	2,270	1,022	1,109	2,131	770		
Other	—	—	—	—	—		
Total	$ 53,439	$ 13,837	$ 36,778	$ 50,615	$ 5,235		

At December 31, 2011, and December 31, 2010, impaired loans, net of government guarantees, totaled $40.1 million and $50.6 million, respectively. Allocations of the allowance for loan losses relative to impaired loans were $3,483,000 and $5,235,000 at December 31, 2011 and 2010, respectively. Approximately $2,073,000, $2,389,000 and $1,398,000 of interest income was recognized on average impaired loans of $46,670,000, $55,754,000 and $36,843,000 for 2011, 2010 and 2009, respectively. Interest recognized on impaired loans on a cash basis during 2011, 2010 and 2009 was immaterial.

Included in certain impaired loan categories are troubled debt restructurings ("TDRs"). When the Company restructures a loan to a borrower that is experiencing financial difficulty and grants a concession that it would not otherwise consider, a "troubled debt restructuring" results and the Company classifies the loan as a TDR. The Company grants various types of concessions, primarily interest rate reduction and/or payment modifications or extensions, with an occasional forgiveness of principal.

Under ASC Topic 310-10-35 – Subsequent Measurement, a TDR is considered to be impaired, and an impairment analysis must be performed. The Company assesses the exposure for each modification, either by collateral discounting or by calculation of the present value of future cash flows, and determines if a specific allocation to the allowance for loan losses is needed.

Once an obligation has been restructured because of such credit problems, it continues to be considered a TDR until paid in full; or, if an obligation yields a market interest rate and no longer has any concession regarding payment amount or amortization, then it is not considered a TDR at the beginning of the calendar year after the year in which the improvement takes place. The Company returns TDRs to accrual status only if (1) all contractual amounts due can reasonably be expected to be repaid within a prudent period, and (2) repayment has been in accordance with the contract for a sustained period, typically at least six months.

During 2011, the Company adopted ASU 2011-02 – A Creditor's Determination of Whether a Restructuring is a Troubled Debt Restructuring. The amendments in ASU 2011-02 require prospective application of the impairment measurement guidance in ASC 31-10-35 for those loans newly identified as impaired. As a result of adopting ASU 2011-02, the Company reassessed all restructurings that occurred on or after January 1, 2011, the beginning of the current fiscal year, for identification as TDRs. The Company identified no loans as TDRs for which the allowance for loan losses had previously been measured under a general allowance for loan losses methodology. Therefore, there was no additional impact to the allowance for loan losses as a result of the adoption.

The following table presents a summary of troubled debt restructurings as of December 31, 2011, excluding loans covered by FDIC loss share agreements, segregated by class of loans.

	Accruing TDR Loans		Nonaccrual TDR Loans		Total TDR Loans	
(Dollars in thousands)	Number	Balance	Number	Balance	Number	Balance
Consumer:						
Credit cards	—	$ —	—	$ —	—	$ —
Student loans	—	—	—	—	—	—
Other consumer	5	23	—	—	5	23
Total consumer	5	23	—	—	5	23
Real estate:						
Construction	1	1,277	—	—	1	1,277
Single-family residential	5	957	1	34	6	991
Other commercial	13	8,602	7	5,082	20	13,683
Total real estate	19	10,836	8	5,116	27	15,951
Commercial:						
Commercial	2	332	1	35	3	367
Agricultural	2	201	—	—	2	201
Total commercial	4	533	1	35	5	568
Other	—	—	—	—	—	—
Total	28	$ 11,391	9	$ 5,151	37	$ 16,542

The following table presents loans that were restructured as TDRs during the year ended December 31, 2011, excluding loans covered by FDIC loss share agreements, segregated by class of loans.

				Modification Type		
(Dollars in thousands)	Number of Loans	Balance Prior to TDR	Balance at December 31, 2011	Change in Maturity Date	Change in Rate	Financial Impact on Date of Restructure
Year Ended December 31, 2011						
Consumer:						
Credit cards	—	$ —	$ —	$ —	$ —	$ —
Student loans	—	—	—	—	—	—
Other consumer	4	30	16	16	—	—
Total consumer	4	30	16	16	—	—
Real estate:						
Construction	—	—	—	—	—	—
Single family residential	—	—	—	—	—	—
Other commercial	4	2,112	2,112	2,112	—	—
Total real estate	4	2,112	2,112	2,112	—	—
Commercial:						
Commercial	2	346	332	332	—	—
Agricultural	—	—	—	—	—	—
Total commercial	2	346	332	332	—	—
Other	—	—	—	—	—	—
Total	10	$ 2,488	$ 2,460	$ 2,460	$ —	$ —

During the year ended December 31, 2011, the Company modified a total of ten loans with a recorded investment of $2.5 million prior to modification which were deemed troubled debt restructurings. Although there was additional modification of terms on some of the loans, the prevailing modification on all ten loans was a change in or extension of the maturity date. Based on the fair value of the collateral, no specific reserve was determined necessary for any of these loans. Also, there was no immediate financial impact from the restructuring of these loans, as it was not considered necessary to charge-off interest or principal on the date of restructure.

The following table presents loans for which a payment default occurred during the year ended December 31, 2011, and that had been modified as a TDR within 12 months or less of the payment default, excluding loans covered by FDIC loss share agreements, segregated by class of loans. We define a payment default as a payment received more than 90 days after its due date.

(Dollars in thousands)	Number of Loans	Recorded Balance at December 31, 2011	Charge-offs	Transfers to OREO
Year Ended December 31, 2011				
Consumer:				
Credit cards	—	$ —	$ —	$ —
Student loans	—	—	—	—
Other consumer	—	—	—	—
Total consumer	—	—	—	—
Real estate:				
Construction	—	—	—	—
Single family residential	—	—	—	—
Other commercial	5	4,051	556	—
Total real estate	5	4,051	556	—
Commercial:				
Commercial	1	35	3	—
Agricultural	—	—	—	—
Total commercial	1	35	3	—
Other	—	—	—	—
Total	6	$ 4,086	$ 559	$ —

Credit Quality Indicators – As part of the on-going monitoring of the credit quality of the Company’s loan portfolio, management tracks certain credit quality indicators including trends related to (i) the weighted-average risk rating of commercial and real estate loans, (ii) the level of classified commercial and real estate loans, (iii) net charge-offs, (iv) non-performing loans (see details above) and (v) the general economic conditions in the States of Arkansas, Kansas and Missouri.

The Company utilizes a risk rating matrix to assign a risk rate to each of its commercial and real estate loans. Loans are rated on a scale of 1 to 8. A description of the general characteristics of the 8 risk ratings is as follows:

- Risk Rate 1 – Pass (Excellent) – This category includes loans which are virtually free to credit risk. Borrowers in this category represent the highest credit quality and greatest financial strength.

- Risk Rate 2 – Pass (Good) - Loans under this category possess a nominal risk of default. This category includes borrowers with strong financial strength and superior financial ratios and trends. These loans are generally fully secured by cash or equivalents (other than those rated "excellent”).

- Risk Rate 3 – Pass (Acceptable – Average) - Loans in this category are considered to possess a normal level of risk. Borrowers in this category have satisfactory financial strength and adequate cash flow coverage to service debt requirements. If secured, the perfected collateral should be of acceptable quality and within established borrowing parameters.

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Risk Rate 4 – Pass (Monitor) - Loans in the Watch (Monitor) category exhibit an overall acceptable level of risk, but that risk may be increased by certain conditions, which represent "red flags". These "red flags" require a higher level of supervision or monitoring than the normal "Pass" rated credit. The borrower may be experiencing these conditions for the first time, or it may be recovering from weakness, which at one time justified a harsher rating. These conditions may include: weaknesses in financial trends; marginal cash flow; one-time negative operating results; non-compliance with policy or borrowing agreements; poor diversity in operations; lack of adequate monitoring information or lender supervision; questionable management ability/stability.

- Risk Rate 5 – Special Mention - A loan in this category has potential weaknesses that deserve management's close attention. If left uncorrected, these potential weaknesses may result in deterioration of the repayment prospects for the asset or in the institution's credit position at some future date. Special Mention loans are not adversely classified (although they are "criticized") and do not expose an institution to sufficient risk to warrant adverse classification. Borrowers may be experiencing adverse operating trends, or an ill-proportioned balance sheet. Non-financial characteristics of a Special Mention rating may include management problems, pending litigation, a non-existent, or ineffective loan agreement or other material structural weakness, and/or other significant deviation from prudent lending practices.

- Risk Rate 6 – Substandard - A Substandard loan is inadequately protected by the current sound worth and paying capacity of the borrower or of the collateral pledged, if any. Loans so classified must have a well-defined weakness, or weaknesses, that jeopardize the liquidation of the debt. The loans are characterized by the distinct possibility that the Company will sustain some loss if the deficiencies are not corrected. This does not imply ultimate loss of the principal, but may involve burdensome administrative expenses and the accompanying cost to carry the loan.

- Risk Rate 7 – Doubtful – A loan classified Doubtful has all the weaknesses inherent in a substandard loan except that the weaknesses make collection or liquidation in full (on the basis of currently existing facts, conditions, and values) highly questionable and improbable. Doubtful borrowers are usually in default, lack adequate liquidity, or capital, and lack the resources necessary to remain an operating entity. The possibility of loss is extremely high, but because of specific pending events that may strengthen the asset, its classification as loss is deferred. Pending factors include: proposed merger or acquisition; liquidation procedures; capital injection; perfection of liens on additional collateral; and refinancing plans. Loans classified as Doubtful are placed on nonaccrual status.

    - Risk Rate 8 – Loss - Loans classified Loss are considered uncollectible and of such little value that their continuance as bankable assets is not warranted. This classification does not mean that the loans has absolutely no recovery or salvage value, but rather it is not practical or desirable to defer writing off this basically worthless loan, even though partial recovery may be affected in the future. Borrowers in the Loss category are often in bankruptcy, have formally suspended debt repayments, or have otherwise ceased normal business operations. Loans should be classified as Loss and charged-off in the period in which they become uncollectible.

Loans covered by FDIC loss share agreements are evaluated using this internal grading system. However, since these loans are accounted for in pools and are currently substantially covered through loss sharing agreements with the FDIC, all of the loan pools were considered satisfactory at December 31, 2011 and December 31, 2010, respectively. See Note 5, Loans Covered by FDIC Loss Share Agreements, for further discussion of the acquired loan pools and loss sharing agreements.

Classified loans for the Company include loans in Risk Ratings 6, 7 and 8. Loans may be classified, but not considered impaired, due to one of the following reasons: (1) The Company has established minimum dollar amount thresholds for loan impairment testing. Loans rated 6 – 8 that fall under the threshold amount are not tested for impairment and therefore are not included in impaired loans. (2) Of the loans that are above the threshold amount and tested for impairment, after testing, some are considered to not be impaired and are not included in impaired loans. Total classified loans were $60.6 million and $67.6 million as of December 31, 2011 and December 31, 2010, respectively.

The following table presents a summary of loans by credit risk rating as of December 31, 2011 and December 31, 2010, segregated by class of loans.

(In thousands)	Risk Rate 1-4	Risk Rate 5	Risk Rate 6	Risk Rate 7	Risk Rate 8	Total
December 31, 2011						
Consumer:						
Credit cards	$ 189,365	$ —	$ 605	$ —	$ —	$ 189,970
Student loans	44,936	—	2,483	—	—	47,419
Other consumer	107,217	12	1,906	50	26	109,211
Total consumer	341,518	12	4,994	50	26	346,600
Real estate:						
Construction	100,534	3,699	5,592	—	—	109,825
Single family residential	345,880	1,377	7,821	16	—	355,094
Other commercial	491,466	8,465	36,441	—	—	536,372
Total real estate	937,880	13,541	49,854	16	—	1,001,291
Commercial:						
Commercial	136,107	510	4,762	43	—	141,422
Agricultural	84,747	148	833	—	—	85,728
Total commercial	220,854	658	5,595	43	—	227,150
Other	4,728	—	—	—	—	4,728
Loans covered by FDIC loss share agreements	158,075	—	—	—	—	158,075
Total	$ 1,663,055	$ 14,211	$ 60,443	$ 109	$ 26	$ 1,737,844

(In thousands)	Risk Rate 1-4	Risk Rate 5	Risk Rate 6	Risk Rate 7	Risk Rate 8	Total
December 31, 2010						
Consumer:						
Credit cards	$ 189,418	$ —	$ 911	$ —	$ —	$ 190,329
Student loans	59,569	—	1,736	—	—	61,305
Other consumer	116,179	15	2,323	64	—	118,581
Total consumer	365,166	15	4,970	64	—	370,215
Real estate:						
Construction	144,482	570	8,720	—	—	153,772
Single family residential	356,271	1,158	6,992	21	—	364,442
Other commercial	494,828	11,543	41,989	—	—	548,360
Total real estate	995,581	13,271	57,701	21	—	1,066,574
Commercial:						
Commercial	146,155	526	3,806	14	—	150,501
Agricultural	85,105	—	1,066	—	—	86,171
Total commercial	231,260	526	4,872	14	—	236,672
Other	10,003	—	—	—	—	10,003
Loans covered by FDIC loss share agreements	231,600	—	—	—	—	231,600
Total	$ 1,833,610	$ 13,812	$ 67,543	$ 99	$ —	$ 1,915,064

Net (charge-offs)/recoveries for the years ended December 31, 2011 and 2010, excluding loans covered by FDIC loss share agreements, segregated by class of loans, were as follows:

(In thousands)	2011	2010
Consumer:		
Credit cards	$ (3,724)	$ (4,286)
Student loans	(54)	(69)
Other consumer	(1,232)	(1,518)
Total consumer	(5,010)	(5,873)
Real estate:		
Construction	(753)	(2,154)
Single family residential	(794)	(864)
Other commercial	(637)	(2,889)
Total real estate	(2,184)	(5,907)
Commercial:		
Commercial	(538)	(721)
Agricultural	(252)	(228)
Total commercial	(790)	(949)
Other	—	—
Total	$ (7,984)	$ (12,729)

Allowance for Loan Losses – The allowance for loan losses is a reserve established through a provision for loan losses charged to expense, which represents management's best estimate of probable losses that have been incurred within the existing portfolio of loans. The allowance, in the judgment of management, is necessary to reserve for estimated loan losses and risks inherent in the loan portfolio. The Company's allowance for loan loss methodology includes allowance allocations calculated in accordance with ASC Topic 310, Receivables, and allowance allocations calculated in accordance with ASC Topic 450, Contingencies. Accordingly, the methodology is based on historical loss experience by type of credit and internal risk grade, specific homogeneous risk pools and specific loss allocations, with adjustments for current events and conditions. The Company's process for determining the appropriate level of the allowance for loan losses is designed to account for credit deterioration as it occurs. The provision for loan losses reflects loan quality trends, including the levels of and trends related to nonaccrual loans, past due loans, potential problem loans, criticized loans and net charge-offs or recoveries, among other factors. The provision for loan losses also reflects the totality of actions taken on all loans for a particular period. In other words, the amount of the provision reflects not only the necessary increases in the allowance for loan losses related to newly identified criticized loans, but it also reflects actions taken related to other loans including, among other things, any necessary increases or decreases in required allowances for specific loans or loan pools.

The allowance for loan losses is determined monthly based on management's assessment of several factors such as (1) historical loss experience based on volumes and types, (2) reviews or evaluations of the loan portfolio and allowance for loan losses, (3) trends in volume, maturity and composition, (4) off balance sheet credit risk, (5) volume and trends in delinquencies and nonaccruals, (6) lending policies and procedures including those for loan losses, collections and recoveries, (7) national, state and local economic trends and conditions, (8) concentrations of credit that might affect loss experience across one or more components of the loan portfolio, (9) the experience, ability and depth of lending management and staff and (10) other factors and trends that will affect specific loans and categories of loans.

As management evaluates the allowance for loan losses, it is categorized as follows: (1) specific allocations, (2) allocations for classified assets with no specific allocation, (3) general allocations for each major loan category and (4) unallocated portion.

Specific allocations are made when factors are present requiring a greater reserve than would be required when using the assigned risk rating allocation. As a general rule, if a specific allocation is warranted, it is the result of an analysis of a previously classified credit or relationship. The Company's evaluation process in specific allocations includes a review of appraisals or other collateral analysis. These values are compared to the remaining outstanding principal balance. If a loss is determined to be reasonably possible, the possible loss is identified as a specific allocation. If the loan is not collateral dependent, the measurement of loss is based on the expected future cash flows of the loan.

87

The Company establishes allocations for loans rated “watch” through “doubtful” based upon analysis of historical loss experience by category. A percentage rate is applied to each of these loan categories to determine the level of dollar allocation. During the second quarter of 2009, management made adjustments to the Company’s methodology in the evaluation of the collectability of loans, which added quantitative factors to the internal and external influences used in determining the credit quality of loans and the allocation of the allowance. This adjustment in methodology resulted in an addition to impaired loans from classified loans and a redistribution of allocated and unallocated reserves. It is likely that the methodology will continue to evolve over time.

Management recognizes that unforeseen risks are inherent in the loan portfolio, and seeks to quantify, to the extent possible, factors that affect both the value and collectability of the asset. Relative to ASC Topic 310, the Company has identified the following risk assessment factors that have the potential to affect loan quality, and correspondingly, loan recognition. The factors are identified as (1) lending policies and procedures, (2) economic outlook and business conditions, (3) level and trend in delinquencies, (4) concentrations of credit and (5) external factors and competition.

The Company establishes general allocations for each major loan category. This section also includes allocations to loans which are collectively evaluated for loss such as credit cards, one-to-four family owner occupied residential real estate loans and other consumer loans. The allocations in this section are based on an analysis of historical losses for each loan category. Management gives consideration to trends, changes in loan mix, delinquencies, prior losses and other related information.

Allowance allocations other than specific, classified and general are included in the unallocated portion. While allocations are made for loans based upon historical loss analysis, the unallocated portion is designed to cover the uncertainty of how current economic conditions and other uncertainties may impact the existing loan portfolio. Factors to consider include national and state economic conditions such as increases in unemployment, the recent real estate lending crisis, the volatility in the stock market and the unknown impact of the various government stimulus programs. Various Federal Reserve articles and reports indicate the economy is in a moderate recovery, but questions remain about the durability of growth and whether it can be sustained by private demand. While the recession may be over, production, income, sales and employment are at very low levels. With moderate economic growth, it is possible the recovery could take years. The unemployment rate seems likely to remain elevated for several years. The unallocated reserve addresses inherent probable losses not included elsewhere in the allowance for loan losses. While calculating allocated reserve, the unallocated reserve supports uncertainties within the loan portfolio.

Loans identified as losses by management, internal loan review and/or bank examiners are charged-off.

The following table details activity in the allowance for loan losses by portfolio segment for the year ended December 31, 2011. Allocation of a portion of the allowance to one category of loans does not preclude its availability to absorb losses in other categories.

(In thousands)	Commercial	Real Estate	Credit Card	Other Consumer and Other	Unallocated	Total
Balance, beginning of year	$ 2,277	$ 9,692	$ 5,549	$ 1,958	$ 6,940	$ 26,416
Provision for loan losses	576	2,609	3,688	1,175	3,628	11,676
Charge-offs	(1,411)	(3,165)	(4,703)	(1,890)	—	(11,169)
Recoveries	621	981	979	604	—	3,185
Net charge-offs	(790)	(2,184)	(3,724)	(1,286)	—	(7,984)
Balance, end of year	$ 2,063	$ 10,117	$ 5,513	$ 1,847	$ 10,568	$ 30,108
Period-end amount allocated to:						
Loans individually evaluated for impairment	$ 367	$ 2,759	$ 91	$ 266	$ —	$ 3,483
Loans collectively evaluated for impairment	1,696	7,358	5,422	1,581	10,568	26,625
Balance, end of year	$ 2,063	$ 10,117	$ 5,513	$ 1,847	$ 10,568	$ 30,108

Activity in the allowance for loan losses for the years ended December 31, 2010 and 2009, was as follows:

(In thousands)	2010	2009
Balance, beginning of year	$ 25,016	$ 25,841
Provision for loan losses	14,129	10,316
Charge-offs	(18,602)	(14,828)
Recoveries	5,873	3,687
Net charge-offs	(12,729)	(11,141)
Balance, end of year	$ 26,416	$ 25,016

The Company's recorded investment in loans, excluding loans covered by FDIC loss share agreements, as of December 31, 2011 and 2010 related to each balance in the allowance for loan losses by portfolio segment on the basis of the Company's impairment methodology is as follows:

(In thousands)	Commercial	Real Estate	Credit Card	Other Consumer and Other	Total
December 31, 2011					
Loans individually evaluated for impairment	$ 1,317	$ 36,855	$ 605	$ 1,331	$ 40,108
Loans collectively evaluated for impairment	225,833	964,436	189,365	160,027	1,539,661
Balance, end of period	$ 227,150	$ 1,001,291	$ 189,970	$ 161,358	$ 1,579,769
December 31, 2010					
Loans individually evaluated for impairment	$ 2,131	$ 46,211	$ 911	$ 1,362	$ 50,615
Loans collectively evaluated for impairment	234,541	1,020,363	189,418	188,527	1,632,849
Balance, end of period	$ 236,672	$ 1,066,574	$ 190,329	$ 189,889	$ 1,683,464

NOTE 5: LOANS COVERED BY FDIC LOSS SHARE AGREEMENTS

The Company evaluated loans purchased in conjunction with the acquisitions of SWCB and SSB described in Note 2, Acquisitions, for impairment in accordance with the provisions of ASC Topic 310-30. Purchased covered loans are considered impaired if there is evidence of credit deterioration since origination and if it is probable that not all contractually required payments will be collected. The following table reflects the carrying value of all purchased covered impaired loans as of December 31, 2011 and 2010, for the SWCB and SSB FDIC-assisted transactions:

(in thousands)	Loans Covered by FDIC Loss Share December 31, 2011	2010
Consumer:		
Other consumer	$ 23	$ 105
Total consumer	23	105
Real estate:		
Construction	23,515	73,527
Single family residential	26,825	50,182
Other commercial	102,198	89,495
Total real estate	152,538	213,204
Commercial:		
Commercial	5,514	17,975
Agricultural	—	316
Total commercial	5,514	18,291
Total covered loans (1)	$ 158,075	$ 231,600

(1) These loans were not classified as non-performing assets at December 31, 2011 and 2010, as the loans are accounted for on a pooled basis and the pools are considered to be performing. Therefore, interest income, through accretion of the difference between the carrying amount of the loans and the expected cash flows, is being recognized on all purchased impaired loans. The loans are grouped in pools sharing common risk characteristics and were treated in the aggregate when applying various valuation techniques.

The acquired loans were grouped into pools based on common risk characteristics and were recorded at their estimated fair values, which incorporated estimated credit losses at the acquisition date. These loan pools are systematically reviewed by the Company to determine the risk of losses that may exceed those identified at the time of the acquisition. Techniques used in determining risk of loss are similar to the Company's non-covered loan portfolio, with most focus being placed on those loan pools which include the larger loan relationships and those loan pools which exhibit higher risk characteristics.

The following is a summary of the covered impaired loans acquired in the acquisitions during 2010, as of the dates of acquisition.

(in thousands)	SWCB	SSB
Contractually required principal and interest at acquisition	$ 58,739	$ 334,582
Non-accretable difference (expected losses and foregone interest)	(15,396)	(78,139)
Cash flows expected to be collected at acquisition	43,343	256,443
Accretable yield	(3,166)	(37,285)
Basis in acquired loans at acquisition	$ 40,177	$ 219,158

As of the respective acquisition dates, the estimates of contractually required payments receivable, including interest, for all covered impaired loans acquired in the SWCB and SSB transactions were $393.3 million. The cash flows expected to be collected as of the acquisition dates for these loans were $299.8 million, including interest. These amounts were determined based upon the estimated remaining life of the underlying loans, which includes the effects of estimated prepayments.

The amount of the estimated cash flows expected to be received from the acquired loan pools in excess of the fair values recorded for the loan pools is referred to as the accretable yield. The accretable yield is recognized as interest income over the estimated lives of the loans. Each quarter, the Company estimates the cash flows expected to be collected from the acquired loan pools, and adjustments may or may not be required. During the fourth quarter of 2011, the cash flows estimate increased based on payment histories and reduced loss expectations of the loan pools. This resulted in increased interest income that will be spread on a level-yield basis over the remaining expected lives of the loan pools. The increases in expected cash flows also reduced the amount of expected reimbursements under the loss sharing agreements with the FDIC, which are recorded as indemnification assets. The estimated adjustments to the indemnification assets will be amortized on a level-yield basis over the remainder of the loss sharing agreements or the remaining expected lives of the loan pools, whichever is shorter. The impact of the fourth quarter adjustments on the Company's financial results for the current reporting period is shown below:

(In thousands, except basis points data)	Year Ended December 31, 2011	
Impact on net interest income/ net interest margin (in basis points)	$ 1,124	4 bps
Non-interest income	(978)	
Net impact to pre-tax income	146	
Net impact, net of taxes	$ 89	

Because these adjustments will be recognized over the remaining lives of the loan pools and the remainder of the loss sharing agreements, respectively, they will impact future periods as well. The current estimate of the remaining accretable yield adjustment that will positively impact interest income is $22.6 million and the remaining adjustment to the indemnification assets that will reduce non-interest income is $19.9 million. Of the remaining adjustments, the Company expects to recognize $11.0 million of interest income and a $9.7 million reduction of non-interest income during 2012. The accretable yield adjustments recorded in future periods will change as the Company continues to evaluate expected cash flows from the acquired loan pools.

Changes in the carrying amount of the accretable yield for purchased impaired and non-impaired loans were as follows for the years ended December 31, 2011 and 2010, for SWCB and SSB.

(in thousands)	Accretable Yield	Carrying Amount of Loans
Balance, January 1, 2010	$ —	$ —
Additions	40,451	259,335
Accretion	(4,204)	4,204
Payments received, net	—	(31,939)
Balance, December 31, 2010	$ 36,247	$ 231,600
Additions	—	—
Accretable yield adjustments	23,704	