PINNACLE FINANCIAL PARTNERS INC
Form 10-Q
May 08, 2015
UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549
FORM 10-Q
(mark one)
x QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d)
OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended March 31, 2015
or
o TRANSITION REPORT PURSUANT TO SECTION 13 OF 15(d)
OF THE SECURITIES AND EXCHANGE ACT OF 1934
For the transition period from $\qquad$ to $\qquad$
Commission File Number: 000-31225
, Inc.
(Exact name of registrant as specified in its charter)

| Tennessee | 62-1812853 |
| :--- | :--- |
| (State or other jurisdiction of incorporation or organization) | (I.R.S. Employer Identification No.) |

150 Third Avenue South, Suite 900, Nashville, Tennessee
(Address of principal executive offices)

$$
\begin{aligned}
& 37201 \\
& \text { (Zip Code) }
\end{aligned}
$$

(615) 744-3700
(Registrant's telephone number, including area code)
Not Applicable
(Former name, former address and former fiscal year, if changes since last report)
Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15 (d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No
Indicate by check mark whether the registrant has submitted electronically and posted on its corporate website, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for shorter period that the registrant was required to submit and post such files).
Yes No
Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See definitions of "large accelerated filer", "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one):
Large Accelerated Filer
Non-accelerated Filer
(do not check if you are a smaller reporting company)
Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).
Yes No
As of May 6, 2015 there were $35,876,498$ shares of common stock, $\$ 1.00$ par value per share, issued and outstanding.

Pinnacle Financial Partners, Inc.
Report on Form 10-Q
March 31, 2015
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## FORWARD-LOOKING STATEMENTS

Certain of the statements in this quarterly report on Form 10-Q may constitute forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. The words "expect," "anticipate," "goal," "objective," "intend," "plan," "believe," "should," "seek," "estimate" and similar expressions are intended to identify such forward-looking statements, but other statements not based on historical information may also be considered forward-looking. All forward-looking statements are subject to risks, uncertainties and other factors that may cause the actual results, performance or achievements of Pinnacle Financial to differ materially from any results expressed or implied by such forward-looking statements. Such risks include, without limitation, (i) deterioration in the financial condition of borrowers resulting in significant increases in loan losses and provisions for those losses; (ii) continuation of the historically low short-term interest rate environment; (iii) the inability of Pinnacle Financial or companies in which Pinnacle Financial has significant investments to grow their loan portfolios at recent growth rates; (iv) changes in loan underwriting, credit review or loss reserve policies associated with economic conditions, examination conclusions, or regulatory developments; (v) effectiveness of Pinnacle Financial's asset management activities in improving, resolving or liquidating lower-quality assets; (vi) increased competition with other financial institutions; (vii) greater than anticipated adverse conditions in the national or local economies including the Nashville-Davidson-Murfreesboro-Franklin MSA and the Knoxville MSA, particularly in commercial and residential real estate markets; (viii) rapid fluctuations or unanticipated changes in interest rates on loans or deposits; (ix) the results of regulatory examinations; (x) the ability to retain large, uninsured deposits; (xi) the development of any new market other than Nashville or Knoxville; (xii) a merger or acquisition, like the proposed mergers with CapitalMark Bank \& Trust (CapitalMark) and Magna Bank (Magna); (xiii) risks of expansion into new geographic or product markets, like the proposed expansion into the Chattanooga, TN-GA MSA associated with the proposed merger with CapitalMark (the CapitalMark Merger) and the Memphis, TN-MS-AR MSA associated with the proposed merger with Magna (the Magna Merger and together with the CapitalMark Merger, the Mergers); (xiv) any matter that would cause Pinnacle Financial to conclude that there was impairment of any asset, including intangible assets; (xv) reduced ability to attract additional financial advisors (or failure of such advisors to cause their clients to switch to Pinnacle Financial) or otherwise to attract customers from other financial institutions; (xvi) further deterioration in the valuation of other real estate owned and increased expenses associated therewith; (xvii) inability to comply with regulatory capital requirements, including those resulting from changes to capital calculation methodologies and required capital maintenance levels; (xviii) risks associated with litigation, including the applicability of insurance coverage; (xix) the risk that the cost savings and any revenue synergies from the proposed mergers may not be realized or take longer than anticipated to be realized; (xx) disruption from the mergers with customers, suppliers or employee relationships; (xxi) the occurrence of any event, change or other circumstances that could give rise to the termination of either of the merger agreements related to the Mergers; (xxii) the risk of successful integration of Pinnacle Financial's business with the business of CapitalMark and Magna; (xxiii) the failure of CapitalMark's or Magna's shareholders to approve the mergers; (xxiv) the amount of the costs, fees, expenses and charges related to the Mergers; (xxv) the ability to obtain required governmental approvals of the proposed terms of the Mergers; (xxvi) reputational risk and the reaction of the parties' customers to the proposed mergers; (xxvii) the failure of the closing conditions for either of the Mergers to be satisfied; (xxviii) the risk that the integration of CapitalMark's or Magna's operations with Pinnacle Financial's will be materially delayed or will be more costly or difficult than expected; (xxix) the possibility that the Mergers may be more expensive to complete than anticipated, including as a result of unexpected factors or events; (xxx) the dilution caused by Pinnacle's issuance of additional shares of its common stock in the Mergers; (xxxi) approval of the declaration of any dividend by Pinnacle Financial's board of directors; (xxxii) the vulnerability of our network and online banking portals to unauthorized access, computer viruses, phishing schemes, spam attacks, human error, natural disasters, power loss and other security breaches; (xxxiii) the possibility of increased compliance costs as a result of increased regulatory oversight, including oversight of companies in which Pinnacle has significant investments, and the development of additional banking products for our corporate and consumer clients; and (xxxiv) changes in state and federal legislation, regulations or policies applicable to banks and other financial service providers, including regulatory or legislative developments arising out of current unsettled conditions in the economy, including implementation of the Dodd-Frank Wall Street Reform and Consumer Protection Act. A more detailed description of these and other risks is
contained in "Part II. Item 1A. Risk Factors" below. Many of such factors are beyond Pinnacle Financial's ability to control or predict, and readers are cautioned not to put undue reliance on such forward-looking statements. Pinnacle Financial disclaims any obligation to update or revise any forward-looking statements contained in this report, whether as a result of new information, future events or otherwise.

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Item 1. Part I. Financial Information
PINNACLE FINANCIAL PARTNERS, INC. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS
(Unaudited)
$\left.\begin{array}{lll} & & \text { December 31, } \\ & \text { March 31, 2015 } & 2014 \\ \text { ASSETS } & & \\ \text { Cash and noninterest-bearing due from banks } & \$ 61,498,151 & \$ 48,741,692 \\ \text { Interest-bearing due from banks } & 227,823,492 & 134,176,054 \\ \text { Federal funds sold and other } & 4,455,077 & 4,989,764 \\ \text { Cash and cash equivalents } & 293,776,720 & 187,907,510 \\ & & \\ \text { Securities available-for-sale, at fair value } & 769,018,224 & 732,054,785 \\ \text { Securities held-to-maturity (fair value of \$39,407,835 and \$38,788,870 at } & & \\ \text { March 31, 2015 and December 31, 2014, respectively) } & 39,275,846 & 38,675,527 \\ \text { Mortgage loans held-for-sale } & 18,909,910 & 14,038,914 \\ \text { Loans held-for-sale } & 7,934,778 & - \\ & & \\ \text { Loans } & 4,645,272,317 & 4,590,026,505 \\ \text { Less allowance for loan losses } & (66,241,583 & (67,358,639\end{array}\right)$

| Additional paid-in capital | $563,831,066$ | $561,431,449$ |
| :--- | :--- | :--- |
| Retained earnings | $218,909,667$ | $201,371,081$ |
| Accumulated other comprehensive income, net of taxes | $5,545,246$ | $4,158,368$ |
| Total stockholders' equity | $824,150,646$ | $802,693,381$ |
| Total liabilities and stockholders' equity | $\$ 6,314,346,368$ | $\$ 6,018,247,797$ |

See accompanying notes to consolidated financial statements (unaudited).
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PINNACLE FINANCIAL PARTNERS, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF INCOME
(Unaudited)

Interest income:
Loans, including fees
Securities:
Taxable
Tax-exempt
Federal funds sold and other
Total interest income
Three Months Ended
March 31,
2015
$\$ 49,466,706$ \$43,695,658

Interest expense:
Deposits
Securities sold under agreements to repurchase
Federal Home Loan Bank advances and other borrowings
Total interest expense
Net interest income
Provision for loan losses
Net interest income after provision for loan losses
2,430,742 2,595,240
30,917 30,515
948,552 757,222
3,410,211 3,382,977
51,268,379 45,907,815
315,091 487,638
50,953,288 45,420,177

Noninterest income:
Service charges on deposit accounts
Investment services
Insurance sales commissions
Gain on mortgage loans sold, net
Gain on sale of investment securities, net
Trust fees
Income from equity-method investment
Other noninterest income
Total noninterest income

| $2,912,549$ | $2,790,968$ |
| :--- | :--- |
| $2,259,440$ | $2,127,834$ |
| $1,512,618$ | $1,384,921$ |
| $1,941,254$ | $1,234,872$ |
| 6,003 | - |
| $1,311,985$ | $1,145,751$ |
| $3,201,302$ | - |
| $5,348,151$ | $4,048,017$ |
| $18,493,302$ | $12,732,363$ |

Noninterest expense:
Salaries and employee benefits
23,530,860 21,749,960
Equipment and occupancy
Other real estate expense
Marketing and other business development
Postage and supplies
Amortization of intangibles
Other noninterest expense
Total noninterest expense
Income before income taxes
Income tax expense
Net income
6,046,223 5,709,030
395,288 651,152
959,750 908,901

Per share information:
Basic net income per common share $\quad \$ 0.62 \quad \$ 0.47$
Diluted net income per common share $\quad \$ 0.62 \quad \$ 0.47$
Weighted average shares outstanding:

Basic
35,041,203 34,602,337
Diluted
See accompanying notes to consolidated financial statements (unaudited).
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PINNACLE FINANCIAL PARTNERS, INC. AND SUBSIDIARIES CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
(Unaudited)

|  | Three Months March 31, 2015 | Ended <br> 2014 |
| :---: | :---: | :---: |
| Net income | \$21,842,711 | \$16,367,123 |
| Other comprehensive income (loss), net of tax: |  |  |
| Change in fair value of available-for-sale securities, net of tax | 1,936,058 | 4,945,912 |
| Change in fair value of cash flow hedges, net of tax | (552,828 | (1,294,306 ) |
| Net gain on sale of investment securities reclassified from other comprehensive |  |  |
| income into net income, net of tax | 3,648 | - |
| Total other comprehensive income (loss), net of tax | 1,386,878 | 3,651,606 |
| Total comprehensive income | \$23,229,589 | \$20,018,729 |

See accompanying notes to consolidated financial statements (unaudited).
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PINNACLE FINANCIAL PARTNERS, INC. AND SUBSIDIARIES CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY (Unaudited)


See accompanying notes to consolidated financial statements (unaudited).

## PINNACLE FINANCIAL PARTNERS, INC. AND SUBSIDIARIES <br> CONSOLIDATED STATEMENTS OF CASH FLOWS <br> (Unaudited)

Operating activities:
Net income
Adjustments to reconcile net income to net cash provided by operating activities:
Net amortization/accretion of premium/discount on securities
Depreciation and amortization
Provision for loan losses
Gain on mortgage loans sold, net
Loss on sale of investment securities
Stock-based compensation expense
Deferred tax expense (benefit)
(Gains) losses on dispositions of other real estate
(Gains) losses on equity-method investment
Excess tax benefit from stock compensation
Mortgage loans held for sale:
Loans originated
Loans sold
Increase in other assets
Decrease in other liabilities
Net cash provided by operating activities
Investing activities:
Activities in securities available-for-sale:
Purchases
Sales
Maturities, prepayments and calls
Activities in securities held-to-maturity:
Purchases
Maturities, prepayments and calls
Increase in loans, net
Purchases of software, premises and equipment
Increase in equity-method investment
Increase in other investments
Net cash used in investing activities
Financing activities:
Net increase in deposits
Net decrease in securities sold under agreements to repurchase
Advances from Federal Home Loan Bank:
Issuances
Payments/maturities
Decrease in other borrowings
Exercise of common stock options and stock appreciation rights,
net of repurchase of restricted shares
Excess tax benefit from stock compensation
(64,826,118 ) (57,753,116 )
216,300
29,890,467 23,192,675
(1,035,995 ) -
235,000 860,000
(65,558,107 ) (40,306,647 )
(1,222,077 ) (604,626 )
(75,000,000 ) -
$(122,500)(304,204)$
$(177,423,030)(74,915,918)$

6,704,511 (32,895,938 )
(25,941,606 ) (2,372,676 )
455,370,280 175,000,000
$(195,385,928)(115,016,116)$
39,375,000 (625,000 )
878,138 1,247,220
$1,348,751 \quad 1,099,570$

Common stock dividends paid
Net cash provided by financing activities
Net decrease in cash and cash equivalents
Cash and cash equivalents, beginning of period
Cash and cash equivalents, end of period
(4,304,125 ) (2,824,493 )
278,045,021 23,612,567
105,869,210 (38,001,330)
187,907,510 208,938,737
\$293,776,720 \$170,937,407

See accompanying notes to consolidated financial statements (unaudited). 7

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PINNACLE FINANCIAL PARTNERS, INC. AND SUBSIDIARIES NOTES TO CONSOLIDATED FINANCIAL STATEMENTS<br>(Unaudited)

Note 1. Summary of Significant Accounting Policies
Nature of Business - Pinnacle Financial Partners, Inc. (Pinnacle Financial) is a bank holding company whose primary business is conducted by its wholly-owned subsidiary, Pinnacle Bank. Pinnacle Bank is a commercial bank headquartered in Nashville, Tennessee. Pinnacle Bank provides a full range of banking services in its primary market areas of the Nashville-Davidson-Murfreesboro-Franklin, Tennessee and Knoxville, Tennessee Metropolitan Statistical Areas.

Basis of Presentation - The accompanying unaudited consolidated financial statements have been prepared in accordance with instructions to Form 10-Q and therefore do not include all information and footnotes necessary for a fair presentation of financial position, results of operations, and cash flows in conformity with U.S. generally accepted accounting principles (U.S. GAAP). All adjustments consisting of normally recurring accruals that, in the opinion of management, are necessary for a fair presentation of the financial position and results of operations for the periods covered by the report have been included. The accompanying unaudited consolidated financial statements should be read in conjunction with the Pinnacle Financial consolidated financial statements and related notes appearing in the 2014 Annual Report previously filed on Form 10-K.

These consolidated financial statements include the accounts of Pinnacle Financial and its wholly-owned subsidiaries. PNFP Statutory Trust I, PNFP Statutory Trust II, PNFP Statutory Trust III and PNFP Statutory Trust IV are affiliates of Pinnacle Financial and are included in these consolidated financial statements pursuant to the equity-method of accounting. Significant intercompany transactions and accounts are eliminated in consolidation.

Use of Estimates - The preparation of financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities as of the balance sheet date 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 in the near term include the determination of the allowance for loan losses, any potential impairment of intangible assets, including goodwill and the valuation of deferred tax assets, other real estate owned, and our investment portfolio, including other-than-temporary impairment. These financial statements should be read in conjunction with Pinnacle Financial's Annual Report on Form 10-K for the year ended December 31, 2014. There have been no significant changes to Pinnacle Financial's significant accounting policies as disclosed in Pinnacle Financial's Annual Report on Form 10-K for the year ended December 31, 2014.

Cash Flow Information - Supplemental cash flow information addressing certain cash and noncash transactions for each of the three months ended March 31, 2015 and 2014 was as follows:

|  | For the three months ended March 31, |  |
| :---: | :---: | :---: |
|  | 2015 | 2014 |
| Cash Transactions: |  |  |
| Interest paid | \$3,426,798 | \$3,447,425 |
| Income taxes paid, net | 8,217,500 | 6,100,000 |
| Noncash Transactions: |  |  |
| Loans charged-off to the allowance for loan losses | 2,649,708 | 1,503,511 |
| Loans foreclosed upon and transferred to other real estate owned | - | 1,645,100 |
| Loans foreclosed upon and transferred to other repossessed assets | 1,738,757 | 347,800 |

Income Per Common Share - Basic net income per common share (EPS) is computed by dividing net income by the weighted average common shares outstanding for the period. Diluted EPS reflects the dilution that could occur if securities or other contracts to issue common stock were exercised or converted. The difference between basic and diluted weighted average shares outstanding is attributable to common stock options, common stock appreciation rights, restricted share awards, and restricted share unit awards. The dilutive effect of outstanding options, common stock appreciation rights, restricted share awards, and restricted share unit awards is reflected in diluted EPS by application of the treasury stock method.

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The following is a summary of the basic and diluted net income per share calculations for the three months ended March 31, 2015 and 2014:

| Three months ended <br> March 31, <br> 2015 | 2014 |
| :--- | :--- |
|  |  |
| $\$ 21,842,711$ | $\$ 16,367,123$ |
|  |  |
| $35,041,203$ | $34,602,337$ |
| $\$ 0.62$ | $\$ 0.47$ |
|  |  |
| $\$ 21,842,711$ | $\$ 16,367,123$ |
|  |  |
| $35,041,203$ | $34,602,337$ |
| 339,326 | 364,263 |
| $35,380,529$ | $34,966,600$ |
| $\$ 0.62$ | $\$ 0.47$ |

Subsequent Events - ASC 855, Subsequent Events, establishes general standards of accounting for and disclosure of events that occur after the balance sheet date but before financial statements are issued. Pinnacle Financial evaluated all events or transactions that occurred after March 31, 2015 through the date of the issued financial statements.

CapitalMark Bank \& Trust - On April 7, 2015, Pinnacle Bank and Pinnacle Financial entered into a definitive agreement with CapitalMark Bank \&Trust (CapitalMark) to acquire CapitalMark via merger. The proposed merger of CapitalMark with and into Pinnacle Bank has been approved by each company's Board of Directors and is expected to close in the third quarter or early in the fourth quarter of 2015, pending regulatory and CapitalMark shareholder approval.

Under the terms of the merger agreement, CapitalMark shareholders will have the option to either convert their outstanding shares of common stock into 0.50 shares of Pinnacle's common stock plus cash in lieu of any fractional shares, a cash payment per CapitalMark share equal to the product of 0.50 multiplied by the average trading price for Pinnacle Financial's common stock on the Nasdaq Global Select Market for a 10-day period prior to the closing of the transaction or into a combination of 0.50 shares of Pinnacle Financial's common stock and the cash consideration at a ratio of 90 percent stock and 10 percent cash, provided that 90 percent of the outstanding shares of CapitalMark common stock will be converted into shares of Pinnacle Financial's common stock. Additionally, CapitalMark's outstanding stock options will be converted into approximately 860,000 Pinnacle Financial options and will be fully vested upon consummation of the merger pursuant to CapitalMark's stock option plan. At closing, CapitalMark shareholders will beneficially own approximately 9.7 percent of Pinnacle's outstanding shares of common stock.

The transaction is currently valued at $\$ 187.0$ million based on Pinnacle Financial's closing price on April 7, 2015, and is comprised of stock consideration of approximately 3.3 million shares of Pinnacle Financial common stock and $\$ 16.4$ million in cash. Additionally, Pinnacle Financial and Pinnacle Bank plan to redeem at closing the $\$ 18.2$ million in preferred stock issued by CapitalMark in connection with its participation in the U.S. Treasury's Small Business Lending Fund program.

Magna Bank - On April 28, 2015, Pinnacle Financial and Pinnacle Bank entered into a definitive agreement with Magna Bank (Magna) to acquire Magna via merger. The proposed merger of Magna with and into Pinnacle Bank has been approved by each company's Board of Directors and is expected to close in the third quarter or early in the fourth quarter of 2015, pending regulatory and Magna shareholder approval.

Under the terms of the merger agreement, Magna shareholders will have the right to elect to convert their outstanding shares of common stock into 0.3369 shares of Pinnacle Financial's common stock plus cash in lieu of any fractional shares, a cash payment equal to $\$ 14.32$ per Magna share, or into a combination of 0.3369 shares of Pinnacle's common stock and $\$ 14.32$ in cash at a ratio of 75 percent stock and 25 percent cash, provided that 75 percent of the outstanding shares of Magna's common stock will be converted into shares of Pinnacle Financial's common stock. Magna's 328,350 stock options will be fully vested upon consummation of the merger pursuant to Magna's stock option plan. At closing, Magna's outstanding unexercised stock options will be settled in cash for the difference between the option's exercise price and $\$ 14.32$. At the closing, Magna shareholders will beneficially own approximately 3.3 percent of Pinnacle Financial's outstanding common stock, assuming all of Magna's options are cashed out and the CapitalMark Merger has been consummated.

The transaction is currently valued at $\$ 83.4$ million based on Pinnacle Financial's closing price on April 28, 2015, based on the issuance of approximately 1.325 million shares of Pinnacle Financial's common stock and $\$ 20.7$ million in cash, in each case assuming none of Magna's options are exercised prior to closing. Additionally, Pinnacle Financial and Pinnacle Bank plan to redeem at closing the $\$ 18.35$ million in Series C preferred stock issued by Magna in connection with its participation in the U.S. Treasury's Small Business Lending Fund program.

Note 2. Acquisition and Intangibles
Acquisition - Bankers Healthcare Group, LLC. On February 1, 2015, Pinnacle Bank acquired a 30\% interest in Bankers Healthcare Group, LLC (BHG) for $\$ 75$ million. Pinnacle Bank accounts for this investment pursuant to the equity-method of accounting and, as such, has recorded its investment in BHG net of identified intangible assets. Earnings on this investment are recorded net of intangible amortization expense as a component of noninterest income. For the first quarter of 2015, Pinnacle Bank recorded earnings of $\$ 3.2$ million, net of approximately $\$ 400,000$ in intangible amortization expense in income from equity-method investment.

In connection with this acquisition, Pinnacle Bank borrowed $\$ 40$ million from an unaffiliated bank pursuant to a loan agreement which requires Pinnacle Financial and Pinnacle Bank to maintain certain financial covenants including minimum capital ratios, liquidity requirements and other non-financial covenants. The loan has a 5 -year maturity and bears interest at approximately $2.95 \%$ per annum currently.

Note 3. Securities
The amortized cost and fair value of securities available-for-sale and held-to-maturity at March 31, 2015 and December 31, 2014 are summarized as follows (in thousands):

|  | Gross | Gross |  |
| :--- | :--- | :--- | :--- |
| Amortized | Unrealized | Unrealized | Fair |
| Cost | Gains | Losses | Value |

March 31, 2015:
Securities available-for-sale:

| U.S. Treasury securities | $\$-$ | $\$-$ | $\$-$ | $\$-$ |
| :--- | :---: | :--- | :--- | :---: |
| U.S. government agency securities | 120,106 | 30 | 1,577 | 118,559 |
| Mortgage-backed agency securities | 458,901 | 11,147 | 1,686 | 468,362 |
| State and municipal securities | 126,041 | 8,046 | 152 | 133,935 |
| Asset-backed securities | 12,340 | 15 | 16 | 12,339 |
| Corporate notes and other | 34,857 | 1,022 | 56 | 35,823 |
|  | $\$ 752,245$ | $\$ 20,260$ | $\$ 3,487$ | $\$ 769,018$ |
| Securities held-to-maturity: |  |  |  |  |
| State and municipal securities | $\$ 39,276$ | $\$ 219$ | $\$ 87$ | $\$ 39,408$ |
|  | $\$ 39,276$ | $\$ 219$ | $\$ 87$ | $\$ 39,408$ |

December 31, 2014:
Securities available-for-sale:
U.S. Treasury securities \$- \$ - \$ \$
U.S. government agency securities $117,098 \quad 12 \quad 3,654 \quad 113,456$

Mortgage-backed agency securities $447,757 \quad 10,322 \quad 2,240 \quad 455,839$
$\begin{array}{lllll}\text { State and municipal securities } & 130,545 & 8,213 & 180 & 138,578\end{array}$
Asset-backed securities
Corporate notes and other

| 13,089 | 14 | 85 | 13,018 |
| :--- | :--- | :--- | :--- |
| 10,196 | 969 | 2 | 11,163 |

\$718,685 \$ 19,530 6,161 \$732,054

Securities held-to-maturity:

| State and municipal securities | $\$ 38,676$ | $\$ 205$ | $\$ 92$ | $\$ 38,789$ |
| :--- | :--- | :--- | :--- | :--- |
|  | $\$ 38,676$ | $\$ 205$ | $\$ 92$ | $\$ 38,789$ |

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At March 31, 2015, approximately $\$ 647.2$ million of securities within Pinnacle Financial's investment portfolio were either pledged to secure public funds and other deposits or securities sold under agreements to repurchase.

The amortized cost and fair value of debt securities as of March 31, 2015 by contractual maturity are shown below. Actual maturities may differ from contractual maturities of mortgage- and asset-backed securities since the mortgages and assets underlying the securities may be called or prepaid with or without penalty. Therefore, these securities are not included in the maturity categories in the following summary (in thousands):

| March 31, 2015: | Cost | Value | Cost | Value |
| :--- | :--- | :--- | :--- | :--- |
| Due in one year or less | $\$ 7,508$ | $\$ 7,545$ | $\$ 1,694$ | $\$ 1,697$ |
| Due in one year to five years | 31,685 | 33,245 | 11,650 | 11,691 |
| Due in five years to ten years | 151,166 | 156,389 | 15,879 | 15,935 |
| Due after ten years | 90,645 | 91,138 | 10,053 | 10,085 |
| Mortgage-backed securities | 458,901 | 468,362 | - | - |
| Asset-backed securities | 12,340 | 12,339 | - | - |
|  | $\$ 752,245$ | $\$ 769,018$ | $\$ 39,276$ | $\$ 39,408$ |

At March 31, 2015 and December 31, 2014, the following investments had unrealized losses. The table below classifies these investments according to the term of the unrealized losses of less than twelve months or twelve months or longer (in thousands):

At March 31, 2015 :

| U.S. Treasury securities | $\$-$ | $\$-$ | $\$-$ | $\$-$ | $\$-$ | $\$-$ |
| :--- | :--- | :--- | :--- | :--- | :--- | :--- |
| U.S. government agency securities | 39,419 | 570 | 66,858 | 1,007 | 106,277 | 1,577 |
| Mortgage-backed securities | 69,138 | 639 | 97,969 | 1,047 | 167,107 | 1,686 |
| State and municipal securities | 12,251 | 63 | 6,293 | 176 | 18,544 | 239 |
| Asset-backed securities | - | - | 8,988 | 16 | 8,988 | 16 |
| Corporate notes | 16,599 | 55 | 152 | 1 | 16,751 | 56 |
| Total temporarily-impaired securities | $\$ 137,407$ | $\$ 1,327$ | $\$ 180,260$ | $\$ 2,247$ | $\$ 317,667$ | $\$ 3,574$ |

At December 31, 2014 :

| U.S. Treasury securities | $\$-$ | $\$-$ | $\$-$ | $\$-$ | $\$-$ | $\$-$ |
| :--- | :--- | :--- | :--- | :--- | :--- | :--- |
| U.S. government agency securities | 3,593 | 10 | 103,658 | 3,644 | 107,251 | 3,654 |
| Mortgage-backed securities | 91,410 | 405 | 102,892 | 1,835 | 194,302 | 2,240 |
| State and municipal securities | 3,561 | 15 | 16,502 | 257 | 20,063 | 272 |
| Asset-backed securities | - | - | 9,289 | 85 | 9,289 | 85 |
| Corporate notes | 950 | 1 | 154 | 1 | 1,104 | 2 |
| Total temporarily-impaired securities | $\$ 99,514$ | $\$ 431$ | $\$ 232,495$ | $\$ 5,822$ | $\$ 332,009$ | $\$ 6,253$ |

The applicable dates for determining when securities are in an unrealized loss position are March 31, 2015 and December 31, 2014. As such, it is possible that a security had a market value that exceeded its amortized cost on other days during the twelve-month periods ended March 31, 2015 and December 31, 2014, but is in the "Investments with
an Unrealized Loss of less than 12 months" category above.
As shown in the tables above, at March 31, 2015, Pinnacle Financial had approximately $\$ 3.6$ million in unrealized losses on $\$ 317.7$ million of securities. The unrealized losses associated with these investment securities are driven by changes in interest rates and the unrealized loss is recorded as a component of equity. These securities will continue to be monitored as a part of our ongoing impairment analysis, but are expected to perform even if the rating agencies reduce the credit rating of the bond issuers. Management evaluates the financial performance of the issuers on a quarterly basis to determine if it is probable that the issuers can make all contractual principal and interest payments. If a shortfall in future cash flows is identified, a credit loss will be deemed to have occurred and will be recognized as a charge to earnings and a new cost basis for the security will be established.

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Because Pinnacle Financial currently does not intend to sell those securities that have an unrealized loss at March 31, 2015, and it is not more-likely-than-not that Pinnacle Financial will be required to sell the securities before recovery of their amortized cost bases, which may be maturity, Pinnacle Financial does not consider these securities to be other-than-temporarily impaired at March 31, 2015.

Periodically, available-for-sale securities may be sold or the composition of the portfolio realigned to improve yields, quality or marketability, or to implement changes in investment or asset/liability strategy, including maintaining collateral requirements and raising funds for liquidity purposes. Additionally, if an available-for-sale security loses its investment grade or tax-exempt status, the underlying credit support is terminated or collection otherwise becomes uncertain based on factors known to management, Pinnacle Financial will consider selling the security, but will review each security on a case-by-case basis as these factors become known.

The carrying values of Pinnacle Financial's investment securities could decline in the future if the financial condition of issuers deteriorates and management determines it is probable that Pinnacle Financial will not recover the entire amortized cost bases of the securities. As a result, there is a risk that other-than-temporary impairment charges may occur in the future. Additionally, there is a risk that other-than-temporary impairment charges may occur in the future if management's intention to hold these securities to maturity and or recovery changes.

Note 4. Loans and Allowance for Loan Losses
For financial reporting purposes, Pinnacle Financial classifies its loan portfolio based on the underlying collateral utilized to secure each loan. This classification is consistent with those utilized in the Quarterly Report of Condition and Income filed with the Federal Deposit Insurance Corporation (FDIC).

Pinnacle Financial uses five loan categories: commercial real estate mortgage, consumer real estate mortgage, construction and land development, commercial and industrial, consumer and other.

Commercial real-estate mortgage loans. Commercial real-estate mortgage loans are categorized as such based on investor exposures where repayment is largely dependent upon the operation, refinance, or sale of the underlying real estate. Commercial real-estate mortgage also includes owner occupied commercial real estate which shares a similar risk profile to our commercial and industrial products.
Consumer real-estate mortgage loans. Consumer real-estate mortgage consists primarily of loans secured by 1-4 residential properties including home equity lines of credit.
Construction and land development loans. Construction and land development loans include loans where the repayment is dependent on the successful operation of the related real estate project. Construction and land development loans include 1-4 family construction projects and commercial construction endeavors such as warehouses, apartments, office and retail space and land acquisition and development.
Commercial and industrial loans. Commercial and industrial loans include loans to business enterprises issued for commercial, industrial and/or other professional purposes.
Consumer and other loans. Consumer and other loans include all loans issued to individuals not included in the -consumer real-estate mortgage classification. Examples of consumer and other loans are automobile loans, credit cards and loans to finance education, among others.

Commercial loans receive risk ratings assigned by a financial advisor and approved by a senior credit officer subject to validation by Pinnacle Financial's independent loan review department. Risk ratings are categorized as pass, special mention, substandard, substandard-nonaccrual or doubtful-nonaccrual. Pinnacle Financial believes that its categories follow those used by Pinnacle Bank's primary regulators. At March 31, 2015, approximately 73\% of our loan portfolio was analyzed as a commercial loan type with a specifically assigned risk rating in the allowance for loan loss assessment. Consumer loans and small business loans are generally not assigned an individual risk rating but are evaluated as either accrual or nonaccrual based on the performance of the individual loans. However, certain
consumer real-estate mortgage loans and certain consumer and other loans receive a specific risk rating due to the loan proceeds being used for commercial purposes even though the collateral may be of a consumer loan nature.
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Risk ratings are subject to continual review by a financial advisor and a senior credit officer. At least annually, our credit procedures require that every risk rated loan of $\$ 500,000$ or more be subject to a formal credit risk review process by the assigned financial advisor. Each loan's risk rating is also subject to review by our independent loan review department, which reviews a substantial portion of our risk rated portfolio annually. Included in the coverage are independent loan reviews of loans in targeted higher-risk portfolio segments such as certain commercial and industrial loans, land loans and/or loan types in certain geographies.

The following table presents our loan balances by primary loan classification and the amount within each risk rating category. Pass rated loans include all credits other than those included in special mention, substandard, substandard-nonaccrual and doubtful-nonaccrual which are defined as follows:

Special mention loans have 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 Pinnacle Financial's credit position at some future date.
Substandard loans are inadequately protected by the current sound worth and paying capacity of the obligor or of the collateral pledged, if any. Assets so classified must have a well-defined weakness or weaknesses that jeopardize collection of the debt. Substandard loans are characterized by the distinct possibility that Pinnacle Financial will sustain some loss if the deficiencies are not corrected.
Substandard-nonaccrual loans are substandard loans that have been placed on nonaccrual status.
Doubtful-nonaccrual loans have all the characteristics of substandard-nonaccrual loans with the added characteristic that the weaknesses make collection or liquidation in full, on the basis of currently existing facts, conditions and values, highly questionable and improbable.

The following table outlines the amount of each loan classification categorized into each risk rating category as of March 31, 2015 and December 31, 2014 (in thousands):

| Consumer |  |  |  |  |  |
| :--- | :--- | :--- | :--- | :--- | :--- |
| Commercial | real estate | Construction | Commercial |  |  |
| real estate | - | and land | and | Consumer |  |
| mortgage | mortgage | development | industrial | and other | Total |

March 31, 2015
Accruing loans
Pass
Special Mention
Substandard ${ }^{(1)}$
Total

| $\$ 1,521,269$ | $\$ 702,047$ | $\$ 308,778$ | $\$ 1,711,829$ | $\$ 224,165$ | $\$ 4,468,088$ |
| :---: | :---: | :---: | :---: | :---: | :---: |
| 12,659 | 2,213 | 6,386 | 38,997 | - | 60,255 |
| 20,929 | 11,279 | 5,230 | 53,850 | - | 91,288 |
| $1,554,857$ | 715,539 | 320,394 | $1,804,676$ | 224,165 | $4,619,631$ |

Impaired loans
Nonaccrual loans

| Nonaccrual loans |  |  |  |  |  |  |
| :--- | :--- | :--- | :--- | :--- | :--- | :--- |
| $\quad$ Substandard-nonaccrual | 5,826 | 4,483 | 3,636 | 1,963 | 1,007 | 16,915 |
| $\quad$ Doubtful-nonaccrual | - | - | - | - | - | - |
| $\quad$ Total nonaccrual loans | 5,826 | 4,483 | 3,636 | 1,963 | 1,007 | 16,915 |
| Troubled debt restructurings ${ }^{(2)}$ |  |  |  |  |  |  |
| $\quad$ Pass | - | 419 | 432 | 563 | 30 | 1,444 |
| $\quad$ Special Mention | - | 447 | - | - | 200 | 647 |
| $\quad$ Substandard | - | 3,019 | - | 3,616 | - | 6,635 |
| $\quad$ Total troubled debt | - | 3,885 | 432 | 4,179 | 230 | 8,726 |
| restructurings | 5,826 | 8,368 | 4,068 | 6,142 | 1,237 | 25,641 |
| Total impaired loans | $\$ 1,560,683$ | $\$ 723,907$ | $\$ 324,462$ | $\$ 1,810,818$ | $\$ 225,402$ | $\$ 4,645,272$ |
| Total loans |  |  |  |  |  |  |

(1)Potential problem loans represent those loans with a well-defined weakness and where information about possible credit problems of borrowers has caused management to have doubts about the borrower's ability to comply with
present repayment terms. This definition is believed to be substantially consistent with the standards established by Pinnacle Bank's primary regulators for loans classified as substandard, excluding the impact of nonaccrual loans and troubled debt restructurings. Potential problem loans, which are not included in nonaccrual loans, amounted to approximately $\$ 91.3$ million at March 31,2015 , compared to $\$ 83.0$ million at December 31, 2014.
Troubled debt restructurings are presented as impaired loans; however, they continue to accrue interest at modified contractual rates.

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December 31, 2014
Accruing loans
Pass
Special Mention
Substandard ${ }^{(1)}$
Total
Impaired loans
Nonaccrual loans Substandard-nonaccrual Doubtful-nonaccrual

Total nonaccrual loans
Troubled debt restructurings ${ }^{(2)}$ Pass Special Mention Substandard
Total troubled debt
restructurings
Total impaired loans
Total loans

| Commercial real estate mortgage | Consumer real estate mortgage | Construction and land development | Commercial and industrial | Consumer and other | Total |
| :---: | :---: | :---: | :---: | :---: | :---: |
| \$ 1,510,718 | \$697,607 | \$ 295,645 | \$ 1,704,910 | \$216,155 | \$4,425,035 |
| 7,353 | 2,536 | 15,215 | 31,733 | - | 56,837 |
| 21,707 | 12,631 | 5,997 | 42,704 | - | 83,039 |
| 1,539,778 | 712,774 | 316,857 | 1,779,347 | 216,155 | 4,564,911 |
| 4,313 | 4,458 | 5,173 | 1,609 | 1,152 | 16,705 |
| - | - | - | - | - | - |
| 4,313 | 4,458 | 5,173 | 1,609 | 1,152 | 16,705 |
| - | 62 | 436 | 575 | 75 | 1,148 |
| - | 811 | - | - | 201 | 1,012 |
| - | 3,053 | - | 3,198 | - | 6,251 |
| - | 3,926 | 436 | 3,773 | 276 | 8,411 |
| 4,313 | 8,384 | 5,609 | 5,382 | 1,428 | 25,116 |
| \$ 1,544,091 | \$721,158 | \$ 322,466 | \$ 1,784,729 | \$ 217,583 | \$4,590,027 |

Potential problem loans represent those loans with a well-defined weakness and where information about possible credit problems of borrowers has caused management to have doubts about the borrower's ability to comply with Pinnacle Bank's primary regulators for loans classified as substandard, excluding the impact of nonaccrual loans and troubled debt restructurings. Potential problem loans, which are not included in nonaccrual loans, amounted to approximately $\$ 91.3$ million at March 31,2015 , compared to $\$ 83.0$ million at December 31, 2014.
(2)

Troubled debt restructurings are presented as impaired loans; however, they continue to accrue interest at contractual rates.

At March 31, 2015 and December 31, 2014, all loans classified as nonaccrual were deemed to be impaired. The principal balances of these nonaccrual loans amounted to $\$ 16.9$ million and $\$ 16.7$ million at March 31 , 2015 and December 31, 2014, respectively, and are included in the tables above. For both the three months ended March 31, 2015 and the twelve months ended December 31, 2014, the average balance of nonaccrual loans was $\$ 17.5$ million. At the date such loans were placed on nonaccrual status, Pinnacle Financial reversed all previously accrued interest income against current year earnings. Pinnacle Financial's policy is that once a loan is placed on nonaccrual status each subsequent payment is reviewed on a case-by-case basis to determine if the payment should be applied to interest or principal pursuant to regulatory guidelines. Pinnacle Financial recognized approximately $\$ 84,000$ in interest income from cash payments received on nonaccrual loans during the three months ended March 31, 2015 and $\$ 256,000$ interest income from cash payments received on nonaccrual loans during the year ended December 31, 2014. Had these remaining nonaccrual loans been on accruing status, interest income would have been higher by $\$ 333,000$ for the three months ended March 31, 2015 and by $\$ 283,000$ for the three months ended March 31, 2014. A nonaccrual loan may be returned to accruing status once the loan has been brought current as to the principal and interest and collection is reasonably assured or the loan has been "well-secured" through other techniques.

The following table details the recorded investment, unpaid principal balance and related allowance and average recorded investment of our nonaccrual loans at March 31, 2015 and December 31, 2014 by loan classification and the amount of interest income recognized on a cash basis throughout the fiscal year-to-date period then ended, respectively, on these loans that remain on the balance sheets (in thousands):

For the three months ended

At March 31, 2015
Unpaid
Recorded principal investmenbalance allowance ${ }^{(1)}$
Collateral dependent nonaccrual loans:
Commercial real estate - mortgage
Consumer real estate - mortgage
Construction and land development
Commercial and industrial
Consumer and other
Total
Cash flow dependent nonaccrual loans:
Commercial real estate - mortgage
Consumer real estate - mortgage
Construction and land development
Commercial and industrial
Consumer and other
Total
Total nonaccrual loans

Total nonaccrual loans

| $\$ 1,829$ | $\$ 2,066$ | $\$ 99$ | $\$ 1,843$ | $\$$ | - |
| :--- | :--- | :--- | :--- | :--- | :--- |
| 3,045 | 3,302 | 656 | 3,071 |  | - |
| 301 | 393 | 65 | 302 |  | - |
| 684 | 696 | 147 | 688 |  | - |
| 1,007 | 1,079 | 217 | 1,042 |  | - |
| $\$ 6,866$ | $\$ 7,536$ | $\$ 1,184$ | $\$ 6,946$ | $\$$ | - |
| $\$ 16,915$ | $\$ 18,659$ | $\$ 1,184$ | $\$ 17,448$ | $\$$ | 84 |


| $\$ 3,997$ | $\$ 4,630$ | $\$-$ | $\$ 4,419$ | $\$$ | - |
| ---: | ---: | ---: | ---: | :--- | :--- |
| 1,438 | 1,594 | - | 1,453 | - |  |
| 3,335 | 3,335 | - | 3,335 |  | 84 |
| 1,279 | 1,564 | - | 1,295 | - |  |
| - | - | - | - | - |  |
| $\$ 10,049$ | $\$ 11,123$ | $\$-$ | $\$ 10,502$ | $\$$ | 84 |

At December 31, 2014
Unpaid
Recorded principal Related investmenbalance allowance $^{(1)}$
Collateral dependent nonaccrual loans:
Commercial real estate - mortgage

| $\$ 2,422$ | $\$ 2,641$ | $\$-$ | $\$ 2,624$ | $\$$ |
| :---: | :---: | :---: | ---: | :--- |
| 1,472 | 1,901 | - | 1,552 | - |
| 4,810 | 4,810 | - | 5,016 | 256 |
| 1,325 | 1,804 | - | 1,561 | - |
| - | - | - | - | - |
| $\$ 10,029$ | $\$ 11,156$ | $\$-$ | $\$ 10,753$ | $\$ 256$ |

Cash flow dependent nonaccrual loans:

| Commercial real estate - mortgage | $\$ 1,891$ | $\$ 2,107$ | $\$ 108$ | $\$ 1,958$ | $\$$ |
| :--- | :---: | :---: | :---: | :---: | :---: |
| Consumer real estate - mortgage | 2,986 | 3,205 | 654 | 3,080 | - |
| Construction and land development | 363 | 406 | 79 | 384 | - |
| Commercial and industrial | 284 | 294 | 62 | 316 | - |
| Consumer and other | 1,152 | 1,184 | 252 | 972 | - |
| Total | $\$ 6,676$ | $\$ 7,196$ | $\$ 1,155$ | $\$ 6,710$ | $\$$ |
| Total nonaccrual loans | $\$ 16,705$ | $\$ 18,352$ | $\$ 1,155$ | $\$ 17,463$ | $\$$ |
| 256 |  |  |  |  |  |

(1) Collateral dependent loans are typically charged-off to their net realizable value and no specific allowance is carried related to those loans.

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Impaired loans also include loans that Pinnacle Bank has elected to formally restructure due to the weakening credit status of a borrower. The restructuring may facilitate a repayment plan that seeks to minimize the potential losses that Pinnacle Bank may otherwise incur. If on nonaccrual status as of the date of restructuring, the loans are included in nonaccrual loans. Loans that have been restructured that were performing as of the restructure date and continue to perform in accordance with the restructured terms are reported separately as troubled debt restructurings.

At March 31, 2015 and December 31, 2014, there were $\$ 8.7$ million and $\$ 8.4$ million, respectively, of troubled debt restructurings that were performing as of their restructure date and which were accruing interest. These troubled debt restructurings are considered impaired loans pursuant to U.S. GAAP. Troubled commercial loans are restructured by specialists within our Special Assets Group, and all restructurings are approved by committees and credit officers separate and apart from the normal loan approval process. These specialists are charged with reducing Pinnacle Financial's overall risk and exposure to loss in the event of a restructuring by obtaining some or all of the following: improved documentation, additional guaranties, increase in curtailments, reduction in collateral release terms, additional collateral or other similar strategies. 15

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The following table outlines the amount of each loan category where troubled debt restructurings were made during the three months ended March 31, 2015 and 2014 (dollars in thousands):

|  |  |  |  | Pos |  |
| :---: | :---: | :---: | :---: | :---: | :---: |
|  |  | Pre |  |  | dification |
|  |  |  | odification |  | standing |
| March 31, 2015 |  |  | utstanding |  | orded |
|  |  |  | corded vestment |  | stment, of related |
|  |  |  |  |  | wance |
| Commercial real estate - mortgage | - | \$ | - | \$ | - |
| Consumer real estate - mortgage | - |  | - |  | - |
| Construction and land development | - |  | - |  |  |
| Commercial and industrial | 1 |  | 434 |  | 337 |
| Consumer and other |  |  | - |  | - |
|  | 1 | \$ | 434 | \$ | 337 |
| March 31, 2014 |  |  |  |  |  |
| Commercial real estate - mortgage |  | \$ |  | \$ | - |
| Consumer real estate - mortgage | - |  | - |  | - |
| Construction and land development |  |  | - |  | - |
| Commercial and industrial | 6 |  | 2,584 |  | 565 |
| Consumer and other | - |  | - |  | - |
|  | 6 | \$ | 2,584 | \$ | 565 |

During the three months ended March 31, 2015 and 2014, Pinnacle Financial did not have any troubled debt restructurings that subsequently defaulted within twelve months of the restructuring.

The table below presents past due balances at March 31, 2015 and December 31, 2014, by loan classification and segment allocated between accruing and nonaccrual status (in thousands):

March 31, 2015
Commercial real estate:
Owner-occupied
All other
Consumer real estate - mortgage
30-89 $\begin{aligned} & \text { 90 days } \\ & \text { or more }\end{aligned}$ Total

| days past | past due | past due | Current |  |
| :--- | :--- | :--- | :--- | :--- |
| due and | and | and |  | and |$\quad$ Total

Construction and land development
Commercial and industrial
Consumer and other

December 31, 2014
Commercial real estate:

| $\$ 3,187$ | $\$ 1,568$ | $\$ 4,755$ | $\$ 3,855$ | $\$ 758,682$ | $\$ 767,292$ |
| :--- | :--- | :--- | :--- | :---: | :--- |
| 133 | - | 133 | 1,971 | 791,287 | 793,391 |
| 1,163 | - | 1,163 | 4,483 | 718,261 | 723,907 |
| 59 | - | 59 | 3,636 | 320,767 | 324,462 |
| 1,005 | 12 | 1,017 | 1,963 | $1,807,838$ | $1,810,818$ |
| 8,588 | 29 | 8,617 | 1,007 | 215,778 | 225,402 |
| $\$ 14,135$ | $\$ 1,609$ | $\$ 15,744$ | $\$ 16,915$ | $\$ 4,612,613$ | $\$ 4,645,272$ |
|  |  |  |  |  |  |
|  | 90 days |  |  |  |  |
| $30-89$ | or more | Total |  | Current |  |
| days past past due past due <br> due and and and <br> accruing accruing accruing | Nonaccrual $^{(1)}$ | and | accruing | Loans |  |


| Owner-occupied | $\$-$ | $\$-$ | $\$-$ | $\$ 4,313$ | $\$ 760,207$ | $\$ 764,520$ |
| :--- | :--- | :--- | :---: | :---: | :---: | :---: |
| All other | 2,232 | - | 2,232 | - | 777,339 | 779,571 |
| Consumer real estate - mortgage | 2,391 | 146 | 2,537 | 4,458 | 714,163 | 721,158 |
| Construction and land development | 421 | - | 421 | 5,173 | 316,872 | 322,466 |
| Commercial and industrial | 3,431 | 5 | 3,436 | 1,609 | $1,779,684$ | $1,784,729$ |
| Consumer and other | 9,532 | 172 | 9,704 | 1,152 | 206,727 | 217,583 |
|  | $\$ 18,007$ | $\$ 323$ | $\$ 18,330$ | $\$ 16,705$ | $\$ 4,554,992$ | $\$ 4,590,027$ |

(1) Approximately $\$ 13.9$ million and $\$ 10.2$ million of nonaccrual loans as of March 31, 2015 and December 31, 2014, respectively, were performing pursuant to their contractual terms at those dates.

The following table shows the allowance allocation by loan classification and accrual status at March 31, 2015 and December 31, 2014 (in thousands):

|  | Impaired Loans |  |  |  |  |  |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
|  | Accruing Loans |  | Nonaccrual Loans |  | Troubled Debt <br> Restructurings ${ }^{(1)}$ |  | Total Allowance for Loan Losses |  |
|  | March | December | March | December | March | December | March | December |
|  | 31, | 31, | 31, | 31, | 31, | 31, | 31, |  |
|  | 2015 | 2014 | 2015 | 2014 | 2015 | 2014 | 2015 | 2014 |
| Commercial real estate |  |  |  |  |  |  |  |  |
| -mortgage | \$19,544 | \$ 22,094 | \$99 | \$ 108 | \$ - | \$ - | \$19,643 | \$ 22,202 |
| Consumer real estate - mortgage | 3,155 | 3,963 | 656 | 654 | 547 | 807 | 4,358 | 5,424 |
| Construction and land |  |  |  |  |  |  |  |  |
| development | 5,299 | 5,555 | 65 | 79 | 30 | 90 | 5,394 | 5,724 |
| Commercial and industrial | 30,267 | 28,329 | 147 | 62 | 1,080 | 776 | 31,494 | 29,167 |
| Consumer and other | 1,424 | 1,261 | 217 | 252 | 45 | 57 | 1,686 | 1,570 |
| Unallocated | - | - | - | - | - | - | 3,667 | 3,272 |
|  | \$59,689 | \$ 61,202 | \$ 1,184 | \$ 1,155 | \$ 1,702 | \$ 1,730 | \$66,242 | \$ 67,359 |

Troubled debt restructurings of $\$ 8.7$ million and $\$ 8.4$ million as of March 31, 2015 and December 31, 2014, (1)respectively, are classified as impaired loans pursuant to U.S. GAAP; however, these loans continue to accrue interest at contractual rates.

The following table details the changes in the allowance for loan losses from December 31, 2013 to December 31, 2014 to March 31, 2015 by loan classification and the allocation of the allowance for loan losses (in thousands):

|  | ```Commercial Consumer Construction Commercial real estate - real estate and land and mortgage - mortgagedevelopment industrial``` |  |  |  | 1 <br> Consumer and other | UnallocatedTotal |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| Allowance for Loan Losses: |  |  |  |  |  |  |  |
| Balance at December 31, 2013 | \$21,372 | \$8,355 | \$ 7,235 | \$25,134 | \$ 1,632 | \$ 4,242 | \$67,970 |
| Charged-off loans | (875 | ) $(1,621$ | ) (301 | ) $(3,095$ | ) $(1,811$ | ) - | (7,703 ) |
|  |  |  |  |  |  |  |  |
| charged-off loans | 538 | 671 | 277 | 1,484 | 487 | - | 3,457 |
| Provision for loan losses | 1,167 | (1,981 | ) $(1,487$ | ) 5,644 | 1,262 | (970 | ) 3,635 |
| Balance at December 31, 2014 | \$22,202 | \$ 5,424 | \$ 5,724 | \$29,167 | \$ 1,570 | \$ 3,272 | \$67,359 |
| Collectively evaluated for impairment | \$22,094 | \$3,963 | \$ 5,555 | \$28,329 | \$ 1,261 |  | \$61,202 |
| Individually evaluated for impairment | 108 | 1,461 | 169 | 838 | 309 |  | 2,885 |
| Loans acquired with deteriorated credit quality | - | - | - | - | - |  | - |
| Balance at December 31, 2014 | \$22,202 | \$ 5,424 | \$ 5,724 | \$29,167 | \$ 1,570 |  | \$67,359 |
| Loans: |  |  |  |  |  |  |  |
| Collectively evaluated for impairment | \$ 1,539,778 | \$712,774 | \$ 316,857 | \$ 1,779,347 | \$216,155 |  | \$4,564,911 |
| Individually evaluated for impairment | 4,313 | 8,384 | 5,609 | 5,382 | 1,428 |  | 25,116 |
|  | - | - | - | - | - |  | - |

Loans acquired with
deteriorated credit quality
Balance at December 31, 2014 \$1,544,091 \$721,158 \$ 322,466 \$1,784,729 \$217,583
17

|  | Commercial real estate mortgage | Consumer 1 real estate mortgage | Construction and land developme | Commercial <br> and industrial | Consumer and other | Unalloc | dTotal |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| Allowance for Loan Losses: |  |  |  |  |  |  |  |
| Balance at December 31, 20 | \$ 22,202 | \$ 5,424 | \$ 5,724 | \$ 29,167 | \$ 1,570 | \$ 3,272 | \$67,359 |
| Charged-off loans | (350 | ) $(134$ | ) $(126$ | ) $(430$ | ) $(1,610$ | - | (2,650 |
| Recovery of previously |  |  |  |  |  |  |  |
| charged-off loans | 6 | 74 | 567 | 92 | 479 | - | 1,218 |
| Provision for loan losses | (2,122 | ) $(963$ | ) 752 | ) 2,491 | 2,447 | (786 | ) 315 |
| Balance at March 31, 2015 | \$19,736 | \$4,401 | \$ 5,413 | \$31,320 | \$2,886 | \$ 2,486 | \$66,242 |
| Collectively evaluated for $\begin{array}{llllll}\text { impairment } & \$ 19,637 & \$ 3,198 & \$ 5,318 & \$ 30,093 & \$ 2,624\end{array}$ |  |  |  |  |  |  |  |
| Individually evaluated for impairment | 99 | 1,203 | 95 | 1,227 | 262 |  | 2,886 |
| Loans acquired with deteriorated credit quality | - | - | - | - | - |  | - |
| Balance at March 31, 2015 | \$ 19,736 | \$4,401 | \$ 5,413 | \$31,320 | \$2,886 |  | \$66,242 |
| Loans: |  |  |  |  |  |  |  |
| Collectively evaluated for impairment | \$ 1,554,857 | \$715,539 | \$ 320,394 | \$ 1,804,676 | \$ 224,165 |  | \$4,619,631 |
| Individually evaluated for impairment | 5,826 | 8,368 | 4,068 | 6,142 | 1,237 |  | 25,641 |
| Loans acquired with deteriorated credit quality | - | - | - | - | - |  | - |
| Balance at March 31, 2015 | \$ 1,560,683 | \$723,907 | \$ 324,462 | \$ 1,810,818 | \$ 225,402 |  | \$4,645,272 |

The adequacy of the allowance for loan losses is assessed at the end of each calendar quarter using a migration analysis compiled using loss data over the previous 24 quarters, which began in the first quarter of 2009. The migration analysis utilized in the second quarter of 2015 allowance for loan losses will include our historical loss experience for the time period from the second quarter of 2009 through the first quarter of 2015 . More recent quarters in the period are more heavily weighted than the earliest quarters. The level of the allowance is based upon evaluation of the loan portfolio, current asset quality trends, known and inherent risks in the portfolio, adverse situations that may affect the borrowers' ability to repay (including the timing of future payment), the estimated value of any underlying collateral, composition of the loan portfolio, economic conditions, historical loss experience, industry and peer bank loan quality indications and other pertinent factors, including regulatory recommendations.

Pinnacle Financial analyzes its commercial loan portfolio to determine if a concentration of credit risk exists to any industry. Pinnacle Financial utilizes broadly accepted industry classification systems in order to classify borrowers into various industry classifications. Pinnacle Financial has a credit exposure (loans outstanding plus unfunded lines of credit) exceeding $25 \%$ of Pinnacle Bank's total risk-based capital to borrowers in the following industries at March 31, 2015 with the comparative exposures for December 31, 2014 (in thousands):

At March 31, 2015:
OutstandingUnfunded Total Total
Principal Commitments exposure Exposure Balances at

December

|  |  |  |  | 31,2014 |
| :--- | ---: | ---: | ---: | ---: | ---: |
| Lessors of nonresidential buildings | $\$ 518,962$ | $\$ 69,708$ | $\$ 588,670$ | $\$ 572,620$ |
| Lessors of residential buildings | 297,283 | 52,613 | 349,896 | 335,399 |

At March 31, 2015, Pinnacle Bank had granted loans and other extensions of credit amounting to approximately $\$ 6.6$ million to current directors, executive officers, and their related entities, of which $\$ 3.5$ million had been drawn upon. At December 31, 2014, Pinnacle Bank had granted loans and other extensions of credit amounting to approximately $\$ 6.4$ million to directors, executive officers, and their related entities, of which approximately $\$ 2.9$ million had been drawn upon. These loans and extensions of credit were made in the ordinary course of business on substantially the same terms, including interest rates and collateral, as those prevailing at the time for comparable loans to persons not related to Pinnacle Bank and did not involve more than the normal risk of collectability or present other unfavorable features. None of these loans to directors, executive officers, and their related entities were impaired at March 31, 2015 or December 31, 2014.

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## Residential Lending

At March 31, 2015, Pinnacle Financial had approximately $\$ 18.9$ million of mortgage loans held-for-sale compared to approximately $\$ 14.0$ million at December 31, 2014. Total loan volumes sold during the three months ended March 31, 2015 were approximately $\$ 95.8$ million compared to approximately $\$ 61.3$ million for the three months ended March 31, 2014. During the three months ended March 31, 2015, Pinnacle Financial recognized $\$ 1.9$ million in gains on the sale of these loans, net of commissions paid, compared to $\$ 1.2$ million during the three months ended March 31, 2014.

These mortgage loans held-for-sale are originated internally and are primarily to borrowers in Pinnacle Bank's geographic markets. These sales are typically on a mandatory basis to investors that follow conventional government sponsored entities (GSE) and the Department of Housing and Urban Development/U.S. Department of Veterans Affairs (HUD/VA) guidelines.

Each purchaser has specific guidelines and criteria for sellers of loans, and the risk of credit loss with regard to the principal amount of the loans sold is generally transferred to the purchasers upon sale. While the loans are sold without recourse, the purchase agreements require Pinnacle Bank to make certain representations and warranties regarding the existence and sufficiency of file documentation and the absence of fraud by borrowers or other third parties such as appraisers in connection with obtaining the loan. If it is determined that the loans sold were in breach of these representations or warranties, Pinnacle Bank has obligations to either repurchase the loan for the unpaid principal balance and related investor fees or make the purchaser whole for the economic benefits of the loan. To date, repurchase activity pursuant to the terms of these representations and warranties has been insignificant to Pinnacle Bank.

Note 5. Income Taxes
ASC 740, Income Taxes, defines the threshold for recognizing the benefits of tax return positions in the financial statements as "more-likely-than-not" to be sustained by the taxing authority. This section also provides guidance on the derecognition, measurement and classification of income tax uncertainties, along with any related interest and penalties, and includes guidance concerning accounting for income tax uncertainties in interim periods.

A reconciliation of the beginning and ending unrecognized tax benefit related to State uncertain tax positions is as follows (in thousands):

|  | Three <br> months <br> ended |  |
| :--- | :--- | :--- |
|  | March 31, |  |
|  | 2015 | 2014 |
|  | $\$ 391$ | $\$-$ |
| Balance at January 1, | - |  |
| Increases due to tax positions taken during the current year | - | - |
| Increases due to tax positions taken during a prior year | - | - |
| Decreases due to the lapse of the statute of limitations during the current year | - |  |
| Decreases due to settlements with the taxing authorities during the current year | - | - |
| Balance at March 31, | $\$ 391$ | $\$-$ |

Pinnacle Financial's policy is to recognize interest and/or penalties related to income tax matters in income tax expense. The total amounts of interest and penalties recorded in the income statement for the three months ended March 31, 2015 was $\$ 9,600$. No interest and penalties were recorded for the three months ended March 31, 2014.

Pinnacle Financial's effective tax rate for the three months ended March 31, 2015 was $33.0 \%$ compared to $33.2 \%$ for the three months ended March 31, 2014. The effective tax rate differs from the Federal and State income tax statutory rate of $39.23 \%$ primarily attributable to our investments in bank qualified municipal securities, investments in low-rate housing loans that qualify for Tennessee state excise tax credits and bank-owned life insurance, offset in part by meals and entertainment, a portion of which is non-deductible.
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Note 6. Commitments and Contingent Liabilities
In the normal course of business, Pinnacle Financial has entered into off-balance sheet financial instruments which include commitments to extend credit (i.e., including unfunded lines of credit) and standby letters of credit. Commitments to extend credit are usually the result of lines of credit granted to existing borrowers under agreements that the total outstanding indebtedness will not exceed a specific amount during the term of the indebtedness. Typical borrowers are commercial concerns that use lines of credit to supplement their treasury management functions, and thus their total outstanding indebtedness may fluctuate during any time period based on the seasonality of their business and the resultant timing of their cash flows. Other typical lines of credit are related to home equity loans granted to consumers. Commitments to extend credit generally have fixed expiration dates or other termination clauses and may require payment of a fee. At March 31, 2015, these commitments amounted to $\$ 1.4$ billion.

Standby letters of credit are generally issued on behalf of an applicant (our customer) to a specifically named beneficiary and are the result of a particular business arrangement that exists between the applicant and the beneficiary. Standby letters of credit have fixed expiration dates and are usually for terms of two years or less unless terminated beforehand due to criteria specified in the standby letter of credit. A typical arrangement involves the applicant routinely being indebted to the beneficiary for such items as inventory purchases, insurance, utilities, lease guarantees or other third party commercial transactions. The standby letter of credit would permit the beneficiary to obtain payment from Pinnacle Financial under certain prescribed circumstances. Subsequently, Pinnacle Financial would then seek reimbursement from the applicant pursuant to the terms of the standby letter of credit. At March 31, 2015 , these commitments amounted to $\$ 68.0$ million.

Pinnacle Financial follows the same credit policies and underwriting practices when making these commitments as it does for on-balance sheet instruments. Each customer's creditworthiness is evaluated on a case-by-case basis, and the amount of collateral obtained, if any, is based on management's credit evaluation of the customer. Collateral held varies but may include cash, real estate and improvements, marketable securities, accounts receivable, inventory, equipment and personal property.

The contractual amounts of these commitments are not reflected in the consolidated financial statements and only amounts drawn upon would be reflected in the future. Since many of the commitments are expected to expire without being drawn upon, the contractual amounts do not necessarily represent future cash requirements. However, should the commitments be drawn upon and should our customers default on their resulting obligation to us, Pinnacle Financial's maximum exposure to credit loss, without consideration of collateral, is represented by the contractual amount of those commitments. At March 31, 2015, and December 31, 2014, Pinnacle Financial had accrued \$1.4 million for the inherent risks associated with these off-balance sheet commitments.

Various legal claims also arise from time to time in the normal course of business. In the opinion of management, the resolution of these claims outstanding at March 31, 2015 will not have a material adverse impact on Pinnacle Financial's consolidated financial condition, operating results or cash flows.

Note 7. Stock Options, Stock Appreciation Rights and Restricted Shares
As described more fully in the Annual Report on Form 10-K, as of March 31, 2015, Pinnacle Financial has one equity incentive plan, the 2014 Equity Incentive Plan (the "2014 Plan").

Total shares available for issuance under the 2014 Plan were approximately 1.2 million shares as of March 31, 2015, inclusive of shares returned to plan reserves during the three months ended March 31, 2015. The 2014 Plan also permits Pinnacle Financial to reissue awards currently outstanding that are subsequently forfeited, settled in cash or expired unexercised and returned to the 2014 Plan.

## Common Stock Options and Stock Appreciation Rights

As of March 31, 2015, there were approximately 629,707 stock options and 3,200 stock appreciation rights outstanding to purchase common shares. A summary of the stock option and stock appreciation rights activity within the equity incentive plans during the three months ended March 31, 2015 and information regarding expected vesting, contractual terms remaining, intrinsic values and other matters is as follows:


The aggregate intrinsic value is calculated as the difference between the exercise price of the underlying awards
(1) and the quoted closing price of Pinnacle Financial common stock of $\$ 39.54$ per common share at December 31, 2014 for the 698,488 options and stock appreciation rights that were in-the-money at December 31, 2014.
The aggregate intrinsic value is calculated as the difference between the exercise price of the underlying awards
(2) and the quoted closing price of Pinnacle Financial common stock of $\$ 44.46$ per common share at March 31, 2015 for the 632,907 options and stock appreciation rights that were in-the-money at March 31, 2015.
(3) 511 SARS were converted into 205 common shares upon exercise.

Compensation costs related to unvested stock options granted under Pinnacle Financial's equity incentive plan had been fully recognized and all outstanding option awards are fully vested.

## Restricted Share Awards

Additionally, the 2014 Plan provides for the granting of restricted share awards and other performance or market-based awards. There were no market-based awards outstanding as of March 31, 2015 under this plan.

A summary of activity for unvested restricted share awards for the three months ended March 31, 2015 is as follows:

|  |  | Grant Date |  |
| :--- | :--- | :--- | :--- |
|  |  | Neighted-Average |  |
| Wumber | Cost |  |  |
| Unvested at December 31, 2014 | 849,198 | $\$$ | 24.26 |
| Shares awarded | 84,859 | 30.91 |  |
| Conversion of restricted share units to restricted share awards | 43,711 | 34.50 |  |
| Restrictions lapsed and shares released to associates/directors | $(201,018)$ | 23.31 |  |
| Shares forfeited ${ }^{(1)}$ | $(6,693$ | $)$ | 24.48 |
| Unvested at March 31, 2015 | 770,057 | $\$$ | 23.86 |

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Pinnacle Financial grants restricted share awards to associates, executive management and outside directors with a combination of time and, in the case of executive management, performance vesting criteria. The following table outlines restricted stock grants that were made, grouped by similar vesting criteria, during the three months ended March 31, 2015:

| Grant Group $^{(1)}$ | Vesting <br> Period in <br> years |
| :--- | :--- |

Shares Restrictions Lapsed and shares awardedreleased to participants

74,904 -

| Shares Forfeited by | Shares |
| :--- | :--- |
| participants ${ }^{(5)}$ | Unvested |

791
74,113
Performance Based
Awards ${ }^{(3)}$
$2015 \begin{aligned} & \text { Leadership } \\ & \text { team }\end{aligned}$
Outside Director
Awards ${ }^{(4)}$
$2015 \begin{array}{lllll}\text { Outside } \\ \text { directors } & 1 & 9,955- & - & 9,955\end{array}$

Groups include employees (referred to as associates above), the leadership team which includes our named executive officers and other key senior leadership members, and outside directors. When the restricted shares are awarded, a participant receives voting rights and forfeitable dividend rights with respect to the shares, but is not

## (1)

 able to transfer the shares until the restrictions have lapsed. Once the restrictions lapse, the participant is taxed on the value of the award and may elect to sell some shares to pay the applicable income taxes associated with the award. For time-based restricted share awards, dividends paid on shares for which the forfeiture restrictions do not lapse will be recouped by the Company at the time of termination. For performance-based awards, dividends are placed into escrow until the forfeiture restrictions on such shares lapse.(2) The forfeiture restrictions on these restricted share awards lapse in equal annual installments on the anniversary date of the grant.
(3) The forfeiture restrictions on these restricted share awards lapse in separate equal installments should Pinnacle
(3)

Financial achieve certain earnings and soundness targets over each year of the subsequent vesting period.
Restricted share awards are issued to the outside members of the board of directors in accordance with their board
(4) c
board member meeting their attendance goals for the various board and board committee meetings to which each member was scheduled to attend.
These shares represent forfeitures resulting from recipients for when employment terminated during the
(5) year-to-date period ended March 31, 2015. Any dividends paid on shares for which the forfeiture restrictions do not lapse will be recouped by the Company at the time of termination.

Compensation expense associated with the time-based restricted share awards is recognized over the time period that the restrictions associated with the awards lapse on a straight-line basis based on the total grant date fair value.
Compensation expense associated with performance-based restricted share awards is recognized over the time period that the restrictions associated with the awards are anticipated to lapse based on a schedule consistent with the nature of the award. For the three months ended March 31, 2015, Pinnacle Financial recognized approximately $\$ 1.7$ million in compensation costs attributable to restricted share awards, compared to $\$ 1.2$ million for the three months ended March 31, 2014.

## Restricted Share Units

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Pinnacle Financial granted restricted share units to the senior executive officers and other members of the Leadership Team in the first quarter of 2015. The senior executive officers' restricted share unit award included a range from 58,200 units at the target compensation level to 101,850 units at the maximum compensation level. These restricted share units will convert to a number of restricted share awards based on the achievement of certain performance metrics. The Leadership Team restricted share unit award of 28,378 units was granted at a target level of performance. For both senior executive officers and the Leadership Team, approximately one-third of these awards are eligible for conversion to restricted share awards based on the achievement of certain predetermined performance goals for each of the fiscal years ended December 31, 2015, 2016 and 2017, respectively. The performance metrics for each of the impacted fiscal years were established concurrently with the restricted share unit grants in January 2015 by the Human Resources and Compensation Committee of Pinnacle Financial's board of directors (HRCC). The awards include a one-year performance period and an additional service period of one-year following the performance period for a combined two-year service period per traunche. At the end of each respective two-year service period, the restricted share units convert to restricted share awards which are then subject to a post-vest holding period to extend the term of each traunche of the award to five years from the date of grant. During the post-vest holding period, the shares will not be released to the recipient and cannot be transacted upon, but will continue to accrue dividends until the awards are released, which is expected to be commensurate with the filing of Pinnacle Financial's Annual Report on Form 10-K for the year ended December 31, 2019 provided Pinnacle Bank achieves a certain soundness threshold as of December 31, 2019. These restricted share units are being expensed based on the requisite service period of the underlying traunche of the award. Each period, the number of shares that is expected to lapse to the recipient is reevaluated and the associated compensation expense is adjusted accordingly. For the three months ended March 31, 2015, Pinnacle Financial recognized expense associated with the first traunche of this award totaling $\$ 105,000$. The expense is being accrued using an anticipated performance level for the senior executive officers between the target and maximum performance levels and at the target performance level for the Leadership Team.
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## Note 8. Regulatory Matters

Pursuant to Tennessee banking law, Pinnacle Bank may not, without the prior consent of the Commissioner of the Tennessee Department of Financial Institutions (TDFI), pay any dividends to Pinnacle Financial in a calendar year in excess of the total of Pinnacle Bank's retained net income for that year plus the retained net income for the preceding two years. During the three months ended March 31, 2015, Pinnacle Bank paid $\$ 7.5$ million in dividends to Pinnacle Financial. As of March 31, 2015, Pinnacle Bank could pay approximately $\$ 103.8$ million of additional dividends to Pinnacle Financial without prior approval of the Commissioner of the TDFI. Pinnacle Financial initiated payment of a quarterly dividend of $\$ 0.08$ per share of common stock in the fourth quarter of 2013 and increased this quarterly dividend to $\$ 0.12$ beginning in the first quarter of 2015. Thus far, Pinnacle Financial has declared seven subsequent dividend payments. The amount and timing of all future dividend payments, if any, is subject to Board discretion and will depend on Pinnacle Financial's earnings, capital position, financial condition and other factors, including new regulatory capital requirements, as they become known to us.

In July 2013, the Federal Reserve Board and the FDIC approved final rules that substantially amend the regulatory risk-based capital rules applicable to Pinnacle Bank and Pinnacle Financial. The final rules implement the regulatory capital reforms of the Basel Committee on Banking Supervision reflected in "Basel III: A Global Regulatory Framework for More Resilient Banks and Banking Systems" (Basel III) and changes required by the Dodd-Frank Act.

Under these rules which became effective on January 1, 2015, the leverage and risk-based capital ratios of bank holding companies may not be lower than the leverage and risk-based capital ratios for insured depository institutions. The final rules also include new minimum risk-based capital and leverage ratios. Moreover, these rules refine the definition of what constitutes "capital" for purposes of calculating those ratios, including the definitions of Tier 1 capital and Tier 2 capital.

The new minimum capital level requirements applicable to bank holding companies and banks subject to the rules are:
(i) a new common equity Tier 1 capital ratio of $4.5 \%$;
(ii) a Tier 1 risk-based capital ratio of $6 \%$ (increased from 4\%);
(iii) a total risk-based capital ratio of $8 \%$ (unchanged from prior rules); and
(iv) a Tier 1 leverage ratio of $4 \%$ for all institutions.

The rules also establish a "capital conservation buffer" of $2.5 \%$ (to be phased in over three years) above the new regulatory minimum risk-based capital ratios, and result in the following minimum ratios once the capital conservation buffer is fully phased in:
(i) a common equity Tier 1 risk-based capital ratio of 7.0\%,
(ii) a Tier 1 risk-based capital ratio of $8.5 \%$, and
(iii) a total risk-based capital ratio of $10.5 \%$.

To be considered well-capitalized under applicable banking regulations following January 1, 2015, Pinnacle Financial and Pinnacle Bank must maintain the following minimum capital ratios and not be subject to a written agreement, order or directive to maintain a higher capital level:
(i) a common equity Tier 1 capital ratio of $6.5 \%$;
(ii) a Tier 1 risk-based capital ratio of $8 \%$;
(iii) a Total risk-based capital ratio of $10 \%$; and
(iv) in the case of Pinnacle Bank, a Tier 1 leverage ratio of 5\%.

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The capital conservation buffer requirement is to be phased in beginning in January 2016 at $0.625 \%$ of risk-weighted assets and will increase each year until fully implemented in January 2019. An institution will be subject to limitations on paying dividends, engaging in share repurchases and paying discretionary bonuses if capital levels fall below minimum levels plus the buffer amounts. These limitations establish a maximum percentage of eligible retained income that could be utilized for such actions.

Under these new rules, Tier 1 capital generally consists of common stock (plus related surplus) and retained earnings, limited amounts of minority interest in the form of additional Tier 1 capital instruments, and non-cumulative preferred stock and related surplus, subject to certain eligibility standards, less goodwill and other specified intangible assets and other regulatory deductions. Cumulative preferred stock and trust preferred securities issued after May 19, 2010, will no longer qualify as Tier 1 capital, but such securities issued prior to May 19, 2010 including in the case of bank holding companies with less than $\$ 15.0$ billion in total assets, trust preferred securities issued prior to that date, will continue to count as Tier 1 capital subject to certain limitations. As a result, Pinnacle Financial's Trust Preferred Securities continue to qualify as Tier 1 capital. The definition of Tier 2 capital is generally unchanged for most banking organizations, subject to certain new eligibility criteria.

Common equity Tier 1 capital generally consist of common stock (plus related surplus) and retained earnings plus limited amounts of minority interest in the form of common stock, less goodwill and other specified intangible assets and other regulatory deductions.

The final rules allow banks and their holding companies with less than $\$ 250$ billion in assets a one-time opportunity to opt-out of a requirement to include unrealized gains and losses in accumulated other comprehensive income in their capital calculation. Pinnacle Financial has opted out of this requirement.

Management believes, as of March 31, 2015, that Pinnacle Financial and Pinnacle Bank met all capital adequacy requirements to which they are subject. To be categorized as well-capitalized under applicable banking regulations, Pinnacle Financial and Pinnacle Bank must maintain minimum total risk-based, Tier I risk-based, common equity Tier I and Tier I leverage ratios as set forth in the following table and not be subject to a written agreement, order or directive to maintain a higher capital level. Pinnacle Financial's and Pinnacle Bank's actual capital amounts and ratios are presented in the following table (in thousands):

## At March 31,2015

|  |  | Minimum | Minimum |
| :--- | :--- | :--- | :--- |
| Capital | To Be |  |  |
| Actual |  | Requirement | Well-Capitalized |
| Amount | Ratio | Amount Ratio | Amount Ratio |

Total capital to risk weighted assets:
Pinnacle Financial
Pinnacle Bank
Tier I capital to risk weighted assets:
Pinnacle Financial
Pinnacle Bank
Common equity Tier I capital to risk weighted assets:
Pinnacle Financial
Pinnacle Bank
Tier I capital to average assets (*):
Pinnacle Financial
Pinnacle Bank

| \$674,270 | 12.1 | \$447,311 | 8.0 | \% | \$559,139 | 10.0 \% |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| \$628,978 | 11.3\% | \$446,242 | 8.0 | \% | \$557,802 | 10.0 \% |
| \$606,657 | 10.9\% | \$335,483 | 6.0 | \% | \$447,311 | 8.0 |
| \$561,365 | 10.1\% | \$334,681 | 6.0 | \% | \$446,242 | 8.0 |
| \$526,557 | 9.4 \% | \$251,612 | 4.5 | \% | \$363,440 | 6.5 |
| \$561,265 | 10.1\% | \$251,011 | 4.5 | \% | \$362,571 | 6.5 |
| \$606,657 | 10.4\% | \$232,438 | 4.0 | \% |  | NA |
| \$561,365 | 9.7 \% | \$230,969 | 4.0 | \% | \$288,71 | 5.0 |

(*) Average assets for the above calculations were based on the most recent quarter.

Note 9. Derivative Instruments
Financial derivatives are reported at fair value in other assets or other liabilities. The accounting for changes in the fair value of a derivative depends on whether it has been designated and qualifies as part of a hedging relationship. For derivatives not designated as hedges, the gain or loss is recognized in current period earnings.

Non-hedge derivatives
Pinnacle Financial enters into interest rate swaps (swaps) to facilitate customer transactions and meet their financing needs. Upon entering into these instruments to meet customer needs, Pinnacle Financial enters into offsetting positions in order to minimize the risk to Pinnacle Financial. These swaps are derivatives, but are not designated as hedging instruments.

Interest rate swap contracts involve the risk of dealing with counterparties and their ability to meet contractual terms. When the fair value of a derivative instrument contract is positive, this generally indicates that the counter party or customer owes Pinnacle Financial, and results in credit risk to Pinnacle Financial. When the fair value of a derivative instrument contract is negative, Pinnacle Financial owes the customer or counterparty and therefore, has no credit risk.

A summary of Pinnacle Financial's interest rate swaps related to customers as of March 31, 2015 and December 31, 2014 is included in the following table (in thousands):

|  | March 31, 2015 |  | December 31, 2014 |  |
| :--- | :---: | :--- | :---: | :--- | :--- |
|  |  | Estimated |  | Estimated |
|  | Notional | Fair | Notional | Fair |
|  | Amount | Value | Amount | Value |
|  |  |  |  |  |
| Interest rate swap agreements: |  |  |  |  |
| Pay fixed $/$ receive variable swaps | $\$ 266,762$ | $\$ 15,340$ | $\$ 251,321$ | $\$ 13,030$ |
| Pay variable / receive fixed swaps | 266,762 | $(15,812)$ | 251,321 | $(13,435)$ |
| Total | $\$ 533,524$ | $\$(472)$ | $\$ 502,642$ | $\$(405)$ |

## Hedge derivatives

Pinnacle Financial has forward cash flow hedge relationships to manage future interest rate exposure. The hedging strategy converts the LIBOR based variable interest rate on forecasted borrowings to a fixed interest rate and protects Pinnacle Financial from floating interest rate variability. The initial hedge relationships were entered into during the second quarter of 2013. During the third quarter of 2014, Pinnacle Financial terminated three individual contracts of the initial hedge relationships based on changes in internal forecasts for future interest rates. As a result of terminating these contracts, Pinnacle Financial will incur a gain of $\$ 64,000$ over the original terms of these agreements which were scheduled to begin in April 2015. Pinnacle Financial entered into additional forward cash flow hedge relationships for interest rate risk management purposes given the aforementioned changes in forecasted interest rates. The terms of the individual contracts within the relationship are as follows (in thousands):

(1)No cash will be exchanged prior to the beginning of the term.

Pinnacle Financial has four interest rate swap agreements designated as cash flow hedges intended to protect against the variability of cash flows on selected LIBOR based loans. The swaps hedge the interest rate risk, wherein Pinnacle Financial receives a fixed rate of interest from a counterparty and pays a variable rate, based on one month LIBOR. The terms of the respective swaps range from seven to ten years and started on July 1, 2014. The swaps were entered into with a counterparty that met Pinnacle Financial's credit standards and the agreements contain collateral provisions protecting the at-risk party. Pinnacle Financial believes that the credit risk inherent in the contract is not significant.

(1)No cash will be exchanged prior to the beginning of the term.

The cash flow hedges were determined to be fully effective during the period presented. And therefore, no amount of ineffectiveness has been included in net income. The aggregate fair value of the swaps is recorded in other assets with changes in fair value recorded in accumulated other comprehensive (loss) income, net of tax. If a hedge was deemed to be ineffective, the amount included in accumulated other comprehensive (loss) income would be reclassified into a line item within the statement of income that impacts operating results. The hedge would no longer be considered effective if a portion of the hedge becomes ineffective, the item hedged is no longer in existence or Pinnacle Financial discontinues hedge accounting. Pinnacle Financial expects the hedges to remain fully effective during the remaining terms of the swaps. Pinnacle Financial does not expect any amounts to be reclassified from accumulated other comprehensive (loss) income related to these swaps over the next twelve months.

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## Note 10. Fair Value of Financial Instruments

FASB ASC 820, Fair Value Measurements and Disclosures, which defines fair value, establishes a framework for measuring fair value in U.S. GAAP and expands disclosures about fair value measurements. The definition of fair value focuses on the exit price, i.e., the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date, not the entry price, i.e., the price that would be paid to acquire the asset or received to assume the liability at the measurement date. The statement emphasizes that fair value is a market-based measurement; not an entity-specific measurement. Therefore, the fair value measurement should be determined based on the assumptions that market participants would use in pricing the asset or liability.

## Valuation Hierarchy

FASB ASC 820 establishes a three-level valuation hierarchy for disclosure of fair value measurements. The valuation hierarchy is based upon the transparency of inputs to the valuation of an asset or liability as of the measurement date. The three levels are defined as follows:

Level 1 - inputs to the valuation methodology are quoted prices (unadjusted) for identical assets or liabilities in active markets.
Level 2 - inputs to the valuation methodology include quoted prices for similar assets and liabilities in active markets, and inputs that are observable for the asset or liability, either directly or indirectly, for substantially the full term of the financial instrument.
Level 3 - inputs to the valuation methodology are unobservable and significant to the fair value measurement.
A financial instrument's categorization within the valuation hierarchy is based upon the lowest level of input that is significant to the fair value measurement. Following is a description of the valuation methodologies used for assets and liabilities measured at fair value, as well as the general classification of such assets and liabilities pursuant to the valuation hierarchy.

## Assets

Securities available-for-sale - Where quoted prices are available for identical securities in an active market, securities are classified within Level 1 of the valuation hierarchy. Level 1 securities include highly liquid government securities and certain other financial products. If quoted market prices are not available, then fair values are estimated by using pricing models that use observable inputs or quoted prices of securities with similar characteristics and are classified within Level 2 of the valuation hierarchy. In certain cases where there is limited activity or less transparency around inputs to the valuation and more complex pricing models or discounted cash flows are used, securities are classified within Level 3 of the valuation hierarchy.

Other investments - Included in other investments are certain investments recorded at fair value primarily in certain nonpublic private equity funds. The valuation of nonpublic private equity investments requires management judgment due to the absence of observable quoted market prices, inherent lack of liquidity and the long-term nature of such assets. These investments are valued initially based upon transaction price. The carrying values of other investments are adjusted either upwards or downwards from the transaction price to reflect expected exit values as evidenced by financing and sale transactions with third parties, or when determination of a valuation adjustment is confirmed through ongoing reviews by senior investment managers. A variety of factors are reviewed and monitored to assess positive and negative changes in valuation including, but not limited to, current operating performance and future expectations of the particular investment, industry valuations of comparable public companies and changes in market outlook and the third-party financing environment over time. In determining valuation adjustments resulting from the investment review process, emphasis is placed on current company performance and market conditions. These investments are included in Level 3 of the valuation hierarchy as these funds are not widely traded and the underling investments of such funds are often privately-held and/or start-up companies for which market values are not readily
available.
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Other assets - Included in other assets are certain assets carried at fair value, including interest rate swap agreements, the cash flow hedge and interest rate locks associated with the mortgage loan pipeline. The carrying amount of interest rate swap agreements is based on Pinnacle Financial's pricing models that utilize observable market inputs. The fair value of the cash flow hedge is determined by calculating the difference between the discounted fixed rate cash flows and the discounted variable rate cash flows. The fair value of the mortgage loan pipeline is based upon the projected sales price of the underlying loans, taking into account market interest rates and other market factors at the measurement date, net of the projected fallout rate. Pinnacle Financial reflects these assets within Level 2 of the valuation hierarchy as these assets are valued using similar transactions that occur in the market.

Nonaccrual loans - A loan is classified as nonaccrual when it is probable Pinnacle Financial will be unable to collect all principal and interest payments due in accordance with the contractual terms of the loan agreement. Nonaccrual loans are measured based on the present value of expected payments using the loan's original effective rate as the discount rate, the loan's observable market price, or the fair value of the collateral less selling costs if the loan is collateral dependent. If the recorded investment in the nonaccrual loan exceeds the measure of fair value, a valuation allowance may be established as a component of the allowance for loan losses or the difference may be recognized as a charge-off. Nonaccrual loans are classified within Level 3 of the hierarchy due to the unobservable inputs used in determining their fair value such as collateral values and the borrower's underlying financial condition.

Other real estate owned - Other real estate owned (OREO) represents real estate foreclosed upon by Pinnacle Bank through loan defaults by customers or acquired by deed in lieu of foreclosure. Substantially all of these amounts relate to lots, homes and development projects that are either completed or are in various stages of construction for which Pinnacle Financial believes it has adequate collateral. Upon foreclosure, the property is recorded at the lower of cost or fair value, based on appraised value, less selling costs estimated as of the date acquired with any loss recognized as a charge-off through the allowance for loan losses. Additional OREO losses for subsequent valuation downward adjustments are determined on a specific property basis and are included as a component of noninterest expense along with holding costs. Any gains or losses realized at the time of disposal are also reflected in noninterest expense, as applicable. OREO is included in Level 3 of the valuation hierarchy due to the lack of observable market inputs into the determination of fair value. Appraisal values are property-specific and sensitive to the changes in the overall economic environment.

## Liabilities

Other liabilities - Pinnacle Financial has certain liabilities carried at fair value including certain interest rate swap agreements to facilitate customer transactions. The fair value of these liabilities is based on Pinnacle Financial's pricing models that utilize observable market inputs and is reflected within Level 2 of the valuation hierarchy.

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The following tables present financial instruments measured at fair value on a recurring basis as of March 31, 2015 and December 31, 2014, by caption on the consolidated balance sheets and by FASB ASC 820 valuation hierarchy (as described above) (in thousands):

March 31, 2015
Investment securities available-for-sale:

## U.S. government agency securities

Mortgage-backed securities
State and municipal securities
Agency-backed securities
Corporate notes and other
Total investment securities available-for-sale
Other investments
Other assets
Total assets at fair value

Other liabilities
Total liabilities at fair value

|  | Quoted <br>  <br>  <br> market <br> prices | Models <br> ith |  |
| :--- | :--- | :--- | :--- |
| Total | in an | significant | significant |
| carrying | active | observable | unobservable |
| value in the | market | market | market |
| consolidated | (Level | parameters | parameters |
| balance sheet | 1) | (Level 2) | (Level 3) |

December 31, 2014
Investment securities available-for-sale:

| $\quad$ U.S. government agency securities | $\$ 113,456$ | $\$$ | - | $\$ 113,456$ | $\$-$ |
| :--- | :--- | :--- | :--- | :--- | :--- |
| $\quad$ Mortgage-backed securities | 455,839 |  | - | 455,839 | - |
| $\quad$ State and municipal securities | 138,578 |  | - | 138,578 | - |
| Agency-backed securities | 13,018 |  | - | 13,018 | - |
| $\quad$ Corporate notes and other | 11,164 |  | - | 11,164 | - |
| Total investment securities available-for-sale | 732,055 |  | - | 732,055 | - |
| Other investments | 8,004 |  | - | - | 8,004 |
| Other assets | 15,987 |  | - | 15,987 | - |
| Total assets at fair value | $\$ 756,046$ | $\$$ | - | $\$ 748,042$ | $\$ 8,004$ |
|  |  |  |  |  |  |
| Other liabilities | $\$ 15,981$ | $\$$ | - | $\$ 15,981$ | $\$-$ |
| Total liabilities at fair value | $\$ 15,981$ | $\$$ | - | $\$ 15,981$ | $\$-$ |

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The following table presents assets measured at fair value on a nonrecurring basis as of March 31, 2015 and December 31, 2014 (in thousands):

March 31, 2015
Other real estate owned
Nonaccrual loans, net ${ }^{(1)}$
Total

|  | Quoted |  |  |  |
| :---: | :---: | :---: | :---: | :---: |
|  | market prices | Models with | Models with | Total losses for |
| Total | in an | significant | significan |  |
| carrying | active | observable | nobservable | year-to-date |
| value in the | market | market | market | period then |
| consolidated | (Level | parameters | parameters | ended |
| balance sheet | 1) | (Level 2) | (Level 3) |  |
| \$ 8,441 | \$ | \$ | \$ 8,441 | \$ (523 |
| 15,731 |  | - | 15,731 | - |
| \$ 24,172 | \$ - | \$ - | \$ 24,172 | \$ (523 |

December 31, 2014

| Other real estate owned | $\$ 11,186$ | $\$$ | - | $\$$ | - | $\$ 11,186$ | $\$(509$ | $)$ |
| :--- | ---: | :--- | :--- | :--- | :--- | :--- | :--- | :--- |
| Nonaccrual loans, net ${ }^{(1)}$ | 15,551 |  | - |  | - | 15,551 | $(1,032$ | $)$ |
| Total | $\$ 26,737$ | $\$$ | - | $\$$ | - | $\$ 26,737$ | $\$(1,541$ | $)$ |

(1) Amount is net of a valuation allowance of $\$ 1.2$ million at March 31, 2015 and December 31, 2014 as required by ${ }^{1)}$ ASC 310-10, "Receivables."

In the case of the investment securities portfolio, Pinnacle Financial monitors the portfolio to ascertain when transfers between levels have been affected. The nature of the remaining assets and liabilities is such that transfers in and out of any level are expected to be rare. For the three months ended March 31, 2015, there were no transfers between Levels 1, 2 or 3.

The table below includes a rollforward of the balance sheet amounts for the three months ended March 31, 2015 (including the change in fair value) for financial instruments classified by Pinnacle Financial within Level 3 of the valuation hierarchy for assets and liabilities measured at fair value on a recurring basis. When a determination is made to classify a financial instrument within Level 3 of the valuation hierarchy, the determination is based upon the significance of the unobservable factors to the overall fair value measurement. However, since Level 3 financial instruments typically include, in addition to the unobservable or Level 3 components, observable components (that is, components that are actively quoted and can be validated to external sources), the gains and losses in the table below include changes in fair value due in part to observable factors that are part of the valuation methodology (in thousands):

Fair value, January 1
Total realized gains (losses) included in income
Change in unrealized gains/losses included in other comprehensive income for assets and liabilities still held at March 31
Purchases
Issuances
Settlements
Transfers out of Level 3

| For the three months ended March |  |  |  |
| :---: | :---: | :---: | :---: |
| 31, |  |  |  |
| 2015 |  | 2014 |  |
| Other | Other | Other | Other |
| assets | liabilities | assets | liabilities |
| \$8,004 | \$ | \$6,701 | \$ |
| 95 | - | 130 | - |
| - | - | - | - |
| 121 | - | 306 | - |
| - | - | - | - |
| (470 ) | - | - | - |
| - | - | - | - |

Fair value, March 31
The amount of (gains) losses for the period included in earnings attributable to the change in unrealized (gains) losses relating to assets still held at the reporting date $\quad \$ 95 \quad \$ \quad-\quad \$ 130 \quad \$ \quad-$

The following methods and assumptions were used by Pinnacle Financial in estimating its fair value disclosures for financial instruments that are not measured at fair value. In cases where quoted market prices are not available, fair values are based on estimates using discounted cash flow models. Those models are significantly affected by the assumptions used, including the discount rates, estimates of future cash flows and borrower creditworthiness. The fair value estimates presented herein are based on pertinent information available to management as of March 31, 2015 and December 31, 2014. Such amounts have not been revalued for purposes of these consolidated financial statements since those dates and, therefore, current estimates of fair value may differ significantly from the amounts presented herein.

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Securities held-to-maturity - Estimated fair values for investment securities are based on quoted market prices where available. If quoted market prices are not available, then fair values are estimated by using pricing models that use observable inputs or quoted prices of securities with similar characteristics.

Loans, net - The fair value of our loan portfolio includes a credit risk factor in the determination of the fair value of our loans. This credit risk assumption is intended to approximate the fair value that a market participant would realize in a hypothetical orderly transaction. Our loan portfolio is initially fair valued using a segmented approach. We divide our loan portfolio into the following categories: variable rate loans, impaired loans and all other loans. The results are then adjusted to account for credit risk.

For variable-rate loans that reprice frequently and have no significant change in credit risk, fair values approximate carrying values. Fair values for impaired loans are estimated using discounted cash flow models or based on the fair value of the underlying collateral. For other loans, fair values are estimated using discounted cash flow models, using current market interest rates offered for loans with similar terms to borrowers of similar credit quality. The values derived from the discounted cash flow approach for each of the above portfolios are then further discounted to incorporate credit risk to determine the exit price.

Mortgage loans held-for-sale - Mortgage loans held-for-sale are carried at the lower of cost or fair value. The estimate of fair value is based on pricing models and other information.

Deposits, securities sold under agreements to repurchase, Federal Home Loan Bank (FHLB) advances, subordinated debt and other borrowings - The carrying amounts of demand deposits, savings deposits, securities sold under agreements to repurchase, floating rate advances from the FHLB, floating rate subordinated debt and other borrowings, and floating rate loans approximate their fair values due to having no stated maturity. Fair values for certificates of deposit, fixed rate advances from the FHLB and fixed rate subordinated debt are estimated using discounted cash flow models, using current market interest rates offered on certificates, advances and other borrowings with similar remaining maturities. For fixed rate subordinated debt, the maturity is assumed to be as of the earliest date that the indebtedness will be repriced.

Off-balance sheet instruments - The fair values of Pinnacle Financial's off-balance-sheet financial instruments are based on fees charged to enter into similar agreements. However, commitments to extend credit do not represent a significant value to Pinnacle Financial until such commitments are funded.
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The following table presents the carrying amounts, estimated fair value and placement in the fair value hierarchy of Pinnacle Financial's financial instruments at March 31, 2015 and December 31, 2014. This table excludes financial instruments for which the carrying amount approximates fair value. For short-term financial assets such as cash and cash equivalents, the carrying amount is a reasonable estimate of fair value due to the relatively short time between the origination of the instrument and its expected realization. For financial liabilities such as non-interest bearing demand, interest-bearing demand, and savings deposits, the carrying amount is a reasonable estimate of fair value due to these products having no stated maturity (in thousands).

|  |  |  |  |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: |
|  |  |  | Quoted market prices | Models with | Models with |
|  |  |  | in an | significant | significant |
|  |  |  | active | observable | unobservable |
|  | Carrying/ | Estimated | market | market | market |
| (dollars in thousands) | Notional | Fair | (Level | parameters | parameters |
| March 31, 2015 | Amount | Value ${ }^{(1)}$ | 1) | (Level 2) | (Level 3) |
| Financial assets: |  |  |  |  |  |
| Securities held-to-maturity | \$39,276 | \$39,408 | \$ - | \$ 39,408 | \$ |
| Loans, net | 4,579,031 | 4,460,738 | - | - | 4,460,738 |
| Mortgage loans held-for-sale | 18,910 | 18,910 | - | 18,910 | - |
| Loans held-for-sale | 7,935 | 7,935 | - | 7,935 | - |
| Financial liabilities: |  |  |  |  |  |
| Deposits and securities sold under agreements to repurchase | 4,857,363 | 4,572,115 | - | - | 4,572,115 |
| Federal Home Loan Bank advances | 455,444 | 454,767 | - | - | 454,767 |
| Subordinated debt and other borrowings | 135,533 | 119,115 | - | - | 119,115 |
| Off-balance sheet instruments: |  |  |  |  |  |
| Commitments to extend credit ${ }^{(2)}$ | 1,339,618 | 1,084 | - | - | 1,084 |
| Standby letters of credit ${ }^{(3)}$ | 69,851 | 287 | - | - | 287 |

December 31, 2014
Financial assets:

| Securities held-to-maturity | $\$ 38,676$ | $\$ 38,789$ | $\$$ | - | $\$ 38,789$ |
| :--- | :---: | :--- | :--- | :--- | :--- |
| Loans, net | $4,522,668$ | $4,406,581$ | - | - | $4,406,581$ |
| Mortgage loans held for sale | 14,039 | 14,322 | - | 14,322 | - |

Financial liabilities:
Deposits and securities sold under agreements to repurchase
Federal Home Loan Bank advances
Subordinated debt and other borrowings

| $4,876,600$ | $4,603,915$ | - | - | $4,603,915$ |
| :--- | :--- | :--- | :--- | :--- |
| 195,476 | 195,450 | - | - | 195,450 |
| 96,158 | 77,433 | - | - | 77,433 |

Off-balance sheet instruments:
Commitments to extend credit (2)
Standby letters of credit ${ }^{(3)}$

| $1,390,593$ | 1,078 | - | - | 1,078 |
| :--- | :--- | :--- | :--- | :--- |
| 65,955 | 293 | - | - | 293 |

(1) Estimated fair values are consistent with an exit-price concept. The assumptions used to estimate the fair values are ${ }^{1}$ intended to approximate those that a market-participant would realize in a hypothetical orderly transaction.
(2)

At the end of each quarter, Pinnacle Financial evaluates the inherent risks of the outstanding off-balance sheet commitments. In making this evaluation, Pinnacle Financial evaluates the credit worthiness of the borrower, the collateral supporting the commitments and any other factors similar to those used to evaluate the inherent risks of our loan portfolio. Additionally, Pinnacle Financial evaluates the probability that the outstanding commitment will eventually become a funded loan. As a result, at both March 31, 2015 and December 31, 2014, Pinnacle Financial included in other liabilities $\$ 1.1$ million representing the inherent risks associated with these off-balance sheet commitments.
At March 31, 2015 and December 31, 2014, the fair value of Pinnacle Financial's standby letters of credit was $\$ 287,000$ and $\$ 293,000$, respectively. This amount represents the unamortized fee associated with these standby
(3)letters of credit and is included in the consolidated balance sheet of Pinnacle Financial and is believed to approximate fair value. This fair value will decrease over time as the existing standby letters of credit approach their expiration dates.

## ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following is a discussion of our financial condition at March 31, 2015 and December 31, 2014 and our results of operations for the three months ended March 31, 2015 and 2014. The purpose of this discussion is to focus on information about our financial condition and results of operations which is not otherwise apparent from the consolidated financial statements. The following discussion and analysis should be read along with our consolidated financial statements and the related notes included elsewhere herein.

## Overview

Our diluted net income per common share for the three months ended March 31, 2015 was $\$ 0.62$ compared to $\$ 0.47$ for the same period in 2014. At March 31, 2015, loans had increased to $\$ 4.645$ billion, as compared to $\$ 4.590$ billion at December 31, 2014, and total deposits increased to $\$ 4.789$ billion at March 31, 2015 from $\$ 4.783$ billion at December 31, 2014.

Results of Operations. Our net interest income increased $\$ 5.4$ million to $\$ 51.3$ million for the first quarter of 2015 compared to $\$ 45.9$ million for the first quarter of 2014. The net interest margin (the ratio of net interest income to average earning assets) for the three months ended March 31, 2015 was $3.78 \%$ compared to $3.76 \%$ for the same period in 2014.
Our provision for loan losses was $\$ 315,000$ for the three months ended March 31, 2015 compared to $\$ 488,000$ for the same period in 2014. Our provision expense correlates with the growth in our net loans offset by an overall reduction in the amount of our allowance for loan losses as a result of credit quality improvement in our loan portfolio. Net charge-offs were $\$ 1.4$ million for the three months ended March 31, 2015, compared to $\$ 934,000$ in the prior year. Our allowance for loan losses as a percentage of total loans decreased from $1.47 \%$ at December 31, 2014 to $1.43 \%$ at March 31, 2015, as a result of improving credit quality within our loan portfolio
Noninterest income increased by $\$ 5.8$ million during the three months ended March 31, 2015, compared to the same period in the prior year. Income from equity-method investment was $\$ 3.2$ million during the three months ended March 31, 2015, due to our 30\% equity-method investment in Bankers Healthcare Group LLC (BHG). Service charges on deposit accounts increased for the three months ended March 31, 2015 as compared to the same period in 2014 consistent with the growth in demand deposits, specifically commercial operating accounts. We experienced increases for the three month period ended March 31, 2015, in each of our wealth management lines of business (trust, insurance agency and investment services) as compared to the same period in 2014. Additionally, we saw an increase in income related to gains on residential mortgage loans sold for the three months ended March 31, 2015 compared to the same period in 2014 largely due to the mandatory delivery process that we began in the latter part of the first quarter of 2014. Other noninterest income includes miscellaneous consumer fees, such as ATM revenues, other consumer fees (primarily interchange), interest rate swap fee transactions for commercial borrowers, and gains from the sale of commercial loans that occur from time to time.
Noninterest expense increased by $\$ 3.2$ million during the three months ended March 31, 2015, as compared to the three months ended March 31, 2014, primarily as a result of increased salaries and employment benefits resulting from annual merit increases awarded in the first quarter of 2015. Costs associated with the disposal and maintenance of other real estate owned decreased by $\$ 256,000$ for the three months ended March 31, 2015, when compared to the same period in 2014. The reduction in OREO expense is also the result of the normalization of property valuations as well as a reduction of OREO inflows and in the overall amount of other real estate owned.
During the three months ended March 31, 2015, Pinnacle Financial recorded income tax expense of $\$ 10.8$ million. Pinnacle Financial's effective tax rate for the three months ended March 31, 2015 and 2014 of $33.0 \%$ and $33.2 \%$, respectively, differs from the combined federal and state income tax statutory rate primarily due to investments in bank qualified municipal securities, our real estate investment trust, and bank-owned life insurance offset in part by a limitation related to deductibility of meals and entertainment expense.
Our efficiency ratio (the ratio of noninterest expense to the sum of net interest income and noninterest income) was $52.8 \%$ for the three months ended March 31, 2015, compared to $57.4 \%$ for the same period in 2014. Net income for
the three months ended March 31, 2015 was $\$ 21.8$ million compared to $\$ 16.4$ million for the same period in 2014. 33

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Financial Condition. Net loans increased $\$ 56.3$ million, or $1.2 \%$, during the three months ended March 31, 2015. Total deposits were $\$ 4.789$ billion at March 31, 2015, compared to $\$ 4.783$ billion at December 31, 2014, an increase of $\$ 6.7$ million. At March 31, 2015, our capital ratios, including our bank's capital ratios, exceeded those levels necessary to be considered well-capitalized under applicable regulatory guidelines.
From time to time we may be required to support the capital needs of our bank (Pinnacle Bank). At March 31, 2015, we had approximately $\$ 39.5$ million of cash at the holding company, substantially all of which could be used to support our bank. Although we do not anticipate our bank needing any additional capital from us currently, we believe we have various capital raising techniques available to us to provide for the capital needs of our bank, if necessary. Critical Accounting Estimates
The accounting principles we follow and our methods of applying these principles conform with U.S. GAAP and with general practices within the banking industry. There have been no significant changes to our Critical Accounting Policies as described in our Annual Report on Form 10-K for the year ended December 31, 2014.
Results of Operations
The following is a summary of our results of operations (dollars in thousands, except per share data):


Net Interest Income. Net interest income represents the amount by which interest earned on various earning assets exceeds interest paid on deposits and other interest-bearing liabilities and is the most significant component of our revenues. Net interest income totaled $\$ 51.3$ million for the three months ended March 31, 2015, an increase of $\$ 5.4$ million, from the levels recorded in the same period of 2014. We were able to increase net interest income during the three months ended March 31, 2015 compared to the same period in 2014 due primarily to our focus on growing our loan portfolio while reducing our funding costs. Average loans for the three months ended March 31, 2015 were $12.0 \%$ greater than average balances for the same period in 2014.

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The following tables set forth the amount of our average balances, interest income or interest expense for each category of interest-earning assets and interest-bearing liabilities and the average interest rate for interest-earning assets and interest-bearing liabilities, net interest spread and net interest margin for the three months ended March 31, 2015 and 2014 (dollars in thousands):

Interest-earning assets:
Loans ${ }^{(1)}$
Securities:
Taxable
Tax-exempt ${ }^{(2)}$
Federal funds sold and other
Total interest-earning assets
Nonearning assets
Intangible assets
Other nonearning assets
Total assets

Three months ended
March 31, 2015

Three months ended
March 31, 2014

| $\$ 4,624,952$ | $\$ 49,467$ | $4.35 \%$ | $\$ 4,130,289$ | $\$ 43,696$ | $4.30 \%$ |
| :---: | :---: | :---: | :---: | :---: | :---: |
| 625,883 | 3,445 | $2.23 \%$ | 573,330 | 3,720 | $2.63 \%$ |
| 162,667 | 1,483 | $4.94 \%$ | 175,209 | 1,598 | $4.94 \%$ |
| 168,006 | 284 | $0.81 \%$ | 144,864 | 277 | $0.92 \%$ |
| $5,581,508$ | $\$ 54,679$ | $4.02 \%$ | $5,023,692$ | $\$ 49,291$ | $4.04 \%$ |
|  |  |  |  |  |  |
| 246,314 |  |  | 247,360 |  |  |
| 274,701 |  | 242,979 |  |  |  |
| $\$ 6,102,523$ |  | $\$ 5,514,031$ |  |  |  |

Interest-bearing liabilities:
Interest-bearing deposits:
Interest checking
Savings and money market
Time
Total interest-bearing deposits
Securities sold under agreements to repurchase
Federal Home Loan Bank advances
Subordinated debt and other borrowings
Total interest-bearing liabilities
Noninterest-bearing deposits
Total deposits and interest-bearing liabilities
Other liabilities
Stockholders' equity
Total liabilities and stockholders' equity
Net interest income
Net interest spread ${ }^{(3)}$
Net interest margin ${ }^{(4)}$

| \$ 1,029,707 | \$473 | 0.19\% | \$921,034 | \$429 | 0.19\% |
| :---: | :---: | :---: | :---: | :---: | :---: |
| 1,996,016 | 1,410 | 0.29\% | 1,951,787 | 1,427 | 0.30\% |
| 423,618 | 548 | 0.52\% | 507,929 | 739 | 0.59\% |
| 3,449,341 | 2,431 | 0.29\% | 3,380,750 | 2,595 | 0.31\% |
| 66,505 | 31 | 0.19\% | 62,500 | 31 | 0.20\% |
| 290,016 | 220 | 0.31\% | 83,787 | 123 | 0.59\% |
| 121,033 | 728 | 2.44\% | 98,651 | 634 | 2.61\% |
| 3,926,895 | 3,410 | 0.35\% | 3,625,688 | 3,383 | 0.38\% |
| 1,342,603 | - | - | 1,128,743 | - | - |
| 5,269,498 | \$3,410 | 0.26\% | 4,754,431 | \$3,383 | 0.29\% |
| 17,319 |  |  | 18,857 |  |  |
| 815,706 |  |  | 740,743 |  |  |
| \$6,102,523 |  |  | \$5,514,031 |  |  |
| \$51,269 |  |  | \$45,908 |  |  |
|  |  | 3.67\% |  |  | 3.66\% |
|  |  | 3.78\% |  |  | 3.76\% |

1. Average balances of nonaccrual loans are included in the above amounts.
2. Yields based on the carrying value of those tax exempt instruments are shown on a fully tax equivalent basis. Yields realized on interest-bearing assets less the rates paid on interest-bearing liabilities. The net interest spread
3. calculation excludes the impact of noninterest bearing demand deposits. Had the impact of noninterest bearing
4. demand deposits been included, the net interest spread for the three months ended March 31, 2015 would have been $3.76 \%$ compared to a net interest spread of $3.75 \%$ for the three months ended March 31, 2014.
5. Net interest margin is the result of annualized net interest income calculated on a tax-equivalent basis divided by average interest-earning assets for the period.

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For the three months ended March 31, 2015 and 2014, our net interest margin was $3.78 \%$ and $3.76 \%$, respectively. The improvement in the net interest margin was primarily attributable to continued lower funding costs. We also entered into a cash flow hedge during the second quarter of 2014 in which we swapped interest rates on $\$ 110$ million of our loan portfolio. For the quarter ended March 31, 2015, we received a weighted average interest rate of 2.33\% and paid the 1 -month LIBOR rate of $0.17 \%$ on this portion of the loan portfolio, pursuant to the terms of our agreement with the swap counterparty. This resulted in an approximate contribution of $\$ 586,000$ to our net interest margin during the first quarter of 2015. The increase in our net interest income for the three months ended March 31, 2015, as compared to the same period in 2014 was primarily the result of an increase in loan volumes.

We continue to deploy various asset liability management strategies to manage our risk to interest rate fluctuations. We believe margin expansion will be challenging due to continued pressure on earning asset yields during this current period of low interest rates. Loan pricing for creditworthy borrowers is very competitive in our markets and has limited our ability to increase pricing on new and renewed loans over the last several quarters, and we anticipate that this challenging competitive environment will continue throughout the remainder of 2015.

We continue to believe our net interest income should increase throughout the remainder of 2015 compared to 2014 due to an increase in average earning asset volumes, primarily loans. We anticipate funding these increased earning assets primarily by growing our core deposits, with limited wholesale funding to fund the shortfall, if any.

Provision for Loan Losses. The provision for loan losses represents a charge to earnings necessary to establish an allowance for loan losses that, in management's evaluation, should be adequate to provide coverage for the inherent losses on outstanding loans. Based upon management's assessment of the loan portfolio, we adjust our allowance for loan losses to an amount deemed appropriate to adequately cover probable losses inherent in the loan portfolio. Our allowance for loan losses as a percentage of total loans decreased from $1.47 \%$ at December 31, 2014 to $1.43 \%$ at March 31, 2015.

Based upon our evaluation of the loan portfolio, we believe the allowance for loan losses to be adequate to absorb our estimate of probable losses existing in the loan portfolio at March 31, 2015. While our policies and procedures used to estimate the allowance for loan losses, as well as the resultant provision for loan losses charged to operations, are considered adequate by management, they are necessarily approximate and imprecise. There are factors beyond our control, such as conditions in the local and national economy, local real estate market, or particular industry or borrower-specific conditions, which may materially negatively impact our asset quality and the adequacy of our allowance for loan losses and, thus, the resulting provision for loan losses.

The provision for loan losses amounted to $\$ 315,000$ and $\$ 488,000$ for the three months ended March 31, 2015 and 2014. Provision expense is impacted by the absolute level of loans, loan growth, the credit quality of the loan portfolio and the amount of net charge-offs. We believe that the level of our allowance for loan losses as a percentage of our loan portfolio will continue to decrease consistent with overall improvement in the credit quality of our portfolio.

Noninterest Income. Our noninterest income is composed of several components, some of which vary significantly between quarterly and annual periods. Service charges on deposit accounts, income from equity-method investment and other noninterest income generally reflect customer growth trends, while fees from our wealth management departments, the origination of mortgage loans and gains and losses on the sale of securities will often reflect market conditions and fluctuate from period to period.

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The following is a summary of our noninterest income for the three months ended March 31, 2015 and 2014 (dollars in thousands):

|  | Three months <br> ended <br> March 31, 2015 |  | Percent <br> Increase |  |
| :--- | :--- | :--- | :--- | :--- |
|  | 2015 | 2014 | (Decrease) |  |
| Noninterest income: | $\$ 2,913$ | $\$ 2,791$ | 4.4 | $\%$ |
| Service charges on deposit accounts | 2,259 | 2,128 | 6.2 | $\%$ |
| Investment services | 1,513 | 1,385 | 9.2 | $\%$ |
| Insurance sales commissions | 1,941 | 1,235 | 57.2 | $\%$ |
| Gains on mortgage loans sold, net | 6 | - | 100.0 | $\%$ |
| Gain on sale of investment securities, net | 1,312 | 1,146 | 14.5 | $\%$ |
| Trust fees | 3,201 | - | 100.0 | $\%$ |
| Income from equity-method investment |  |  |  |  |
| Other noninterest income: | 3,799 | 2,951 | 28.7 | $\%$ |
| Interchange and other consumer fees | 600 | 615 | $(2.4$ | $\%)$ |
| Bank-owned life insurance | 482 | 25 | NM |  |
| Loan swap fees | 467 | 456 | 2.4 | $\%$ |
| Other noninterest income | 5,348 | 4,047 | 32.2 | $\%$ |
| Total other noninterest income | $\$ 18,493$ | $\$ 12,732$ | 45.2 | $\%$ |
| Total noninterest income |  |  |  |  |

The increase in service charges on deposit accounts in the three months ended March 31, 2015 compared to the three months ended March 31, 2014 is primarily related to increased analysis fees due to an increase in the volume and number of commercial checking accounts.

Income from our wealth management groups (investments, insurance and trust) is also included in noninterest income. For the three months ended March 31, 2015, commissions and fees from investment services at our financial advisory unit, Pinnacle Asset Management, a division of Pinnacle Bank, increased by $\$ 132,000$ as compared to the three months ended March 31, 2014. At March 31, 2015, Pinnacle Asset Management was receiving commissions and fees in connection with approximately $\$ 1.7$ billion in brokerage assets held with Raymond James Financial Services, Inc. compared to $\$ 1.6$ billion at March 31, 2014. Revenues from the sale of insurance products by our insurance subsidiary were approximately $\$ 1.5$ million and $\$ 1.4$ million for both the three months ended March 31, 2015 and 2014. Included in insurance revenues for the three months ended March 31, 2015 was $\$ 372,000$ of contingent income received based on 2014 sales production compared to $\$ 243,000$ recorded in the same prior year period. Additionally, at March 31, 2015, our trust department was receiving fees on approximately $\$ 783.0$ million and $\$ 827.8$ million of managed and custodied assets, respectively, compared to $\$ 648.0$ million and $\$ 793.1$ million at March 31, 2014. Accordingly, trust fees increased by $14.5 \%$ between the year-to-date periods presented.

Gains on mortgage loans sold, net, consists of fees from the origination and sale of mortgage loans. These mortgage fees are for loans we originate in both the Middle Tennessee and Knoxville markets that are subsequently sold to third-party investors. All of these loan sales transfer servicing rights to the buyer. Generally, mortgage origination fees increase in lower interest rate environments and more robust housing markets and decrease in rising interest rate environments and more challenging housing markets. Mortgage origination fees will fluctuate from quarter to quarter as the rate environment changes. Gains on mortgage loans sold, net, were $\$ 1.9$ million for the three months ended March 31, 2015 as compared to $\$ 1.2$ million for the same period in the prior year as a result of the mandatory delivery process we began in the latter part of the first quarter in 2014 as well as a slight uptick in the market.

Income from equity-method investment is comprised of income from our 30\% equity-method investment in BHG, which was entered into during the first quarter of 2015, and was $\$ 3.2$ million for the first quarter of 2015. Income from equity-method investment is recorded net of any associated expenses, including amortization expense of $\$ 400,000$ associated with amortizing intangibles identified in the acquisition. The income associated with this equity-method investment may fluctuate from period to period.

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Included in other noninterest income are interchange and other consumer fees, gains from bank-owned life insurance, swap fees earned for the facilitation of derivative transactions for our clients and other items. Interchange revenues increased as a result of the number of cards being used as compared to the comparable periods in 2014. Other noninterest income included changes in the cash surrender value of bank-owned life insurance which was $\$ 600,000$ for the three months ended March 31, 2015 compared to $\$ 615,000$ for the three months ended March 31, 2014. The assets that support these policies are administered by the life insurance carriers and the income we receive (i.e., increases or decreases in the cash surrender value of the policies) on these policies is dependent upon the returns the insurance carriers are able to earn on the underlying investments that support the policies. Earnings on these policies generally are not taxable. Loan swap fees are also included in other noninterest income and increased by $\$ 457,000$ when compared to the three months ended March 31, 2014 as a result of increase in market demand in the current rate environment.

Noninterest Expense. Noninterest expense consists of salaries and employee benefits, equipment and occupancy expenses, other real estate expenses, and other operating expenses. The following is a summary of our noninterest expense for the three months ended March 31, 2015 and 2014 (in thousands):

| Three months |  |
| :--- | :--- |
| ended | 2015 - |
| March 31, | 2014 |
| Percent |  |
| $2015 \quad 2014$ | Increase <br> (Decrease) |

Noninterest expense:
Salaries and employee benefits:

| Salaries | $\$ 12,824$ | $\$ 12,454$ | 3.0 | $\%$ |
| :--- | :---: | :--- | :--- | :--- |
| Commissions | 1,388 | 1,337 | 3.8 | $\%$ |
| Cash and equity incentives | 5,479 | 4,576 | 19.7 | $\%$ |
| Employee benefits and other | 3,840 | 3,383 | 13.5 | $\%$ |
| Total salaries and employee benefits | 23,531 | 21,750 | 8.2 | $\%$ |
| Equipment and occupancy | 6,046 | 5,709 | 5.9 | $\%$ |
| Other real estate expense | 395 | 651 | $(39.3$ | $\%)$ |
| Marketing and business development | 960 | 909 | 5.6 | $\%$ |
| Postage and supplies | 649 | 561 | 15.8 | $\%$ |
| Amortization of intangibles | 227 | 238 | $(4.3$ | $\%)$ |
| Other noninterest expense | 5,023 | 3,832 | 31.1 | $\%$ |
| Total noninterest expense | $\$ 36,831$ | $\$ 33,650$ | 9.5 | $\%$ |

Total salaries and employee benefits expenses increased approximately $\$ 1.8$ million for the first three months of 2015 over the same period in 2014. The increase in salaries is the result of our annual merit increases being effective January 1 as well as the overall increase in our associate base. At March 31, 2015, our associate base had expanded to 774.5 full-time equivalent associates as compared to 744.0 at December 31, 2014. We expect that total salaries and employee benefits expense will continue to increase throughout the remainder of 2015 when compared to comparable periods in 2014 as a result of the additional associates we have already hired in 2015 and our intention to hire additional experienced financial advisors during the year.

We believe that cash and equity incentives are a valuable tool in motivating an employee base that is focused on providing our clients effective financial advice and increasing shareholder value. As a result, and unlike many other financial institutions, all of our non-commissioned associates participate in our annual cash incentive plan and all of our associates participate in our equity compensation plans. As compared to 2014, cash and equity incentives increased by $\$ 903,000$ for the three months ended March 31, 2015. Under the annual cash incentive plan, the targeted level of incentive payments requires achievement of a certain soundness threshold, a revenue component and a targeted level of earnings (subject to certain adjustments). To the extent that the soundness threshold is met and
revenues and earnings are above or below the targeted amount, the aggregate incentive payments are increased or decreased. Historically, we have paid between $0 \%$ and $125 \%$ of our targeted incentives. We currently believe that our performance for fiscal 2015 will exceed our targets, and we are currently accruing incentive costs for the cash incentive plan in 2015 at $114 \%$ of targeted awards. Under our equity incentive plans, we provide a broad-based equity incentive program for all associates including both restricted share awards and performance unit awards. We believe that equity incentives provide an excellent vehicle for all associates to become meaningful stockholders of Pinnacle Financial over an extended period of time and create a stockholder-centric culture throughout our organization. We expect that compensation expense associated with equity awards for the remainder of 2015 will continue to increase as a result of the additional associates we have hired already hired in 2015 and our intention to hire additional experienced financial advisors throughout the remainder of 2015.

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Equipment and occupancy expenses for the three months ended March 31, 2015, increased $\$ 337,000$ as compared to the same period in the prior year. We expanded our retail operations opening our fifth Knoxville location late in the fourth quarter of 2014. We intend to add an additional branch in the Knoxville market during 2015. In future periods, these expansions may lead to higher equipment and occupancy expenses as well as related increases in salaries and benefits expense.

At March 31, 2015, we had $\$ 8.4$ million in OREO assets compared to $\$ 11.2$ million at December 31, 2014. Other real estate expense was $\$ 395,000$ for the three months ended March 31, 2015, compared to $\$ 651,000$ for the same periods in the prior year. The remaining other real estate expense consisted of carrying costs to maintain or improve the properties.

Intangible amortization expense was slightly over $\$ 200,000$ for both the three months ended March 31, 2015 and 2014. The remaining expense for the amortization of intangibles relates primarily to the intangible acquired in the Mid-America merger in November 2007. This core deposit intangible is being amortized over ten years, using an accelerated method which anticipates the life of the underlying deposits to which the intangible is attributable. Amortization expense for the remaining amortization period associated with this core deposit intangible will approximate $\$ 825,000, \$ 789,000$ and $\$ 691,000$, respectively, for the three years ending December 31, 2015, 2016 and 2017. Additionally, in connection with our acquisition of Miller Loughry Beach, an insurance brokerage firm, in July of 2008, we recorded a customer list intangible of $\$ 1,270,000$ which is being amortized over 20 years on an accelerated basis. Amortization of the customer list intangible will approximate $\$ 54,000$ to $\$ 79,000$ per year for the next five years with amounts declining each year for the remaining amortization period.

Total other noninterest expenses increased by $\$ 1.2$ million during the three months ended March 31, 2015 when compared to 2014. Increases in noninterest expense related primarily to Tennessee franchise tax expense of $\$ 500,000$ as well as other administrative expenses.

Our efficiency ratio (ratio of noninterest expense to the sum of net interest income and noninterest income) was $52.8 \%$ for the three months ended March 31, 2015 compared to $57.4 \%$ for the three months ended March 31, 2014. The efficiency ratio measures the amount of expense that is incurred to generate a dollar of revenue.

Income Taxes. During the three months ended March 31, 2015, we recorded income tax expense of $\$ 10.8$ million compared to $\$ 8.1$ million for the three months ended March 31, 2014. Our income tax expense for the year-to-date period ended March 31, 2015 reflects an effective income tax rate of $33.0 \%$ compared to $33.2 \%$ for the year-to-date period ended March 31, 2014 which is principally impacted by our investments in bank qualified municipal securities, investments in low-rate housing loans that qualify for Tennessee state excise tax credits and bank-owned life insurance offset in part by meals and entertainment expense, a portion of which is non-deductible.

## Financial Condition

Our consolidated balance sheet at March 31, 2015 reflects an increase in total loans outstanding to $\$ 4.645$ billion at March 31, 2015 compared to $\$ 4.590$ billion at December 31, 2014. Total deposits increased by $\$ 6.7$ million between December 31, 2014 and March 31, 2015. Total assets were $\$ 6.314$ billion at March 31, 2015 compared to $\$ 6.018$ billion at December 31, 2014.

Loans. The composition of loans at March 31, 2015 and at December 31, 2014 and the percentage (\%) of each classification to total loans are summarized as follows (dollars in thousands):

|  | March 31, 2015 |  | December 31, 2014 |  |  |  |
| :--- | :---: | :---: | :---: | :---: | :---: | :---: |
|  | Amount | Percent | Amount | Percent |  |  |
|  |  |  |  |  |  |  |
| Commercial real estate - mortgage | $\$ 1,560,683$ | 33.6 | $\%$ | $\$ 1,544,091$ | 33.6 | $\%$ |
| Consumer real estate - mortgage | 723,907 | 15.6 | $\%$ | 721,158 | 15.7 | $\%$ |


| Construction and land development | 324,462 | 7.0 | $\%$ | 322,466 | 7.0 | $\%$ |
| :--- | :---: | :--- | :--- | :--- | :--- | :--- |
| Commercial and industrial | $1,810,818$ | 39.0 | $\%$ | $1,784,729$ | 38.9 | $\%$ |
| Consumer and other | 225,402 | 4.9 | $\%$ | 217,583 | 4.7 | $\%$ |
| Total loans | $\$ 4,645,272$ | 100.0 | $\%$ | $\$ 4,590,027$ | 100.0 | $\%$ |

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The primary changes within the composition of our loan portfolio at March 31, 2015 as compared to December 31, 2014 reflect slight increases in loan demand in the commercial and industrial and commercial real-estate mortgage segments. We believe that loan growth in the remainder of 2015 with the commercial real estate segment will outpace loan payoffs in that segment of the portfolio resulting in an increase in the percentage of commercial real estate loans as a percentage of total loans. The commercial real estate - mortgage category includes owner-occupied commercial real estate loans. At March 31, 2015, approximately $49.1 \%$ of the outstanding principal balance of our commercial real estate mortgage loans was secured by owner-occupied properties. Owner-occupied commercial real estate is similar in many ways to our commercial and industrial lending in that these loans are generally made to businesses on the basis of the cash flows of the business rather than on the valuation of the real estate. Growth in the consumer and other segment is primarily the result of increased indirect automobile lending.

The following table classifies our fixed and variable rate loans at March 31, 2015 according to contractual maturities of (1) one year or less, (2) after one year through five years, and (3) after five years. The table also classifies our variable rate loans pursuant to the contractual repricing dates of the underlying loans (dollars in thousands):

|  | Amounts at March 31, 2015 |  |  | Percentage <br> At March |
| :---: | :---: | :---: | :---: | :---: |
|  |  |  |  |  |
|  | Fixed | Variable |  | 31, |
|  | Rates | Rates | Totals | 2015 |
| Based on contractual maturity: |  |  |  |  |
| Due within one year | \$ 190,798 | \$797,053 | \$987,851 | 21.3 \% |
| Due in one year to five years | 1,162,790 | 1,101,168 | 2,263,958 | 48.7 \% |
| Due after five years | 568,344 | 825,120 | 1,393,464 | 30.0 \% |
| Totals | \$1,921,932 | \$2,723,340 | \$4,645,272 | 100.0 \% |
| Based on contractual repricing dates: |  |  |  |  |
| Daily floating rate (*) | \$- | \$ 1,465,101 | \$ 1,465,101 | 31.5 \% |
| Due within one year | 190,798 | 440,608 | 631,406 | 13.6 \% |
| Due in one year to five years | 1,162,790 | 514,921 | 1,677,711 | 36.1 \% |
| Due after five years | 568,344 | 302,710 | 871,054 | 18.8 \% |
| Totals | \$1,921,932 | \$2,723,340 | \$4,645,272 | 100.0 \% |

The above information does not consider the impact of scheduled principal payments.
(*) Daily floating rate loans are tied to Pinnacle Bank's prime lending rate or a national interest rate index with the underlying loan rates changing in relation to changes in these indexes. Interest rate floors are currently in effect on approximately $\$ 529.2$ million of our daily floating rate loan portfolio and on approximately $\$ 427.7$ million of the remaining variable rate loan portfolio at varying maturities. The weighted average rate of the floors for the daily floating rate portfolio is $4.32 \%$ compared to the average coupon of $3.72 \%$ for this portfolio. The weighted average rate of the floors for the remaining variable rate portfolio is $4.04 \%$ compared to the average coupon rate of $3.29 \%$ for this portfolio. As a result, interest income on these loans will not adjust until the contractual rate on the underlying loan exceeds the interest rate floor. This analysis is presented using the underlying structure of the individual loans in our portfolio and does not consider hedging strategies currently employed by Pinnacle Bank.
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Accruing Loans in Past Due Status. The following table is a summary of our accruing loans that were past due at least 30 days but less than 89 days and 90 days or more past due as of March 31, 2015 and December 31, 2014 (dollars in thousands):

|  | March | December |
| :--- | :--- | :--- |
|  | 31, | 31, |
| Accruing loans past due 30 to 89 days: | 2015 | 2014 |
| Commercial real estate - mortgage | $\$ 3,320$ | $\$ 2,232$ |
| Consumer real estate - mortgage | 1,163 | 2,391 |
| Construction and land development | 59 | 421 |
| Commercial and industrial | 1,005 | 3,431 |
| Consumer and other | 8,588 | 9,532 |
| $\quad$ Total accruing loans past due 30 to 89 days | $\$ 14,135$ | $\$ 18,007$ |
| Accruing loans past due 90 days or more: |  |  |
| Commercial real estate - mortgage | $\$ 1,568$ | $\$-$ |
| Consumer real estate - mortgage | - | 146 |
| Construction and land development | - | - |
| Commercial and industrial | 12 | 5 |
| Consumer and other | 29 | 172 |
| Total accruing loans past due 90 days or more | $\$ 1,609$ | $\$ 323$ |

## Ratios:

Accruing loans past due 30 to 89 days as a percentage of total loans $\quad \begin{array}{lllll}0.30 & \% & 0.39 & \%\end{array}$
Accruing loans past due 90 days or more as a percentage of total loans
Total accruing loans in past due status as a percentage of total loans

| 0.30 | $\%$ | 0.39 | $\%$ |
| :--- | :--- | :--- | :--- |
| 0.03 | $\%$ | 0.01 | $\%$ |
| 0.34 | $\%$ | 0.40 | $\%$ |

Potential Problem Loans. Potential problem loans, which are not included in nonperforming assets, amounted to approximately $\$ 91.3$ million or $2.0 \%$ of total loans at March 31, 2015 compared to $\$ 83.0$ million or $1.8 \%$ of total loans at December 31, 2014. Potential problem loans represent those loans with a well-defined weakness and where information about possible credit problems of borrowers has caused management to have serious doubts about the borrower's ability to comply with present repayment terms. This definition is believed to be substantially consistent with the standards established by Pinnacle Bank's primary regulators for loans classified as substandard, excluding the impact of substandard nonaccrual loans and substandard troubled debt restructurings. Troubled debt restructurings are not included in potential problem loans. Approximately $\$ 3.1$ million of potential problem loans were past due at least 30 days but less than 90 days as of March 31, 2015.

Nonperforming Assets and Troubled Debt Restructurings. At March 31, 2015, we had $\$ 25.4$ million in nonperforming assets compared to $\$ 27.9$ million at December 31, 2014. Included in nonperforming assets were $\$ 16.9$ million in nonaccrual loans and $\$ 8.4$ million in OREO at March 31, 2015 and $\$ 16.7$ million in nonaccrual loans and $\$ 11.2$ million in OREO assets at December 31, 2014. At March 31, 2015 and December 31, 2014, there were $\$ 8.7$ million and $\$ 8.4$ million, respectively, of troubled debt restructurings, all of which were accruing as of the restructured date and remain on accrual status but are considered impaired loans pursuant to U.S. GAAP.

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The following table is a summary of our nonperforming assets and troubled debt restructurings at March 31, 2015 and December 31, 2014 (dollars in thousands):


Payments, sales and reductions in nonaccrual loans are primarily attributable to payments we have collected from borrowers, charge-offs of recorded balances and nonaccrual loans that have been returned to accruing status during the three months ended March 31, 2015. Payments, sales and reductions in other real estate owned represent either
(1) the sale, disposition or valuation adjustment on properties which had previously been foreclosed upon or acquired by deed in lieu of foreclosure. Payments, sales and reductions in troubled debt restructurings are those loans which were previously restructured whereby the borrower has reduced the outstanding balance of the loan or re-defaulted on the terms of the loan and therefore been charged-off.
${ }^{2}$ Foreclosures in nonaccrual loans and troubled debt restructurings are representative of transfers of balances to
${ }^{(2)}$ OREO during the three months ended March 31, 2015.
(3)Inflows in nonaccrual loans are attributable to loans where we have discontinued the accrual of interest at some point during the three months ended March 31, 2015. Increases in troubled debt restructurings are the result of

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increases in the number of loans where we have granted a concession due to the deteriorating financial condition of the borrower during 2015. These concessions can be in the form of a reduced interest rate, extended maturity date or other matters.
(4) Approximately $\$ 13.9$ million and $\$ 10.2$ million as of March 31, 2015 and December 31, 2014, respectively, of nonaccrual loans included above are currently paying pursuant to their contractual terms.
(5)Classified assets as a percentage of Tier 1 capital plus allowance for loan losses.

At March 31, 2015, we owned $\$ 8.4$ million in other real estate which we had acquired (usually through foreclosure) from borrowers, compared to $\$ 11.2$ million at December 31, 2014, substantially all of which is located within our principal markets. We segment our OREO into three categories: developed lots, undeveloped land, and other. The other category primarily consists of office buildings and existing homes. The following table shows the classification of our OREO (dollars in thousands):

|  | March | December |
| :--- | :--- | :--- |
|  | 31, | 31, |
|  | 2015 | 2014 |
| Developed lots | $\$-$ | $\$ 275$ |
| Undeveloped land | 7,484 | 9,240 |
| Other | 957 | 1,671 |
|  | $\$ 8,441$ | $\$ 11,186$ |

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Allowance for Loan Losses (allowance). We maintain the allowance at a level that our management deems appropriate to adequately cover the probable losses inherent in the loan portfolio. As of March 31, 2015 and December 31, 2014, our allowance for loan losses was approximately $\$ 66.2$ million and $\$ 67.4$ million, respectively, which our management deemed to be adequate at each of the respective dates. The judgments and estimates associated with our allowance determination are substantially consistent with those described under Critical Accounting Estimates in our Annual Report on Form 10-K for the year ended December 31, 2014.

The following table sets forth, based on management's best estimate, the allocation of the allowance to categories of loans as well as the unallocated portion as of March 31, 2015 and December 31, 2014 and the percentage of loans in each category to total loans (dollars in thousands):

|  |  | December 31, |  |  |  |  |
| :--- | :---: | :---: | :---: | :---: | :---: | :---: |
|  | March 31, 2015 |  | 2014 |  |  |  |
|  | Amount | Percent | Amount | Percent |  |  |
| Commercial real estate - mortgage | $\$ 19,643$ | 33.6 | $\%$ | $\$ 22,202$ | 33.6 | $\%$ |
| Consumer real estate - mortgage | 4,358 | 15.6 | $\%$ | 5,424 | 15.7 | $\%$ |
| Construction and land development | 5,394 | 7.0 | $\%$ | 5,724 | 7.0 | $\%$ |
| Commercial and industrial | 31,494 | 39.0 | $\%$ | 29,167 | 38.9 | $\%$ |
| Consumer and other | 1,686 | 4.9 | $\%$ | 1,570 | 4.7 | $\%$ |
| Unallocated | 3,667 | NA | 3,272 | NA |  |  |
| Total allowance for loan losses | $\$ 66,242$ | 100.0 | $\%$ | $\$ 67,359$ | 100.0 | $\%$ |

The following is a summary of changes in the allowance for loan losses for the year-to-date period ended March 31, 2015 and for the year ended December 31, 2014 and the ratio of the allowance for loan losses to total loans as of the end of each period (dollars in thousands):
$\left.\begin{array}{llll}\text { Balance at beginning of period } & \$ 67,359 & \$ 67,970 \\ \text { Provision for loan losses } & 315 & 3,635 \\ \text { Charged-off loans: } & & & \\ \text { Commercial real estate - mortgage } & (350 & ) & (875 \\ \hline \text { Consumer real estate - mortgage } & (134 & ) & (1,621\end{array}\right)$

Ratio of net charge-offs to average total loans outstanding for the period ${ }^{(1)} \quad 0.13 \quad \% \quad 0.10 \quad \%$ (1) Net charge-offs for the year-to-date period ended March 31, 2015 have been annualized.

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Management assesses the adequacy of the allowance prior to the end of each calendar quarter. This assessment includes procedures to estimate the allowance and test the adequacy and appropriateness of the resulting balance. The level of the allowance is based upon management's evaluation of the loan portfolios, past loan loss experience, known and inherent risks in the portfolio, the views of Pinnacle Bank's regulators, adverse situations that may affect the borrower's ability to repay (including the timing of future payments), the estimated value of any underlying collateral, composition of the loan portfolio, economic conditions, industry and peer bank loan quality indications and other pertinent factors. This evaluation is inherently subjective as it requires material estimates including the amounts and timing of future cash flows expected to be received on impaired loans that may be susceptible to significant change. For further discussion regarding our allowance for loan losses, refer to the Annual Report on Form 10-K as of and for the year ended December 31, 2014.
Investments. Our investment portfolio, consisting primarily of U.S. Treasuries, Federal agency bonds, mortgage-backed securities, and state and municipal securities amounted to $\$ 808.3$ million and $\$ 770.7$ million at March 31, 2015 and December 31, 2014, respectively. Our investment portfolio serves many purposes including serving as a stable source of income, as collateral for public funds deposits and as a potential liquidity source. A summary of our investment portfolio at March 31, 2015 and December 31, 2014 follows:

March 31, 2015 December 31, 2014

| Weighted average life | 4.41 years | 4.55 years |
| :--- | :--- | :--- |
| Effective duration | $2.90 \%$ | $2.81 \%$ |
| Weighted average coupon | $3.18 \%$ | $3.31 \%$ |
| Tax equivalent yield | $2.79 \%$ | $2.81 \%$ |

Deposits and Other Borrowings. We had approximately $\$ 4.789$ billion of deposits at March 31, 2015 compared to $\$ 4.783$ billion at December 31, 2014. Our deposits consist of noninterest and interest-bearing demand accounts, savings accounts, money market accounts and time deposits. Additionally, we entered into agreements with certain customers to sell certain securities under agreements to repurchase the security the following day. These agreements (which are typically associated with comprehensive treasury management programs for our clients and provide them with short-term returns for their excess funds) amounted to $\$ 68.1$ million at March 31, 2015 and $\$ 94.0$ million at December 31, 2014. Additionally, at March 31, 2015 and December 31, 2014, Pinnacle Bank had borrowed \$455.4 million and $\$ 195.5$ million, respectively, in advances from the FHLB. At March 31, 2015, Pinnacle Bank also had approximately $\$ 561$ million in additional availability with the FHLB.

Generally, we have classified our funding base as either core funding or non-core funding. Core funding consists of all deposits other than time deposits issued in denominations greater than $\$ 250,000$. All other funding is deemed to be non-core. The following table represents the balances of our deposits and other funding and the percentage of each type to the total at March 31, 2015 and December 31, 2014 (dollars in thousands):


Other time deposits
Securities sold under agreements to repurchase Total relationship based non-core funding Wholesale funding:
Brokered deposits
Federal Home Loan Bank advances
Holding company loan
Pinnacle Bank loan
Subordinated debt- Pinnacle Financial
Total wholesale funding
Total non-core funding
Totals

| 71,193 | 1.3 | $\%$ | 69,278 | 1.3 | $\%$ |
| :--- | :--- | :--- | :--- | :--- | :--- |
| 68,053 | 1.3 | $\%$ | 93,995 | 1.8 | $\%$ |
| 444,728 | 8.2 | $\%$ | 495,422 | 9.6 | $\%$ |
|  |  |  |  |  |  |
| - | 0.0 | $\%$ | - | 0.0 | $\%$ |
| 455,444 | 8.4 | $\%$ | 195,476 | 3.8 | $\%$ |
| 13,057 | 0.2 | $\%$ | 13,682 | 0.3 | $\%$ |
| 40,000 | 0.7 | $\%$ | - | 0.0 | $\%$ |
| 82,476 | 1.5 | $\%$ | 82,476 | 1.6 | $\%$ |
| 590,977 | 10.9 | $\%$ | 291,634 | 5.6 | $\%$ |
| $1,035,705$ | 19.0 | $\%$ | 787,056 | 15.2 | $\%$ |
| $\$ 5,448,338$ | 100.0 | $\%$ | $\$ 5,168,233$ | 100.0 | $\%$ |

The reciprocating categories consists of deposits we receive from a bank network (the CDARS network) in
(1) connection with deposits of our customers in excess of our FDIC coverage limit that we place with the CDARS network.

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Our funding policies impose limits on the amount of non-core funding we can utilize. Periodically, we may exceed our policy limitations, at which time management will develop plans to bring our core funding ratios back within compliance. At March 31, 2014 and December 31, 2014, we were in compliance with our core funding policies. As noted in the table above, our core funding as a percentage of total funding decreased slightly from $84.8 \% \%$ at December 31,2014 to $81.0 \%$ at March 31,2015 , primarily as a result of our increased FHLB advances.

Continuing to grow our core deposit base is a key strategic objective of our firm. We have numerous commercial and affluent consumer depositors that maintain significant balances in their transaction and money market accounts. These deposits are subject to significant fluctuations from time to time for such purposes as distributions to owners, taxes, business acquisitions, etc. As a result, our core funding ratios may also fluctuate meaningfully based on these factors.

The amount of time deposits as of March 31, 2015 amounted to $\$ 420.2$ million. The following table shows our time deposits in denominations of $\$ 100,000$ and less and in denominations greater than $\$ 100,000$ by category based on time remaining until maturity and the weighted average rate for each category (in thousands):

|  |  | Weighted <br> Avg. |  |
| :--- | :---: | :--- | :--- |
|  | Balances | Rate |  |

Subordinated debt and other borrowings. We have four wholly-owned subsidiaries that are statutory business trusts. We are the sole sponsor of the Trusts and acquired each Trust's common securities. The Trusts were created for the exclusive purpose of issuing 30-year capital trust preferred securities and using the proceeds to acquire junior subordinated debentures (Subordinated Debentures) issued by ourselves. The sole assets of the Trusts are the Subordinated Debentures. At March 31, 2015, our $\$ 2,476,000$ investment in the Trusts is included in other investments in the accompanying consolidated balance sheets and our $\$ 82,476,000$ obligation is reflected as subordinated debt.

|  | Date Established | Maturity | Common Securities | Subordinated <br> Debentures | Floating Interest Rate | Interest Rate at March 31, 2015 |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: |
|  | December 29, | December 30, |  |  |  |  |
| Trust I | 2003 | 2033 | \$ 310,000 | \$ 10,000,000 | Libor + 2.80\% | 3.07\% |
|  | September 15, | September 30, |  |  |  |  |
| Trust II | 2005 | 2035 | 619,000 | 20,000,000 | Libor + 1.40\% | 1.67\% |
| Trust | September 7, | September 30, |  |  |  |  |
| III | 2006 | 2036 | 619,000 | 20,000,000 | Libor + 1.65\% | 1.93\% |
| Trust |  | September 30, |  |  |  |  |
| IV | October 31, 2007 | 2037 | 928,000 | 30,000,000 | Libor + 2.85\% | 3.12\% |

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The Trust Preferred Securities bear a floating interest rate based on a spread over 3-month LIBOR which is set each quarter. Distributions are payable quarterly. The Trust Preferred Securities are subject to mandatory redemption upon repayment of the Subordinated Debentures at their stated maturity date or their earlier redemption in an amount equal to their liquidation amount plus accumulated and unpaid distributions to the date of redemption. We guarantee the payment of distributions and payments for redemption or liquidation of the Trust Preferred Securities to the extent of funds held by the Trusts. Our obligations under the Subordinated Debentures together with the guarantee and other back-up obligations, in the aggregate, constitute a full and unconditional guarantee by ourselves of the obligations of the Trusts under the Trust Preferred Securities.

The Subordinated Debentures are unsecured, bear interest at a rate equal to the rates paid by the Trusts on the Trust Preferred Securities and mature on the same dates as those noted above for the Trust Preferred Securities. Interest is payable quarterly. We may defer the payment of interest at any time for a period not exceeding 20 consecutive quarters provided that the deferral period does not extend past the stated maturity. During any such deferral period, distributions on the Trust Preferred Securities will also be deferred and our ability to pay dividends on our common shares and preferred shares will be restricted.

The Trust Preferred Securities may be redeemed prior to maturity at our option. The Trust Preferred Securities may also be redeemed at any time in whole (but not in part) in the event of unfavorable changes in laws or regulations that result in (1) the Trust becoming subject to federal income tax on income received on the Subordinated Debentures, (2) interest payable by the parent company on the Subordinated Debentures becoming non-deductible for federal tax purposes, (3) the requirement for the Trust to register under the Investment Company Act of 1940, as amended, or (4) loss of the ability to treat the trust preferred securities as "Tier I capital" under the Federal Reserve capital adequacy guidelines. Under current Federal Reserve regulations, the trust preferred securities qualify as Tier 1 capital. The Federal Reserve published final Basel III capital regulations in June 2013 which continued the treatment of preferred securities as Tier I capital for holding companies under $\$ 15.0$ billion in assets.
On June 15, 2012, we entered into a loan agreement with an unaffiliated bank for $\$ 25$ million. Our borrowings under the Loan Agreement bear interest at a LIBOR rate generally defined as the sum of (i) the average of the offered rates of interest quoted in the London Inter-Bank Eurodollar Market for U.S. Dollar deposits with prime banks (as published by Reuters or other commercially available sources) for three months (all as selected by the Company), and (ii) an applicable margin. The applicable margin under the Loan Agreement ranges from 2.25\% ( 225 basis points) to $3.00 \%$ ( 300 basis points) depending on the total aggregate principal amount outstanding under the Loan Agreement. At March 31, 2015, the rate was $2.71 \%$.

We began making quarterly principal payments of $\$ 625,000$ on September 30, 2012, and the loan matures on June 15, 2017. We are also permitted to prepay all or a portion of the principal amount outstanding under the Loan Agreement without penalty (in minimum aggregate amounts of $\$ 100,000$ ) at any time so long as no event of default or unmatured event of default has occurred and is continuing. As of March 31, 2015, we had prepaid $\$ 5.0$ million on this loan. At March 31, 2015, the balance owed on this loan was $\$ 13.1$ million.

On October 2, 2013, the Loan Agreement was amended to permit us to pay dividends on its capital stock so long as no event of default was then existing or would be caused by the payment of such dividends. As of March 31, 2015, we are aware of no defaults.

In conjunction with our equity-method investment in BHG, on February 4, 2015, Pinnacle Bank entered into a loan agreement with an unaffiliated bank for $\$ 40$ million. Pinnacle Bank's borrowings under the loan agreement bear interest at rates at the greater of (i) zero percent $(0 \%)$ and (ii) the one-month LIBOR rate quoted by the lender (as published by Reuters), plus in each case an applicable margin. The applicable margin under the loan agreement ranges from $1.65 \%$ ( 165 basis points) to $1.95 \%$ (195 basis points) depending on the total aggregate principal amount outstanding under the loan agreement. The initial applicable margin is $1.95 \%$ ( 195 basis points).

Capital Resources. At March 31, 2015 and December 31, 2014, our stockholders' equity amounted to $\$ 824.2$ million and $\$ 802.7$ million, respectively, an increase of approximately $\$ 21.5$ million. Substantially all of this increase is attributable to our net income.

In July 2013, the Federal Reserve Board and the FDIC approved final rules that substantially amend the regulatory risk-based capital rules applicable to Pinnacle Bank and Pinnacle Financial. The final rules implement the regulatory capital reforms of the Basel Committee on Banking Supervision reflected in "Basel III: A Global Regulatory Framework for More Resilient Banks and Banking Systems" and changes required by the Dodd-Frank Act. These rules became effective for Pinnacle Bank and Pinnacle Financial on January 1, 2015. The final rules allow banks and their holding companies with less than $\$ 250$ billion in assets a one-time opportunity to opt-out of a requirement to include unrealized gains and losses in accumulated other comprehensive income in their capital calculation. Pinnacle Financial and Pinnacle Bank have opted out of this requirement. The adoption of these rules resulted in the dilution of our capital ratios, but we remain above regulatory minimums to be considered well-capitalized. In connection with our proposed mergers with CapitalMark and Magna, we are considering whether to issue additional debt securities at our holding company or bank subsidiary to enhance our capital ratios following the closing of those transactions.

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Dividends. Pursuant to Tennessee banking law, our bank may not, without the prior consent of the TDFI, pay any dividends to us in a calendar year in excess of the total of our bank's retained net profits for that year plus the retained net profits for the preceding two years. During the three months ended March 31, 2015, our bank paid dividends of $\$ 7.5$ million to us which is within the limits allowed by the TDFI.

During the three months ended March 31, 2015, we paid $\$ 4.3$ million in dividends to common shareholders. On April 7, 2015, our Board of Directors declared a $\$ 0.12$ quarterly cash dividend to common shareholders which should approximate $\$ 4.3$ million in aggregate dividend payments that will be paid on May 29, 2015 to common shareholders of record as of the close of business on May 1, 2015. The amount and timing of all future dividend payments, if any, is subject to Board discretion and will depend on our earnings, capital position, financial condition and other factors, including new regulatory capital requirements, as they become known to us.

## Market and Liquidity Risk Management

Our objective is to manage assets and liabilities to provide a satisfactory, consistent level of profitability within the framework of established liquidity, loan, investment, borrowing, and capital policies. Our Asset Liability Management Committee (ALCO) is charged with the responsibility of monitoring these policies, which are designed to ensure acceptable composition of asset/liability mix. Two critical areas of focus for ALCO are interest rate sensitivity and liquidity risk management.

Interest Rate Sensitivity. In the normal course of business, we are exposed to market risk arising from fluctuations in interest rates. ALCO measures and evaluates the interest rate risk so that we can meet customer demands for various types of loans and deposits. ALCO determines the most appropriate amounts of on-balance sheet and off-balance sheet items. Measurements which we use to help us manage interest rate sensitivity include an earnings simulation model and an economic value of equity ("EVE") model.

Our interest rate sensitivity modeling incorporates a number of assumptions for both earnings simulation and EVE, including loan and deposit re-pricing characteristics, the rate of loan prepayments, etc. ALCO periodically reviews these assumptions for accuracy based on historical data and future expectations. Our ALCO policy requires that the base scenario assume rates remain flat and is the scenario to which all others are compared in order to measure the change in net interest income and EVE. Policy limits are applied to the results of certain modeling scenarios. While the primary policy scenarios focus on a twelve month time frame, longer time horizons are also modeled. All policy scenarios assume a static balance sheet, although other scenarios are modeled.

Earnings simulation model. We believe interest rate risk is best measured by our earnings simulation modeling. Earning assets, interest-bearing liabilities and off-balance sheet financial instruments are combined with forecasts of interest rates for the next 12 months and are combined with other factors in order to produce various earnings simulations. To limit interest rate risk, we have policy guidelines for our earnings at risk which seek to limit the variance of net interest income in both gradual and instantaneous changes to interest rates. For changes up or down in rates from management's flat interest rate forecast over the next twelve months, policy limits in the decline in net interest income are as follows:
$\cdot+/-10.0 \%$ for a gradual change of 400 points; $+/-20.0 \%$ for an instantaneous change of 400 basis points
$\cdot+/-7.5 \%$ for a gradual change of 300 points; $+/-15.0 \%$ for an instantaneous change of 300 basis points
$\cdot+/-5.0 \%$ for a gradual change of 200 points; $+/-10.0 \%$ for an instantaneous change of 200 basis points
$+/-2.5 \%$ for a gradual change of 100 points; $+/-5.0 \%$ for an instantaneous change of 100 basis points
At March 31, 2015, our earnings simulation model indicated we were in compliance with our policies for both the gradual and instantaneous interest rate changes.
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Economic value of equity. Our EVE model measures the extent that estimated economic values of our assets, liabilities and off-balance sheet items will change as a result of interest rate changes. Economic values are determined by discounting expected cash flows from assets, liabilities and off-balance sheet items, which establishes a base case EVE. To help limit interest rate risk, we have stated policy guidelines for an instantaneous basis point change in interest rates, such that our EVE should not decrease from our base case by more than the following:
$\cdot+/-400$ basis point change in interest rates, EVE shall not decrease by more than 40 percent
$\cdot+/-300$ basis point change in interest rates, EVE shall not decrease by more than 30 percent
$\cdot+/-200$ basis point change in interest rates, EVE shall not decrease by more than 20 percent
$\cdot+/-100$ basis point change in interest rates, EVE shall not decrease by more than 10 percent
At March 31, 2015, our EVE model indicated we were in compliance with our policies noted above. However, our policies provide that during certain interest rate cycles, the down basis point rate changes may not be particularly significant given the current slope of the yield curve. Accordingly, we have currently suspended the calculation of the down rate scenarios for EVE measurement for the down 200, down 300 and down 400 scenarios.

Another commonly analyzed scenario is a most-likely earnings simulation scenario that projects the expected change in rates based on a forward yield curve adopted by management using expected balance sheet volumes forecasted by management. Separate growth assumptions are developed for loans, investments, deposits, etc. Other interest rate scenarios analyzed by management may include delayed rate shocks, yield curve steepening or flattening, or other variations in rate movements to further analyze or stress our balance sheet under various interest rate scenarios.

Each of the above analyses may not, on its own, be an accurate indicator of how our net interest income will be affected by changes in interest rates. Income associated with interest-earning assets and costs associated with interest-bearing liabilities may not be affected uniformly by changes in interest rates. In addition, the magnitude and duration of changes in interest rates may have a significant impact on net interest income. For example, although certain assets and liabilities may have similar maturities or periods of repricing, they may react in different degrees to changes in market interest rates. Interest rates on certain types of assets and liabilities fluctuate in advance of changes in general market rates, while interest rates on other types may lag behind changes in general market rates. In addition, certain assets, such as adjustable rate mortgage loans, have features (generally referred to as interest rate caps and floors) which limit changes in interest rates. Prepayment and early withdrawal levels also could deviate significantly from those assumed in calculating the maturity of certain instruments. The ability of many borrowers to service their debts also may decrease during periods of rising interest rates. ALCO reviews each of the above interest rate sensitivity analyses along with several different interest rate scenarios as part of its responsibility to provide a satisfactory, consistent level of profitability within the framework of established liquidity, loan, investment, borrowing, and capital policies.

We may also use derivative financial instruments to improve the balance between interest-sensitive assets and interest-sensitive liabilities and as one tool to manage our interest rate sensitivity while continuing to meet the credit and deposit needs of our customers. We may also enter into interest rate swaps to facilitate customer transactions and meet their financing needs. These swaps qualify as derivatives, even though they are not designated as hedging instruments.

Based on information gathered from these various modeling scenarios, management believes that at March 31, 2015, our balance sheet would likely be neutral to asset sensitive the first 25 to 50 bps of an interest rate increases and would increase in asset sensitivity as rates increased further as many of the floors attached to variable rate loans would be surpassed. Our modeling indicates that our level of asset sensitivity would accelerate until rates had increased 300 bps and would become neutral at that point as we believe deposit pricing would become increasingly competitive at that point.

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ALCO may determine that Pinnacle Financial should over time become more or less asset or liability sensitive depending on the underlying balance sheet circumstances and the firm's conclusions as to anticipated interest rate fluctuations in future periods. At present, ALCO has determined that its "most likely" rate scenario considers an initial rise in short-term interest rates in late-2015 and that such rates will continue to increase over several quarters while the longer end of the rate curve will rise only slightly. The firm's "most likely" rate forecast has been basically consistent for several quarters and is based primarily on information we acquire from a service which includes a consensus forecast of numerous benchmarks. As a result and in preparing for an eventual rise in interest rates, we have implemented the following strategies:
Reduced our exposure to fixed rate investment securities in relation to total assets from approximately $23 \%$ as of - December 31, 2010 to a current position of approximately $13 \%$ of total assets. This reduction should assist the firm in becoming more asset sensitive over time.
Executed a series of cash flow hedges involving approximately $\$ 200$ million in FHLB borrowings at pre-established fixed rates. Fixed rate liabilities also provide for a more asset sensitive balance sheet.
Participated in interest rate swaps whereby our customers pay a fixed rate which we remit to our counterparty while -we receive in return a floating rate on these commercial loans. These loans amounted to approximately $\$ 267$ million at March 31, 2015. Floating rate loans promote an asset sensitive balance sheet.
Reduced the amount of rate floors attached to floating and variable rate commercial loans from $\$ 1.300$ billion at - December 31, 2013 to $\$ 957$ million as of March 31, 2015 thus promoting a more asset sensitive balance sheet over time.
Reduced the difference between the weighted average floor rate on floating and variable rate commercial loans and the weighted average contract rate on these type of loans from $0.84 \%$ at December 31, 2013 to $0.67 \%$ at March 31, 2015. This reduction results in requiring a lesser increase in shorter-term rates for the floors to be overcome, thus making these loans with rate floors more asset sensitive over time.

We believe current growth in our balance sheet will also assist us in achievement of increased asset sensitivity over time; however, we may also implement a series of actions designed to accelerate our achievement of neutrality or asset sensitivity as conditions warrant.

Liquidity Risk Management. The purpose of liquidity risk management is to ensure that there are sufficient cash flows to satisfy loan demand, deposit withdrawals, and our other needs. Traditional sources of liquidity for a bank include asset maturities and growth in core deposits. A bank may achieve its desired liquidity objectives from the management of its assets and liabilities and by internally generated funding through its operations. Funds invested in marketable instruments that can be readily sold and the continuous maturing of other earning assets are sources of liquidity from an asset perspective. The liability base provides sources of liquidity through attraction of increased deposits and borrowing funds from various other institutions.

To assist in determining the adequacy of our liquidity, we perform a variety of liquidity stress tests including idiosyncratic, systemic and combined scenarios for both moderate and severe events. Liquidity is defined as the ability to convert assets into cash or cash equivalents without significant loss and to raise additional funds by increasing liabilities. Liquidity management involves maintaining our ability to meet the daily cash flow requirements of our customers, both depositors and borrowers. We maintain a minimum liquid asset buffer to ensure our ability to meet our obligations. The size of the minimum liquid asset buffer is determined through severe liquidity stress testing. At March 31, 2015, we were in compliance with our minimum liquidity asset buffer calculation.

Changes in interest rates also affect our liquidity position. We currently price deposits in response to market rates and our management intends to continue this policy. If deposits are not priced in response to market rates, a loss of deposits could occur which would negatively affect our liquidity position.

Scheduled loan payments are a relatively stable source of funds, but loan payoffs and deposit flows fluctuate significantly, being influenced by interest rates, general economic conditions and competition. Additionally, debt security investments are subject to prepayment and call provisions that could accelerate their payoff prior to stated
maturity. We attempt to price our deposit products to meet our asset/liability objectives consistent with local market conditions. Our ALCO is responsible for monitoring our ongoing liquidity needs. Our regulators also monitor our liquidity and capital resources on a periodic basis.

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In addition, our bank is a member of the FHLB. As a result, our bank receives advances from the FHLB, pursuant to the terms of various borrowing agreements, which assist it in the funding of its home mortgage and commercial real estate loan portfolios. Under the borrowing agreements with the FHLB, our bank has pledged certain qualifying residential mortgage loans and, pursuant to a blanket lien, all qualifying commercial mortgage loans as collateral. At March 31, 2015, our bank had received advances from the FHLB totaling $\$ 455.4$ million at the following rates and maturities (dollars in thousands):

| Scheduled |  | Interest |  |
| :--- | :--- | :---: | :--- |
| Maturities | Amount | Rates $^{(1)}$ |  |
| 2015 | $\$ 440,000$ | 0.20 | $\%$ |
| 2016 | 15,000 | 2.35 | $\%$ |
| 2017 | - | 0.00 | $\%$ |
| 2018 | 8 | 0.20 | $\%$ |
| 2019 | - | 0.00 | $\%$ |
| Thereafter | 363 | 2.43 | $\%$ |
| Total | $\$ 455,371$ |  |  |
| Weighted average |  |  |  |
| interest rate | 0.27 | $\%$ |  |

${ }_{(1)}$ Some FHLB advances include variable interest rates and could increase in the future. The table reflects rates in 1) effect as of March 31, 2015.

Our bank also has accommodations with upstream correspondent banks available for unsecured short-term advances which aggregate $\$ 170.0$ million. These accommodations have various covenants related to their term and availability, and in most cases must be repaid within a month. There were no outstanding borrowings at March 31, 2015, or during the quarter then ended under these agreements. Our bank also has approximately $\$ 1.5$ billion in available Federal Reserve discount window lines of credit.

At March 31, 2015, excluding reciprocating time deposits issued through the CDARS network, we had no brokered certificates of deposit. Historically, we have issued brokered certificates through several different brokerage houses based on competitive bid. Typically, these funds have been for varying maturities of up to two years and were issued at rates which were competitive to rates we would be required to pay to attract similar deposits within our local markets as well as rates for FHLB advances of similar maturities. Although we consider these deposits to be a ready source of liquidity under current market conditions, we anticipate that these deposits will not represent a significant percentage of our total funding in 2015 as we seek to maintain a higher level of core deposits.

At March 31, 2015, we had no significant commitments for capital expenditures, although we intend to construct a new retail location in the Knoxville MSA during 2015. Our management believes that we have adequate liquidity to meet all known contractual obligations and unfunded commitments, including loan commitments and reasonable borrower, depositor, and creditor requirements over the next twelve months.

Industry regulators have defined additional liquidity guidelines, through the issuance of the Basel III Liquidity Coverage Ratio (LCR) and the Modified LCR, for banking institutions greater than $\$ 250$ billion in assets, and $\$ 50$ billion in assets respectively, in the United States. These regulatory guidelines became effective January 2015 with phase in over subsequent years and will require these large institutions to follow prescriptive guidance in determining an absolute level of a high quality liquid asset (HQLA) buffer that must be maintained on their balance sheets in order to withstand a potential liquidity crisis event. Although Pinnacle follows the principles outlined in the Interagency Policy Statement on Liquidity Risk Management, issued March 2010, to determine its HQLA buffer, Pinnacle is not currently subject to these regulations. However, these formulas could eventually be imposed on smaller banks, such as Pinnacle Bank, and require an increase in the absolute level of liquidity on our balance sheet. Consequently, this could result in lower net interest margins for us in future periods.

Off-Balance Sheet Arrangements. At March 31, 2015, we had outstanding standby letters of credit of $\$ 68.0$ million and unfunded loan commitments outstanding of $\$ 1.4$ billion. Because these commitments generally have fixed expiration dates and many will expire without being drawn upon, the total commitment level does not necessarily represent future cash requirements. If needed to fund these outstanding commitments, Pinnacle Bank has the ability to liquidate Federal funds sold or on a short-term basis to borrow and purchase Federal funds from other financial institutions.

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## Impact of Inflation

The consolidated financial statements and related consolidated financial data presented herein have been prepared in accordance with U.S. GAAP and practices within the banking industry which require the measurement of financial position and operating results in terms of historical dollars without considering the changes in the relative purchasing power of money over time due to inflation. Unlike most industrial companies, virtually all the assets and liabilities of a financial institution are monetary in nature. As a result, interest rates have a more significant impact on a financial institution's performance than the effects of general levels of inflation.

## Recently Issued Accounting Pronouncements

Except as set forth below, there are currently no new accounting standards that have been issued that will have a significant impact on the Company's financial position, results of operations or cash flows upon adoption that were not disclosed in the Company's most recent Annual Report on Form 10-K.

In April 2015, the FASB issued ASU No. 2015-02, Consolidation (Topic 810): Amendments to the Consolidation Analysis. The amendments in this ASU affect reporting entities that are required to evaluate whether they should consolidate certain legal entities. All legal entities are subject to reevaluation under the revised consolidation model. Specifically, the amendments: 1) Modify the evaluation of whether limited partnerships and similar legal entities are variable interest entities (VIEs) or voting interest entities, 2) Eliminate the presumption that a general partner should consolidate a limited partnership, 3) Affect the consolidation analysis of reporting entities that are involved with VIEs, particularly those that have fee arrangements and party relationships, 4) Provide a scope exception from consolidation guidance for reporting entities with interests in legal entities that are required to comply with or operate in accordance with requirements that are similar to those in Rule 2A-7 of the Investment Company Act of 1940 for registered money market funds. The amendments in this ASU are effective for public business entities for fiscal years, and for interim periods within those fiscal years, beginning after December 15, 2015. We currently do not expect this ASU to have a material impact our consolidated financial statements.

## ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

The information required by this Item 3 is included on pages 33 through 51 of Part I - Item 2 - "Management's Discussion and Analysis of Financial Condition and Results of Operations."

## ITEM 4. CONTROLS AND PROCEDURES

## Evaluation of Disclosure Controls and Procedures

Pinnacle Financial maintains disclosure controls and procedures, as defined in Rule 13a-15(e) promulgated under the Securities Exchange Act of 1934 (the "Exchange Act"), that are designed to ensure that information required to be disclosed by it in the reports that it files or submits under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms and that such information is accumulated and communicated to Pinnacle Financial's management, including its Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure. Pinnacle Financial carried out an evaluation, under the supervision and with the participation of its management, including its Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of its disclosure controls and procedures as of the end of the period covered by this report. Based on the evaluation of these disclosure controls and procedures, the Chief Executive Officer and Chief Financial Officer concluded that Pinnacle Financial's disclosure controls and procedures were effective.

## Changes in Internal Controls

There were no changes in Pinnacle Financial's internal control over financial reporting during Pinnacle Financial's fiscal quarter ended March 31, 2015 that have materially affected, or are reasonably likely to materially affect, Pinnacle Financial's internal control over financial reporting.

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## PART II. OTHER INFORMATION

## ITEM 1. LEGAL PROCEEDINGS

Various legal proceedings to which Pinnacle Financial or a subsidiary of Pinnacle Financial is a party arise from time to time in the normal course of business. Except as described below, there are no material pending legal proceedings to which Pinnacle Financial or a subsidiary of Pinnacle Financial is a party or of which any of their property is the subject.

## ITEM 1A. RISK FACTORS

Except as set forth below there have been no material changes to the risk factors included in "Item 1A Risk Factors" in our Annual Report on Form 10-K for the fiscal year ended December 31, 2014:

Investing in our common stock involves various risks which are particular to our company, our industry and our market area. If any of the following risks were to occur, we may not be able to conduct our business as currently planned and our financial condition or operating results could be materially and negatively impacted. These matters could cause the trading price of our common stock to decline in future periods.

Negative developments in the U.S. and local economy and in local real estate markets have adversely impacted our results and may continue to adversely impact our results in the future.

Economic conditions in the markets in which we operate deteriorated significantly between early 2008 and the middle of 2010. These challenges resulted primarily from provisions for loan losses and other real estate expense related to declining collateral values in our real estate loan portfolio and increased costs associated with our portfolio of other real estate owned. Although economic conditions appear to have stabilized in our markets in the more recent periods and we have refocused our efforts on growing our earning assets, we believe that we will continue to experience a slower growth economic environment in 2015. Accordingly, we expect that our results of operations could continue to be negatively impacted by economic conditions, including reduced loan demand, in 2015. There can be no assurance that the economic conditions that have adversely affected the financial services industry, and the capital, credit and real estate markets, generally, or us in particular, will improve materially, or at all, in the near future, or thereafter, in which case we could continue to experience reduced earnings or again experience significant losses and write-downs of assets, and could face capital and liquidity constraints or other business challenges.

Fluctuations in interest rates could reduce our profitability.
The absolute level of interest rates as well as changes in interest rates may affect our level of interest income, the primary component of our gross revenue, as well as the level of our interest expense. Interest rate fluctuations are caused by many factors which, for the most part, are not under our control. For example, national monetary policy plays a significant role in the determination of interest rates. Additionally, competitor pricing and the resulting negotiations that occur with our customers also impact the rates we collect on loans and the rates we pay on deposits.

As interest rates change, we expect that we will periodically experience "gaps" in the interest rate sensitivities of our assets and liabilities, meaning that either our interest-bearing liabilities (usually deposits and borrowings) will be more sensitive to changes in market interest rates than our interest-earning assets (usually loans and investment securities), or vice versa. In either event, if market interest rates should move contrary to our position, this "gap" may work against us, and our earnings may be negatively affected. During 2014 and the first quarter of 2015, and in anticipation of increases in short term interest rates in the second half of 2015 that we anticipate will occur, we have reduced the amount of variable rate loans with interest rate floors by approximately $\$ 313$ million. We believe that the reduction in the amount of variable rate loans with interest rate floors should better position our balance sheet for a rising rate environment. In the event that short-term interest rates don't rise in the second half of 2015, our efforts to transition our balance sheet to a more asset sensitive position may negatively impact our results of operations as we may earn
less interest on these loans than we would have had we maintained these loan floors.

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Changes in the level of interest rates also may negatively affect our ability to originate loans, the value of our assets and our ability to realize gains from the sale of our assets, all of which ultimately affect our earnings. A decline in the market value of our assets may limit our ability to borrow additional funds. As a result, we could be required to sell some of our loans and investments under adverse market conditions, upon terms that are not favorable to us, in order to maintain our liquidity. If those sales are made at prices lower than the amortized costs of the investments, we will incur losses. Because of the number of loans that we have made with interest rate floors above current rates, in a rising rate environment our liabilities may reprice faster than our loans, which would negatively impact our results of operations.

We have entered into certain hedging transactions including interest rate swaps, which are designed to lessen elements of our interest rate exposure. In the event that interest rates do not change in the manner anticipated, such transactions may not be effective.

We have a concentration of credit exposure to borrowers in certain industries, and we also target small to medium-sized businesses.

We have meaningful credit exposures to borrowers in certain businesses, including commercial and residential building lessors, new home builders, and land subdividers. These industries experienced adversity during 2008 through 2010 as a result of sluggish economic conditions, and, as a result, an increased level of borrowers in these industries were unable to perform under their loan agreements with us, or suffered loan downgrades which negatively impacted our results of operations. If the economic environment in our markets weakens in 2015 or beyond, these industry concentrations could result in increased deterioration in credit quality, past dues, loan charge offs and collateral value declines, which could cause our earnings to be negatively impacted. Furthermore, any of our large credit exposures that deteriorate unexpectedly could cause us to have to make significant additional loan loss provisions, negatively impacting our earnings.

A substantial focus of our marketing and business strategy is to serve small to medium-sized businesses in our market areas. As a result, a relatively high percentage of our loan portfolio consists of commercial loans primarily to small to medium-sized businesses. At March 31, 2015, our commercial and industrial loans accounted for almost $38.9 \%$ of our total loans, up from 31.5\% at December 31, 2010. Additionally, approximately, $16.5 \%$ of our loans at March 31, 2015 are owner-occupied commercial real estate loans, which are loans to businesses secured by the businesses' real estate. We expect to seek to expand the amount and percentage of such loans in our portfolio in 2015. During periods of lower economic growth like those we have experienced in recent years, small to medium-sized businesses may be impacted more severely and more quickly than larger businesses. Consequently, the ability of such businesses to repay their loans may deteriorate, and in some cases this deterioration may occur quickly, which would adversely impact our results of operations and financial condition.

We are geographically concentrated in the Nashville, Tennessee and Knoxville, Tennessee MSAs, and changes in local economic conditions impact our profitability.

We currently operate primarily in the Nashville, Tennessee and Knoxville, Tennessee MSAs, and most of our borrowers, depositors and other customers live or have operations in these areas. Accordingly, our success significantly depends upon the growth in population, income levels, deposits and housing starts in these markets, along with the continued attraction of business ventures to the areas, and our profitability is impacted by the changes in general economic conditions in these markets. We cannot assure you that economic conditions, including loan demand, in our markets will improve during 2015 or thereafter, and in that case, we may not be able to grow our loan portfolio in line with our expectations, the ability of our customers to repay their loans to us may be negatively impacted and our financial condition and results of operations could be negatively impacted.

We have agreed to acquire banks in Chattanooga and Memphis, which if consummated will provide additional geographic diversity. Nonetheless, compared to regional or national financial institutions, we are less able to spread
the risks of unfavorable local economic conditions across a large number of diversified economies. Moreover, we cannot give any assurance that we will benefit from any market growth or return of more favorable economic conditions in our primary market areas if they do occur.

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If our allowance for loan losses is not sufficient to cover losses inherent in our portfolio, our earnings will decrease.
If loan customers with significant loan balances fail to repay their loans, our earnings and capital levels will suffer. We make various assumptions and judgments about the probable losses in our loan portfolio, including the creditworthiness of our borrowers and the value of any collateral securing the loans. We maintain an allowance for loan losses to cover our estimate of the probable losses in our loan portfolio. In determining the size of this allowance, we utilize estimates based on analyses of volume and types of loans, internal loan classifications, trends in classifications, volume and trends in delinquencies, nonaccruals and charge-offs, loss experience of various loan categories, national and local economic conditions, industry and peer bank loan quality indications, and other pertinent factors and information. If our assumptions are inaccurate, our current allowance may not be sufficient to cover potential loan losses, and additional provisions may be necessary which would decrease our earnings.

In addition, federal and state regulators periodically review our loan portfolio and may require us to increase our allowance for loan losses or recognize loan charge-offs. Their conclusions about the quality of a particular borrower or our entire loan portfolio may be different than ours. Any increase in our allowance for loan losses or loan charge offs as required by these regulatory agencies could have a negative effect on our operating results. Moreover, additions to the allowance may be necessary based on changes in economic and real estate market conditions, new information regarding existing loans, identification of additional problem loans, accounting rule changes and other factors, both within and outside of our management's control. These additions may require increased provision expense which would negatively impact our results of operations.

Our acquisitions and future expansion may result in additional risks.
On April 7, 2015 we announced the signing of a definitive merger agreement which provides for the merger of CapitalMark with and into Pinnacle Bank (the "CapitalMark Merger"), and on April 28, 2015 we announced the signing of a definitive merger agreement which provides for the merger of Magna with and into Pinnacle Bank (the "Magna Merger" and together with the Capital Mark Merger, the "Mergers"), in each case with Pinnacle Bank continuing as the surviving corporation.

Following consummation of the Mergers, our current geographic expansion plans will be complete; however, we expect to continue to expand in Knoxville, Chattanooga and Memphis through additional branches and also may consider expansion within our current and expected markets through acquisitions of all or part of other financial institutions. These types of expansions involve various risks, including (all of which are generally applicable to an analysis of the risks relating to the Mergers):

Management of Growth. We may be unable to successfully:
-maintain loan quality in the context of significant loan growth;
$\cdot$ avoid diversion or disruption of our existing operations or management as well as those of the acquired institution;
-maintain adequate management personnel and systems to oversee such growth;
-maintain adequate internal audit, loan review and compliance functions; and
-implement additional policies, procedures and operating systems required to support such growth.
Expansion into New Markets. Upon consummation of the Mergers, we will enter two new markets, the highly-competitive metropolitan areas of Memphis and Chattanooga, Tennessee. In these new markets we will face competition from a wide array of financial institutions, including much larger, well-established financial institutions.

Operating Results. There is no assurance that existing offices or future offices will maintain or achieve deposit levels, loan balances or other operating results necessary to avoid losses or produce profits. Our growth strategy necessarily entails growth in overhead expenses as we routinely add new offices and staff. Our historical results may not be indicative of future results or results that may be achieved as we continue to increase the number and concentration of our branch offices in our newer markets.
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Development of Offices. There are considerable costs involved in opening branches, and new branches generally do not generate sufficient revenues to offset their costs until they have been in operation for at least a year or more. Accordingly, any new branches we establish, including in the Chattanooga and Memphis markets after consummation of the Mergers, can be expected to negatively impact our earnings for some period of time until they reach certain economies of scale. Our expenses could be further increased if we encounter delays in opening any of our new branches. We may be unable to accomplish future branch expansion plans due to a lack of available satisfactory sites, difficulties in acquiring such sites, increased expenses or loss of potential sites due to complexities associated with zoning and permitting processes, higher than anticipated merger and acquisition costs or other factors. Finally, we have no assurance any branch will be successful even after it has been established or acquired, as the case may be.

Regulatory and Economic Factors. Our growth and expansion plans may be adversely affected by a number of regulatory and economic developments or other events. Failure to obtain required regulatory approvals, changes in laws and regulations or other regulatory developments and changes in prevailing economic conditions or other unanticipated events may prevent or adversely affect our continued growth and expansion. Such factors may cause us to alter our growth and expansion plans or slow or halt the growth and expansion process, which may prevent us from entering our expected markets or allow competitors to gain or retain market share in our existing markets.

Failure to successfully address these and other issues related to our expansion could have a material adverse effect on our financial condition and results of operations, and could adversely affect our ability to successfully implement our business strategy. Also, if our growth occurs more slowly than anticipated or declines, our operating results could be materially adversely affected.

We may not be able to successfully integrate CapitalMark or Magna or to realize the anticipated benefits of the Mergers.

A successful integration of CapitalMark's or Magna's operations with our operations will depend substantially on our ability to consolidate operations, systems and procedures and to eliminate redundancies and costs. We may not be able to combine our operations with the operations of CapitalMark or Magna without encountering difficulties, such as:
-the loss of key employees and customers;
-the disruption of operations and business;
-inability to maintain and increase competitive presence;

- loan and deposit attrition, customer loss and revenue loss;
- possible inconsistencies in standards, control procedures and policies;
- unexpected problems with costs, operations, personnel, technology and credit; and/or
problems with the assimilation of new operations, sites or personnel, which could divert resources from regular banking operations.

Additionally, general market and economic conditions or governmental actions affecting the financial industry generally may inhibit our successful integration of CapitalMark or Magna.

Further, we entered into the merger agreements with the expectation that the Mergers will result in various benefits including, among other things, benefits relating to enhanced revenues, a strengthened market position for the combined company, cross selling opportunities, technology, cost savings and operating efficiencies. Achieving the anticipated benefits of the Mergers is subject to a number of uncertainties, including whether we integrate

CapitalMark and Magna in an efficient and effective manner, and general competitive factors in the marketplace. Failure to achieve these anticipated benefits could result in a reduction in the price of our shares as well as in increased costs, decreases in the amount of expected revenues and diversion of management's time and energy and could materially and adversely affect our business, financial condition and operating results. Finally, any cost savings that are realized may be offset by losses in revenues or other charges to earnings.

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The combined company will incur significant transaction and merger-related costs in connection with the Mergers.
We expect to incur significant costs associated with combining the operations of CapitalMark and Magna with our operations. We have just recently begun collecting information in order to formulate detailed integration plans to deliver anticipated cost savings. Additional unanticipated costs may be incurred in the integration of our business with the businesses of CapitalMark and Magna. Although we expect that the elimination of duplicative costs, as well as the realization of other efficiencies related to the integration of the businesses, may offset incremental transaction and merger-related costs over time, this net benefit may not be achieved in the near term, or at all.

Whether or not either of the Mergers is consummated, we will incur substantial expenses, such as legal, accounting and financial advisory fees, in pursuing the Mergers which will adversely impact our earnings until after the acquisitions have been completed. Completion of the Mergers is conditioned upon the receipt of all material governmental authorizations, consents, orders and approvals, including approval by federal banking regulators. We and CapitalMark and Magna, as the case may be, intend to pursue all required approvals in accordance with the merger agreements.

Failure to complete the Mergers could cause our stock price to decline.
If either of the Mergers is not completed for any reason, our stock price may decline because costs related to the Mergers, such as legal, accounting and financial advisory fees, must be paid even if such Merger is not completed. In addition, if either of the Mergers is not completed, our stock price may decline to the extent that the current market price reflects a market assumption that both Mergers will be completed.

We may face risks with respect to future acquisitions.
When we attempt to expand our business through mergers and acquisitions, we seek targets that are culturally similar to us, have experienced management and possess either significant market presence or have potential for improved profitability through economies of scale or expanded services. We believe that each of the Mergers meets these criteria. In addition to the general risks associated with our growth plans which is highlighted above, in general acquiring other banks, businesses or branches involves various risks commonly associated with acquisitions, including, among other things:
-the time and costs associated with identifying and evaluating potential acquisition and merger targets;
inaccuracies in the estimates and judgments used to evaluate credit, operations, management and market risks with respect to the target institution;
the time and costs of evaluating new markets, hiring experienced local management and opening new bank locations, - and the time lags between these activities and the generation of sufficient assets and deposits to support the costs of the expansion;

- our ability to finance an acquisition and possible dilution to our existing shareholders;
-the diversion of our management's attention to the negotiation of a transaction;
the incurrence of an impairment of goodwill associated with an acquisition and adverse effects on our results of operations;
- entry into new markets where we lack experience; and
-risks associated with integrating the operations and personnel of the acquired business.

All of the foregoing matters are applicable to the Mergers.

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We expect to continue to evaluate merger and acquisition opportunities that are presented to us in our current and expected markets and conduct due diligence activities related to possible transactions with other financial institutions. As a result, merger or acquisition discussions and, in some cases, negotiations may take place and future mergers or acquisitions involving cash, debt or equity securities may occur at any time. Historically, acquisitions of non-failed financial institutions involve the payment of a premium over book and market values, and, therefore, some dilution of our book value and fully diluted earnings per share may occur in connection with any future transaction. Failure to realize the expected revenue increases, cost savings, increases in product presence and/or other projected benefits from an acquisition could have a material adverse effect on our financial condition and results of operations.

Our ability to declare and pay dividends is limited.
While our board of directors has approved the payment of a quarterly cash dividend on our common stock since the fourth quarter of 2013, there can be no assurance of whether or when we may pay dividends on our common stock in the future. Future dividends, if any, will be declared and paid at the discretion of our board of directors and will depend on a number of factors. Our principal source of funds used to pay cash dividends on our common stock will be dividends that we receive from Pinnacle Bank. Although Pinnacle Bank's asset quality, earnings performance, liquidity and capital requirements will be taken into account before we declare or pay any future dividends on our common stock, our board of directors will also consider our liquidity and capital requirements and our board of directors could determine to declare and pay dividends without relying on dividend payments from Pinnacle Bank.

Federal and state banking laws and regulations and state corporate laws restrict the amount of dividends we may declare and pay. For example, Federal Reserve Board regulations implementing the capital rules required under Basel III do not permit dividends unless capital levels exceed certain higher levels applying capital conservation buffers that begin to apply on January 1, 2016 and are thereafter phased in over three years.

In addition, the terms of the indentures pursuant to which our subordinated debentures have been issued prohibit us from paying dividends on our common stock at times when we are deferring the payment of interest on our subordinated debentures. Moreover, the terms of our and our bank subsidiary's loan agreements prohibit us from paying dividends on our common stock when there is an event of default or unmatured event of default under the loan agreements or when the payment of the dividend would result in an event of default or unmatured event of default under the loan agreements.

Our ability to grow our loan portfolio may be limited by, among other things, economic conditions, competition within our market areas, the timing of loan repayments and seasonality.

Our ability to continue to improve our operating results is dependent upon, among other things, aggressively growing our loan portfolio. While we believe that our strategy to grow our loan portfolio is sound and our growth targets are achievable over an extended period of time, competition within our market areas is significant, particularly for borrowers whose businesses have been less negatively impacted by the challenging economic conditions of the last few years. We compete with both large regional and national financial institutions, who are sometimes able to offer more attractive interest rates and other financial terms than we choose to offer, and smaller community-based financial institutions who seek to offer a similar level of service to that which we offer. This competition can make loan growth challenging, particularly if we are unwilling to price loans at levels that would cause unacceptable levels of compression of our net interest margin or if we are unwilling to structure a loan in a manner that we believe results in a level of risk to our Company that we are not willing to accept. Moreover, loan growth throughout the year can fluctuate due in part to seasonality of the businesses of our borrowers and potential borrowers and the timing on loan repayments, particularly those of our borrowers with significant relationships with us, resulting from, among other things, excess levels of liquidity.

Our investment in BHG may not produce the contribution to our results of operations that we expect.

On February 4, 2015 we acquired a 30\% interest in BHG for $\$ 75$ million in cash. Although we have made other investments in businesses that we do not control, this is the largest investment of this type that we have made. While we have a significant stake in BHG, are entitled to designate one member of BHG's four person board of managers and in some instances have protective rights to block BHG from engaging in certain activities, we do not control BHG and the other managers and members of BHG make most decisions regarding BHG's operations without our consent or approval, including a decision to sell BHG subject to the satisfaction of certain conditions. Moreover, there are certain limitations on our ability to sell our interest in BHG without first offering BHG and the other members a right of first refusal.

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A significant portion of BHG's revenue (and correspondingly our interest in any of BHG's net profits) comes from the sale of loans originated by BHG to community banks, and the market for these loans, and BHG's net income in many instances, is conditioned upon these loan sales qualifying as "true sales" under applicable accounting guidance. In the event that these sales did not constitute "true sales" BHG's business model and its results of operations may be materially and adversely affected. Moreover, the purchase price we paid to acquire our interest in BHG was based on our expectation that BHG will continue to grow its business and increase the amount of loans that it is able to originate and sell. In the event that BHG's loan growth slows over historical levels and the resulting loan sales decrease, its results of operations (and our interest in the net profits of BHG) would be materially and adversely affected and our non-interest income would be adversely affected. BHG currently operates in most states without the need for a permit or any other license. In the event that BHG was required to register or become licensed in any state in which it operates, or regulations are adopted that seek to limit BHG's ability to operate in any jurisdiction or that seek to limit the amounts of interest that BHG can charge on its loans, BHG's results of operations (and our interest in BHG's net profits) could be materially and adversely affected.

We anticipate that foreclosed real estate expense will continue to negatively impact our earnings.
As we acted to resolve non-performing real estate loans over the last few years, our level of other real estate owned was elevated in comparison to our first six years of operation. As a result, we experienced elevated levels of foreclosed real estate expense. Foreclosed real estate expense consists of three types of charges: maintenance costs, valuation adjustments to appraisal values and gains or losses on disposition. Should levels of other real estate owned increase or should local real estate values decline, these charges will continue to negatively impact our results of operations.

Our loan portfolio includes a meaningful amount of real estate construction and development loans, which have a greater credit risk than residential mortgage loans.

Although we have made meaningful progress over the last three years in reducing our concentration of real estate construction and development loans, the percentage of these loans in Pinnacle Bank's portfolio was approximately $7.0 \%$ of total loans at March 31, 2015. These loans make up approximately $21.5 \%$ of our non-performing loans at March 31, 2015. This type of lending is generally considered to have relatively high credit risks because the principal is concentrated in a limited number of loans with repayment dependent on the successful completion and operation of the related real estate project. The credit quality of many of these loans deteriorated during the challenging economic period of 2008 to 2012 due to the adverse conditions in the real estate market during that period and that type of deterioration could occur again. Weakness in residential real estate market prices as well as demand could result in price reductions in home and land values adversely affecting the value of collateral securing the construction and development loans that we hold. Should we experience the return of these adverse economic and real estate market conditions we may again experience increases in non-performing loans and other real estate owned, increased losses and expenses from the management and disposition of non-performing assets, increases in provision for loan losses, and increases in operating expenses as a result of the allocation of management time and resources to the collection and work out of loans, all of which would negatively impact our financial condition and results of operations.

Changes to capital requirements for bank holding companies and depository institutions that became effective on January 1, 2015 may negatively impact Pinnacle Financial's and Pinnacle Bank's results of operations.

In July 2013, the Federal Reserve Board and the FDIC approved final rules that substantially amend the regulatory risk-based capital rules applicable to Pinnacle Bank and Pinnacle Financial. The final rules, which became effective on January 1, 2015, implement the Basel III regulatory capital reforms and changes required by the Dodd-Frank Act.

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Under these rules, the leverage and risk-based capital ratios of bank holding companies may not be lower than the leverage and risk-based capital ratios for insured depository institutions. The final rules include new minimum risk-based capital and leverage ratios. Moreover, these rules refine the definition of what constitutes "capital" for purposes of calculating those ratios, including the definitions of Tier 1 capital and Tier 2 capital. The new minimum capital level requirements applicable to bank holding companies and banks subject to the rules are: (i) a new common equity Tier 1 capital ratio of $4.5 \%$; (ii) a Tier 1 risk-based capital ratio of $6 \%$ (increased from $4 \%$ ); (iii) a total risk-based capital ratio of $8 \%$ (unchanged from prior rules); (iv) a Tier 1 leverage ratio of $4 \%$ for all institutions. The rules also establish a "capital conservation buffer" of $2.5 \%$ (to be phased in over three years) above the new regulatory minimum risk-based capital ratios, and result in the following minimum ratios once the capital conservation buffer is fully phased in: (i) a common equity Tier 1 risk-based capital ratio of $7 \%$, (ii) a Tier 1 risk-based capital ratio of $8.5 \%$, and (iii) a total risk-based capital ratio of $10.5 \%$. The capital conservation buffer requirement is to be phased in beginning in January 2016 at $0.625 \%$ of risk-weighted assets and would increase each year until fully implemented in January 2019. We will be subject to limitations on paying dividends, engaging in share repurchases and paying discretionary bonuses if our capital levels fall below these minimums plus the buffer amounts. These limitations establish a maximum percentage of eligible retained income that could be utilized for such actions.

Under these new rules, Tier 1 capital generally consists of common stock (plus related surplus) and retained earnings, limited amounts of minority interest in the form of additional Tier 1 capital instruments, and non-cumulative preferred stock and related surplus, subject to certain eligibility standards, less goodwill and other specified intangible assets and other regulatory deductions. Cumulative preferred stock and trust preferred securities issued after May 19, 2010, no longer qualify as Tier 1 capital, but such securities issued prior to May 19, 2010, including in the case of bank holding companies with less than $\$ 15.0$ billion in total assets, trust preferred securities issued prior to that date, continue to count as Tier 1 capital subject to certain limitations. The definition of Tier 2 capital is generally unchanged for most banking organizations, subject to certain new eligibility criteria.

Common equity Tier 1 capital generally consists of common stock (plus related surplus) and retained earnings plus limited amounts of minority interest in the form of common stock, less goodwill and other specified intangible assets and other regulatory deductions.

The final rules allow banks and their holding companies with less than $\$ 250$ billion in assets a one-time opportunity to opt-out of a requirement to include unrealized gains and losses in accumulated other comprehensive income in their capital calculation. Pinnacle Financial and Pinnacle Bank have each opted out of this requirement.

The application of more stringent capital requirements for Pinnacle Financial and Pinnacle Bank, like those adopted to implement the Basel III reforms, could, among other things, result in lower returns on invested capital, require the raising of additional capital (including, as a result of any debt financing done by us or our bank subsidiary in connection with our proposed mergers with CapitalMark and Magna), and result in regulatory actions if we were to be unable to comply with such requirements. Furthermore, the imposition of liquidity requirements in connection with the implementation of Basel III could result in our having to lengthen the term of our funding, restructure our business models and/or increase our holdings of liquid assets. Implementation of changes to asset risk weightings for risk based capital calculations, items included or deducted in calculating regulatory capital and/or additional capital conservation buffers could result in management modifying its business strategy and could limit our ability to make distributions, including paying dividends or buying back shares.

We are dependent on our information technology and telecommunications systems and third-party servicers, and systems failures, interruptions or breaches of security could have an adverse effect on our financial condition and results of operations.

Our operations rely on the secure processing, storage and transmission of confidential and other information in our computer systems and networks. Although we take protective measures and endeavor to modify these systems as circumstances warrant, the security of our computer systems, software and networks may be vulnerable to breaches,
unauthorized access, misuse, computer viruses or other malicious code and other events that could have a security impact. We outsource many of our major systems, such as data processing, loan servicing and deposit processing systems. The failure of these systems, or the termination of a third-party software license or service agreement on which any of these systems is based, could interrupt our operations. Because our information technology and telecommunications systems interface with and depend on third-party systems, we could experience service denials if demand for such services exceeds capacity or such third-party systems fail or experience interruptions. If sustained or repeated, a system failure or service denial could result in a deterioration of our ability to process new and renewal loans, gather deposits and provide customer service, compromise our ability to operate effectively, damage our reputation, result in a loss of customer business and/or subject us to additional regulatory scrutiny and possible financial liability, any of which could have a material adverse effect on our financial condition and results of operations.

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In addition, we provide our customers the ability to bank remotely, including over the Internet or through their mobile device. The secure transmission of confidential information is a critical element of remote and mobile banking. Our network could be vulnerable to unauthorized access, computer viruses, phishing schemes, spam attacks, human error, natural disasters, power loss and other security breaches. We may be required to spend significant capital and other resources to protect against the threat of security breaches and computer viruses, or to alleviate problems caused by security breaches or viruses. To the extent that our activities or the activities of our customers involve the storage and transmission of confidential information, security breaches (including breaches of security of customer systems and networks) and viruses could expose us to claims, litigation and other possible liabilities. Any inability to prevent security breaches or computer viruses could also cause existing customers to lose confidence in our systems and could adversely affect our reputation, results of operations and ability to attract and maintain customers and businesses. In addition, a security breach could also subject us to additional regulatory scrutiny, expose us to civil litigation and possible financial liability and cause reputational damage.

Environmental liability associated with commercial lending could result in losses.
In the course of business, Pinnacle Bank may acquire, through foreclosure, or deed in lieu of foreclosure, properties securing loans it has originated or purchased which are in default. Particularly in commercial real estate lending, there is a risk that hazardous substances could be discovered on these properties. In this event, we, or Pinnacle Bank, might be required to remove these substances from the affected properties at our sole cost and expense. The cost of this removal could substantially exceed the value of affected properties. We may not have adequate remedies against the prior owner or other responsible parties and could find it difficult or impossible to sell the affected properties. These events could have a material adverse effect on our business, results of operations and financial condition.

National or state legislation or regulation may increase our expenses and reduce earnings.
Bank regulators are increasing regulatory scrutiny, and additional restrictions (including those originating from the Dodd-Frank Act) on financial institutions have been proposed or adopted by regulators and by Congress. Changes in tax law, federal legislation, regulation or policies, such as bankruptcy laws, deposit insurance, consumer protection laws, and capital requirements, among others, can result in significant increases in our expenses and/or charge-offs, which may adversely affect our earnings. Changes in state or federal tax laws or regulations can have a similar impact. Many state and municipal governments, including the State of Tennessee, though showing signs of improvement, remain under financial stress due to the economy. As a result, these governments could seek to increase their tax revenues through increased tax levies which could have a meaningful impact on our results of operations. Furthermore, financial institution regulatory agencies are expected to continue to be very aggressive in responding to concerns and trends identified in examinations, including the continued issuance of additional formal or informal enforcement or supervisory actions. These actions, whether formal or informal, could result in our agreeing to limitations or to take actions that limit our operational flexibility, restrict our growth or increase our capital or liquidity levels. Failure to comply with any formal or informal regulatory restrictions, including informal supervisory actions, could lead to further regulatory enforcement actions. Negative developments in the financial services industry and the impact of recently enacted or new legislation in response to those developments could negatively impact our operations by restricting our business operations, including our ability to originate or sell loans, and adversely impact our financial performance. In addition, industry, legislative or regulatory developments may cause us to materially change our existing strategic direction, capital strategies, compensation or operating plans.

Implementation of the various provisions of the Dodd-Frank Act may increase our operating costs or otherwise have a material effect on our business, financial condition or results of operations.

On July 21, 2010, President Obama signed the Dodd-Frank Act. This landmark legislation includes, among other things, (i) the creation of a Financial Services Oversight Counsel to identify emerging systemic risks and improve interagency cooperation; (ii) the elimination of the Office of Thrift Supervision and the transfer of oversight of federally chartered thrift institutions and their holding companies to the Office of the Comptroller of the Currency and
the Federal Reserve; (iii) the creation of a Consumer Financial Protection Agency authorized to promulgate and enforce consumer protection regulations relating to financial products that would affect banks and non-bank finance companies; (iv) the establishment of new capital and prudential standards for banks and bank holding companies; (v) the termination of investments by the U.S. Treasury under TARP; (vi) enhanced regulation of financial markets, including the derivatives, securitization and mortgage origination markets; (vii) the elimination of certain proprietary trading and private equity investment activities by banks; (viii) the elimination of barriers to de novo interstate branching by banks; (ix) a permanent increase of FDIC deposit insurance to $\$ 250,000$; (x) the authorization of interest-bearing transaction accounts; and (xi) changes in how the FDIC deposit insurance assessments will be calculated and an increase in the minimum designated reserve ratio for the Deposit Insurance Fund.

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Certain provisions of the legislation are not immediately effective or are subject to required studies and implementing regulations. Further, community banks with less than $\$ 10$ billion in assets (like us) are exempt from certain provisions of the legislation. In the event that our assets were to exceed $\$ 10$ billion, we would become subject to these additional regulations and our results of operations may be materially impacted by the additional costs to comply with these additional regulations. Although several regulations implementing portions of the Dodd-Frank Act have been promulgated, we are still unable to predict how this significant legislation may be interpreted and enforced or how implementing regulations and supervisory policies may affect us. There can be no assurance that these or future reforms will not significantly increase our compliance or operating costs or otherwise have a significant impact on our business, financial condition and results of operations.

Our ability to maintain required capital levels and adequate sources of funding and liquidity could be impacted by changes in the capital markets and deteriorating economic and market conditions.

We, and Pinnacle Bank, are required to maintain certain capital levels established by banking regulations or specified by bank regulators, including those capital maintenance standards imposed on us as a result of the Dodd-Frank Act, and we are required to serve as a source of strength to Pinnacle Bank. We must also maintain adequate funding sources in the normal course of business to support our operations and fund outstanding liabilities. Our ability to maintain capital levels, sources of funding and liquidity could be impacted by changes in the capital markets in which we operate and deteriorating economic and market conditions. Pinnacle Bank is required to obtain regulatory approval in order to pay dividends to us unless the amount of such dividends does not exceed its retained net income for that calendar year plus net income for the preceding two years. Any restriction in the ability of Pinnacle Bank to pay dividends to us could impact our ability to continue to pay dividends on our common stock. Moreover, failure by our bank subsidiary to meet applicable capital guidelines or to satisfy certain other regulatory requirements could subject our bank subsidiary to a variety of enforcement remedies available to the federal regulatory authorities.

Certain of our deposits and other funding sources may be volatile and impact our liquidity.
In addition to the traditional core deposits, such as demand deposit accounts, interest checking, money market savings and certificates of deposits less than $\$ 250,000$, we utilize or in the past have utilized several noncore funding sources, such as brokered certificates of deposit, Federal Home Loan Bank (FHLB) of Cincinnati advances, federal funds purchased and other sources. We utilize these noncore funding sources to fund the ongoing operations and growth of Pinnacle Bank. The availability of these noncore funding sources is subject to broad economic conditions and to investor assessment of our financial strength and, as such, the cost of funds may fluctuate significantly and/or be restricted, thus impacting our net interest income, our immediate liquidity and/or our access to additional liquidity. We have somewhat similar risks to the extent high balance core deposits exceed the amount of deposit insurance coverage available.

We impose certain internal limits as to the absolute level of noncore funding we will incur at any point in time. Should we exceed those limitations, we may need to modify our growth plans, liquidate certain assets, participate loans to correspondents or execute other actions to allow for us to return to an acceptable level of noncore funding within a reasonable amount of time.

If the federal funds and interbank funding rates remain at current extremely low levels, our net interest margin, and consequently our net earnings, may be negatively impacted.

Because of significant competitive pressures in our market and the negative impact of these pressures on our deposit and loan pricing, coupled with the fact that a significant portion of our loan portfolio has variable rate pricing that moves in concert with changes to the Federal Reserve Board of Governors' federal funds rate or the London Interbank Offered Rate (LIBOR) (both of which are at extremely low levels as a result of current economic conditions), our net interest margin may be negatively impacted. Additionally, the amount of non-accrual loans and other real estate owned has been and may continue to be elevated. We also expect loan pricing to remain competitive in 2015 and
believe that economic factors affecting broader markets will likely result in reduced yields for our investment securities portfolio. As a result, our net interest margin, and consequently our profitability, may continue to be negatively impacted in 2015 and beyond.

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A decline in our stock price or expected future cash flows, or a material adverse change in our results of operations or prospects, could result in impairment of our goodwill.

A significant and sustained decline in our stock price and market capitalization below book value, a significant decline in our expected future cash flows, a significant adverse change in the business climate, slower growth rates or other factors could result in impairment of our goodwill. At March 31, 2015, our goodwill and other identifiable intangible assets totaled approximately $\$ 246.1$ million. If we were to conclude that a write-down of our goodwill is necessary, then the appropriate charge would likely cause a material loss. Any significant loss would further adversely impact the capacity of Pinnacle Bank to pay dividends to us without seeking prior regulatory approval, which could adversely affect our ability to pay required interest payments and preferred stock dividends.

Competition with other banking institutions could adversely affect our profitability.
A number of banking institutions in our geographic markets have higher lending limits, more banking offices, and a larger market share of loans or deposits than do we. In addition, our asset management division competes with numerous brokerage firms and mutual fund companies which are also much larger. In some respects, this may place these competitors in a competitive advantage. This competition may limit or reduce our profitability, reduce our growth and adversely affect our results of operations and financial condition.

Inability to retain senior management and key employees or to attract new experienced financial services professionals could impair our relationship with our customers, reduce growth and adversely affect our business.

We have assembled a senior management team which has substantial background and experience in banking and financial services in the Nashville and Knoxville markets. Moreover, much of our loan growth in 2012 through the first quarter of 2015 was the result of our ability to attract experienced financial services professionals who have been able to attract customers from other financial institutions. Inability to retain these key personnel or to continue to attract experienced lenders with established books of business could negatively impact our growth because of the loss of these individuals' skills and customer relationships and/or the potential difficulty of promptly replacing them.

We are subject to certain litigation, and our expenses related to this litigation may adversely affect our results.
We are from time to time subject to certain litigation in the ordinary course of our business. These claims and legal actions, including supervisory actions by our regulators, could involve large monetary claims and significant defense costs. The outcome of these cases is uncertain. However, we have seen both the number of cases and our expenses related to those cases increase. Substantial legal liability or significant regulatory action against us could have material adverse financial effects or cause significant reputational harm to us, which in turn could seriously harm our business prospects.

We may issue additional common stock or other equity securities in the future which could dilute the ownership interest of existing shareholders.

In order to maintain our or Pinnacle Bank's capital at desired or regulatory-required levels, we may issue additional shares of common stock, or securities convertible into, exchangeable for or representing rights to acquire shares of common stock. We may sell these shares at prices below the current market price of shares, and the sale of these shares may significantly dilute shareholder ownership. We could also issue additional shares in connection with acquisitions of other financial institutions, which would also dilute shareholder ownership.

Even though our common stock is currently traded on the Nasdaq Stock Market's Global Select Market, it has less liquidity than many other stocks quoted on a national securities exchange.

The trading volume in our common stock on the Nasdaq Global Select Market has been relatively low when compared with larger companies listed on the Nasdaq Global Select Market or other stock exchanges. Although we have experienced increased liquidity in our stock, we cannot say with any certainty that a more active and liquid trading market for our common stock will continue to develop. Because of this, it may be more difficult for stockholders to sell a substantial number of shares for the same price at which stockholders could sell a smaller number of shares.

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We cannot predict the effect, if any, that future sales of our common stock in the market, or the availability of shares of common stock for sale in the market, will have on the market price of our common stock. We can give no assurance that sales of substantial amounts of common stock in the market, or the potential for large amounts of sales in the market, would not cause the price of our common stock to decline or impair our future ability to raise capital through sales of our common stock.

The market price of our common stock has fluctuated significantly, and may fluctuate in the future. These fluctuations may be unrelated to our performance. General market or industry price declines or overall market volatility in the future could adversely affect the price of our common stock, and the current market price may not be indicative of future market prices.

Holders of Pinnacle Financial's indebtedness and junior subordinated debentures have rights that are senior to those of Pinnacle Financial's stockholders.

Pinnacle Financial has issued trust preferred securities from special purpose trusts and accompanying junior subordinated debentures. At March 31, 2015, Pinnacle Financial had outstanding trust preferred securities and accompanying junior subordinated debentures totaling $\$ 82.5$ million. Payments of the principal and interest on the trust preferred securities of these trusts are conditionally guaranteed by Pinnacle Financial. Further, the accompanying junior subordinated debentures Pinnacle Financial issued to the trusts are senior to Pinnacle Financial's shares of common stock. As a result, Pinnacle Financial must make payments on the junior subordinated debentures before any dividends can be paid on common stock and, in the event of Pinnacle Financial's bankruptcy, dissolution or liquidation, the holders of the junior subordinated debentures must be satisfied before any distributions can be made on Pinnacle Financial's common stock. Pinnacle Financial has the right to defer distributions on its junior subordinated debentures (and the related trust preferred securities) for up to five years, during which time no dividends may be paid on its common stock. If our financial condition deteriorates or if we do not receive required regulatory approvals, we may be required to defer distributions on our junior subordinated debentures.

On June 15, 2012, Pinnacle Financial entered into a loan agreement with a bank for $\$ 25$ million, which was subsequently amended on October 2, 2013 (the "Loan Agreement"). Borrowings under the Loan Agreement, combined with available cash, were used for the redemption, on June 20, 2012, of the remaining 71,250 shares of preferred stock owned by the U.S. Treasury that had been issued under the CPP. Pinnacle Financial is required to make quarterly principal payments of $\$ 625,000$ which began on September 30, 2012, until the loan matures on June 15, 2017. The Loan Agreement includes negative covenants that limit, among other things, certain fundamental transactions, additional indebtedness, transactions with affiliates, liens, and sales of assets. As amended, the Loan Agreement permits Pinnacle Financial to pay dividends so long as there is no event of default or unmatured event of default under the Loan Agreement and the payment of the dividend would not cause an event of default or unmatured event of default. The Loan Agreement specifically restricts transfers or encumbrances of the shares of the capital stock of Pinnacle Financial's bank subsidiary. The Loan Agreement also includes financial covenants related to Pinnacle Financial's, and in some cases, Pinnacle Bank's, capitalization, levels of risk-based capital, ratio of nonperforming assets to tangible primary capital and ratio of allowance for loan and lease losses to nonperforming loans. The Loan Agreement also contains other customary affirmative and negative covenants, representations, warranties and events of default, which include but are not limited to, payment defaults, breaches of representations and warranties, covenant defaults, events of bankruptcy and insolvency, and the institution of certain regulatory enforcement actions against Pinnacle Financial or Pinnacle Bank. If an event of default occurs and is continuing, Pinnacle Financial may be required immediately to repay all amounts outstanding under the Loan Agreement. Furthermore, in the event of Pinnacle Financial's bankruptcy, dissolution or liquidation, the holders of this borrowing must be satisfied before any distributions can be made on Pinnacle Financial's common stock.

On February 4, 2015, Pinnacle Bank entered into a loan agreement (the "Bank Loan Agreement") with a bank for \$40 million, the borrowings from which Pinnacle Bank used to acquire a $30 \%$ interest in BHG. The Bank Loan Agreement contains many of the same affirmative and negative covenants as are in the Loan Agreement. If an event of default
occurs under the Bank Loan Agreement, Pinnacle Bank may be required to pay all amounts outstanding under the Bank Loan Agreement. Moreover, in the event of Pinnacle Bank's bankruptcy, dissolution or liquidation the obligations under the Bank Loan Agreement must be repaid before any distributions can be made to Pinnacle Financial.

In connection with the Mergers, Pinnacle Bank or Pinnacle Financial may incur additional indebtedness or amend its existing loan agreements and any such borrowings or amendments could contain further restrictions or provisions.

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Our business is dependent on technology, and an inability to invest in technological improvements may adversely affect our results of operations and financial condition.

The financial services industry is undergoing rapid technological changes with frequent introductions of new technology-driven products and services. In addition to better serving customers, the effective use of technology increases efficiency and enables financial institutions to reduce costs. We have made significant investments in data processing, management information systems and internet banking accessibility. Our future success will depend in part upon our ability to create additional efficiencies in our operations through the use of technology. Many of our competitors have substantially greater resources to invest in technological improvements. We cannot make assurances that our technological improvements will increase our operational efficiency or that we will be able to effectively implement new technology-driven products and services or be successful in marketing these products and services to our customers.

We are subject to various statutes and regulations that may impose additional costs or limit our ability to take certain actions.

We operate in a highly regulated industry and are subject to examination, supervision, and comprehensive regulation by various regulatory agencies. Our compliance with these regulations is costly and restricts certain of our activities, including payment of dividends, mergers and acquisitions, investments, loans and interest rates charged on loans, interest rates paid on deposits and locations of offices. We are also subject to capital requirements established by our regulators, which require us to maintain specified levels of capital. It is possible that our FDIC assessments may increase in the future. Any future assessment increases could negatively impact our results of operations. Significant changes in laws and regulations applicable to the banking industry have been recently adopted and others are being considered in Congress. We cannot predict the effects of these changes on our business and profitability. Because government regulation greatly affects the business and financial results of commercial banks and bank holding companies, our cost of compliance could adversely affect our ability to operate profitably.
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## ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

Maximum
Total Number (or
Number of Approximate
Shares Dollar Value)
Purchased of Shares

| Total |  | as Part of | That May Yet <br> Number of |
| :--- | :--- | :--- | :--- |
| Average | Publicly | Be Purchased |  |
| Shares | Price | Announced | Under the |
| Repurchased | Paid Per | Plans or | Plans or |
| $(1)$ | Share | Programs | Programs |
| 33,044 | $\$ 36.06$ | - | - |
| 21,919 | 41.95 | - | - |
| - | - | - | - |
| 54,963 | $\$ 38.41$ | - | - |

During the quarter ended March 31, 2015, 182,368 shares of restricted stock previously awarded to certain of our (1) associates vested. We withheld 54,963 shares to satisfy tax withholding requirements associated with the vesting of these restricted shares.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES
Not applicable

ITEM 4. MINE SAFETY DISCLOSURES
Not applicable

ITEM 5. OTHER INFORMATION
None

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## ITEM 6. EXHIBITS

Agreement and Plan of Merger by and among Pinnacle Financial Partners, Inc., Pinnacle Bank and CapitalMark Bank \& Trust (Schedules and exhibits omitted pursuant to Item 601(b)(2) of Regulation S-K will be furnished supplementally to the Securities and Exchange Commission upon request) (incorporated by reference to the Current Report on Form 8-K filed by Pinnacle Financial Partners, Inc. on April 8, 2015) Agreement and Plan of Merger by and among Pinnacle Financial Partners, Inc., Pinnacle Bank and Magna Bank (Schedules and exhibits omitted pursuant to Item 601(b)(2) of Regulation S-K will be furnished supplementally to the Securities and Exchange Commission upon request) (incorporated by reference to the Current Report on Form 8-K filed by Pinnacle Financial Partners, Inc. on April 29, 2015) Amended and Restated Charter of Pinnacle Financial Partners, Inc., as amended (Restated for SEC filing 3.1 purposes only) (incorporated by reference to the Current Report on Form 8-K filed by Pinnacle Financial Partners, Inc. on April 27, 2015) Bylaws of Pinnacle Financial Partners, Inc., as amended (Restated for SEC filing purposes only)
3.2 (incorporated by reference to the Current Report on Form 8-K filed by Pinnacle Financial Partners, Inc. on April 27, 2015)
31.1 Certification pursuant to Rule 13a-14(a)/15d-14(a)
31.2 Certification pursuant to Rule 13a-14(a)/15d-14(a)
32.1 Certification pursuant to 18 USC Section 1350 - Sarbanes-Oxley Act of 2002
32.2 Certification pursuant to 18 USC Section 1350 - Sarbanes-Oxley Act of 2002
101.INS XBRL Instance Document
101.SCH XBRL Schema Document
101.CALXBRL Calculation Linkbase Document
101.LAB XBRL Label Linkbase Document
101.PRE XBRL Presentation Linkbase Document
101.DEF XBRL Definition Linkbase Document

## SIGNATURES

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

PINNACLE FINANCIAL PARTNERS, INC.

May 8, 2015 /s/ M. Terry Turner
M. Terry Turner

President and Chief Executive Officer

May 8, 2015 /s/ Harold R. Carpenter
Harold R. Carpenter
Chief Financial Officer


[^0]:    1) Represents shares forfeited due to employee termination and/or retirement. No shares were forfeited due to failure ${ }^{1}$ to meet performance targets.
