PINNACLE FINANCIAL PARTNERS INC
Form 10-Q
May 04, 2012

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, 2012

or

o TRANSITION REPORT PURSUANT TO SECTION 13 OF 15(d) OF THE SECURITIES AND EXCHANGE ACT OF 1934

For the transition period from ____ to ____

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 37201	
(Address of principal executive offices)	(Zip Code)

(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 x No o

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 x No o

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

Large Accelerated Filer o Accelerated Filer x

Non-accelerated Filer o Smaller reporting company o

(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 o No x

As of April 27, 2012 there were 34,588,975 shares of common stock, $1.00 par value per share, issued and outstanding.

Pinnacle Financial Partners, Inc.
Report on Form 10-Q
March 31, 2012

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FORWARD-LOOKING STATEMENTS

Certain of the statements in this quarterly report 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 s 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 to grow its loan portfolio in the Nashville-Davidson-Murfreesboro-Franklin MSA (“the Nashville MSA”) and the Knoxville MSA; (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 MSA and the Knoxville MSA, particularly in commercial and residential real estate markets; (viii) rapid fluctuations or unanticipated changes in interest rates; (ix) the results of regulatory examinations; (x) the development of any new market other than Nashville or Knoxville; (xi) a merger or acquisition; (xii) any matter that would cause Pinnacle Financial to conclude that there was impairment of any asset, including intangible assets; (xiii) the ability to attract additional financial advisors or to attract customers from other financial institutions and conversely, the inability to realize the economic benefits of newly hired financial advisors; (xiv) the impact of governmental restrictions on and discretionary regulatory authority over entities participating in the Capital Purchase Program (the “CPP”) of the U.S. Department of the Treasury (the “U.S. Treasury”); (xv) further deterioration in the valuation of other real estate owned and increased expenses associated therewith; (xvi) inability to comply with regulatory capital requirements or to secure any required regulatory approvals for capital actions, including redemption of the remaining preferred shares sold to the U.S. Treasury that are outstanding; and (xvii) 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 (the “Dodd-Frank Act”). A more detailed description of these and other risks is contained in “Item 1A. Risk Factors” of the Company’s Annual Report on Form 10-K filed with the Securities and Exchange Commission on March 2, 2012. 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 quarterly 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 SHEET
(Unaudited)

	March 31, 2012	December 31, 2011
ASSETS		
Cash and noninterest-bearing due from banks	$60,400,972	$63,015,997
Interest-bearing due from banks	70,901,830	108,422,470
Federal funds sold	764,526	724,573
Cash and cash equivalents	132,067,328	172,163,040
Securities available-for-sale, at fair value	838,718,889	894,962,246
Securities held-to-maturity (fair value of $1,074,394 and $2,369,118 at March 31, 2012 and December 31, 2011, respectively)	1,049,793	2,329,917
Mortgage loans held-for-sale	23,541,493	35,363,038
Loans	3,337,869,085	3,291,350,857
Less allowance for loan losses	(71,379,400)	(73,974,675)
Loans, net	3,266,489,685	3,217,376,182
Premises and equipment, net	76,378,894	77,127,361
Other investments	44,990,439	44,653,840
Accrued interest receivable	16,019,272	15,243,366
Goodwill	244,071,513	244,076,492
Core deposits and other intangible assets	7,156,200	7,842,267
Other real estate owned	34,018,658	39,714,415
Other assets	105,080,416	113,098,540
Total assets	$4,789,582,580	$4,863,950,704
LIABILITIES AND STOCKHOLDERS' EQUITY		
Deposits:		
Noninterest-bearing	$756,909,243	$717,378,933
Interest-bearing	694,755,093	637,203,420
Savings and money market accounts	1,480,671,167	1,585,260,139
Time	655,783,708	714,496,974
Total deposits	3,588,119,211	3,654,339,466
Securities sold under agreements to repurchase	118,088,532	131,591,412
Federal Home Loan Bank advances	226,031,695	226,068,796
Subordinated debt	97,476,000	97,476,000
Accrued interest payable	1,912,756	2,233,330
Other liabilities	39,288,938	42,097,132
Total liabilities	4,070,917,132	4,153,806,136
Stockholders’ equity:		
Preferred stock, no par value; 10,000,000 shares authorized; 71,250 shares issued and outstanding at March 31, 2012 and December 31, 2011	69,355,475	69,096,828

Common stock, par value $1.00; 90,000,000 shares authorized; 34,616,013 shares and 34,354,960 shares issued and outstanding at March 31, 2012 and December 31, 2011, respectively	34,616,013	34,354,960
Common stock warrants	3,348,402	3,348,402
Additional paid-in capital	537,860,446	536,227,537
Retained earnings	56,999,267	49,783,584
Accumulated other comprehensive income, net of taxes	16,485,845	17,333,257
Total stockholders' equity	718,665,448	710,144,568
Total liabilities and stockholders' equity	$4,789,582,580	$4,863,950,704

See accompanying notes to consolidated financial statements.

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PINNACLE FINANCIAL PARTNERS, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF INCOME
(Unaudited)

	Three Months Ended March 31, 2012	Three Months Ended March 31, 2011
Interest income:		
Loans, including fees	$38,637,719	$38,353,481
Securities:		
Taxable	4,929,284	6,360,899
Tax-exempt	1,703,146	1,935,888
Federal funds sold and other	553,939	574,006
Total interest income	45,824,088	47,224,274
Interest expense:		
Deposits	4,827,476	9,424,241
Securities sold under agreements to repurchase	155,576	381,569
Federal Home Loan Bank advances and other borrowings	1,337,031	1,397,831
Total interest expense	6,320,083	11,203,641
Net interest income	39,504,005	36,020,633
Provision for loan losses	1,034,245	6,139,138
Net interest income after provision for loan losses	38,469,760	29,881,495
Noninterest income:		
Service charges on deposit accounts	2,323,962	2,261,457
Investment services	1,646,778	1,508,086
Insurance sales commissions	1,287,560	1,049,232
Gain on mortgage loans sold, net	1,494,472	609,377
Gain (loss) on sale of investment securities, net	113,600	(159,103)
Trust fees	795,435	729,988
Other noninterest income	2,287,531	2,325,020
Total noninterest income	9,949,338	8,324,057
Noninterest expense:		
Salaries and employee benefits	19,792,566	17,923,622
Equipment and occupancy	5,008,655	5,006,710
Other real estate expense	4,676,064	4,334,118
Marketing and other business development	785,325	753,751
Postage and supplies	563,294	489,877
Amortization of intangibles	686,067	715,904
Other noninterest expense	4,307,735	5,476,846
Total noninterest expense	35,819,706	34,700,828
Income before income taxes	12,599,392	3,504,724
Income tax expense	4,234,438	-
Net income	8,364,954	3,504,724
Preferred stock dividends	900,519	1,187,500
Accretion on preferred stock discount	258,647	305,974
Net income available to common stockholders	$7,205,788	$2,011,250

Per share information:		
Basic net income per common share available to common stockholders	$0.21	$0.06
Diluted net income per common share available to common stockholders	$0.21	$0.06
Weighted average shares outstanding:		
Basic	33,811,871	33,366,053
Diluted	34,423,898	34,013,810

See accompanying notes to consolidated financial statements.

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PINNACLE FINANCIAL PARTNERS, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
(Unaudited)

	Three Months Ended March 31,	
	2012	2011
Net income:	$8,364,954	$3,504,724
Other comprehensive income, net of tax:		
Decrease in net gains on securities available-for-sale, net of deferred tax	(847,412)	(292,817)
Total Comprehensive income	$7,517,542	$3,211,907

See accompanying notes to consolidated financial statements.

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PINNACLE FINANCIAL PARTNERS, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY
(Unaudited)

	Preferred Stock Amount	Common Stock Shares	Common Stock Amount	Common Stock Warrants	Additional Paid-in Capital	Retained Earnings	Accumulated Other Comp. Income, net	Total Stockh Equity
Balances, December 31, 2010	$90,788,682	33,870,380	$33,870,380	$3,348,402	$530,829,019	$12,996,202	$5,624,600	$677,4
Exercise of employee common stock options and related tax benefits	-	106,730	106,730	-	610,337	-	-	717,0
Repurchase of preferred stock		-	-	-	-	-	-	-
Issuance of restricted common shares, net of forfeitures	-	165,822	165,822	-	(165,822)	-	-	-
Issuance of Salary Stock Units	-	6,169	6,169	-	90,886	-	-	97,05
Restricted shares withheld for taxes	-	(16,845)	(16,845)	-	(230,892)	-	-	(247,
Compensation expense for restricted shares	-	-	-	-	808,207	-	-	808,2
Compensation expense for stock options	-	-	-	-	370,092	-	-	370,0
Accretion on preferred stock discount	305,974	-	-	-	-	(305,974)	-	-
Preferred dividends paid	-	-	-	-	-	(1,187,500)	-	(1,187
Net income	-	-	-	-	-	3,504,724	-	3,504
Other comprehensive loss							(292,817)	(292,8
Balances, March 31, 2011	$91,094,656	34,132,256	$34,132,256	$3,348,402	$532,311,827	$15,007,452	$5,331,783	$681,2

Balances, December 31, 2011	$69,096,828	34,354,960	$34,354,960	$3,348,402	$536,227,537	$49,783,584	$17,333,257	$710,1
Exercise of employee common stock options and related tax benefits	-	180,487	180,487	-	304,428	-	-	484,9
Issuance of restricted common shares, net of forfeitures	-	95,912	95,912	-	(95,912)	-	-	-
Issuance of Salary Stock Units	-	27,672	27,672	-	449,891	-	-	477,5
Restricted shares withheld for taxes	-	(43,018)	(43,018)	-	(36,459)	-	-	(79,47
Compensation expense for restricted shares	-	-	-	-	857,160	-	-	857,1
Compensation expense for stock options	-	-	-	-	153,801	-	-	153,8
Accretion on preferred stock discount	258,647	-	-	-	-	(258,647)	-	-
Preferred dividends paid	-	-	-	-	-	(890,624)	-	(890,6
Net income	-	-	-	-	-	8,364,954	-	8,364
Other comprehensive loss							(847,412)	(847,4
Balances, March 31, 2012	$69,355,475	34,616,013	$34,616,013	$3,348,402	$537,860,446	$56,999,267	$16,485,845	$718,6

See accompanying notes to consolidated financial statements.

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

	Three Months ended March 31, 2012	2011
Operating activities:		
Net income	$8,364,954	$3,504,724
Adjustments to reconcile net income to net cash provided by operating activities:		
Net amortization/accretion of premium/discount on securities	1,971,889	2,102,529
Depreciation and amortization	2,660,347	2,795,884
Provision for loan losses	1,034,245	6,139,138
Gain on mortgage loan sales, net	(1,494,472)	(609,377)
(Gain) loss on sale of investment securities, net	(113,600)	159,103
Stock-based compensation expense	1,488,522	1,275,354
Deferred tax benefit	(1,831,027)	-
Losses on dispositions of other real estate and other investments	4,283,855	3,297,185
Excess tax benefit from stock compensation	(4,978)	(7,117)
Mortgage loans held for sale:		
Loans originated	(105,694,598)	(62,944,534)
Loans sold	119,023,000	70,980,585
Increase in other assets	15,794,855	8,577,073
(Decrease) increase in other liabilities	(3,128,767)	595,804
Net cash provided by operating activities	42,354,225	35,866,351
Investing activities:		
Activities in securities available-for-sale:		
Purchases	(17,954,670)	(49,158,590)
Sales	14,359,785	19,277,990
Maturities, prepayments and calls	56,585,619	60,713,289
Activities in securities held-to-maturity:		
Maturities, prepayments and calls	1,280,000	1,049,999
Increase in loans, net	(54,941,031)	(21,304,654)
Purchases of software, premises and equipment	(1,271,826)	(975,525)
Other investments	(286,569)	(238,101)
Net cash (used in) provided by investing activities	(2,228,692)	9,364,408
Financing activities:		
Net decrease in deposits	(66,220,256)	(101,153,661)
Net (decrease) increase in securities sold under agreements to repurchase	(13,502,880)	18,837,951
Advances from Federal Home Loan Bank:		
Issuances	215,000,000	-
Payments/maturities	(215,017,901)	(10,019,502)
Preferred dividends paid	(890,624)	(1,187,500)
Exercise of common stock options and stock appreciation rights	405,438	469,330
Excess tax benefit from stock compensation	4,978	7,117
Net cash used in financing activities	(80,221,245)	(93,046,265)
Net decrease in cash and cash equivalents	(40,095,712)	(47,815,506)
Cash and cash equivalents, beginning of period	172,163,040	188,586,181

Cash and cash equivalents, end of period	$132,067,328	$140,770,675

See accompanying notes to consolidated financial statements.

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PINNACLE FINANCIAL PARTNERS, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(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 National Bank (Pinnacle National.) Pinnacle National is a commercial bank headquartered in Nashville, Tennessee. Pinnacle National 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 2011 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. generally accepted accounting principles 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, of other real estate owned, and of 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, 2011. 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, 2011.

Recently Adopted Accounting Pronouncements — In May 2011, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) No. 2011-04, Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and International Financial Reporting Standards (Topic 820)-Fair Value Measurement (ASU 2011-04), to provide a consistent definition of fair value and ensure that the fair value measurement and disclosure requirements are similar between U.S. GAAP and International Financial Reporting Standards. ASU 2011-04 changes certain fair value measurement principles and enhances the disclosure requirements particularly for level 3 fair value measurements. ASU 2011-04 was effective for Pinnacle Financial during the first quarter of fiscal 2012 and was applied prospectively.

In June 2011, the FASB issued ASU No. 2011-05, Comprehensive Income — Presentation of Comprehensive Income. This ASU eliminates the option to present the components of other comprehensive income as part of the statement of stockholders’ equity. Rather, it gives an entity the choice to present the components of net income and other comprehensive income in either a single continuous statement or two separate but consecutive statements. The components of comprehensive income and timing of reclassification of an item to net income do not change with this update. ASU 2011-05 requires retrospective application and is effective for annual and interim periods beginning after December 15, 2011. Pinnacle Financial adopted this ASU in the first quarter of 2012 and has presented separate Consolidated Statements of Comprehensive Income.

In September 2011, the FASB issued ASU No. 2011-8, Intangibles — Goodwill and Other, regarding testing goodwill for impairment. The new guidance provides an entity the option to first perform a qualitative assessment to determine whether it is more likely than not that the fair value of a reporting unit is less than its carrying amount. If an entity determines that this is the case, it is required to perform the currently prescribed two-step goodwill impairment test to identify potential goodwill impairment and measure the amount of goodwill impairment loss to be recognized for that reporting unit (if any). Based on the qualitative assessment, if an entity determines that the fair value of a reporting unit is more than its carrying amount, the two-step goodwill impairment test is not required. The new guidance was adopted by Pinnacle Financial beginning January 1, 2012.

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

Cash Flow Information — Supplemental cash flow information addressing certain cash and noncash transactions for each of the three months ended March 31, 2012 and 2011 was as follows:

	For the three months ended March 31,	
	2012	2011
Cash Transactions:		
Interest paid	$ 6,659,856	$ 12,493,306
Income taxes received, net	7,825,894	-
Noncash Transactions:		
Loans charged-off to the allowance for loan losses	4,925,559	11,658,354
Loans foreclosed upon and transferred to other real estate owned	4,574,792	6,401,209

Income Per Common Share — Basic net income per share available to common stockholders (EPS) is computed by dividing net income available to common stockholders by the weighted average common shares outstanding for the period. Weighted average common shares outstanding also include salary stock units issued to the named executive officers. 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, warrants and restricted shares with time-based vesting criteria. The dilutive effect of outstanding options, common stock appreciation rights, warrants and restricted shares with time-based vesting criteria is reflected in diluted EPS by application of the treasury stock method.

As of March 31, 2012, there were approximately 1,392,000 stock options and 7,800 stock appreciation rights outstanding to purchase common shares. Additionally, as of March 31, 2012, there were 267,445 outstanding warrants to purchase shares of Pinnacle Financial common stock. These warrants were issued in conjunction with Pinnacle Financial's participation in the U.S. Treasury's Capital Purchase Program (CPP) as more fully discussed in Note 2. For the three months ended March 31, 2012, approximately 612,000 of dilutive stock options, stock appreciation rights, warrants and restricted shares with time-based vesting criteria included in the earnings per share calculation. As of March 31, 2011, there were approximately 1,667,700 stock options and 8,200 stock appreciation rights outstanding to purchase common shares. For the quarter ended March 31, 2011, there were approximately 648,000 dilutive stock options, stock appreciation rights, warrants and time-based restricted shares with time-based vesting criteria outstanding to purchase common shares that were included in the earnings per share calculation.

The following is a summary of the basic and diluted earnings per share calculations for the three months ended March 31, 2012 and 2011:

	2012	2011
Basic earnings per share calculation:		
Numerator - Net income available to common stockholders	$7,205,788	$2,011,250
Denominator - Average common shares outstanding	33,811,871	33,366,053
Basic net income per share available to common stockholders	$0.21	$0.06
Diluted earnings per share calculation:		
Numerator – Net income available to common stockholders	$7,205,788	$2,011,250
Denominator - Average common shares outstanding	33,811,871	33,366,053

Dilutive shares contingently issuable	612,027	647,757
Average diluted common shares outstanding	34,423,898	34,013,810
Diluted net income per share available to common stockholders	$0.21	$0.06

Note 2. Participation in U.S. Treasury Capital Purchase Program

On December 12, 2008, Pinnacle Financial issued 95,000 shares of preferred stock to the Treasury for $95 million pursuant to the Treasury's Capital Purchase Program (CPP) under the Troubled Assets Relief Program (TARP). The CPP preferred stock is non-voting, other than having class voting rights on certain matters, and pays cumulative dividends quarterly at a rate of 5% per annum for the first five years and 9% thereafter. Pinnacle Financial can redeem the preferred shares issued to the Treasury under the CPP at any time subject to a requirement that it must consult with its primary federal regulator before redemption. Additionally, Pinnacle Financial issued warrants to purchase 534,910 shares of common stock to the Treasury as a condition to its participation in the CPP. The warrants have an exercise price of $26.64 each, are immediately exercisable and expire 10 years from the date of issuance. On June 16, 2009, Pinnacle Financial completed the sale of 8,855,000 shares of its common stock in a public offering, resulting in net proceeds to Pinnacle Financial of approximately $109 million. As a result, and pursuant to the terms of the warrants issued to the U.S. Treasury in connection with Pinnacle Financial's participation in the CPP, the number of shares issuable upon exercise of the warrants issued to the Treasury in connection with the CPP was reduced by 50%, or 267,455 shares.

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

During the fourth quarter of 2011, Pinnacle Financial repurchased 23,750 of the preferred shares originally issued to the U.S. Treasury under the CPP in a transaction totaling approximately $23.9 million. Following the partial redemption of preferred shares, 71,250 shares of Series A preferred stock remain issued and outstanding and held by the U.S. Treasury at December 31, 2011. At March 31, 2012, the Series A preferred stock represents approximately $69 million of our stockholders' equity.

Note 3. Securities

The amortized cost and fair value of securities available-for-sale and held-to-maturity at March 31, 2012 and December 31, 2011 are summarized as follows (in thousands):

	March 31, 2012			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Securities available-for-sale:				
U.S. government agency securities	$19,786	$133	$4	$19,915
Mortgage-backed securities	591,033	21,796	253	612,576
State and municipal securities	182,207	13,042	59	195,190
Corporate notes and other	9,681	1,357	-	11,038
	$802,707	$36,328	$316	$838,719
Securities held-to-maturity:				
State and municipal securities	$1,050	$24	$-	$1,074
	$1,050	$24	$-	$1,074

	December 31, 2011			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Securities available-for-sale:				
U.S. Government agency securities	$41,978	$344	$9	$42,313
Mortgage-backed securities	623,684	22,254	371	645,567
State and municipal securities	182,206	13,768	22	195,952
Corporate notes and other	9,687	1,443	-	11,130
	$857,555	$37,809	$402	$894,962
Securities held-to-maturity:				
State and municipal securities	2,330	39	$-	2,369
	$2,330	$39	$-	$2,369

At March 31, 2012, approximately $606.1 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, 2012 by contractual maturity are shown below. Actual maturities may differ from contractual maturities of mortgage-backed securities since the mortgages 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):

	Available-for-sale		Held-to-maturity	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
Due in one year or less	$3,259	$3,293	$475	$477
Due in one year to five years	40,954	42,299	575	597
Due in five years to ten years	80,025	86,618	-	-
Due after ten years	87,436	93,933	-	-
Mortgage-backed securities	591,033	612,576	-	-
	$802,707	$838,719	$1,050	$1,074

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At March 31, 2012 and December 31, 2011, included in securities were the following investments with unrealized losses. The information below classifies these investments according to the term of the unrealized losses of less than twelve months or twelve months or longer (in thousands):

	Investments with an Unrealized Loss of less than 12 months		Investments with an Unrealized Loss of 12 months or longer		Total Investments with an Unrealized Loss	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
At March 31, 2012:						
U.S. government agency securities	$1,386	$4	$-	$-	$1,386	$4
Mortgage-backed securities	35,449	245	9,678	8	45,127	253
State and municipal securities	5,162	56	845	3	6,007	59
Corporate notes	-	-	-	-	-	-
Total temporarily-impaired securities	$41,997	$305	$10,523	$11	$52,520	$316
At December 31, 2011:						
U.S. government agency securities	$5,452	$9	$-	$-	$5,452	$9
Mortgage-backed securities	41,598	341	17,826	30	59,424	371
State and municipal securities	1,967	17	1,205	5	3,172	22
Corporate notes	-	-	-	-	-	-
Total temporarily-impaired securities	$49,017	$367	$19,031	$35	$68,048	$402

The applicable date for determining when securities are in an unrealized loss position is March 31, 2012. As such, it is possible that a security had a market value that exceeded its amortized cost on other days during the past twelve-month period, but is in the “Investments with an Unrealized Loss of less than 12 months” category above.

As shown in the table above, at March 31, 2012, Pinnacle Financial had unrealized losses of $316,000 on $52.5 million of available-for-sale securities. The unrealized losses associated with these investment securities are primarily driven by changes in interest rates and are not due to the credit quality of the securities. 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. Because Pinnacle Financial currently does not intend to sell these securities, that have an unrealized loss at March 31, 2012, 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, 2012.

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, raising funds for liquidity purposes and in the event of a bank merger where certain investment holdings acquired via the merger are outside of the firm's investment policy. Additionally, if an available-for-sale security loses its investment grade, 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 it becomes known. The table below shows the fair value of securities that have been sold during 2012 and the amount of gain or loss recognized on those securities as well as any other-than-temporary impairment identified during 2012.

For the quarter ended,	Fair Value of securities sold(1)	Gain recognized	Loss recognized	Net	Other-than-temporary impairment(2)	Gain on the sale of securities, net
March 31, 2012	$ 14,360	$148	$-	$148	$ 34	$114

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(1) Pinnacle Financial sold these securities due to their relatively short terms maturity and a weighted average coupon of 0.50%.

(2) During the first quarter of 2012, Pinnacle Financial determined four mortgage-backed securities were other-than-temporarily impaired (OTTI) because of management's intent to sell them in the second quarter of 2012. The decision to sell was based on their relative underperformance compared to expectations.

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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.

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).

Commercial loans receive risk ratings by the assigned financial advisor that are subject to validation by our independent loan review department. Risk ratings are categorized as pass, special mention, substandard, substandard-impaired or doubtful-impaired. Pinnacle Financial believes that our categories follow those outlined by Pinnacle National's primary regulator. At March 31, 2012, approximately 75% 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 loan. 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.

Risk ratings are subject to continual review by the loan officer. At least annually and in many cases twice per year, our credit policy requires that each risk-rated loan is subject to a formal credit risk review to be performed by the respective loan officer. Each loan grade is also subject to review by our independent loan review department. Currently, our independent loan review department targets reviews of at least 70% of our risk rated portfolio annually. Included in the 70% coverage are independent loan reviews of loans in targeted higher-risk portfolio segments such as certain consumer loans, land loans, loans assigned to a particular lending officer and/or loan types in certain geographies.

The following table presents our loan balances by primary loan classification and the amount classified within each risk rating category. Pass rated loans include all credits other than those included in special mention, substandard, substandard-impaired and doubtful-impaired 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-impaired loans are substandard loans that have been placed on nonaccrual.
- Doubtful-impaired loans have all the characteristics of substandard-impaired 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. Pinnacle Financial considers all doubtful-impaired loans to be impaired and places the loan on nonaccrual status.

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The following table outlines the amount of each loan classification categorized into each risk rating class as of March 31, 2012 and December 31, 2011 (in thousands):

	Accruing Loans				Impaired Loans			
March 31, 2012	Pass	Special Mention	Substandard (1)	Total Accruing	Substandard Impaired	Doubtful Impaired	Total Impaired	Total Loans
Commercial real estate - mortgage	$1,010,060	$24,359	$ 72,741	$1,107,160	$16,530	$-	$16,530	$1,123,690
Consumer real estate - mortgage	645,624	10,957	20,650	677,231	11,097	489	11,586	688,817
Construction and land development	218,512	27,416	28,717	274,645	6,979	-	6,979	281,624
Commercial and industrial	1,136,339	19,205	17,792	1,173,336	7,144	98	7,242	1,180,578
Consumer and other	62,645	-	-	62,645	515	-	515	63,160
	$3,073,180	$81,937	$ 139,900	$3,295,017	$42,265	$587	$42,852	$3,337,869
December 31, 2011								
Commercial real estate - mortgage	$994,252	$19,403	$ 87,345	$1,101,000	$9,962	$-	$9,962	$1,110,962
Consumer real estate - mortgage	647,555	15,225	20,478	683,258	11,990	497	12,487	695,745
Construction and land development	204,773	27,553	28,957	261,283	12,965	-	12,965	274,248
Commercial and industrial	1,099,847	17,029	16,969	1,133,845	11,194	696	11,890	1,145,735
Consumer and other	63,460	649	1	64,110	551	-	551	64,661
	$3,009,887	$79,859	$ 153,750	$3,243,496	$46,662	$1,193	$47,855	$3,291,351

(1) Potential problem loans, which are not included in nonperforming assets, amounted to approximately $117.1 million at March 31, 2012, compared to $130.4 million at December 31, 2011. At March 31, 2012 and December 31, 2011, approximately $22.8 million and $23.4 million, respectively of substandard loans were deemed to be accruing troubled debt restructurings and were not included in potential problem loans but are considered impaired loans under U.S. GAAP and for the purposes of evaluating inherent losses in the allowance for loan loss. 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 the Office of the Comptroller of the Currency, or OCC, Pinnacle National's primary regulator, for loans classified as substandard, excluding the impact of substandard nonperforming loans and substandard troubled debt restructurings.

At March 31, 2012 and December 31, 2011, there were no loans classified as nonaccrual that were not deemed to be impaired. The principal balances of these nonaccrual loans amounted to $42.9 million and $47.9 million at March 31, 2012 and December 31, 2011, respectively, and are included in the table above. For the three months ended March 31, 2012, the average balance of impaired loans was $51.4 million as compared to $63.9 million for the twelve months ended December 31, 2011. At the date such loans were placed on nonaccrual status, Pinnacle Financial reversed all previously accrued interest income against current year earnings. Had nonaccruing loans been on accruing status, interest income would have been higher by $1.8 million and $1.6 million for the quarter ended March 31, 2012 and March 31, 2011, respectively.

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The following table details the recorded investment, unpaid principal balance and related allowance and average recorded investment of our impaired loans at March 31, 2012 and December 31, 2011 by loan category and the amount of interest income recognized on a cash basis throughout the quarter and year then ended, respectively, on these loans that remain on our balance sheet (in thousands):

	At March 31, 2012			For the three months ended March 31, 2012	
	Recorded investment	Unpaid principal balance	Related allowance(1)	Average recorded investment	Interest income recognized
Collateral dependent impaired loans:					
Commercial real estate – mortgage	$ 15,676	$ 18,330	$ -	$ 18,366	$ -
Consumer real estate – mortgage	8,760	9,632	-	9,632	-
Construction and land development	3,542	4,071	-	4,088	-
Commercial and industrial	1,535	1,975	-	1,975	-
Consumer and other	-	-	-	-	-
Total	$ 29,513	$ 34,008	$ -	$ 34,061	$ -
Cash flow dependent impaired loans:					
Commercial real estate – mortgage	$ 854	$ 921	$ 1,306	$ 921	$ -
Consumer real estate – mortgage	2,826	4,485	462	4,488	-
Construction and land development	3,437	4,274	292	4,274	-
Commercial and industrial	5,707	6,822	1,063	6,800	-
Consumer and other	515	846	84	846	-
Total	$ 13,339	$ 17,348	$ 3,207	$ 17,329	$ -
Total Impaired Loans	$ 42,852	$ 51,356	$ 3,207	$ 51,390	$ -

	At December 31, 2011			For the year ended December 31, 2011	
	Recorded investment	Unpaid principal balance	Related allowance(1)	Average recorded investment	Interest income recognized

Collateral dependent impaired loans:										
Commercial real estate – mortgage	$	9,345	$	12,099	$	-	$	12,450	$	5
Consumer real estate – mortgage		9,248		9,961		-		10,140		-
Construction and land development		6,917		9,093		-		9,288		37
Commercial and industrial		3,036		3,546		-		3,689		-
Consumer and other		-		-		-		-		-
Total	$	28,546	$	34,699	$	-	$	35,567	$	42
Cash flow dependent impaired loans:										
Commercial real estate – mortgage	$	617	$	661	$	57	$	792	$	-
Consumer real estate – mortgage		3,239		4,902		301		5,005		-
Construction and land development		6,048		6,822		1,264		7,074		-
Commercial and industrial		8,854		11,041		2,767		11,497		-
Consumer and other		551		856		51		857		-
Total	$	19,309	$	24,282	$	4,440	$	25,225	$	-
Total Impaired Loans	$	47,855	$	58,981	$	4,440	$	60,792	$	42

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

Pinnacle Financial's policy is that once a loan is classified as impaired and 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 no interest income from cash payments received during the three months ended March 31, 2012 and $42,000 of interest income during the year ended December 31, 2011 while the underlying loans were placed on impaired status.

Impaired loans also include loans that Pinnacle National has elected to formally restructure when, 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 National may have to otherwise incur. If on nonaccruing status as of the date of restructuring, the loans are included in nonperforming loans and are classified as impaired loans. Loans that have been restructured that were performing as of the restructure date and continue to perform are reported separately as troubled debt restructurings. At March 31, 2012 and December 31, 2011, there were $22.8 million and $23.4 million, respectively, of troubled debt restructurings that were performing as of the restructure date which are considered impaired loans pursuant to U.S. GAAP and not included in the table above. These troubled debt restructurings are presented separately in the table below. Troubled commercial loans are restructured by specialists within our Special Asset 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 through obtaining either or all of the following: improved documentation, additional guaranties, increase in curtailments, reduction in collateral release terms, additional collateral or other similar strategies.

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	March 31, 2012				December 31, 2011			
	Number of contracts	Pre Modification Outstanding Recorded Investment	Related Allowance	Post Modification Outstanding Recorded Investment, net of related allowance	Number of contracts	Pre Modification Outstanding Recorded Investment	Related Allowance	Post Modification Outstanding Recorded Investment, net of related allowance