PINNACLE FINANCIAL PARTNERS INC
Form 10-Q
November 05, 2007

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 September 30, 2007
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 (State or other jurisdiction of incorporation or organization)	62-1812853 (I.R.S. Employer Identification No.)
211 Commerce Street, Suite 300, Nashville, Tennessee (Address of principal executive offices)	37201 (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 is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act. (Check one):

Large Accelerated Filer o　　　　Accelerated Filer x　　　　Non-accelerated Filer o

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes o No x

As of October 31, 2007 there were 15,553,537 shares of common stock, $1.00 par value per share, issued and outstanding.

Pinnacle Financial Partners, Inc.
Report on Form 10-Q
September 30, 2007

TABLE OF CONTENTS

FORWARD-LOOKING STATEMENTS

Pinnacle Financial Partners, Inc. ("Pinnacle Financial") may from time to time make written or oral statements, including statements contained in this report which may constitute forward-looking statements within the meaning of Section 21E of the Securities Exchange Act of 1934 (the "Exchange Act"). The words "expect", "anticipate", "intend", "consider", "plan", "believe", "seek", "should", "estimate", and similar expressions are intended to identify such forward-looki statements, but other statements may constitute forward-looking statements. All forward-looking statements are subject to risks, uncertainties and other facts 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 factors include, without limitation, (i) unanticipated deterioration in the financial condition of borrowers resulting in significant increases in loan losses and provisions for those losses, (ii) the inability of Pinnacle Financial to continue to grow its loan portfolio at historic rates in the Nashville-Davidson-Murfreesboro-Franklin MSA or projected rates in the Knoxville MSA, (iii) increased competition with other financial institutions, (iv) lack of sustained growth in the economy in the Nashville-Davidson-Murfreesboro-Franklin MSA and the Knoxville MSA, (v) rapid fluctuations or unanticipated changes in interest rates, (vi) the inability of Pinnacle Financial to satisfy regulatory requirements for its expansion plans, (vii) the inability of Pinnacle Financial to execute its expansion plans and (viii) changes in the legislative and regulatory environment. Additionally, risk factors exist in connection with Pinnacle Financial's proposed merger with Mid-America Bancshares, Inc. ("Mid-America") including among others, (1) the risk that the cost savings and any revenue synergies from the merger may not be realized or take longer than anticipated, (2) disruption from the merger with customers, suppliers or employee relationships, (3) the occurrence of any event, change or other circumstances that could give rise to the termination of the merger agreement, (4) the risk of successful integration of the two companies' businesses, (5) the failure of Mid-America's or Pinnacle Financial's shareholders to approve the merger, (6) the amount of the costs, fees, expenses and charges related to the merger, and (7) the ability to obtain required governmental approvals of the proposed terms of the merger and anticipated schedule. A more detailed description of these and other risks is contained in Pinnacle Financial's most recent annual report on Form 10-K and below in Item 1A of Part II. 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.

Table of Contents

Item 1. **Part I. FINANCIAL INFORMATION**

PINNACLE FINANCIAL PARTNERS, INC. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS
(Unaudited)

	September 30, 2007	December 31, 2006
ASSETS		
Cash and noninterest-bearing due from banks	$ 48,865,526	$ 43,611,533
Interest-bearing due from banks	5,819,607	1,041,174
Federal funds sold	26,522,858	47,866,143
Cash and cash equivalents	81,207,991	92,518,850
Securities available-for-sale, at fair value	325,171,126	319,237,428
Securities held-to-maturity (fair value of $26,603,414 and $26,594,235 at September 30, 2007 and December 31, 2006, respectively)	27,050,937	27,256,876
Mortgage loans held-for-sale	5,685,674	5,654,381
Loans	1,731,245,280	1,497,734,824
Less allowance for loan losses	(17,978,429)	(16,117,978)
Loans, net	1,713,266,851	1,481,616,846
Premises and equipment, net	38,208,897	36,285,796
Investments in unconsolidated subsidiaries and other entities	17,424,718	16,200,684
Accrued interest receivable	12,056,089	11,019,173
Goodwill	114,287,640	114,287,640
Core deposit intangible, net	9,837,744	11,385,006
Other assets	23,881,242	26,724,183
Total assets	$ 2,368,078,909	$ 2,142,186,863
LIABILITIES AND STOCKHOLDERS' EQUITY		
Deposits:		
Noninterest-bearing demand	$ 316,542,088	$ 300,977,814
Interest-bearing demand	254,958,551	236,674,425
Savings and money market accounts	538,976,126	485,935,897
Time	716,407,184	598,823,167
Total deposits	1,826,883,949	1,622,411,303
Securities sold under agreements to repurchase	145,331,726	141,015,761
Federal Home Loan Bank advances	35,685,005	53,725,833
Federal funds purchased	19,986,000	-
Subordinated debt	51,548,000	51,548,000
Accrued interest payable	5,973,825	4,952,422
Other liabilities	8,033,974	12,516,523
Total liabilities	2,093,442,479	1,886,169,842
Stockholders' equity:		
Preferred stock, no par value; 10,000,000 shares authorized; no shares issued and outstanding	-	-
	15,553,037	15,446,074

Common stock, par value $1.00; 90,000,000 shares authorized; 15,553,037 issued and outstanding at September 30, 2007 and 15,446,074 issued and outstanding at December 31, 2006		
Additional paid-in capital	213,644,006	211,502,516
Retained earnings	47,908,839	31,109,324
Accumulated other comprehensive loss, net of deferred income taxes	(2,469,452)	(2,040,893)
Total stockholders' equity	274,636,430	256,017,021
Total liabilities and stockholders' equity	$ 2,368,078,909	$ 2,142,186,863

See accompanying notes to consolidated financial statements.

Table of Contents

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

	Three Months Ended September 30, 2007	Three Months Ended September 30, 2006	Nine Months Ended September 30, 2007	Nine Months Ended September 30, 2006
Interest income:				
Loans, including fees	$ 32,750,403	$ 26,771,110	$ 92,283,516	$ 64,195,835
Securities:				
Taxable	3,387,464	3,240,878	10,127,943	9,250,455
Tax-exempt	743,921	521,240	2,106,857	1,416,862
Federal funds sold and other	1,464,795	806,829	3,075,372	1,591,941
Total interest income	38,346,583	31,340,057	107,593,688	76,455,093
Interest expense:				
Deposits	16,043,425	11,800,394	44,037,317	27,213,738
Securities sold under agreements to repurchase	2,061,333	1,382,418	5,664,167	2,569,383
Federal funds purchased and other borrowings	1,282,159	997,899	4,189,055	3,110,660
Total interest expense	19,386,917	14,180,711	53,890,539	32,893,781
Net interest income	18,959,666	17,159,346	53,703,149	43,561,312
Provision for loan losses	772,064	586,589	2,460,028	2,680,638
Net interest income after provision for loan losses	18,187,602	16,572,757	51,243,121	40,880,674
Noninterest income:				
Service charges on deposit accounts	1,965,965	1,357,280	5,683,199	3,151,664
Investment sales commissions	868,738	644,931	2,453,505	1,811,428
Insurance sales commissions	563,367	549,584	1,829,282	1,562,946
Gain on loans and loan participations sold, net	378,682	490,254	1,380,883	1,285,609
Trust fees	466,581	311,997	1,312,076	675,994
Other noninterest income	1,088,430	1,069,811	3,249,918	2,364,592
Total noninterest income	5,331,763	4,423,857	15,908,863	10,852,233
Noninterest expense:				
Compensation and employee benefits	9,106,256	7,576,011	26,167,610	19,314,365
Equipment and occupancy	2,632,747	2,070,727	7,209,977	5,325,274
Marketing and other business development	375,066	351,432	1,057,092	899,807
Postage and supplies	474,083	487,689	1,453,197	1,118,308
Amortization of core deposit intangible	515,754	534,957	1,547,262	1,248,335
Other noninterest expense	2,005,752	1,815,392	5,282,516	3,999,832
Merger related expense	-	218,167	-	1,582,734
Total noninterest expense	15,109,658	13,054,375	42,717,654	33,488,655
Income before income taxes	8,409,707	7,942,239	24,434,330	18,244,252
Income tax expense	2,637,897	2,595,465	7,634,815	5,963,112
Net income	$ 5,771,810	$ 5,346,774	$ 16,799,515	$ 12,281,140
Per share information:				
Basic net income per common share	$ 0.37	$ 0.35	$ 1.09	$ 0.91
Diluted net income per common share	$ 0.35	$ 0.32	$ 1.01	$ 0.84

Weighted average shares outstanding:				
Basic	15,503,284	15,393,735	15,477,339	13,450,282
Diluted	16,609,328	16,655,349	16,630,311	14,649,418

See accompanying notes to consolidated financial statements.

Table of Contents

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

For the nine months ended September 30, 2007 and 2006

	Common Stock						
	Shares	**Amount**	**Additional Paid-in Capital**	**Unearned Compensation**	**Retained Earnings**	**Accumulated Other Comprehensive Loss**	**Total Stockholders' Equity**
Balances, December 31, 2005	8,426,551	$ 8,426,551	$ 44,890,912	$ (169,689)	$ 13,182,291	$ (2,893,640)	$ 63,436,425
Transfer of unearned compensation to additional paid-in capital upon adoption of SFAS No. 123(R)	-	-	(169,689)	169,689	-	-	-
Exercise of employee common stock options and related tax benefits	93,435	93,435	964,582	-	-	-	1,058,017
Issuance of restricted common shares pursuant to 2004 Equity Incentive Plan	22,057	22,057	(22,057)	-	-	-	-
Exercise of director common stock warrants	11,000	11,000	44,000	-	-	-	55,000
Stock based compensation expense	-	-	1,001,372	-	-	-	1,001,372
Dividends paid to minority interest shareholders of PNFP Properties, Inc.	-	-	-	-	(7,813)	-	(7,813)
Merger with Cavalry Bancorp, Inc.	6,856,298	6,856,298	164,231,274	-	-	-	171,087,572

Costs to register common stock issued in connection with the merger with Cavalry Bancorp, Inc.	-	-	(187,609)	-	-	-	(187,609)
Comprehensive income:							
Net income	-	-	-	-	12,281,140	-	12,281,140
Net unrealized holding gains on available-for-sale securities, net of deferred tax expense of $205,497	-	-	-	-	-	335,284	335,284
Total comprehensive income							12,616,424
Balances, September 30, 2006	15,409,341	$ 15,409,341	$ 210,752,785	$ -	$ 25,455,618	$ (2,558,356)	$ 249,059,388
Balances, December 31, 2006	15,446,074	$ 15,446,074	$ 211,502,516	$ -	$ 31,109,324	$ (2,040,893)	$ 256,017,021
Exercise of employee common stock options and related tax benefits	78,437	78,437	645,118	-	-	-	723,555
Issuance of restricted common shares pursuant to 2004 Equity Incentive Plan	28,526	28,526	(28,526)	-	-	-	-
Stock based compensation expense	-	-	1,524,898	-	-	-	1,524,898
Comprehensive income:							
Net income	-	-	-	-	16,799,515	-	16,799,515
Net unrealized holding losses on available-for-sale securities, net of deferred tax benefit of	-	-	-	-	-	(428,559)	(428,559)

$262,665							
Total comprehensive income							16,370,956
Balances, September 30, 2007	15,553,037	$ 15,553,037	$ 213,644,006	$ -	$ 47,908,839	$ (2,469,452)	$ 274,636,430

See accompanying notes to consolidated financial statements.

Table of Contents

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

	Nine months ended September 30, 2007	Nine months ended September 30, 2006
Operating activities:		
Net income	$ 16,799,515	$ 12,281,140
Adjustments to reconcile net income to net cash provided by operating activities:		
Net amortization of premium on securities	376,450	591,794
Depreciation and net amortization	2,010,487	1,263,375
Provision for loan losses	2,460,028	2,680,638
Gains on loans and loan participations sold, net	(1,380,883)	(1,285,609)
Stock-based compensation expense	1,524,898	1,001,372
Deferred tax (benefit) expense	1,587,523	(1,110,490)
Excess tax benefit from stock compensation	(128,678)	(110,244)
Mortgage loans held for sale:		
Loans originated	(125,018,617)	(104,455,073)
Loans sold	126,137,833	102,030,399
(Increase) decrease in other assets	1,728,650	(3,580,936)
Decrease in other liabilities	(3,461,145)	(9,368,829)
Net cash provided (used in) by operating activities	22,636,061	(62,463)
Investing activities:		
Activities in securities available-for-sale:		
Purchases	(36,988,675)	(38,573,610)
Sales	-	-
Maturities, prepayments and calls	30,193,241	26,320,244
	(6,795,434)	(12,253,366)
Increase in loans, net	(232,911,778)	(205,522,296)
Purchases of premises and equipment and software	(5,097,092)	(3,708,595)
Cash and cash equivalents acquired in merger with Cavalry Bancorp, Inc., net of acquisition costs	-	37,420,210
Investments in unconsolidated subsidiaries and other entities	(1,222,570)	(65,647)
Purchases of other assets	-	(1,206,335)
Net cash used in investing activities	(246,026,874)	(185,336,029)
Financing activities:		
Net increase in deposits	205,095,262	192,206,552
Net increase in securities sold under agreements to repurchase	4,315,965	56,520,032
Net increase in Federal funds purchased	19,986,000	-
Advances from Federal Home Loan Bank:		
Issuances	35,000,000	31,000,000
Payments	(53,040,828)	(61,527,218)
Proceeds from the issuance of subordinated debt	-	20,619,000
Exercise of common stock warrants	-	55,000
Exercise of common stock options	594,877	947,773
Excess tax benefit from stock compensation	128,678	110,244

Costs incurred in connection with registration of common stock issued in merger	-	(187,609)
Net cash provided by financing activities	212,079,954	239,743,774
Net increase (decrease) in cash and cash equivalents	(11,310,859)	54,345,282
Cash and cash equivalents, beginning of period	92,518,850	58,654,270
Cash and cash equivalents, end of period	$ 81,207,991	$ 112,999,552

See accompanying notes to consolidated financial statements.

Table of Contents

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 with operations in Nashville and Knoxville, Tennessee. Pinnacle National provides a full range of financial services, including banking, investments, mortgages, and insurance.

Basis of Presentation — 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 Collateral Plus, LLC, 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. The unaudited consolidated financial statements include, in the opinion of management, all adjustments necessary for a fair presentation of such financial statements for all periods presented. On the Consolidated Statements of Cash Flows for the nine months ended September 30, 2006, Pinnacle Financial reclassified $2.4 million of amortization of intangible assets arising from the acquisition of Cavalry Bancorp, Inc. ("Cavalry") to properly reflect the cash flow from operations for that period.

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.

Impairment— Long-lived assets, including purchased intangible assets subject to amortization, such as Pinnacle Financial's core deposit intangible asset, are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset to estimated undiscounted future cash flows expected to be generated by the asset. If the carrying amount of an asset exceeds its estimated future cash flows, an impairment charge is recognized for the excess of the carrying amount over the fair value of the asset. Assets to be disposed of are reported at the lower of the carrying amount or fair value less costs to sell, and are no longer depreciated.

Goodwill and intangible assets that have indefinite useful lives are tested annually for impairment and more frequently if events and circumstances indicate that the asset might be impaired. An impairment loss is recognized to the extent that the carrying amount exceeds the asset's fair value. Pinnacle Financial's annual assessment date is as of September 30 such that the assessment will be completed during the fourth quarter of each year. Should Pinnacle Financial determine in a future period that the goodwill recorded in connection with the acquisition of Cavalry has been impaired, then a charge to earnings will be recorded in the period such determination is made.

Cash and Cash Flows — Cash on hand, cash items in process of collection, amounts due from banks, Federal funds sold and securities purchased under agreements to resell, with original maturities within ninety days, are included in cash and cash equivalents. The following supplemental cash flow information addresses certain cash payments and noncash transactions for each of the nine months ended September 30, 2007 and 2006 as follows:

	For the nine months ended September 30,	
	2007	***2006***
Cash Payments:		
Interest	$ 53,491,752	$ 34,444,269
Income taxes	7,850,000	6,380,000
Noncash Transactions:		
Loans charged-off to the allowance for loan losses	809,703	627,838
Loans foreclosed upon with repossessions transferred to other assets	240,878	-
Common stock and options issued to acquire Cavalry Bancorp, Inc	-	171,087,572

Table of Contents

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

Income Per Common Share — Basic earnings per 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 was attributable to common stock options, warrants and restricted shares. The dilutive effect of outstanding options, warrants and restricted shares is reflected in diluted earnings per share by application of the treasury stock method.

As of September 30, 2007 and 2006, there were options outstanding to purchase 1,929,000 and 1,562,000 common shares, respectively. Most of these options have exercise prices, compensation costs attributable to future services and excess tax benefits, which when considered in relation to the average market price of Pinnacle Financial's common stock, are considered dilutive and are considered in Pinnacle Financial's diluted income per share calculation for the three and nine months ended September 30, 2007 and 2006. There were common stock options of 352,000, and 177,000 outstanding as of September 30, 2007 and 2006, respectively, which were considered anti-dilutive and thus have not been considered in the diluted earnings per share calculations below. Additionally, as of September 30, 2007 and 2006, Pinnacle Financial had outstanding warrants to purchase 395,000 of common shares which have been considered in the calculation of Pinnacle Financial's diluted net income per share for three and nine months ended September 30, 2007 and 2006.

The following is a summary of the basic and diluted earnings per share calculation for the three and nine months ended September 30, 2007 and 2006:

	For the three months ended September 30,		*For the nine months ended September 30,*	
	2007	***2006***	***2007***	***2006***
Basic earnings per share calculation:				
Numerator - Net income	$ 5,771,810	$ 5,346,774	$ 16,799,515	$ 12,281,140
Denominator - Average common shares outstanding	15,503,284	15,393,735	15,477,339	13,450,282
Basic net income per share	$ 0.37	$ 0.35	$ 1.09	$ 0.91
Diluted earnings per share calculation:				
Numerator - Net income	$ 5,771,810	$ 5,346,774	$ 16,799,515	$ 12,281,140
Denominator - Average common shares outstanding	15,503,284	15,393,735	15,477,339	13,450,282
Dilutive shares contingently issuable	1,106,044	1,261,614	1,152,972	1,199,136
Average diluted common shares outstanding	16,609,328	16,655,349	16,630,311	14,649,418
Diluted net income per share	$ 0.35	$ 0.32	$ 1.01	$ 0.84

Comprehensive Income — SFAS No. 130, "Reporting Comprehensive Income" describes comprehensive income as the total of all components of comprehensive income including net income. Other comprehensive income refers to revenues, expenses, gains and losses that under U.S. generally accepted accounting principles are included in comprehensive income but excluded from net income. Currently, Pinnacle Financial's other comprehensive income consists of unrealized gains and losses, net of deferred income taxes, on securities available-for-sale. Pinnacle Financial's total comprehensive income for the nine months ended September 30, 2007 and 2006 is included in the Consolidated Statements of Stockholders' Equity and Comprehensive Income.

Note 2. Definitive Merger Agreement with Mid-America Bancshares, Inc.

On August 15, 2007, Pinnacle Financial announced that it had entered into a definitive merger agreement to acquire all of the outstanding common stock of Mid-America Bancshares, Inc. ("Mid-America"), a two-bank holding company located in Nashville, Tennessee with approximately $1.1 billion in assets as of September 30, 2007. Terms of the agreement call for each share of Mid-America to be exchanged for 0.4655 Pinnacle shares and $1.50 in cash, which results in the transaction approximating 90 percent paid in Pinnacle Financial shares and 10 percent paid in cash. As of the date the merger was announced, the transaction has an implied purchase price of $196.2 million. Additionally, all Mid-America stock options and stock appreciation rights will be converted to Pinnacle Financial stock options and stock appreciation rights upon the closing of the transaction. Mid-America was formed in 2006 for the purpose of combining two Nashville community banks: PrimeTrust Bank and Bank of the South, both founded in 2001. Subject to receipt of shareholder and regulatory approval and the satisfaction of customary closing conditions, the transaction is expected to close in the fourth quarter of 2007. At that time, Pinnacle Financial will have estimated assets of approximately $3.7 billion with 31 offices in nine counties, including several high-growth counties new to the Pinnacle footprint.

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

The aggregate consideration approximates 6.6 million shares of Pinnacle Financial common stock and $21.3 million in cash. As a result, Mid-America shareholders will own approximately 30 percent of the combined company. Including restricted shares, Mid-America had approximately 14.2 million common shares outstanding as of August 15, 2007. In order to finance the $21.3 million cash component of the aggregate consideration, on October 31, 2007, Pinnacle Financial issued approximately $30 million in trust preferred securities prior to the closing of the Mid-America transaction. The trust preferred securities will bear a floating interest rate based on a spread over 3-month LIBOR of approximately 2.85% which is set each quarter and mature in 2037. Distributions are payable quarterly. Subject to approval by the Federal Reserve Bank of Atlanta, the trust preferred securities may be redeemed prior to maturity at Pinnacle Financial's option beginning in 2012.

Note 3. Merger with Cavalry Bancorp, Inc.

On March 15, 2006, Pinnacle Financial consummated its merger with Cavalry, a one-bank holding company located in Murfreesboro, Tennessee. Pursuant to the merger agreement, Pinnacle acquired all of the outstanding shares of Cavalry common stock via a tax-free exchange whereby Cavalry shareholders received a fixed exchange ratio of 0.95 shares of Pinnacle Financial common stock for each share of Cavalry common stock, or approximately 6.9 million Pinnacle Financial shares. The accompanying consolidated financial statements include the activities of the former Cavalry since March 15, 2006.

In accordance with SFAS No. 141, "Accounting for Business Combinations" ("SFAS No. 141"), SFAS No. 142, "Goodwill and Intangible Assets" ("SFAS No. 142") and SFAS No. 147, "Acquisition of Certain Financial Institutions" ("SFAS No. 147"), Pinnacle Financial recorded at fair value the following assets and liabilities of Cavalry as of March 15, 2006:

Cash and cash equivalents	$ 37,420,210
Investment securities – available-for-sale	39,476,178
Loans, net of an allowance for loan losses of $5,102,296	545,598,367
Goodwill	114,287,640
Core deposit intangible	13,168,236
Other assets	42,936,956
Total assets acquired	792,887,587
Deposits	583,992,422
Federal Home Loan Bank advances	17,766,661
Other liabilities	18,851,261
Total liabilities assumed	620,610,344
Total consideration paid for Cavalry	$ 172,277,243

As shown in the table above, total consideration for Cavalry approximates $172.3 million of which $171.1 million was in the form of Pinnacle Financial common shares and options to acquire Pinnacle Financial common shares and $1.2 million in investment banking fees, attorney's fees and other costs related to the acquisition which have been accounted for as a component of the purchase price. Pinnacle Financial issued 6,856,298 shares of Pinnacle Financial common stock to the former Cavalry shareholders. In accordance with EITF No. 99-12, "Determination of the Measurement Date for the Market Price of Acquirer Securities Issued in a Purchase Business Combination," the consideration shares were valued at $24.53 per common share which represents the average closing price of Pinnacle Financial common stock from the two days prior to the merger announcement on September 30, 2005 through the two days after the merger announcement. Aggregate consideration for the common stock issued was approximately $168.2 million. Additionally, Pinnacle Financial also has assumed the Cavalry Bancorp, Inc. 1999 Stock Incentive Plan (the "Cavalry Plan") pursuant to which Pinnacle is obligated to issue 195,551 shares of Pinnacle Financial common stock upon exercise of stock options awarded to certain former Cavalry employees who held outstanding options as of March 15, 2006. All of these options were fully vested prior to the merger announcement date and expire at various dates between 2011 and 2012. The exercise prices for these stock options range between $10.26 per share and $13.68 per share. In accordance with SFAS No. 141, Pinnacle Financial has considered the fair value of these options in determining the acquisition cost of Cavalry. The fair value of these vested options approximated $2.9 million which has been included as a component of the aggregate purchase price.

Table of Contents

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

In accordance with SFAS Nos. 141 and 142, Pinnacle Financial recognized $13.2 million as a core deposit intangible in connection with its merger with Cavalry. This identified intangible is being amortized over seven years using an accelerated method which anticipates the life of the underlying deposits to which the intangible is attributable. For the nine months ended September 30, 2007 and 2006, $1,547,000 and $1,248,000 of amortization, respectively, was recognized in the accompanying statement of income. Amortization expense associated with this identified intangible will approximate $1.8 million to $2.1 million per year for the next four years with lesser amounts for the remaining two years.

Pinnacle Financial also recorded other adjustments to the carrying value of Cavalry's assets and liabilities in order to reflect the fair value of those net assets in accordance with U.S. generally accepted accounting principles, including a $4.8 million discount associated with the loan portfolio, a $2.9 million premium for Cavalry's certificates of deposit and a $4.6 million premium for Cavalry's land and buildings. Pinnacle Financial also recorded the corresponding deferred tax assets or liabilities associated with these adjustments. The discounts and premiums related to financial assets and liabilities are being amortized into the statements of income using a method that approximates the level yield method over the anticipated lives of the underlying financial assets or liabilities. For the nine months ended September 30, 2007 and 2006, the accretion of the fair value discounts related to the acquired loans and certificates of deposit increased net interest income by approximately $2,061,000 and $2,382,000, respectively. Based on the estimated useful lives of the acquired loans and deposits, Pinnacle Financial expects to recognize increases in net interest income related to accretion of these purchase accounting adjustments of $1.9 million for the remainder of 2007 and in subsequent years.

Statement of Position 03-03, "Accounting for Certain Loans or Debt Securities Acquired in a Transfer" ("SOP 03-03") addresses accounting for differences between contractual cash flows and cash flows expected to be collected from an investor's initial investment in loans or debt securities (loans) acquired in a transfer if those differences are attributable, at least in part, to credit quality. It includes loans acquired in purchase business combinations and applies to all nongovernmental entities, including not-for-profit organizations. The SOP does not apply to loans originated by the entity. At March 15, 2006, Pinnacle Financial identified $3.9 million in loans to which the application of the provisions of SOP 03-03 was required. The purchase accounting adjustments reflect a reduction in loans and the allowance for loan losses of $1.0 million related to Cavalry's impaired loans, thus reducing the carrying value of these loans to $2.9 million as of March 15, 2006. At September 30, 2007, the carrying value of these loans had been reduced to $756,000 due to cash payments received from the borrowers.

The following pro forma income statements assume the merger was consummated on January 1, 2006 and purchase accounting adjustments began to be recorded at that time. The pro forma information does not reflect Pinnacle Financial's results of operations that would have actually occurred had the merger been consummated on such date (dollars in thousands, except per share information).

		Nine months ended September 30, 2006 (1)
Pro Forma Income Statements:		
Net interest income	$	49,855
Provision for loan losses		3,662
Noninterest income		13,249

Noninterest expense:		
Compensation		22,095
Other noninterest expense		15,140
Net income before taxes		22,207
Income tax expense		7,867
Net income	$	14,340
Pro Forma Per Share Information:		
Basic net income per common share	$	0.97
Diluted net income per common share	$	0.89
Weighted average shares outstanding:		
Basic		14,840,326
Diluted		16,039,462

Table of Contents

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

---

(1) In preparation and as a result of the merger during 2006, Cavalry and Pinnacle Financial incurred significant merger related charges of approximately $10.6 million in the aggregate, primarily for severance benefits, accelerated vesting of defined compensation agreements, investment banker fees, etc. Including these charges would have decreased pro forma net income for the nine months ended September 30, 2006 by $7.5 million resulting in net income of $6,841,000 and a basic and fully diluted net income per share of $0.46 and $0.43, respectively.

During the three and nine months ended September 30, 2006, Pinnacle Financial incurred merger integration expense related to the merger with Cavalry of $218,000 and $1,583,000, respectively. These expenses were directly related to the merger, recognized as incurred and reflected on the accompanying consolidated statement of income as merger related expense.

Note 4. Securities

The amortized cost and fair value of securities available-for-sale and held-to-maturity at September 30, 2007 and December 31, 2006 are summarized as follows:

	September 30, 2007			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Securities available-for-sale:				
U.S. Treasury securities	$ -	$ -	$ -	$ -
U.S. government agency securities	37,094,336	39,148	171,478	36,962,006
Mortgage-backed securities	216,191,499	309,176	3,523,811	212,976,864
State and municipal securities	74,509,398	51,644	768,496	73,792,546
Corporate notes and other	1,487,539	-	47,829	1,439,710
	$ 329,282,772	$ 399,968	$ 4,511,614	$ 325,171,126
Securities held-to-maturity:				
U.S. government agency securities	$ 17,747,473	$ -	$ 185,173	$ 17,562,300
State and municipal securities	9,303,464	-	262,350	9,041,114
	$ 27,050,937	$ -	$ 447,523	$ 26,603,414

	December 31, 2006			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Securities available-for-sale:				
U.S. Treasury securities	$ -	$ -	$ -	$ -
U.S. Government agency securities	38,076,428	9,739	457,321	37,628,846
Mortgage-backed securities	220,397,093	455,203	3,028,241	217,824,055
State and municipal securities	62,215,952	131,412	388,124	61,959,240
Corporate notes and other	1,887,475	-	62,188	1,825,287
	$ 322,576,948	$ 596,354	$ 3,935,874	$ 319,237,428

Securities held-to-maturity:				
U.S. government agency securities	$ 17,747,228	$ -	$ 378,528	$ 17,368,700
State and municipal securities	9,509,648	-	284,113	9,225,535
	$ 27,256,876	$ -	$ 662,641	$ 26,594,235

At September 30, 2007, approximately $176,081,000 of Pinnacle Financial's investment portfolio was pledged to secure public funds and other deposits and securities sold under agreements to repurchase.

Table of Contents

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

At September 30, 2007 and December 31, 2006, included in securities were the following investments with unrealized losses. The information below classifies these investments according to the term of the unrealized loss of less than twelve months or twelve months or longer:

	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 September 30, 2007:						
U.S. government agency securities	$ -	$ -	$ 42,161,570	$ 356,651	$ 42,161,570	$ 356,651
Mortgage-backed securities	35,898,115	258,967	127,576,903	3,264,844	163,475,018	3,523,811
State and municipal securities	33,377,347	254,388	35,579,684	776,458	68,957,031	1,030,846
Corporate notes and other	-	-	1,439,710	47,829	1,439,710	47,829
Total temporarily-impaired securities	$ 69,275,462	$ 513,355	$ 206,757,867	$ 4,445,782	$ 276,033,329	$ 4,959,137
At December 31, 2006:						
U.S. government agency securities	$ -	$ -	$ 47,988,246	$ 835,849	$ 47,988,246	$ 835,849