

FIRST HORIZON NATIONAL CORP  
Form 10-Q  
November 07, 2007

FORM 10-Q

SECURITIES AND EXCHANGE COMMISSION  
Washington, D. C. 20549

(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

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission file number 001-15185

CIK number 0000036966

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

Tennessee  
(State or other jurisdiction of  
incorporation or organization)

62-0803242  
(I.R.S. Employer  
Identification No.)

165 Madison Avenue, Memphis, Tennessee  
(Address of principal executive offices)

38103  
(Zip Code)

(901) 523-4444  
(Registrant's telephone number, including area code)

(Former name, former address and former fiscal year,  
if changed 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 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  Accelerated filer  Non-accelerated filer

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

Yes \_\_\_ No x

APPLICABLE ONLY TO CORPORATE ISSUERS:

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

Common Stock, \$.625 par value

126,387,854

Class

Outstanding on September 30, 2007

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FIRST HORIZON NATIONAL CORPORATION

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PART I.

FINANCIAL INFORMATION

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This financial information reflects all adjustments that are, in the opinion of management, necessary for a fair presentation of the financial position and results of operations for the interim periods presented.

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**CONSOLIDATED CONDENSED STATEMENTS  
OF CONDITION****First Horizon National Corporation**

<i>(Dollars in thousands)(Unaudited)</i>	2007	September 30 2006	December 31 2006
<b>Assets:</b>			
Cash and due from banks	\$ 936,707	\$ 872,528	\$ 943,555
Federal funds sold and securities purchased under agreements to resell	1,096,624	1,992,426	1,202,537
Total cash and cash equivalents	2,033,331	2,864,954	2,146,092
Investment in bank time deposits	30,993	17,798	18,037
Trading securities	1,734,653	2,512,744	2,230,745
Loans held for sale	2,900,464	2,798,281	2,873,577
Loans held for sale-divestiture	565,492	-	-
Securities available for sale	3,076,120	4,013,634	3,923,215
Securities held to maturity (fair value of \$241 on September 30, 2007; \$373 on September 30, 2006; and \$272 on December 31, 2006)	240	369	269
Loans, net of unearned income	21,973,004	21,955,030	22,104,905
Less: Allowance for loan losses	236,611	206,829	216,285
Total net loans	21,736,393	21,748,201	21,888,620
Mortgage servicing rights, net	1,470,589	1,498,341	1,533,942
Goodwill	267,228	274,534	275,582
Other intangible assets, net	58,738	70,546	64,530
Capital markets receivables	1,219,720	1,027,927	732,282
Premises and equipment, net	411,515	441,659	451,708
Real estate acquired by foreclosure	75,656	65,224	63,519
Discontinued assets	-	939,728	416
Other assets	1,874,497	1,802,243	1,715,725
Other assets-divestiture	22,623	-	-
<b>Total assets</b>	<b>\$ 37,478,252</b>	<b>\$ 40,076,183</b>	<b>\$ 37,918,259</b>
<b>Liabilities and shareholders' equity:</b>			
Deposits:			
Savings	\$ 3,592,732	\$ 3,256,680	\$ 3,354,180
Time deposits	2,822,792	2,906,424	2,924,050
Other interest-bearing deposits	1,674,624	1,742,276	1,969,700
Interest-bearing deposits-divestiture	361,368	-	-
Certificates of deposit \$100,000 and more	5,142,169	11,920,226	6,517,629
Certificates of deposit \$100,000 and more-divestiture	41,037	-	-

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Interest-bearing	13,634,722	19,825,606	14,765,559
Noninterest-bearing	4,928,233	5,458,935	5,447,673
Noninterest-bearing-divestiture	72,404	-	-
Total deposits	18,635,359	25,284,541	20,213,232
Federal funds purchased and securities			
sold under agreements to repurchase	4,039,827	2,416,974	4,961,799
Trading liabilities	543,060	847,453	789,957
Commercial paper and other short-term borrowings	2,396,316	926,292	1,258,513
Term borrowings	6,015,954	5,226,772	5,243,961
Other collateralized borrowings	784,599	260,416	592,399
Total long-term debt	6,800,553	5,487,188	5,836,360
Capital markets payables	1,053,349	989,332	799,489
Discontinued liabilities	-	6,977	6,966
Other liabilities	1,253,295	1,311,628	1,294,283
Other liabilities-divestiture	39,389	-	-
Total liabilities	34,761,148	37,270,385	35,160,599
Preferred stock of subsidiary	295,277	295,274	295,270
<b>Shareholders' equity</b>			
Preferred stock - no par value (5,000,000 shares authorized, but unissued)	-	-	-
Common stock - \$.625 par value (shares authorized - 400,000,000;			
shares issued and outstanding - 126,387,854 on September 30, 2007;			
124,467,143 on September 30, 2006; and	78,992	77,792	78,041
124,865,982 on December 31, 2006)			
Capital surplus	360,016	301,857	312,521
Undivided profits	2,048,689	2,124,312	2,144,276
Accumulated other comprehensive (loss)/ income, net	(65,870)	6,563	(72,448)
Total shareholders' equity	2,421,827	2,510,524	2,462,390
<b>Total liabilities and shareholders' equity</b>	<b>\$ 37,478,252</b>	<b>\$ 40,076,183</b>	<b>\$ 37,918,259</b>

See accompanying notes to consolidated condensed financial statements.

Certain previously reported amounts have been reclassified to agree with current presentation.



**CONSOLIDATED CONDENSED  
STATEMENTS OF INCOME**

	<b>First Horizon National Corporation</b>			
	Three Months Ended September 30		Nine Months Ended September 30	
	2007	2006	2007	2006
<i>(Dollars in thousands except per share data)(Unaudited)</i>				
<b>Interest income:</b>				
Interest and fees on loans	\$ 413,275	\$ 416,898	\$ 1,236,956	\$ 1,173,832
Interest on investment securities	44,990	54,138	146,365	132,024
Interest on loans held for sale	66,570	72,135	191,338	224,309
Interest on trading securities	41,898	44,850	132,530	126,963
Interest on other earning assets	16,002	24,577	53,634	67,421
Total interest income	<b>582,735</b>	612,598	<b>1,760,823</b>	1,724,549
<b>Interest expense:</b>				
Interest on deposits:				
Savings	29,140	25,083	85,090	62,256
Time deposits	34,745	32,090	101,337	86,544
Other interest-bearing deposits	6,179	6,562	19,876	18,474
Certificates of deposit \$100,000 and more	92,557	130,875	309,463	360,239
Interest on trading liabilities	10,295	19,233	40,928	57,503
Interest on short-term borrowings	75,114	66,871	211,210	190,495
Interest on long-term debt	96,901	80,263	278,264	198,098
Total interest expense	<b>344,931</b>	360,977	<b>1,046,168</b>	973,609
<b>Net interest income</b>	<b>237,804</b>	251,621	<b>714,655</b>	750,940
Provision for loan losses	43,352	23,694	116,246	60,146
<b>Net interest income after provision for loan losses</b>	<b>194,452</b>	227,927	<b>598,409</b>	690,794
<b>Noninterest income:</b>				
Capital markets	63,722	95,215	235,889	290,238
Mortgage banking	39,022	85,935	183,419	283,089
Deposit transactions and cash management	44,863	44,503	127,300	125,282
Revenue from loan sales and securitizations	4,774	11,830	24,052	35,399
Insurance commissions	6,747	10,534	24,210	37,681
Trust services and investment management	9,922	9,609	30,238	31,090
Equity securities gains, net	-	8,757	2,967	10,271
Debt securities gains/(losses), net	-	-	6,292	(78,902)
All other income and commissions	34,425	51,544	132,595	116,401
Total noninterest income	<b>203,475</b>	317,927	<b>766,962</b>	850,549
<b>Adjusted gross income after provision for loan losses</b>	<b>397,927</b>	545,854	<b>1,365,371</b>	1,541,343
<b>Noninterest expense:</b>				
Employee compensation, incentives and benefits	236,683	260,351	741,217	766,288
Occupancy	34,778	29,745	96,964	87,372
Equipment rentals, depreciation and maintenance	17,270	17,893	56,674	56,015
Operations services	18,774	17,976	54,052	52,491

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Communications and courier	<b>10,959</b>	12,950	<b>33,245</b>	41,271
Amortization of intangible assets	<b>2,647</b>	3,233	<b>8,095</b>	9,002
Goodwill impairment	<b>13,010</b>	-	<b>13,010</b>	-
All other expense	<b>87,501</b>	110,751	<b>278,617</b>	298,552
Total noninterest expense	<b>421,622</b>	452,899	<b>1,281,874</b>	1,310,991
<b>(Loss)/ income before income taxes</b>	<b>(23,695)</b>	92,955	<b>83,497</b>	230,352
(Benefit)/provision for income taxes	<b>(9,330)</b>	25,776	<b>5,611</b>	55,830
<b>(Loss)/ income from continuing operations</b>	<b>(14,365)</b>	67,179	<b>77,886</b>	174,522
Income/ (loss) from discontinued operations, net of tax	<b>209</b>	(69)	<b>628</b>	210,580
<b>(Loss)/ income before cumulative effect of changes in accounting principle</b>	<b>(14,156)</b>	67,110	<b>78,514</b>	385,102
Cumulative effect of changes in accounting principle, net of tax	-	-	-	1,345
<b>Net (loss)/ income</b>	<b>\$ (14,156)</b>	<b>\$ 67,110</b>	<b>\$ 78,514</b>	<b>\$ 386,447</b>
(Loss)/ earnings per common share from continuing operations	<b>\$ (.11)</b>	<b>\$ .54</b>	<b>\$ .62</b>	<b>\$ 1.40</b>
Earnings per common share from discontinued operations, net of tax	-	-	-	1.69
Earnings per common share from cumulative effect of changes in accounting principle	-	-	-	.02
<b>(Loss)/ earnings per common share (Note 7)</b>	<b>\$ (.11)</b>	<b>\$ .54</b>	<b>\$ .62</b>	<b>\$ 3.11</b>
(Loss)/ diluted earnings per common share from continuing operations	<b>\$ (.11)</b>	<b>\$ .53</b>	<b>\$ .61</b>	<b>\$ 1.36</b>
Diluted earnings per common share from discontinued operations, net of tax	-	-	-	1.65
Diluted earnings per common share from cumulative effect of changes in accounting principle	-	-	-	.01
<b>(Loss)/ diluted earnings per common share (Note 7)</b>	<b>\$ (.11)</b>	<b>\$ .53</b>	<b>\$ .61</b>	<b>\$ 3.02</b>
<b>Weighted average common shares (Note 7)</b>	<b>126,058</b>	124,150	<b>125,760</b>	124,431
<b>Diluted average common shares (Note 7)</b>	<b>126,058</b>	127,523	<b>127,823</b>	127,962

See accompanying notes to consolidated condensed financial statements.

Certain previously reported amounts have been reclassified to agree with current presentation.

**CONSOLIDATED CONDENSED STATEMENTS OF SHAREHOLDERS' EQUITY**

*(Dollars in thousands)(Unaudited)*

Balance, January 1

**First Horizon National Corporation**

**2007**

**2006**

**\$2,462,390**

**\$2,347,539**



Adjustment to reflect change in accounting for tax benefits (FIN 48)	(862)	-
Adjustment to reflect adoption of measurement date provisions for SFAS No. 158	6,233	-
Adjustment to reflect change in accounting for purchases of life insurance (EITF Issue No. 06-5)	(548)	-
Net income	78,514	386,447
Other comprehensive income:		
Unrealized fair value adjustments, net of tax:		
Cash flow hedges	(268)	434
Securities available for sale	(5,591)	48,373
Recognized pension and other employee benefit plans net periodic benefit costs	4,127	-
Comprehensive income	76,782	435,254
Cash dividends declared	(170,620)	(168,065)
Common stock repurchased	(1,099)	(165,569)
Common stock issued for:		
Stock options and restricted stock	34,243	49,432
Acquisitions	-	486
Excess tax benefit from stock-based compensation arrangements	6,261	3,592
Adjustment to reflect change in accounting for employee stock option forfeitures	-	(1,780)
Stock-based compensation expense	9,016	9,635
Other	31	-
<b>Balance, September 30</b>	<b>\$2,421,827</b>	<b>\$2,510,524</b>

See accompanying notes to consolidated condensed financial statements.

## CONSOLIDATED CONDENSED STATEMENTS OF CASH FLOWS

**First Horizon National Corporation**  
Nine Months Ended September 30

(All amounts in thousands)(Unaudited)

	2007	2006
<b>Operating</b> Net income	\$ 78,514	\$ 386,447
<b>Activities</b> Adjustments to reconcile net income to net cash provided/(used) by operating activities:		
Provision for loan losses	116,246	60,100
Provision for deferred income tax	5,611	55,800
Depreciation and amortization of premises and equipment	44,286	39,700
Amortization of intangible assets	8,095	9,200
Net other amortization and accretion	48,978	61,100
Decrease in derivatives, net	(103,163)	(164,300)
Market value adjustment on mortgage servicing rights	258	(35,800)
Provision for foreclosure reserve	4,144	9,200
Cumulative effect of changes in accounting principle, net of tax	-	(1,300)
Gain on divestiture	-	(208,500)
Stock-based compensation expense	9,016	9,600
Excess tax benefit from stock-based compensation arrangements	(6,261)	(3,500)
Equity securities gains, net	(2,967)	(10,200)
Debt securities (gains)/losses, net	(6,292)	78,900
Net losses on disposal of fixed assets	1,093	3,100

Net (increase)/decrease in:		
Trading securities	<b>496,092</b>	(379,3
Loans held for sale	<b>(26,887)</b>	1,619,3
Capital markets receivables	<b>(487,438)</b>	(516,4
Interest receivable	<b>3,466</b>	(22,2
Other assets	<b>24,965</b>	(1,132,6
Net increase/(decrease) in:		
Capital markets payables	<b>253,860</b>	398,0
Interest payable	<b>4,984</b>	49,0
Other liabilities	<b>(74,502)</b>	40,4
Trading liabilities	<b>(246,897)</b>	53,8
Total adjustments	<b>66,687</b>	13,2
Net cash provided by operating activities	<b>145,201</b>	399,6
Investing Held to maturity securities:		
Maturities	<b>29</b>	
Available for sale securities:		
Sales	<b>636,188</b>	2,286,8
Maturities	<b>765,601</b>	514,3
Purchases	<b>(543,545)</b>	(3,854,0
Premises and equipment:		
Sales	<b>-</b>	
Purchases	<b>(24,194)</b>	(75,9
Net increase in loans	<b>(581,368)</b>	(1,499,5
Net increase in investment in bank time deposits	<b>(12,952)</b>	(7,1
Proceeds from divestitures, net of cash and cash equivalents	<b>-</b>	280,0
Acquisitions, net of cash and cash equivalents acquired	<b>-</b>	(4
Net cash provided/(used) by investing activities	<b>239,759</b>	(2,355,8
Financing Common stock:		
Exercise of stock options	<b>34,450</b>	49,4
Cash dividends paid	<b>(168,506)</b>	(167,5
Repurchase of shares	<b>(1,099)</b>	(165,5
Excess tax benefit from stock-based compensation arrangements	<b>6,261</b>	3,5
Long-term debt:		
Issuance	<b>1,222,431</b>	2,234,1
Payments	<b>(265,056)</b>	(189,6
Issuance of preferred stock of subsidiary	<b>8</b>	
Repurchase of preferred stock of subsidiary	<b>(1)</b>	
Net increase/(decrease) in:		
Deposits	<b>(1,577,872)</b>	1,848,3
Short-term borrowings	<b>251,663</b>	(1,194,4
Net cash (used)/provided by financing activities	<b>(497,721)</b>	2,418,2
Net (decrease)/increase in cash and cash equivalents	<b>(112,761)</b>	462,0
Cash and cash equivalents at beginning of period	<b>2,146,092</b>	2,402,8
Cash and cash equivalents at end of period	<b>\$2,033,331</b>	\$2,864,9
Cash and cash equivalents from discontinued operations at beginning of period, included above	<b>\$ -</b>	\$ -
Total interest paid	<b>1,039,828</b>	923,1
Total income taxes paid	<b>14,016</b>	105,7

accompanying notes to consolidated condensed financial statements.

ain previously reported amounts have been reclassified to agree with current presentation.



**Note 1 - Financial Information**

The unaudited interim consolidated financial statements of First Horizon National Corporation (FHN), including its subsidiaries, have been prepared in conformity with accounting principles generally accepted in the United States of America and follow general practices within the industries in which it operates. This preparation requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. These estimates and assumptions are based on information available as of the date of the financial statements and could differ from actual results. In the opinion of management, all necessary adjustments have been made for a fair presentation of financial position and results of operations for the periods presented. The operating results for the interim 2007 periods are not necessarily indicative of the results that may be expected going forward. For further information, refer to the audited consolidated financial statements in the 2006 Annual Report to shareholders.

**Income Taxes.** FHN or one of its subsidiaries files income tax returns in the U.S. federal jurisdiction and various states jurisdictions. With few exceptions, FHN is no longer subject to U.S. federal or state and local income tax examinations by tax authorities for years before 2002. The Internal Revenue Service (IRS) has completed its examination of all U.S. federal returns through 2004; although 2003 and 2004 remain open under the statute. All proposed adjustments with respect to examinations of federal returns filed for 2004 and prior years have been settled.

FHN adopted the provisions of FASB Interpretation No. 48, "Accounting for Uncertainty in Income Taxes" (FIN 48), on January 1, 2007. As a result of the implementation of FIN 48, FHN recognized a \$.9 million increase in the liability for unrecognized tax benefits, which was accounted for as a reduction to the January 1, 2007, balance of undivided profits. The total balance of unrecognized tax benefits at January 1, 2007, was \$41.0 million. First Horizon does not expect that unrecognized tax benefits will significantly increase or decrease within the next 12 months. Included in the balance at January 1, 2007, were \$15.6 million of tax positions for which the ultimate deductibility is highly certain but for which there is uncertainty about the timing of such deductibility. Because of the impact of deferred tax accounting, other than interest, the disallowance of the shorter deductibility period would not affect the annual effective tax rate but would accelerate the payment of cash to the taxing authority to an earlier period. FHN recognizes interest accrued related to unrecognized tax benefits in tax expense and penalties in tax expense. FHN had approximately \$4.8 million accrued for the payment of interest at January 1, 2007. As of September 30, 2007, no significant changes to these amounts have occurred since the adoption of FIN 48.

**Accounting Changes.** Effective January 1, 2007, FHN adopted Statement of Financial Accounting Standards No. 155, "Accounting for Certain Hybrid Financial Instruments" (SFAS No. 155), which permits fair value remeasurement for hybrid financial instruments that contain an embedded derivative that otherwise would require bifurcation. Additionally, SFAS No. 155 clarifies the accounting guidance for beneficial interests in securitizations. Under SFAS No. 155, all beneficial interests in a securitization require an assessment in accordance with SFAS No. 133 to determine if an embedded derivative exists within the instrument. In addition, effective January 1, 2007, FHN adopted Derivatives

Implementation Group Issue B40, "Application of Paragraph 13(b) to Securitized Interests in Prepayable Financial Assets" (DIG B40). DIG B40 provides an exemption from the embedded derivative test of paragraph 13(b) of SFAS No. 133 for instruments that would otherwise require bifurcation if the test is met solely because of a prepayment feature included within the securitized interest and prepayment is not controlled by the security holder. Since FHN presents all retained interests in its proprietary securitizations as trading securities and due to the clarifying guidance of DIG B40, the impact of adopting SFAS No. 155 was immaterial to the results of operations.

Effective January 1, 2007, FHN adopted FIN 48 which provides guidance for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. FIN 48 also provides guidance on the classification and disclosure of uncertain tax positions in the financial statements. As previously mentioned, upon

adoption of FIN 48, FHN recognized a cumulative effect adjustment to the beginning balance of undivided profits in the amount of \$.9 million for differences between the tax benefits recognized in the statements of condition prior to the adoption of FIN 48 and the amounts reported after adoption.

Effective January 1, 2007, FHN adopted EITF Issue No. 06-5, "Accounting for Purchases of Life Insurance—Determining the Amount That Could Be Realized in Accordance with FASB Technical Bulletin No. 85-4, Accounting for Purchases of Life Insurance" (EITF 06-5). EITF 06-5 provides that in addition to cash surrender value, the asset recognized for a life insurance contract should consider certain other provisions included in a policy's contractual terms with additional amounts being discounted if receivable beyond one year. Additionally, EITF 06-5 requires that the determination of the amount that could be realized under an insurance contract be performed at the individual policy level. FHN recognized a reduction of undivided profits in the amount of \$.5 million as a result of adopting EITF 06-5.

**Note 1 - Financial Information (continued)**

Effective January 1, 2007, FHN elected early adoption of the final provisions of Statement of Financial Accounting Standards No. 158, "Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans—an amendment of FASB Statements No. 87, 88, 106, and 132(R)" (SFAS No. 158), which required that the annual measurement date of a plan's assets and liabilities be as of the date of the financial statements. As a result of adopting the measurement date provisions of SFAS No. 158, total equity was increased by \$6.2 million on January 1, 2007, consisting of a reduction to undivided profits of \$2.1 million and a credit to accumulated other comprehensive income of \$8.3 million. Effective December 31, 2006, FHN adopted the provisions of SFAS No. 158 related to the requirements to recognize the overfunded or underfunded status of a defined benefit postretirement plan as an asset or liability in the statements of condition. SFAS No. 158 did not change measurement or recognition requirements for periodic pension and postretirement costs. SFAS No. 158 also provides that changes in the funded status of a defined benefit postretirement plan should be recognized in the year such changes occur through comprehensive income. As a result of adopting the recognition provisions of SFAS No. 158, unrecognized transition assets and obligations, unrecognized actuarial gains and losses, and unrecognized prior service costs and credits were recognized as a component of accumulated other comprehensive income resulting in a reduction in equity of \$76.7 million, net of tax, on December 31, 2006.

In fiscal 2006, FHN adopted SEC Staff Accounting Bulletin No. 108 (SAB No. 108). SAB No. 108 requires that registrants assess the impact on both the statement of condition and the statement of income when quantifying and evaluating the materiality of a misstatement. Under SAB No. 108, adjustment of financial statements is required when either approach results in quantifying a misstatement that is material to a reporting period presented within the financial statements, after considering all relevant quantitative and qualitative factors. The adoption of SAB No. 108 had no effect on FHN's statement of condition or results of operations.

Effective January 1, 2006, FHN elected early adoption of SFAS No. 156. This amendment to SFAS No. 140 requires servicing rights be initially measured at fair value. Subsequently, companies are permitted to elect, on a class-by-class basis, either fair value or amortized cost accounting for their servicing rights. FHN elected fair value accounting for its MSR. Accordingly, FHN recognized the cumulative effect of a change in accounting principle totaling \$.2 million, net of tax, representing the excess of the fair value of the servicing asset over the recorded value on January 1, 2006.

FHN also adopted Statement of Financial Accounting Standards No. 154, "Accounting Changes and Error Corrections" (SFAS No. 154), as of January 1, 2006. SFAS No. 154 requires retrospective application of voluntary changes in accounting principle. A change in accounting principle mandated by new accounting pronouncements should follow the transition method specified by the new guidance. However, if transition guidance is not otherwise specified, retrospective application will be required. SFAS No. 154 does not alter the accounting requirement for changes in estimates (prospective) and error corrections (restatement). The adoption of SFAS No. 154 did not affect FHN's reported results of operations.

FHN adopted SFAS No. 123-R as of January 1, 2006. SFAS No. 123-R requires recognition of expense over the requisite service period for awards of share-based compensation to employees. The grant date fair value of an award is used to measure the compensation expense to be recognized over the life of the award. For unvested awards granted prior to the adoption of SFAS No. 123-R, the fair values utilized equal the values developed in preparation of the disclosures required under the original SFAS No. 123. Compensation expense recognized after adoption of SFAS No. 123-R incorporates an estimate of awards expected to ultimately vest, which requires estimation of forfeitures as well as projections related to the satisfaction of performance conditions that determine vesting. As permitted by SFAS No. 123-R, FHN retroactively applied the provisions of SFAS No. 123-R to its prior period financial statements. The Consolidated Condensed Statements of Income were revised to incorporate expenses previously presented in the footnote disclosures. The Consolidated Condensed Statements of Condition were revised to reflect the effects of including equity compensation expense in

those prior periods. Additionally, all deferred compensation balances were reclassified within equity to capital surplus. Since FHN's prior disclosures included forfeitures as they occurred, a cumulative effect adjustment, as required by SFAS No. 123-R, of \$1.1 million net of tax, was made for unvested awards that are not expected to vest due to anticipated forfeiture.

**Accounting Changes Issued but Not Currently Effective.** In November 2007, the SEC issued Staff Accounting Bulletin No. 109, "Written Loan Commitments Recorded at Fair Value Through Earnings" (SAB No. 109). SAB No. 109 rescinds SAB No. 105's prohibition on inclusion of expected net future cash flows related to loan servicing activities in the fair value measurement of a written loan commitment. SAB No. 109 also applies to any loan commitments for which fair value accounting is elected under SFAS No. 159. SAB No. 109 is effective prospectively for derivative loan commitments issued or modified in fiscal quarters beginning after December 15, 2007. FHN is currently assessing the financial impact of adopting SAB No. 109.

In June 2007, the American Institute of Certified Public Accountants (AICPA) issued Statement of Position 07-1, "Clarification of the Scope of the Audit and Accounting Guide *Investment Companies* and Accounting by Parent Companies and Equity Method Investors for Investments in Investment Companies" (SOP 07-1), which provides guidance for determining whether an entity is within the scope of the AICPA's Investment Companies Guide. Additionally, SOP 07-1 provides certain criteria that must be met in order for investment company accounting applied by a subsidiary or equity method investee to be retained in the financial statements of the parent company or an equity method investor. SOP 07-1 also provides expanded disclosure requirements regarding the retention of such investment company accounting in the consolidated financial statements. In May 2007, FASB Staff Position No. FIN 46(R)- 7, "Application of FASB Interpretation No. 46(R) to Investment Companies" (FSP FIN 46(R)-7) was issued. FSP FIN 46(R)-7 amends FIN 46(R) to provide a permanent exception to its scope for companies within the scope

**Note 1 - Financial Information (continued)**

of the revised Investment Companies Guide under SOP 07-1. The FASB has indefinitely deferred the effective date of SOP 07-1 and FSP FIN 46(R)-7.

In April 2007, FASB Staff Position No. FIN 39-1, "Amendment of FASB Interpretation No. 39" (FSP FIN 39-1) was issued. FSP FIN 39-1 permits the offsetting of fair value amounts recognized for the right to reclaim cash collateral or the obligation to return cash collateral against fair value amounts recognized for derivative instruments executed with the same counterparty under the same master netting arrangement. Upon adoption of FSP FIN 39-1, entities are permitted to change their previous accounting policy election to offset or not offset fair value amounts recognized for derivative instruments under master netting arrangements. Additionally, FSP FIN 39-1 requires additional disclosures for derivatives and collateral associated with master netting arrangements. FSP FIN 39-1 is effective for fiscal years beginning after November 15, 2007, through retrospective application, with early application permitted. FHN is currently assessing the financial impact of adopting FSP FIN 39-1.

In February 2007, the FASB issued Statement of Financial Accounting Standards No. 159, "The Fair Value Option for Financial Assets and Financial Liabilities" (SFAS No. 159), which allows an irrevocable election to measure certain financial assets and financial liabilities at fair value on an instrument-by-instrument basis, with unrealized gains and losses recognized currently in earnings. Under SFAS No. 159, the fair value option may only be elected at the time of initial recognition of a financial asset or financial liability or upon the occurrence of certain specified events. Additionally, SFAS No. 159 provides that application of the fair value option must be based on the fair value of an entire financial asset or financial liability and not selected risks inherent in those assets or liabilities. SFAS No. 159 requires that assets and liabilities which are measured at fair value pursuant to the fair value option be reported in the financial statements in a manner that separates those fair values from the carrying amounts of similar assets and liabilities which are measured using another measurement attribute. SFAS No. 159 also provides expanded disclosure requirements regarding the effects of electing the fair value option on the financial statements. SFAS No. 159 is effective prospectively for fiscal years beginning after November 15, 2007. FHN is currently assessing the financial impact of adopting SFAS No. 159.

In September 2006, the FASB issued Statement of Financial Accounting Standards No. 157, "Fair Value Measurements" (SFAS No. 157), which establishes a hierarchy to be used in performing measurements of fair value. SFAS No. 157 emphasizes that fair value should be determined from the perspective of a market participant while also indicating that valuation methodologies should first reference available market data before using internally developed assumptions. Additionally, SFAS No. 157 provides expanded disclosure requirements regarding the effects of fair value measurements on the financial statements. SFAS No. 157 is effective prospectively for fiscal years beginning after November 15, 2007. FHN is currently assessing the financial impact of adopting SFAS No. 157.

In September 2006, the consensus reached in EITF Issue No. 06-4, "Accounting for Deferred Compensation and Postretirement Benefit Aspects of Endorsement Split-Dollar Life Insurance Arrangements" (EITF 06-4) was ratified by the FASB. EITF 06-4 requires that a liability be recognized for contracts written to employees which provide future postretirement benefits that are covered by endorsement split-dollar life insurance arrangements because such obligations are not considered to be effectively settled upon entering into the related insurance arrangements. EITF 06-4 is effective for fiscal years beginning after December 15, 2007, with the guidance applied using either a retrospective approach or through a cumulative-effect adjustment to beginning undivided profits. FHN anticipates recognizing a liability, with a corresponding decrease to undivided profits, of approximately \$8 million, net of tax, upon adoption of EITF 06-4.



## Note 2 - Acquisitions/Divestitures

Due to FHN's ongoing efforts to improve profitability, in July 2007 management decided to pursue the sale, closure, or consolidation of 34 full-service First Horizon Bank branches in Atlanta, Baltimore, Dallas and Northern Virginia. In September 2007, it was announced that agreements for the sale of all 34 of the branches had been reached. The branch sales are expected to close by the first quarter of 2008 and are expected to result in a gain up to \$40 million for FHN in the aggregate after recognition of \$13.9 million in impairment losses in the third quarter of 2007. Each of the agreements is to purchase certain loans and fixed assets, including branch locations, and to assume all of the deposit relationships of the First Horizon Bank branches being purchased. The assets and liabilities related to the branches to be sold, which are included in the Retail/Commercial Banking segment, are reflected as held-for-sale on the Consolidated Condensed Statements of Condition. The aggregate carrying amounts of transferred loans, deposits, other assets and other liabilities were \$565.5 million, \$474.8 million, \$22.6 million, and \$39.4 million, respectively, as of September 30, 2007. As a result of impairment assessments completed in relation to two Georgia branches, a goodwill writedown of \$13.0 million and a writedown of core deposit intangibles of \$.9 million were recognized in the third quarter of 2007. The goodwill impairment loss was estimated based on the implied fair value as of September 30, 2007 of the goodwill originally recognized upon FHN's purchase of such branches, and was calculated using the bid price for the associated branches. The fair value of the core deposit intangible asset, which is included in the Retail/Commercial Banking segment, was determined based on the discounted present value of cash flows remaining related to the associated deposit accounts. These impairment losses are included in all other expense on the Consolidated Condensed Statements of Income and are recognized in the Corporate segment as described in Note 12 – Restructuring, Repositioning, and Efficiency Charges.

On June 28, 2006, First Horizon Merchant Services, Inc. (FHMS) sold all of the outstanding capital stock of Global Card Services, Inc. (GCS), a wholly-owned subsidiary. As a result, tax benefits of \$4.2 million were recognized associated with the difference between FHMS' tax basis in the stock and net proceeds from the sale.

On March 1, 2006, FHN sold substantially all the assets of its national merchant processing business conducted primarily through FHMS and GCS. The sale was to NOVA Information Systems (NOVA), a wholly-owned subsidiary of U.S. Bancorp. This transaction resulted in a pre-tax gain of \$351.5 million. In addition, a supplement to the purchase price may be paid to FHN if certain performance goals are achieved during a period following closing. This divestiture was accounted for as a discontinued operation, and prior periods were adjusted to exclude the impact of merchant operations from the results of continuing operations. In conjunction with the sale, FHN entered into a transitional service agreement with NOVA to provide or continue on-going services such as telecommunications, back-end processing and disaster recovery until NOVA converts the operations to their systems.

In addition to the divestitures mentioned above, FHN acquires or divests assets from time to time in transactions that are considered business combinations or divestitures but are not material to FHN individually or in the aggregate.

**Note 3 - Loans**

The composition of the loan portfolio is detailed below:

<i>(Dollars in thousands)</i>	September 30 2007	2006	December 31 2006
Commercial:			
Commercial, financial and industrial	\$ 6,978,643	\$ 6,945,207	\$ 7,201,009
Real estate commercial	1,326,261	1,199,084	1,136,590
Real estate construction	2,828,545	2,660,415	2,753,458
Retail:			
Real estate residential	7,544,048	8,428,652	7,973,313
Real estate construction	2,160,593	2,096,440	2,085,133
Other retail	144,526	163,134	161,178
Credit card receivables	196,967	202,866	203,307
Real estate loans pledged against other collateralized borrowings	793,421	259,232	590,917
Loans, net of unearned income	21,973,004	21,955,030	22,104,905
Allowance for loan losses	236,611	206,829	216,285
Total net loans	\$ 21,736,393	\$ 21,748,201	\$ 21,888,620

Certain previously reported amounts have been reclassified to agree with current presentation.

Nonperforming loans consist of loans which management has identified as impaired, other nonaccrual loans and loans which have been restructured. On September 30, 2007 and 2006, there were no outstanding commitments to advance additional funds to customers whose loans had been restructured. The following table presents nonperforming loans on:

<i>(Dollars in thousands)</i>	September 30 2007	2006	December 31 2006
Impaired loans			