PINNACLE FINANCIAL PARTNERS INC
Form 10-Q
May 05, 2011

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, 2011
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.)
150 Third Avenue South, Suite 800, 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 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 o 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 (do not check if you are a smaller reporting company)	Smaller reporting company 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 May 4, 2011 there were 34,136,278 shares of common stock, $1.00 par value per share, issued and outstanding.

Pinnacle Financial Partners, Inc.
Report on Form 10-Q
March 31, 2011

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FORWARD-LOOKING STATEMENTS

Certain of the statements in this 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 similar express 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 reduction of Pinnacle Financial's loan balances, and conversely, the inability of Pinnacle Financial to ultimately grow its loan portfolio in the Nashville-Davidson-Murfreesboro-Franklin 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 deterioration or lack of sustained growth in the national or local economies including the Nashville-Davidson-Murfreesboro-Franklin MSA and the Knoxville MSA, particularly in commercial and residential real estate markets; (viii) rapid fluctuations or unanticipated changes in interest rates; (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 impact of governmental restrictions on entities participating in the Capital Purchase Program, of the U.S. Department of the Treasury (the "Treasury"); (xiv) further deterioration in the valuation of other real estate owned; (xv) inability to comply with regulatory capital requirements and to secure any required regulatory approvals for capital actions; (xvi) 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; and (xvii) Pinnacle Financial recording a change in the valuation allowance related to its deferred tax asset. A more detailed description of these and other risks is contained in Pinnacle Financial's most recent annual report on Form 10-K filed with the Securities and Exchange Commission on February 23, 2011, as updated in Part II, Item 1A, "Risk Factors," of this Quarterly Report on Form 10-Q. 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 release, whether as a result of new information, future events or otherwise.

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Item 1. Part I. Financial Information

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

	March 31, 2011	December 31, 2010
ASSETS		
Cash and noninterest-bearing due from banks	$ 54,182,339	$ 40,154,247
Interest-bearing due from banks	71,352,180	140,647,481
Federal funds sold	15,236,156	7,284,685
Short-term discount notes	-	499,768
Cash and cash equivalents	140,770,675	188,586,181
Securities available-for-sale, at fair value	980,934,694	1,014,316,831
Securities held-to-maturity (fair value of $3,336,765 and $4,411,856 at March 31, 2011 and December 31, 2010, respectively)	3,265,497	4,320,486
Mortgage loans held-for-sale	8,781,289	16,206,034
Loans	3,217,429,627	3,212,440,190
Less allowance for loan losses	(78,987,905)	(82,575,235)
Loans, net	3,138,441,722	3,129,864,955
Premises and equipment, net	81,532,475	82,374,228
Other investments	42,649,837	42,282,255
Accrued interest receivable	16,518,216	16,364,573
Goodwill	244,083,193	244,090,311
Core deposits and other intangible assets	9,989,201	10,705,105
Other real estate owned	55,999,915	59,608,224
Other assets	98,023,877	100,284,697
Total assets	$ 4,820,990,591	$ 4,909,003,880
LIABILITIES AND STOCKHOLDERS' EQUITY		
Deposits:		
Noninterest-bearing	$ 608,428,298	$ 586,516,637
Interest-bearing	614,171,897	573,670,188
Savings and money market accounts	1,549,354,342	1,596,306,386
Time	959,928,728	1,076,564,179
Total deposits	3,731,883,265	3,833,057,390
Securities sold under agreements to repurchase	165,132,330	146,294,379
Federal Home Loan Bank advances	111,350,749	121,393,026
Subordinated debt	97,476,000	97,476,000
Accrued interest payable	3,951,497	5,197,925
Other liabilities	29,970,374	28,127,875
Total liabilities	4,139,764,215	4,231,546,595
Stockholders' equity:		
Preferred stock, no par value; 10,000,000 shares authorized; 95,000 shares issued and outstanding at March 31, 2011, and December 31, 2010	91,094,656	90,788,682
	34,132,256	33,870,380

Common stock, par value $1.00; 90,000,000 shares authorized; 34,132,256 issued and outstanding at March 31, 2011 and 33,870,380 issued and outstanding at December 31, 2010				
Common stock warrants		3,348,402		3,348,402
Additional paid-in capital		532,311,827		530,829,019
Retained earnings		15,007,452		12,996,202
Accumulated other comprehensive income, net of taxes		5,331,783		5,624,600
Total stockholders' equity		681,226,376		677,457,285
Total liabilities and stockholders' equity	$	4,820,990,591	$	4,909,003,880

See accompanying notes to consolidated financial statements.

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

	Three Months Ended March 31, 2011	Three Months Ended March 31, 2010
Interest income:		
Loans, including fees	$ 38,353,481	$ 41,075,107
Securities:		
Taxable	6,360,899	9,087,588
Tax-exempt	1,935,888	2,050,253
Federal funds sold	574,006	477,142
Total interest income	47,224,274	52,690,090
Interest expense:		
Deposits	9,424,241	13,463,815
Securities sold under agreements to repurchase	381,569	552,313
Federal Home Loan Bank advances and other borrowings	1,397,831	2,114,055
Total interest expense	11,203,641	16,130,183
Net interest income	36,020,633	36,559,907
Provision for loan losses	6,139,138	13,225,920
Net interest income after provision for loan losses	29,881,495	23,333,987
Noninterest income:		
Service charges on deposit accounts	2,261,457	2,365,311
Investment services	1,508,086	1,236,383
Insurance sales commissions	1,049,232	1,099,019
Trust fees	729,988	896,573
Gain on loans sold, net	609,377	562,598
Net (loss) gain on sale of investment securities	(159,103)	364,550
Other noninterest income	2,325,020	1,961,212
Total noninterest income	8,324,057	8,485,646
Noninterest expense:		
Salaries and employee benefits	17,923,622	17,004,526
Equipment and occupancy	5,006,710	5,366,187
Other real estate expense	4,334,118	5,402,153
Marketing and other business development	753,751	753,918
Postage and supplies	489,877	733,539
Amortization of intangibles	715,904	746,001
Other noninterest expense	5,476,846	6,160,231
Total noninterest expense	34,700,828	36,166,555
Income (loss) before income taxes	3,504,724	(4,346,922)
Income tax expense (benefit)	-	(523,697)
Net income (loss)	3,504,724	(3,823,225)
Preferred stock dividends	1,187,500	1,187,500
Accretion on preferred stock discount	305,974	357,994
Net income (loss) available to common stockholders	$ 2,011,250	$ (5,368,719)

Per share information:		
Basic net income (loss) per common share available to common stockholders	$ 0.06	$ (0.16)
Diluted net income (loss) per common share available to common stockholders	$ 0.06	$ (0.16)
Weighted average shares outstanding:		
Basic	33,366,053	32,558,016
Diluted	34,013,810	32,558,016

See accompanying notes to consolidated financial statements.

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

		Common Stock						
	Preferred Stock Amount	Shares	Amount	Common Stock Warrants	Additional Paid-in Capital	Retained Earnings	Accumulated Other Comp. Income, net	T Stock E
Balances, December 31, 2009	$89,462,633	33,029,719	$33,029,719	$3,348,402	$524,366,603	$43,372,743	$7,440,081	$701.
Exercise of employee common stock options, stock appreciation rights, common stock warrants and related tax benefits	-	70,573	70,573	-	636,726	-	-	707.
Issuance of restricted common shares, net of forfeitures	-	258,705	258,705	-	(258,705)	-	-	-
Restricted shares withheld for taxes	-	(7,879)	(7,879)	-	(107,011)	-	-	(114
Compensation expense for restricted shares	-	-	-	-	741,573	-	-	741.
Compensation expense for stock options	-	-	-	-	444,496	-	-	444.
Accretion on preferred stock dividend	357,994	-	-	-	-	(357,994)	-	-
Preferred dividends paid	-	-	-	-	-	(1,187,500)	-	(1,1
Comprehensive income (loss):								
Net loss	-	-	-	-	-	(3,823,225)	-	(3,8
Net unrealized gains on securities available-for-sale, net of deferred tax benefit of	-	-	-	-	-	-	2,473,080	2,47

$1,596,494								
Total comprehensive loss								(1,3
Balances, March 31, 2010	$89,820,627	33,351,118	$33,351,118	$3,348,402	$525,823,682	$38,004,024	$9,913,161	$700.
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.
Exercise of employee common stock options, and related tax benefits	-	106,730	106,730	-	610,337	-	-	717.
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	-	-	97,0
Restricted shares withheld for taxes	-	(16,845)	(16,845)	-	(230,892)	-	-	(247
Compensation expense for restricted shares	-	-	-	-	808,207	-	-	808.
Compensation expense for stock options	-	-	-	-	370,092	-	-	370.
Accretion on preferred stock discount	305,974	-	-	-	-	(305,974)	-	-
Preferred dividends paid	-	-	-	-	-	(1,187,500)	-	(1,1
Comprehensive income (loss):								
Net income	-	-	-	-	-	3,504,724	-	3,50
Net unrealized losses on securities available-for-sale, net of deferred tax benefit of $115,000	-	-	-	-	-	-	(292,817)	(292
Total comprehensive income								3,21
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.

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, 2011	Three months ended March 31, 2010
Operating activities:		
Net income (loss)	$3,504,724	$(3,823,225)
Adjustments to reconcile net income (loss) to net cash provided by operating activities:		
Net amortization/accretion of premium/discount on securities	2,102,529	1,051,879
Depreciation and amortization	2,795,884	2,875,880
Provision for loan losses	6,139,138	13,225,920
Gain on loan sales, net	(609,377)	(562,598)
Loss (gain) on sale of investment securities, net	159,103	(364,550)
Stock-based compensation expense	1,275,354	1,186,069
Deferred tax expense (benefit)	-	(1,529,004)
Losses on foreclosed real estate and other investments	3,297,185	4,819,280
Excess tax benefit from stock compensation	(7,117)	(2,321)
Mortgage loans held for sale:		
Loans originated	(62,944,534)	(70,806,622)
Loans sold	70,980,585	72,195,961
Decrease in other assets	8,577,073	8,397,287
Increase (decrease) in other liabilities	595,804	11,182,734
Net cash provided by operating activities	35,866,351	37,846,690
Investing activities:		
Activities in securities available-for-sale:		
Purchases	(49,158,590)	(161,445,670)
Sales	19,277,990	30,431,826
Maturities, prepayments and calls	60,713,289	79,906,149
Activities in securities held-to-maturity:		
Sales	-	954,389
Maturities, prepayments and calls	1,049,999	1,764,999
Decrease (increase) in loans, net	(21,304,654)	62,168,779
Purchases of premises and equipment	(975,525)	(4,003,674)
Other investments	(238,101)	(927,235)
Net cash provided by investing activities	9,364,408	8,849,563
Financing activities:		
Net (decrease) increase in deposits	(101,153,661)	12,846,742
Net (decrease) increase in securities sold under agreements to repurchase	18,837,951	(74,976,494)
Advances from Federal Home Loan Bank:		
Issuances	-	70,000,000
Payments	(10,019,502)	(125,295,583)
Preferred dividends paid	(1,187,500)	(1,187,500)
Exercise of common stock options and stock appreciation rights	469,330	592,409
Excess tax benefit from stock compensation	7,117	2,321
Net cash used in financing activities	(93,046,265)	(118,018,105)

Net increase in cash and cash equivalents	(47,815,506)	(71,321,852)
Cash and cash equivalents, beginning of period	188,586,181	166,602,074
Cash and cash equivalents, end of period	$ 140,770,675	$ 95,280,222

See accompanying notes to consolidated financial statements.

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. 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 2010 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, PNFP Statutory Trust IV 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.

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, the determination of any impairment of intangible assets, including goodwill, the valuation of other real estate owned, the determination of the valuation of deferred tax assets, and the valuation of our investment portfolio including other-than-temporary impairment.

Loans — Loans are reported at their outstanding principal balances less unearned income, the allowance for loan losses and any deferred fees or costs on originated loans. Interest income on loans is accrued based on the principal balance outstanding. Loan origination fees, net of certain loan origination costs, are deferred and recognized as an adjustment to the related loan yield using a method which approximates the interest method. At March 31, 2011 and December 31, 2010, net deferred loan fees of $348,000 and $579,000, respectively, were included in loans on the accompanying consolidated balance sheets.

Loans are charged off when management believes that the full collectability of the loan is unlikely. As such, a loan may be partially charged-off after a “confirming event” has occurred which serves to validate that full repayment pursuant to the terms of the loan is unlikely.

Loans are placed on nonaccrual status when there is a significant deterioration in the financial condition of the borrower, which often is determined when the principal or interest is more than 90 days past due, unless the loan is both well-secured and in the process of collection. Generally, all interest accrued but not collected for loans that are placed on nonaccrual status is reversed against current income. Interest income is subsequently recognized only to the extent cash payments are received while the loan is classified as nonaccrual, but interest income recognition is reviewed on a case-by-case basis. A nonaccrual loan is returned to accruing status once the loan has been brought current and collection is reasonably assured or the loan has been “well-secured” through other techniques. Past due status is determined based on the contractual due date per the underlying loan agreement.

All loans that are placed on nonaccrual are further analyzed to determine if they should be classified as impaired loans. At December 31, 2010 and at March 31, 2011, there were no loans classified as nonaccrual that were not also deemed to be impaired. A loan is considered to be impaired when it is probable Pinnacle Financial will be unable to collect all principal and interest payments due in accordance with the contractual terms of the loan. This determination is made using a variety of techniques, which include a review of the borrower’s financial condition, debt-service coverage ratios, global cash flow analysis, guarantor support, other loan file information, meetings with borrowers, inspection or reappraisal of collateral and/or consultation with legal counsel as well as results of reviews of other similar industry credits (e.g. builder loans, development loans, church loans, etc). Generally, loans with an identified weakness and principal balance of $250,000 or more are subject to individual identification for impairment. Individually identified impaired loans are measured based on the present value of expected payments using the loan’s original effective rate as the discount rate, the loan’s observable market price, or the fair value of the collateral if the loan is collateral dependent. If the recorded investment in the impaired loan exceeds the measure of fair value, a specific valuation allowance is established as a component of the allowance for loan losses or, in the case of collateral dependent loans, the excess is charged off. Changes to the valuation allowance are recorded as a component of the provision for loan losses. Any subsequent adjustments to present value calculations for impaired loan valuations as a result of the passage of time, such as changes in the anticipated payback period for repayment, are recorded as a component of the provision for loan losses. For loans less than $250,000, Pinnacle Financial assigns a valuation allowance to these loans utilizing an allocation rate equal to the allocation rate calculated for loans of a similar type greater than $250,000. In addition, Pinnacle Financial reviews impaired collateral dependent loans less than $250,000 to determine if any amounts should be charged-off pursuant to regulatory requirements. At March 31, 2011, the principal balance of these small impaired loans was $8.8 million, which represented 11.5% of all impaired loans. Pinnacle Financial does not have any loan portfolios that are collectively evaluated for impairment such as credit card or automobile portfolios.

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

Allowance for Loan Losses —The allowance for loan losses is maintained at a level that management believes to be adequate to absorb probable losses in the loan portfolio. Loan losses are charged against the allowance when they are known. Subsequent recoveries are credited to the allowance. Management's determination of the adequacy of the allowance is based on an evaluation of the portfolio, current economic conditions, volume, growth, composition of the loan portfolio, homogeneous pools of loans, risk ratings of specific loans, historical loan loss factors, loss experience of various loan segments, identified impaired loans and other factors related to the portfolio. This evaluation is performed quarterly and is inherently subjective, as it requires material estimates that are susceptible to significant change including the amounts and timing of future cash flows expected to be received on any impaired loans.

In assessing the adequacy of the allowance, we also consider the results of our ongoing independent loan review process. We undertake this process both to ascertain whether there are loans in the portfolio whose credit quality has weakened over time and to assist in our overall evaluation of the risk characteristics of the entire loan portfolio. Our loan review process includes the judgment of management, independent loan reviewers, and reviews that may have been conducted by third-party reviewers. We incorporate relevant loan review results in the loan impairment determination. In addition, regulatory agencies, as an integral part of their examination process, will periodically review Pinnacle Financial's allowance for loan losses, and may require Pinnacle Financial to record adjustments to the allowance based on their judgment about information available to them at the time of their examinations.

As part of management's quarterly assessment of the allowance, management divides the loan portfolio into five segments: commercial, commercial real estate, small business lending, consumer and consumer real estate. Each segment is then analyzed such that an allocation of the allowance is estimated for each loan segment. Prior to 2010, because of Pinnacle Financial's limited loss history, loss estimates were primarily derived from historical loss data by loan categories for comparable peer institutions. During 2010, we incorporated the results of our proprietary historical loan loss migration analysis into our determination of the allowance for loan losses. We believe the increased emphasis on our historical loss experience metrics provides a better estimate of losses inherent in our portfolio. This refinement of our methodology did not result in a material change in our allowance.

The allowance allocation for commercial, commercial real estate loans and small business lending begins with a process of estimating the probable losses inherent for these types of loans. The estimates for these loans are established by category and based on our internal system of credit risk ratings and historical loss data. The estimated loan loss allocation rate for our internal system of credit risk grades for commercial and commercial real estate loans is based our historical loss experience adjusted for current factors and industry loss factors. Our historical loss experience is based on a migration analysis of all loans that were charged-off during prior years. The migration analysis was based on an eight quarter look-back to capture the recent loan loss experience of the firm. In this current economic environment, the eight quarter look-back is indicative of the risks inherent in our loan portfolio. As we move through the economic cycle, we will continue to monitor our look-back period to capture the inherent risks in our portfolio. The migration analysis assists in evaluating loan loss allocation rates for the various risk grades assigned to loans in our portfolio. We compare the migration analysis results to the other factors used to determine the loss allocation rates for the commercial, commercial real estate and small business lending portfolios. The loss allocation rates from our migration analysis and the industry loss factors are weighted to determine a weighted average loss allocation rate for these portfolios.

The allowance allocation for consumer and consumer real estate loans which includes installment, home equity, consumer mortgages, automobiles and others is established for each of the categories by estimating probable losses inherent in that particular category of consumer and consumer real estate loans. The estimated loan loss allocation rate for each category is based on consideration of our actual historical loss rates and industry loss rates. Consumer and consumer real estate loans are evaluated as a group by category (i.e. retail real estate, installment, etc.) rather than on a loan credit risk rating basis because these loans are smaller and homogeneous. We weight the allocation methodologies for the consumer and consumer real estate portfolios and determine a weighted average allocation for these portfolios.

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

The estimated loan loss allocation for all five loan portfolio segments is then adjusted for management's estimate of probable losses for several environmental factors. The allocation for environmental factors is particularly subjective and does not lend itself to exact mathematical calculation. This amount represents estimated probable inherent credit losses which exist, but have not yet been identified, as of the balance sheet date, and is based upon quarterly trend assessments in delinquent and nonaccrual loans, unanticipated charge-offs, credit concentration changes, prevailing economic conditions, changes in lending personnel experience, changes in lending policies or procedures and other influencing factors. These environmental factors are considered for each of the five loan segments, and the allowance allocation, as determined by the processes noted above for each component, is increased or decreased based on the incremental assessment of these various environmental factors. The environmental factors accounted for approximately 5.6% of the allowance for loan losses at March 31, 2011 compared to 6.8% of allowance for loan losses at December 31, 2010. As of March 31, 2011 and December 31, 2010, the environmental allocation was 0.15% and 0.19%, respectively, of the outstanding principal balance of commercial, commercial real estate and small business loans and 0.13% and 0.16%, respectively, of consumer and consumer real estate loans. The decrease in the environmental allocation between the two periods is based on our analysis of the above factors as of both balance sheet dates.

The assessment also includes an unallocated component. We believe that the unallocated amount is warranted for inherent factors that cannot be practically assigned to individual loan categories, such as the imprecision in the overall loss allocation measurement process, the volatility of the local economies in the markets we serve and imprecision in our credit risk ratings process.

Cash Flow Information — Supplemental cash flow information addressing certain cash and noncash transactions for each of the three months ended March 31, 2011 and 2010 was as follows:

	For the three months ended March 31,	
	2011	2010
Cash Transactions:		
Interest paid	$12,493,306	$16,474,470
Income taxes received	-	8,189,745
Noncash Transactions:		
Loans charged-off to the allowance for loan losses	11,658,354	15,746,176
Loans foreclosed upon and transferred to other real estate owned	6,401,209	6,346,272

Income (Loss) Per Common Share — Basic net income (loss) per share available to common stockholders (EPS) is computed by dividing net income or loss available to common stockholders by the weighted average common shares outstanding for the period. Weighted average common shares outstanding for the period include restricted shares that have been issued to associates and outside directors. 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 performance based criteria. The dilutive effect of outstanding options, common stock appreciation rights, warrants and restricted shares with performance based criteria is reflected in diluted EPS by application of the treasury stock method.

As of March 31, 2011, there were approximately 1,667,700 stock options and 8,200 stock appreciation rights outstanding to purchase common shares. Additionally, as of March 31, 2011, there were outstanding warrants to purchase 267,455 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, 2011, approximately 647,757 dilutive stock options, stock appreciation rights and warrants were included in the earnings per share calculation. As of March 31, 2010, there were 2,050,000 stock options and 10,000 stock appreciation rights outstanding to purchase common shares. Additionally, as of March 31, 2010, there were outstanding warrants to purchase 552,455 of common shares of Pinnacle Financial common stock. Due to the net loss attributable to common stockholders for the three months ended March 31, 2010, no potentially dilutive shares related to these stock options, stock appreciation rights, and warrants were included in the loss per share calculations, as including such shares would have an antidilutive effect on the loss per share.

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The following is a summary of the basic and diluted earnings per share calculations for the three months ended March 31, 2011 and 2010:

	For the three months ended March 31, 2011	2010
Basic earnings per share calculation:		
Numerator - Net income (loss) available to common stockholders	$ 2,011,250	$ (5,368,719)
Denominator - Average common shares outstanding	33,366,053	32,558,016
Basic income (loss) per share available to common stockholders	$ 0.06	$ (0.16)
Diluted earnings per share calculation:		
Numerator – Net income (loss) available to common stockholders	$ 2,011,250	$ (5,368,719)
Denominator - Average common shares outstanding	33,366,053	32,558,016
Dilutive shares contingently issuable	647,757	-
Average diluted common shares outstanding	34,013,810	32,558,016
Diluted net income (loss) per share available to common stockholders	$ 0.06	$ (0.16)

Recently Issued Accounting Pronouncement — In April 2011, FASB issued ASU No. 2011-02 A Creditor's Determination of Whether a Restructuring Is a Troubled Debt Restructuring, intended to provide additional guidance to assist creditors in determining whether a restructuring of a receivable meets the criteria to be considered a troubled debt restructuring. The amendments in this ASU are effective for the first interim or annual period beginning on or after June 15, 2011, and are to be applied retrospectively to the beginning of the annual period of adoption. As a result of applying these amendments, an entity may identify receivables that are newly considered troubled debt restructurings. Pinnacle Financial is continuing to evaluate the impact of adoption of this ASU.

Note 2. Participation in U.S. Treasury Capital Purchase Program and Private Placement of Common Stock

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 regulators 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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Note 3. Securities

The amortized cost and fair value of securities available-for-sale and held-to-maturity at March 31, 2011 and December 31, 2010 are summarized as follows:

March 31, 2011	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Securities available-for-sale:				
U.S. government agency securities	$80,575,837	$242,611	$363,235	$80,455,213
Mortgage-backed securities	671,360,062	14,920,892	1,375,054	684,905,900
State and municipal securities	201,251,903	4,847,341	1,200,113	204,899,131
Corporate notes and other	9,908,884	766,173	607	10,674,450
	$963,096,686	$20,777,017	$2,939,009	$980,934,694
Securities held-to-maturity:				
State and municipal securities	3,265,497	80,141	8,873	3,336,765
	$3,265,497	$80,141	$8,873	$3,336,765

December 31, 2010	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Securities available-for-sale:				
U.S. Government agency securities	$90,214,825	$487,320	$286,707	$90,415,438
Mortgage-backed securities	686,938,731	16,742,783	2,419,943	701,261,571
State and municipal securities	208,562,713	4,580,704	1,662,378	211,481,039
Corporate notes and other	10,474,074	761,487	76,778	11,158,783
	$996,190,343	$22,572,294	$4,445,806	$1,014,316,831
Securities held-to-maturity:				
State and municipal securities	4,320,486	104,643	13,273	4,411,856
	$4,320,486	$104,643	$13,273	$4,411,856

During the quarter ended March 31, 2011, Pinnacle Financial realized approximately $612,000 in gains and $365,000 in losses from the sale of $19.0 million of available-for-sale securities. These sales were mortgage backed securities where the resulting balance had been paid down to minimal amounts and municipal securities that had fallen outside of the parameters of our Asset/Liability policy due to a change in the quality of the security. During the three months ended March 31, 2010, Pinnacle Financial realized approximately $611,000 in gains and $246,000 in losses from the sale of $30.4 million of available-for-sale securities and approximately $954,000 of held-to-maturity securities. During the first quarter of 2011, Pinnacle Financial determined that an available-for-sale security was other-than-temporarily impaired as the credit worthiness of the security had deteriorated. This resulted in a $406,000 impairment charge during the first quarter of 2011 which offset the net gain on the sale of investment securities.

At March 31, 2011, approximately $806.7 million of 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, 2011 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.

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	Available-for-sale		Held-to-maturity	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
Due in one year or less	$3,235,552	$3,266,885	$2,056,641	$2,092,883
Due in one year to five years	52,399,353	53,103,379	1,208,856	1,243,882
Due in five years to ten years	122,022,968	125,422,181	-	-
Due after ten years	114,078,751	114,236,349	-	-
Mortgage-backed securities	671,360,062	684,905,900	-	-
	$963,096,686	$980,934,694	$3,265,497	$3,336,765

At March 31, 2011 and December 31, 2010, 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:

	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, 2011:						
U.S. government agency securities	$40,473,544	$363,235	$-	$-	$40,476,544	$363,235
Mortgage-backed securities	209,261,775	1,374,435	254,178	619	209,515,953	1,375,054
State and municipal securities	45,926,967	891,968	4,204,042	317,018	50,131,009	1,208,986
Corporate notes	257,545	607	-	-	257,545	607
Total temporarily-impaired securities	$295,919,831					