

PINNACLE FINANCIAL PARTNERS INC

Form 10-Q

May 09, 2008

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**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549
FORM 10-Q**

(mark one)

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

For the quarterly period ended March 31, 2008

or

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

For the transition period from _____ to _____

Commission File Number: 000-31225

, Inc.

(Exact name of registrant as specified in its charter)

Tennessee

62-1812853

(State or other jurisdiction of
incorporation or organization)

(I.R.S. Employer Identification No.)

211 Commerce Street, Suite 300, Nashville, Tennessee

37201

(Address of principal executive offices)

(Zip Code)

(615) 744-3700

(Registrant's telephone number, including area code)

Not Applicable

(Former name, former address and former fiscal year, if changes since last report)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes

No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. 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

Accelerated Filer

Non-accelerated Filer

Smaller reporting company

(do not check if you are a smaller reporting company)

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

Yes

No

As of May 7, 2008 there were 22,596,497 shares of common stock, \$1.00 par value per share, issued and outstanding.

Pinnacle Financial Partners, Inc.
Report on Form 10-Q
March 31, 2008
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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-looking statements, but other statements may constitute forward-looking statements. These statements should be considered subject to various risks and uncertainties. Such forward-looking statements are made based upon management's belief as well as assumptions made by, and information currently available to, management pursuant to "safe harbor" provisions of the Private Securities Litigation Reform Act of 1995. Pinnacle Financial's actual results may differ materially from the results anticipated in forward-looking statements due to a variety of factors. Such factors are described below in "Item 1A. Risk Factors" and 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) increased competition with other financial institutions, (iii) lack of sustained growth in the economy in the Nashville and Knoxville, Tennessee areas, (iv) rapid fluctuations or unanticipated changes in interest rates, (v) the inability of our bank subsidiary, Pinnacle National Bank, to satisfy regulatory requirements for its expansion plans, and (vi) changes in state or federal legislation or regulations applicable to financial service providers, including banks. 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 does not intend to update or reissue any forward-looking statements contained in this report as a result of new information or other circumstances that may become known to Pinnacle Financial. Forward-looking statements made by us in this report are also subject to those risks identified within "Item 1A. Risk Factors."

Table of Contents**Item 1.**

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

| | March 31, 2008 | December 31, 2007 |
|---|---------------------------|------------------------------|
| <u>ASSETS</u> | | |
| Cash and noninterest-bearing due from banks | \$ 68,352,893 | \$ 76,941,931 |
| Interest-bearing due from banks | 26,890,349 | 24,706,966 |
| Federal funds sold | 21,043,348 | 20,854,966 |
| Cash and cash equivalents | 116,286,590 | 122,503,863 |
| Securities available-for-sale, at fair value | 494,114,484 | 495,651,939 |
| Securities held-to-maturity (fair value of \$11,375,050 and \$26,883,473 at March 31, 2008 and December 31, 2007, respectively) | 11,262,901 | 27,033,356 |
| Mortgage loans held-for-sale | 13,672,849 | 11,251,652 |
| Loans | 2,866,535,567 | 2,749,640,689 |
| Less allowance for loan losses | (29,871,384) | (28,470,207) |
| Loans, net | 2,836,664,183 | 2,721,170,482 |
| Premises and equipment, net | 69,168,517 | 68,385,946 |
| Other investments | 24,752,783 | 22,636,029 |
| Accrued interest receivable | 16,630,336 | 18,383,004 |
| Goodwill | 242,107,449 | 243,573,636 |
| Core deposit intangible, net | 17,935,955 | 17,325,988 |
| Other assets | 46,690,061 | 46,254,566 |
| Total assets | \$ 3,889,286,108 | \$ 3,794,170,461 |
| <u>LIABILITIES AND STOCKHOLDERS' EQUITY</u> | | |
| Deposits: | | |
| Non-interest-bearing | \$ 429,289,392 | \$ 400,120,147 |
| Interest-bearing | 406,906,848 | 410,661,187 |
| Savings and money market accounts | 757,776,325 | 742,354,465 |
| Time | 1,373,052,003 | 1,372,183,317 |
| Total deposits | 2,967,024,568 | 2,925,319,116 |
| Securities sold under agreements to repurchase | 171,186,458 | 156,070,830 |
| Federal Home Loan Bank advances and other borrowings | 168,605,882 | 141,666,133 |
| Subordinated debt | 82,476,000 | 82,476,000 |
| Accrued interest payable | 9,679,145 | 10,374,538 |
| Other liabilities | 13,155,622 | 11,653,550 |

| | | |
|--|------------------|------------------|
| Total liabilities | 3,412,127,675 | 3,327,560,167 |
| Stockholders equity: | | |
| Preferred stock, no par value; 10,000,000 shares authorized; no shares issued and outstanding | | |
| Common stock, par value \$1.00; 90,000,000 shares authorized; 22,467,263 issued and outstanding at March 31, 2008 and 22,264,817 issued and outstanding at December 31, 2007 | 22,467,263 | 22,264,817 |
| Additional paid-in capital | 391,942,152 | 390,977,308 |
| Retained earnings | 59,616,770 | 54,150,679 |
| Accumulated other comprehensive income (loss), net of taxes | 3,132,248 | (782,510) |
| Total stockholders equity | 477,158,433 | 466,610,294 |
| Total liabilities and stockholders equity | \$ 3,889,286,108 | \$ 3,794,170,461 |

See accompanying notes to consolidated financial statements.

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

| | Three months ended | |
|--|---------------------------|-----------------------|
| | March 31, | |
| | 2008 | 2007 |
| Interest income: | | |
| Loans, including fees | \$ 45,392,162 | \$ 28,977,224 |
| Securities: | | |
| Taxable | 4,637,277 | 3,346,120 |
| Tax-exempt | 1,351,037 | 669,519 |
| Federal funds sold and other | 780,917 | 746,379 |
| Total interest income | 52,161,393 | 33,739,242 |
| Interest expense: | | |
| Deposits | 21,085,633 | 13,537,263 |
| Securities sold under agreements to repurchase | 832,053 | 1,712,091 |
| Federal funds purchased and other borrowings | 2,884,586 | 1,407,460 |
| Total interest expense | 24,802,272 | 16,656,814 |
| Net interest income | 27,359,121 | 17,082,428 |
| Provision for loan losses | 1,591,123 | 787,966 |
| Net interest income after provision for loan losses | 25,767,998 | 16,294,462 |
| Noninterest income: | | |
| Service charges on deposit accounts | 2,573,737 | 1,797,149 |
| Investment services | 1,268,248 | 734,560 |
| Insurance sales commissions | 1,063,663 | 636,962 |
| Gain on loans and loan participations sold, net | 656,088 | 363,306 |
| Trust fees | 505,000 | 420,290 |
| Other noninterest income | 2,300,667 | 1,073,316 |
| Total noninterest income | 8,367,403 | 5,025,583 |
| Noninterest expense: | | |
| Salaries and employee benefits | 13,866,737 | 8,266,501 |
| Equipment and occupancy | 4,276,273 | 2,164,702 |
| Marketing and other business development | 375,871 | 251,735 |
| Postage and supplies | 648,340 | 454,916 |
| Amortization of core deposit intangible | 766,033 | 515,754 |
| Other noninterest expense | 2,452,641 | 1,470,083 |
| Merger related expense | 3,105,763 | |

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| | | |
|--|--------------|--------------|
| Total noninterest expense | 25,491,658 | 13,123,691 |
| Income before income taxes | 8,643,743 | 8,196,354 |
| Income tax expense | 2,578,953 | 2,594,513 |
| Net income | \$ 6,064,790 | \$ 5,601,841 |
| <i>Per share information:</i> | | |
| Basic net income per common share | \$ 0.27 | \$ 0.36 |
| Diluted net income per common share | \$ 0.26 | \$ 0.34 |
| Weighted average shares outstanding: | | |
| Basic | 22,331,398 | 15,433,442 |
| Diluted | 23,484,754 | 16,617,484 |

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**

(Unaudited)

For the three months ended March 31, 2008 and 2007

| | Common Stock | | Additional Paid-in Capital | Retained Earnings | Accumulated Other Comprehensive Income (Loss) | Total Stockholders' Equity |
|--|---------------------|---------------|---|------------------------------|--|---|
| | Shares | Amount | Capital | Earnings | (Loss) | Equity |
| 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 | 58,475 | 58,475 | 389,808 | | | 448,283 |
| Issuance of restricted common shares pursuant to 2004 Equity Incentive Plan | 26,426 | 26,426 | (26,426) | | | |
| Compensation expense for restricted stock | | | 105,282 | | | 105,282 |
| Compensation expense for stock options | | | 362,000 | | | 362,000 |
| Comprehensive income: | | | | | | |
| Net income | | | | 5,601,841 | | 5,601,841 |
| Net unrealized holding gains on available-for-sale securities, net of deferred taxes of \$234,187 | | | | | 382,094 | 382,094 |
| Total comprehensive income | | | | | | 5,983,935 |
| Balances, March 31, 2007 | 15,530,975 | \$ 15,530,975 | \$ 212,333,180 | \$ 36,711,165 | \$ (1,658,799) | \$ 262,916,521 |
| Balances, December 31, 2007 | 22,264,817 | \$ 22,264,817 | \$ 390,977,308 | \$ 54,150,679 (598,699) | \$ (782,510) | \$ 466,610,294 (598,699) |

| | | | | | | |
|---|------------|---------------|----------------|---------------|--------------|----------------|
| Cumulative effect of change in accounting principle due to adoption of EITF 06-4, net of tax | | | | | | |
| Exercise of employee common stock options and stock appreciation rights and related tax benefits | 62,073 | 62,073 | 623,276 | | | 685,349 |
| Issuance of restricted common shares pursuant to 2004 Equity Incentive Plan | 140,373 | 140,373 | (140,373) | | | |
| Compensation expense for restricted stock | | | (32,641) | | | (32,641) |
| Compensation expense for stock options | | | 514,582 | | | 514,582 |
| Comprehensive income: | | | | | | |
| Net income | | | | 6,064,790 | | 6,064,790 |
| Net unrealized holding gains on available-for-sale securities, net of deferred taxes of \$2,404,397 | | | | | 3,914,758 | 3,914,758 |
| Total comprehensive income | | | | | | 9,979,548 |
| Balances, March 31, 2008 | 22,467,263 | \$ 22,467,263 | \$ 391,942,152 | \$ 59,616,770 | \$ 3,132,248 | \$ 477,158,433 |

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, | |
| | 2008 | 2007 |
| Operating activities: | | |
| Net income | \$ 6,064,790 | \$ 5,601,841 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | |
| Net amortization of premium on securities | 182,563 | 132,221 |
| Depreciation and net amortization | 1,112,113 | 1,823,194 |
| Provision for loan losses | 1,591,123 | 787,966 |
| Gains on loans and loan participations sold, net | (656,088) | (363,306) |
| Stock-based compensation expense | 481,941 | 467,282 |
| Deferred tax (benefit) expense | 1,487,344 | (1,310,271) |
| Excess tax benefit from stock compensation | (50,299) | (20,742) |
| Mortgage loans held for sale: | | |
| Loans originated | (61,526,765) | (36,739,515) |
| Loans sold | 59,757,305 | 31,044,228 |
| Increase in other assets | 273,098 | 2,035,596 |
| Decrease in other liabilities | (257,260) | (2,504,034) |
| Net cash provided by operating activities | 8,459,865 | 954,460 |
| Investing activities: | | |
| Purchases of securities available-for-sale | (57,529,865) | (3,355,360) |
| Maturities, prepayments and calls of securities available-for-sale | 65,224,367 | 9,928,338 |
| Maturities, prepayments and calls of securities held-to-maturity | 15,750,000 | 150,000 |
| Increase in loans, net | (119,667,223) | (56,801,579) |
| Purchases of premises and equipment and software | (2,603,806) | (2,292,955) |
| Purchases of other investments | (1,486,800) | (718,846) |
| Net cash used in investing activities | (100,313,327) | (53,090,402) |
| Financing activities: | | |
| Net increase in deposits | 42,735,290 | 78,001,234 |
| Net increase (decrease) in securities sold under agreements to repurchase | 15,115,628 | (24,064,130) |
| Net increase (decrease) in Federal funds purchased | (39,668,000) | 19,907,000 |
| Advances from Federal Home Loan Bank: | | |
| Issuances | 70,000,000 | |
| Payments | (3,336,883) | (27,013,609) |
| Exercise of common stock options and stock appreciation rights | 739,855 | 427,541 |
| Excess tax benefit from stock compensation | 50,299 | 20,742 |
| Net cash provided by financing activities | 85,636,189 | 47,278,778 |

| | | |
|--|----------------|---------------|
| Net decrease in cash and cash equivalents | (6,217,273) | (4,857,164) |
| Cash and cash equivalents, beginning of period | 122,503,863 | 92,518,850 |
| Cash and cash equivalents, end of period | \$ 116,286,590 | \$ 87,661,686 |

See accompanying notes to consolidated financial statements

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

Note 1. Summary of Significant Accounting Policies

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

In addition to Pinnacle National, Pinnacle Financial, for the time period following its merger with Mid-America Bancshares, Inc. (Mid-America) on November 30, 2007 through February 29, 2008, conducted banking operations through the two banks formerly owned by Mid-America: PrimeTrust Bank in Nashville, Tennessee and Bank of the South in Mt. Juliet, Tennessee. On February 29, 2008, Pinnacle National purchased all of the assets and assumed all of the liabilities of PrimeTrust Bank and contemporaneously, through a series of transactions, sold the charter (and rights to operate a branch in Tennessee) of PrimeTrust Bank to an unaffiliated out-of-state third party for \$500,000. Pinnacle Financial also merged Bank of the South into Pinnacle National on that date. References to Pinnacle National as of December 31, 2007 include PrimeTrust Bank and Bank of the South.

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 option 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 the 2007 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.

Cash Flow Information The following supplemental cash flow information addresses certain cash payments and noncash transactions for the three months ended March 31, 2008 and 2007 was as follows:

| | <i>For the three months ended March</i> | |
|--|---|---------------|
| | <i>31,</i> | |
| | <i>2008</i> | <i>2007</i> |
| <i>Cash Payments:</i> | | |
| Interest | \$ 25,035,879 | \$ 16,469,389 |
| Income taxes | | 1,100,000 |
| <i>Noncash Transactions:</i> | | |
| Loans charged-off to the allowance for loan losses | 757,276 | 187,818 |
| | 2,855,967 | 110,570 |

Loans foreclosed upon with repossessions transferred to other assets

Net unrealized holding gains on available-for-sale securities, net of deferred taxes

3,914,758

382,094

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, common stock appreciation rights, warrants and restricted shares. The dilutive effect of outstanding options, common stock appreciation rights, warrants and restricted shares is reflected in diluted earnings per share by application of the treasury stock method.

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PINNACLE FINANCIAL PARTNERS, INC. AND SUBSIDIARIES
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(Unaudited)

As of March 31, 2008, there were 2,457,000 stock options and 14,000 stock appreciation rights outstanding to purchase common shares. As of March 31, 2007, there were 1,846,000 stock options outstanding to purchase common shares. Most of these options have exercise prices and compensation costs attributable to current services, 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 months ended March 31, 2008 and 2007. There were common stock options of 481,000 and 618,000 outstanding as of March 31, 2008 and 2007, respectively, which were considered anti-dilutive and thus have not been considered in the fully-diluted share calculations below. Additionally, as of March 31, 2008 and 2007, Pinnacle Financial had outstanding warrants to purchase 395,000 common shares which have been considered in the calculation of Pinnacle Financial's diluted income per share for the three months ended March 31, 2008 and 2007.

The following is a summary of the basic and diluted earnings per share calculation for the three months ended March 31, 2008 and 2007:

| | <i>For the three months ended March</i> | |
|--|---|--------------|
| | <i>31,</i> | |
| | <i>2008</i> | <i>2007</i> |
| <i>Basic earnings per share calculation:</i> | | |
| Numerator - Net income | \$ 6,064,790 | \$ 5,601,841 |
| Denominator - Average common shares outstanding | 22,331,398 | 15,433,442 |
| Basic net income per share | \$ 0.27 | \$ 0.36 |
| <i>Diluted earnings per share calculation:</i> | | |
| Numerator - Net income | \$ 6,064,790 | \$ 5,601,841 |
| Denominator - Average common shares outstanding | 22,331,398 | 15,433,442 |
| Dilutive shares contingently issuable | 1,153,356 | 1,184,042 |
| Average diluted common shares outstanding | 23,484,754 | 16,617,484 |
| Diluted net income per share | \$ 0.26 | \$ 0.34 |

Newly Adopted Accounting Pronouncements

Split-Dollar Life Insurance Arrangements Pinnacle Financial acquired Cavalry Banking, Inc. in March of 2006. Certain executives and directors of Cavalry Banking, Inc. were participants in a deferred compensation arrangement which included split-dollar life insurance arrangements. In September 2006, the FASB ratified the consensus reached by the Task Force on Issue No. 06-4 (EITF 06-4) *Accounting for Deferred Compensation and Postretirement Benefit Aspects of Endorsement Split-Dollar Life Insurance Arrangements*. The EITF concluded that deferred compensation or postretirement benefit aspects of an endorsement split-dollar life insurance arrangement should be recognized as a liability by the employer and the obligation is not effectively settled by the purchase of a life insurance policy. The effective date is for fiscal years beginning after December 15, 2007. On January 1, 2008, we accounted for this EITF as a change in accounting principle and recorded a liability of \$985,000 along with a corresponding adjustment to beginning retained earnings, net of tax.

Fair Value Measurement - In September 2006, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards (SFAS) No. 157 (SFAS 157), Fair Value Measurements SFAS 157, which defines fair value, establishes a framework for measuring fair value in U.S. generally accepted accounting principles and expands disclosures about fair value measurements. SFAS 157 applies only to fair-value measurements

that are already required or permitted by other accounting standards and is expected to increase the consistency of those measurements. The definition of fair value focuses on the exit price, i.e., the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date, not the entry price, i.e., the price that would be paid to acquire the asset or received to assume the liability at the measurement date. The statement emphasizes that fair value is a market-based measurement; not an entity-

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PINNACLE FINANCIAL PARTNERS, INC. AND SUBSIDIARIES
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(Unaudited)

specific measurement. Therefore, the fair value measurement should be determined based on the assumptions that market participants would use in pricing the asset or liability. The effective date for SFAS No. 157 is for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years. Pinnacle Financial partially adopted SFAS 157 effective January 1, 2008. The adoption of SFAS 157 had no impact on the consolidated financial statements of Pinnacle Financial. SFAS 157 has not been applied to nonfinancial assets and liabilities pursuant to FSP FAS 157-2. This standard is applicable for nonfinancial assets and liabilities for fiscal periods beginning after November 30, 2008.

In February of 2007, the FASB issued SFAS No. 159 (SFAS 159), The Fair Value Option for Financial Assets and Financial Liabilities , which gives entities the option to measure eligible financial assets, and financial liabilities at fair value on an instrument by instrument basis, that are otherwise not permitted to be accounted for at fair value under other accounting standards. The election to use the fair value option is available when an entity first recognizes a financial asset or financial liability. Subsequent changes in fair value must be recorded in earnings. This statement was effective as of January 1, 2008; however it had no impact on the consolidated financial statements of Pinnacle Financial because it did not elect the fair value option for any financial instrument not presently being accounted for at fair value.

Pinnacle Financial has an established process for determining fair values. Fair value is based upon quoted market prices, where available. If listed prices or quotes are not available, fair value is based upon internally developed models or processes that use primarily market-based or independently-sourced market data, including interest rate yield curves, option volatilities and third party information. Valuation adjustments may be made to ensure that financial instruments are recorded at fair value. Furthermore, while Pinnacle Financial believes its valuation methods are appropriate and consistent with other market participants, the use of different methodologies, or assumptions, to determine the fair value of certain financial instruments could result in a different estimate of fair value at the reporting date.

Valuation Hierarchy

SFAS 157 establishes a three-level valuation hierarchy for disclosure of fair value measurements. The valuation hierarchy is based upon the transparency of inputs to the valuation of an asset or liability as of the measurement date. The three levels are defined as follows.

Level 1 inputs to the valuation methodology are quoted prices (unadjusted) for identical assets or liabilities in active markets.

Level 2 inputs to the valuation methodology include quoted prices for similar assets and liabilities in active markets, and inputs that are observable for the asset or liability, either directly or indirectly, for substantially the full term of the financial instrument.

Level 3 inputs to the valuation methodology are unobservable and significant to the fair value measurement.

A financial instrument's categorization within the valuation hierarchy is based upon the lowest level of input that is significant to the fair value measurement. Following is a description of the valuation methodologies used for instruments measured at fair value, as well as the general classification of such instruments pursuant to the valuation hierarchy.

Assets

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

Mortgage loans held-for-sale - Mortgage loans held-for-sale are carried at fair value and are classified within level 2 of the valuation hierarchy. The inputs for valuation of these assets are based on the anticipated sales price of these loans as the loans are usually sold within a few weeks of their origination.

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(Unaudited)

Impaired loans 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 agreement. 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 valuation allowance may be established as a component of the allowance for loan losses. Impaired loans are classified within level 3 of the hierarchy.

Other investments Included in other investments are investments in certain nonpublic private equity funds. The valuation of nonpublic private equity investments requires significant management judgment due to the absence of quoted market prices, inherent lack of liquidity and the long-term nature of such assets. These investments are valued initially based upon transaction price. The carrying values of other investments are adjusted either upwards or downwards from the transaction price to reflect expected exit values as evidenced by financing and sale transactions with third parties, or when determination of a valuation adjustment is confirmed through ongoing reviews by senior investment managers. A variety of factors are reviewed and monitored to assess positive and negative changes in valuation including, but not limited to, current operating performance and future expectations of the particular investment, industry valuations of comparable public companies, changes in market outlook and the third-party financing environment over time. In determining valuation adjustments resulting from the investment review process, emphasis is placed on current company performance and market conditions. These equity investments are included in level 3 of the valuation hierarchy.

Other assets Included in other assets are certain assets carried at fair value, including the cash value of bank owned life insurance policies and interest rate swap agreements. The carrying amount of bank owned life insurance is based on information received from the insurance carriers indicating the financial performance of the policies and the amount Pinnacle Financial would receive should the policies be surrendered. The carrying amount of interest rate swap agreements is based on information obtained from a third party bank. Pinnacle Financial reflects these assets within level 2 of the valuation hierarchy.

Liabilities

Other liabilities Pinnacle Financial has certain liabilities carried at fair value including certain interest rate swap agreements. The fair value of these liabilities is based on information obtained from a third party bank and is reflected within level 2 of the valuation hierarchy.

The following table presents the financial instruments carried at fair value as of March 31, 2008, by caption on the consolidated balance sheets and by SFAS 157 valuation hierarchy (as described above) (dollars in thousands):

Assets and liabilities measured at fair value on a recurring basis as of March 31, 2008

| | Total | | Internal models with | Internal models with |
|-------------------------------|---------------------|---------------|-------------------------------------|-------------------------------------|
| | carrying | Quoted | significant | significant |
| | value in the | market | observable | unobservable |
| | consolidated | prices | market | market |
| | balance | in an | parameters | parameters |
| | sheet | active | (Level 2) | (Level 3) |
| | | market | (Level 1) | |
| Available-for-sale securities | \$ 494,114 | \$ | \$ 494,114 | \$ |

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| | | | | |
|--|-------------------|-----------|-------------------|------------------|
| Mortgage loans held-for-sale | 13,673 | | 13,673 | |
| Other investments | 1,329 | | | 1,329 |
| Other assets | 37,401 | | 2,609 | 34,792 |
| Total assets at fair value | \$ 546,517 | \$ | \$ 510,396 | \$ 36,121 |
| Other liabilities | 2,632 | | 2,632 | |
| Total liabilities at fair value | \$ 2,632 | \$ | \$ 2,632 | \$ |

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Assets and liabilities measured at fair value on a nonrecurring basis as of March 31, 2008

| | Total | | Internal | |
|--|---------------------|------------------|--------------------|---------------------|
| | carrying | Quoted | models | Internal |
| | value in the | market | with | models |
| | consolidated | prices | significant | with |
| | balance | in an | observable | significant |
| | sheet | active | market | unobservable |
| | | market | parameters | parameters |
| | | (Level 1) | (Level 2) | (Level 3) |
| Impaired loans | \$ 17,124 | \$ | \$ | \$ 17,124 |
| Total assets at fair value | \$ 17,124 | \$ | \$ | \$ 17,124 |
| Other liabilities | | | | |
| Total liabilities at fair value | \$ | \$ | \$ | \$ |

Changes in level 3 fair value measurements

The table below includes a rollforward of the balance sheet amounts for the first quarter of 2008 (including the change in fair value) for financial instruments classified by Pinnacle Financial within level 3 of the valuation hierarchy for assets and liabilities measured at fair value on a recurring basis. When a determination is made to classify a financial instrument within level 3 of the valuation hierarchy, the determination is based upon the significance of the unobservable factors to the overall fair value measurement. However, since level 3 financial instruments typically include, in addition to the unobservable or level 3 components, observable components (that is, components that are actively quoted and can be validated to external sources); accordingly, the gains and losses in the table below include changes in fair value due in part to observable factors that are part of the valuation methodology.

| Three months ended March 31, 2008 (in thousands) | Assets | Liabilities |
|--|---------------|--------------------|
| Fair value, January 1, 2008 | \$ 35,336 | \$ |
| Total realized and unrealized gains and (losses) included in income | 65 | |
| Purchases, issuances and settlements, net | 720 | |
| Transfers in and/or out of level 3 | | |
| Fair value, March 31, 2008 | \$ 36,121 | \$ |
| Total unrealized gains and (losses) included in income related to financial assets and liabilities still on the consolidated balance sheet at March 31, 2008 | \$ 65 | \$ |

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

On November 30, 2007, Pinnacle Financial consummated its merger with Mid-America, a two-bank holding company located in Nashville, Tennessee.

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 Mid-America as of November 30, 2007. The table below details the amounts our consolidated financial statements as of December 31, 2007 and the updated amounts as of March 31, 2008 for changes in the purchase price allocation recorded during the first quarter of 2008 (in thousands):

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| | November 30, 2007 purchase price allocation | Changes in purchase price allocation recorded during first quarter of 2008 | Revised November 30, 2007 purchase price allocation |
|---|--|---|--|
| <i>Mid-America Purchase Price Allocation (1)</i> | | | |
| Cash and cash equivalents | \$ 60,795 | \$ | \$ 60,795 |
| Investment securities available-for-sale | 147,766 | | 147,766 |
| Loans, net of an allowance for loan losses of \$8,695 | 855,887 | | 855,887 |
| Goodwill | 129,334 | (1,466) | 127,868 |
| Core deposit intangible | 8,085 | 1,351 | 9,436 |
| Other assets | 49,854 | 139 | 49,993 |
| Total assets acquired | 1,251,721 | 24 | 1,251,745 |
| Deposits | 957,076 | | 957,076 |
| Federal Home Loan Bank advances | 61,383 | | 61,383 |
| Other liabilities | 27,107 | 79 | 27,186 |
| Total liabilities assumed | 1,045,566 | 79 | 1,045,645 |
| Total consideration paid for Mid-America | \$ 206,155 | \$ (55) | \$ 206,100 |

(1) *Pinnacle Financial is still in the process of finalizing the allocation of the purchase price to the acquired net assets noted above. Accordingly, the above allocations should be considered preliminary as*

*of March 31,
2008.*

In accordance with SFAS Nos. 141 and 142, Pinnacle Financial has preliminarily recognized \$9.4 million as a core deposit intangible through March 31, 2008. This identified intangible is being amortized over ten years using an accelerated method which anticipates the life of the underlying deposits to which the intangible is attributable. For the three months ended March 31, 2008, approximately \$273,000 was recognized in the accompanying consolidated statement of income as other noninterest expense. Amortization expense associated with this identified intangible will approximate \$700,000 to \$1.1 million per year for the next ten years.

At November 30, 2007, Pinnacle Financial also recorded other adjustments to the carrying value of Mid-America's assets and liabilities in order to reflect the fair value at the date of acquisition. The discounts and premiums related to financial assets and liabilities are being accreted and amortized into the consolidated statements of income using a method that approximates the level yield over the anticipated lives of the underlying financial assets or liabilities. For the quarter ended March 31, 2008, the accretion and amortization of the fair value discounts and premiums related to the acquired assets and liabilities increased net interest income by approximately \$1,111,000. Based on the estimated useful lives of the acquired loans, deposits and FHLB advances, Pinnacle Financial will recognize increases in net interest income related to accretion of these purchase accounting adjustments of \$2.91 million in subsequent years.

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The following pro forma income statements assume the merger was consummated on January 1, 2007 and thus the amounts in the pro form information below will differ from the actual results as presented in the accompanying consolidated statements of income. 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).

| | Three months ended March | |
|--|---------------------------------|-------------|
| | 31, | |
| | 2008 | 2007 |
| | (unaudited) | |
| <i>Pro Forma Income Statements:</i> | | |
| Net interest income | \$ 26,452 | \$ 26,024 |
| Provision for loan losses | 1,591 | 976 |
| Noninterest income | 8,367 | 6,923 |
| Noninterest expense | 25,486 | 20,707 |
| | | |
| Net income before taxes | 7,742 | 11,264 |
| Income tax expense | 2,225 | 3,653 |
| | | |
| Net income | \$ 5,516 | \$ 7,611 |
| | | |
| <i>Pro Forma Per Share Information:</i> | | |
| Basic net income per common share | \$ 0.25 | \$ 0.34 |
| Diluted net income per common share | \$ 0.24 | \$ 0.33 |
| | | |
| Weighted average shares outstanding: | | |
| Basic | 22,088,665 | 22,110,022 |
| Diluted | 23,242,022 | 23,294,064 |

During the three months ended March 31, 2008, Pinnacle Financial incurred merger integration expense related to the merger with Mid-America of \$3,106,000. These expenses were directly related to the merger and consisted primarily of severance costs and costs to integrate systems and are reflected on the accompanying consolidated statement of income as merger related expense.

Following the merger with Mid-America, on February 29, 2008, Pinnacle National purchased all of the assets and assumed all of the liabilities of PrimeTrust Bank and simultaneously sold the charter of PrimeTrust Bank to an unaffiliated third party for \$500,000. Pinnacle Financial also merged Bank of the South into Pinnacle National on that date, leaving Pinnacle National as the sole banking subsidiary of Pinnacle Financial. Goodwill was reduced for the proceeds of the sale of the charter, and therefore no gain was recorded.

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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, 2008 and December 31, 2007 are summarized as follows:

| | March 31, 2008 | | | |
|---------------------------------------|---------------------------|---------------------------------------|--|-----------------------|
| | Amortized Cost | Gross Unrealized Gains | Gross Unrealized Losses | Fair Value |
| Securities available-for-sale: | | | | |
| U.S. Treasury securities | \$ | \$ | \$ | \$ |
| U.S. government agency securities | 32,921,120 | 624,092 | 3,022 | 33,542,190 |
| Mortgage-backed securities | 329,639,159 | 4,361,031 | 280,933 | 333,719,257 |
| State and municipal securities | 124,204,397 | 2,045,951 | 1,774,177 | 124,476,171 |
| Corporate notes and other | 2,414,318 | 17,961 | 55,413 | 2,376,866 |
| | \$ 489,178,994 | \$ 7,049,035 | \$ 2,113,545 | \$ 494,114,484 |
| Securities held-to-maturity: | | | | |
| U.S. government agency securities | \$ 1,997,672 | \$ 14,628 | \$ | \$ 2,012,300 |
| State and municipal securities | 9,265,229 | 105,508 | 7,987 | 9,362,750 |
| | \$ 11,262,901 | \$ 120,136 | \$ 7,987 | \$ 11,375,050 |
| | December 31, 2007 | | | |
| | Amortized Cost | Gross Unrealized Gains | Gross Unrealized Losses | Fair Value |
| Securities available-for-sale: | | | | |
| U.S. Treasury securities | \$ | \$ | \$ | \$ |
| U.S. Government agency securities | 69,481,328 | 220,833 | 39,598 | 69,662,563 |
| Mortgage-backed securities | 297,909,174 | 1,237,807 | 1,441,635 | 297,705,346 |
| State and municipal securities | 127,220,978 | 206,102 | 1,521,273 | 125,905,807 |
| Corporate notes | 2,415,783 | | 37,560 | 2,378,223 |
| | \$ 497,027,263 | \$ 1,664,742 | \$ 3,040,066 | \$ 495,651,939 |
| Securities held-to-maturity: | | | | |
| U.S. government agency securities | \$ 17,747,589 | \$ 4,436 | \$ | \$ 17,752,025 |
| State and municipal securities | 9,285,767 | 4,242 | 158,561 | 9,131,448 |
| | \$ 27,033,356 | \$ 8,678 | \$ 158,561 | \$ 26,883,473 |

At March 31, 2008, approximately \$424,263,000 of Pinnacle Financial's investment portfolio was pledged to secure public funds and other deposits and securities sold under agreements to repurchase.

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At March 31, 2008 and December 31, 2007, 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 |
| <i>At March 31, 2008:</i> | | | | | | |
| U.S. government agency securities | \$ 853,999 | \$ 3,022 | \$ | \$ | \$ 853,999 | \$ 3,022 |
| Mortgage-backed securities | 31,580,268 | 147,641 | 15,696,314 | 133,292 | 47,276,582 | 280,933 |
| State and municipal securities | 43,869,958 | 1,773,395 | 1,561,784 | 8,769 | 45,431,742 | 1,782,164 |
| Corporate notes | 493,601 | 6,518 | 441,000 | 48,895 | 934,601 | 55,413 |
| Total temporarily-impaired securities | \$ 76,797,826 | \$ 1,930,576 | \$ 17,699,098 | \$ 190,956 | \$ 94,496,924 | \$ 2,121,532 |
| <i>At December 31, 2007:</i> | | | | | | |
| U.S. government agency securities | \$ 13,942,078 | \$ 25,198 | \$ 2,985,600 | \$ 14,400 | \$ 16,927,678 | \$ 39,598 |
| Mortgage-backed securities | 51,240,090 | 181,098 | 97,593,453 | 1,260,537 | 148,833,543 | 1,441,635 |
| State and municipal securities | 54,467,544 | 1,193,763 | 35,481,739 | 486,071 | 89,949,283 | 1,679,834 |
| Corporate notes | 527,115 | 300 | 1,451,108 | 37,260 | 1,978,223 | 37,560 |
| Total temporarily-impaired securities | \$ 120,176,827 | \$ 1,400,359 | \$ 137,511,900 | \$ 1,798,268 | \$ 257,688,727 | \$ 3,198,627 |

Management evaluates securities for other-than-temporary impairment on at least a quarterly basis, and more frequently when economic or market concerns warrant such evaluation. Consideration is given to (1) the length of time and the extent to which the fair value has been less than cost, (2) the financial condition and near-term prospects of the issuer, and (3) the intent and ability of Pinnacle Financial to retain its investment in the issue for a period of time sufficient to allow for any anticipated recovery in fair value. Because the declines in fair value noted above were attributable to increases in interest rates and not attributable to credit quality and because Pinnacle Financial has the

ability and intent to hold all of these investments until a market price recovery or maturity, the impairment of these investments is not deemed to be other-than-temporary.

Note 4. Loans and Allowance for Loan Losses

The composition of loans at March 31, 2008 and December 31, 2007 is summarized as follows:

| | At March 31, 2008 | At December 31, 2007 |
|-----------------------------------|------------------------------|---------------------------------|
| Commercial real estate Mortgage | \$ 771,926,021 | \$ 728,200,839 |
| Consumer real estate Mortgage | 584,104,279 | 562,720,828 |
| Construction and land development | 557,069,605 | 517,399,037 |
| Commercial and industrial | 859,364,380 | 838,160,611 |
| Consumer and other | 94,071,282 | 103,159,374 |
| | | |
| Total Loans | 2,866,535,567 | 2,749,640,689 |
| Allowance for loan losses | (29,871,384) | (28,470,207) |
| | | |
| Loans, net | \$ 2,836,664,183 | \$ 2,721,170,482 |

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Changes in the allowance for loan losses for the three months ended March 31, 2008 and for the year ended December 31, 2007 are as follows:

| | March 31, 2008 | December 31, 2007 |
|--|---------------------------|------------------------------|
| Balance at beginning of period | \$ 28,470,207 | \$ 16,117,978 |
| Charged-off loans | (757,276) | (1,341,890) |
| Recovery of previously charged-off loans | 567,330 | 279,491 |
| Allowance from Mid-America acquisition | | 8,694,787 |
| Provision for loan losses | 1,591,123 | 4,719,841 |
| Balance at end of period | \$ 29,871,384 | \$ 28,470,207 |

At March 31, 2008 and at December 31, 2007, Pinnacle Financial had certain impaired loans on nonaccruing interest status. The principal balance of these nonaccrual loans amounted to \$17,124,000 and \$19,677,000 at March 31, 2008 and December 31, 2007, respectively. In each case, at the date such loans were placed on nonaccrual status, Pinnacle Financial reversed all previously accrued interest income against current year earnings. Had nonaccruing loans been on accruing status, interest income would have been higher by \$482,000 and \$102,000 for the three months ended March 31, 2008 and 2007, respectively.

At March 31, 2008, Pinnacle Financial had granted loans and other extensions of credit amounting to approximately \$28,936,000 to directors, executive officers, and their related entities, of which \$20,391,000 had been drawn upon. During the three months ended March 31, 2008, \$1,602,000 of loan and other commitment increases and \$319,000 of principle and other reductions were made by directors, executive officers, and their related entities. The terms on these loans and extensions are on substantially the same terms customary for other persons for the type of loan involved. None of these loans to directors, executive officers, and their related entities, were impaired at March 31, 2008.

During the three months ended March 31, 2008 and 2007, Pinnacle Financial sold participations in certain loans to correspondent banks at an interest rate that was less than that of the borrower's rate of interest. In accordance with U.S. generally accepted accounting principles, Pinnacle Financial recognized a net gain on the sale of these participated loans for the three months ended March 31, 2008 and 2007 of approximately \$4,000 and \$45,000, respectively, which is attributable to the present value of the future net cash flows of the difference between the interest payments the borrower is projected to pay Pinnacle Financial and the amount of interest that will be owed the correspondent bank based on their participation in the loans. At March 31, 2008, Pinnacle Financial was servicing \$165 million of loans for correspondent banks and other entities, of which \$114 million was commercial loans.

Note 5. Income Taxes

Pinnacle Financial's income tax expense differs from the amounts computed by applying the Federal income tax statutory rates of 35% to income before income taxes. A reconciliation of the differences for the three months ended March 31, 2008 and 2007 is as follows:

| | 2008 | 2007 |
|--|--------------|--------------|
| Income taxes at statutory rate | \$ 3,025,310 | \$ 2,868,724 |
| State tax (benefit) expense, net of Federal tax effect | (14,857) | 57,864 |
| Federal tax credits | (57,625) | (90,000) |
| Tax-exempt securities | (296,618) | (196,607) |
| Bank owned life insurance | (81,097) | (48,134) |
| Insurance premiums | (63,184) | (102,430) |

| | | |
|--------------------|--------------|--------------|
| Other items | 67,024 | 105,096 |
| Income tax expense | \$ 2,578,953 | \$ 2,594,513 |

The effective tax rate for 2008 and 2007 is impacted by Federal tax credits related to the New Markets Tax Credit program whereby a subsidiary of Pinnacle National has been awarded approximately \$2.3 million in future Federal tax credits which are available through 2010. Tax benefits related to these credits will be recognized for financial reporting purposes in the same periods

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that the credits are recognized in the Company's income tax returns. The credit that was available for the years ended December 31, 2008 and 2007 was \$360,000. Pinnacle Financial believes that it will comply with the various regulatory provisions of the New Markets Tax Credit program, and therefore has reflected the impact of the credits in its estimated annual effective tax rate for 2008 and 2007.

Note 6. Commitments and Contingent Liabilities

In the normal course of business, Pinnacle Financial has entered into off-balance sheet financial instruments which include commitments to extend credit (i.e., including unfunded lines of credit) and standby letters of credit. Commitments to extend credit are usually the result of lines of credit granted to existing borrowers under agreements that the total outstanding indebtedness will not exceed a specific amount during the term of the indebtedness. Typical borrowers are commercial concerns that use lines of credit to supplement their treasury management functions, thus their total outstanding indebtedness may fluctuate during any time period based on the seasonality of their business and the resultant timing of their cash flows. Other typical lines of credit are related to home equity loans granted to consumers. Commitments to extend credit generally have fixed expiration dates or other termination clauses and may require payment of a fee.

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

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

The contractual amounts of these commitments are not reflected in the consolidated financial statements and would only be reflected if drawn upon. Since many of the commitments are expected to expire without being drawn upon, the contractual amounts do not necessarily represent future cash requirements. However, should the commitments be drawn upon and should our customers default on their resulting obligation to us, Pinnacle Financial's maximum exposure to credit loss, without consideration of collateral, is represented by the contractual amount of those instruments.

A summary of Pinnacle Financial's total contractual amount for all off-balance sheet commitments at March 31, 2008 is as follows:

| | |
|------------------------------|----------------|
| Commitments to extend credit | \$ 869,938,000 |
| Standby letters of credit | 90,893,000 |

Various legal claims also arise from time to time in the normal course of business. As of March 31, 2008, management is not aware of any such proceedings against Pinnacle Financial.

Visa Litigation

Pinnacle National is a member of the Visa USA network. Under Visa USA bylaws, Visa members are obligated to indemnify Visa USA and/or its parent company, Visa, Inc., for potential future settlement of, or judgments resulting from, certain litigation, which Visa refers to as the covered litigation. Pinnacle National's indemnification obligation is limited to its membership proportion of Visa USA. On November 7, 2007, Visa announced the settlement of its American Express litigation, and disclosed in its annual report to the SEC on Form 10-K for the year ended September

30, 2007 that Visa had accrued a contingent liability for the estimated settlement of its Discover litigation. Accordingly, Pinnacle National has recognized a contingent liability in the amount of \$145,000 as an estimate for its membership proportion of the American Express settlement and the potential Discover

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settlement, as well as its membership proportion of the amount that Pinnacle National estimates will be required for Visa to settle the remaining covered litigation.

Visa, Inc. completed an initial public offering (the Visa IPO) in March 2008. Visa used a portion of the proceeds from the IPO to establish a \$3.0 billion escrow for settlement of covered litigation and used substantially all of the remaining portion to redeem class B and class C shares held by Visa issuing members. During the three months ended March 31, 2008, Pinnacle Financial recognized a pre-tax gain of \$140,000 on redemption proceeds received from Visa, Inc. and reversed \$63,000 of the \$145,000 litigation expense recognized as its pro-rata share of the \$3.0 billion escrow funded by Visa, Inc. The timing for ultimate settlement of all covered litigation is not determinable at this time.

Note 7. Equity Compensation

Pinnacle Financial has two equity incentive plans under which it has granted stock options to its employees to purchase common stock at or above the fair market value on the date of grant and granted restricted share awards to employees and directors. At March 31, 2008, there were 452,083 shares available for issue under these plans.

Common Stock Options and Stock Appreciation Rights

As of March 31, 2008, of the 2,457,431 stock options and 14,070 stock appreciation rights outstanding, 1,365,356 options were granted with the intention to be incentive stock options qualifying under Section 422 of the Internal Revenue Code for favorable tax treatment to the option holder while 1,106,145 options would be deemed non-qualified stock options or stock appreciation rights and thus not subject to favorable tax treatment to the option holder. All stock options granted under the Pinnacle equity incentive plans vest in equal increments over five years from the date of grant and are exercisable over a period of ten years from the date of grant.

A summary of the stock option and stock appreciation rights activity during the three months ended March 31, 2008 and information regarding expected vesting, contractual terms remaining, intrinsic values and other matters was as follows:

| | Number | Weighted- Average Exercise Price | Weighted- Average Contractual Remaining Term (in years) | Aggregate Intrinsic Value (1) (000's) |
|--|------------------|---|--|--|
| Outstanding at December 31, 2007 | 2,398,823 | \$ 16.84 | 6.9 | \$ 23,784 |
| Granted | 163,360 | 21.51 | | |
| Exercised (2) | (63,527) | 11.55 | | |
| Forfeited | (27,155) | 27.14 | | |
| Outstanding at March 31, 2008 | 2,471,501 | \$ 17.14 | 6.9 | \$ 23,855 |
| Outstanding and expected to vest as of March 31, 2008 | 2,431,645 | \$ 17.01 | 6.9 | \$ 23,780 |
| Options exercisable at March 31, 2008 | 1,610,064 | \$ 12.11 | 6.1 | \$ 20,937 |

(1) The aggregate intrinsic value is

calculated as the difference between the exercise price of the underlying awards and the quoted price of Pinnacle Financial common stock of \$25.60 per common share for the approximately 1.8 million options and stock appreciation rights that were in-the-money at March 31, 2008.

- (2) The 626 stock appreciation rights exercised during 2008 resulted in the issuance of 314 shares of Pinnacle Financial common stock.

During the three months ended March 31, 2008, 141,632 option awards vested at an average exercise price of \$24.54 and an intrinsic value of approximately \$3.3 million. On January 18, 2008, Pinnacle Financial granted options to purchase 163,360 common shares to certain employees at an exercise price of \$21.51 per share. These options, which were issued as non-qualified stock options, will vest in varying increments over five years beginning one year after the date of the grant and are exercisable over a period of ten years from the date of grant. Pursuant to SAB 110, Share-Based Payment, Pinnacle Financial will continue to use the simplified method for estimating the expense of stock compensation during 2008.

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During the three months ended March 31, 2008, the aggregate intrinsic value of options and stock appreciation rights exercised was \$1.4 million determined as of the date of exercise. As of March 31, 2008, there was approximately \$6.7 million of total unrecognized compensation cost related to unvested stock options granted. That cost is expected to be recognized over a weighted-average period of 3.1 years.

During the three months ended March 31, 2008 and 2007, Pinnacle Financial recorded stock-based compensation expense of \$515,000 and \$362,000 for the three months ended March 31, 2008 and 2007, respectively, using the Black-Scholes valuation model for awards granted prior to, but not yet vested, as of January 1, 2006 and for stock-based awards granted after January 1, 2006. For these awards, Pinnacle Financial has recognized compensation expense using a straight-line amortization method. Stock-based compensation expense has been reduced for estimated forfeitures.

The fair value of options granted for each of the three month periods ended March 31, 2008 and 2007 was estimated using the Black-Scholes option pricing model and the following assumptions:

| | 2008 | 2007 |
|-----------------------------|-------------|-------------|
| Risk free interest rate | 3.20% | 4.78% |
| Expected life of options | 6.5 years | 6.5 years |
| Expected dividend yield | 0.00% | 0.00% |
| Expected volatility | 24.58% | 20.94% |
| Weighted average fair value | \$ 7.07 | \$ 10.79 |

Pinnacle Financial's computation of expected volatility is based on weekly historical volatility since September of 2002. Pinnacle Financial used the simplified method in determining the estimated life of stock option issuances. The risk free interest rate of the award is based on the closing market bid for U.S. Treasury securities corresponding to the expected life of the stock option issuances in effect at the time of grant.

Restricted Shares

Additionally, Pinnacle Financial's 2004 Equity Incentive Plan provides for the granting of restricted share awards and other performance or market-based awards. There were no market-based awards outstanding as of March 31, 2008 under the 2004 Equity Incentive Plan. During the three months ended March 31, 2008, Pinnacle Financial awarded 140,373 shares of restricted common stock to Pinnacle Financial directors, officers and associates. The weighted average fair value of these awards as of the date of grant was \$21.95 per share. The forfeiture restrictions on 77,000 of the restricted shares awarded to Pinnacle Financial associates lapse in annual increments of 20% over the next five years. The forfeiture restrictions on 26,805 restricted shares awarded to members of Pinnacle Financial's senior management lapse in three separate tranches should Pinnacle achieve certain earnings and soundness targets over the subsequent three year period. Additionally, the forfeiture restrictions on 26,805 restricted shares issued to members of Pinnacle Financial's senior management lapse in annual increments of 10% over the next ten years if Pinnacle Financial is profitable in the prior year. The remaining 9,763 restricted shares were awarded to Pinnacle Financial directors with the restrictions on these shares lapsing on the one year anniversary date of the award based on each individual board member meeting their attendance goals for the various board and board committee meetings to which each member was scheduled to attend during the period from March 1, 2008 through February 28, 2009.

Compensation expense associated with the performance based restricted share awards is recognized over the time period that the restrictions associated with the awards lapse based on a graded vesting schedule such that each tranche is amortized separately. Compensation expense associated with the time based restricted share awards is recognized over the time period that the restrictions associated with the awards lapse based on the total cost of the award. For the three months ended March 31, 2008, Pinnacle Financial recognized approximately \$168,000 in compensation costs attributable to all restricted share awards issued prior to March 31, 2008. During the three months ended March 31, 2008, \$201,000 in previously expensed compensation associated with certain tranches of restricted share awards was reversed when Pinnacle Financial determined that the performance targets required to vest the

awards were unlikely to be achieved.

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A summary of activity for unvested restricted share awards for the three months ended March 31, 2008 follows:

| | Number |
|---|--------------------|
| Unvested awards at December 31, 2007 | 54,349 |
| New awards granted | 140,373 |
| Awards whereby restrictions have lapsed and shares released to participants | (3,230) |
| Forfeited awards (i.e., restrictions not met by participants) | |
| Unvested awards at March 31, 2008 | 191,492 |

Note 8. Regulatory Matters

Pinnacle National is subject to restrictions on the payment of dividends to Pinnacle Financial under federal banking laws and the regulations of the Office of the Comptroller of the Currency. Pinnacle Financial is also subject to limits on payment of dividends to its shareholders by the rules, regulations and policies of federal banking authorities. Pinnacle Financial has not paid any cash dividends since inception, and it does not anticipate that it will consider paying dividends until Pinnacle National generates sufficient capital from operations to support both anticipated asset growth and dividend payments. At March 31, 2008, pursuant to federal banking regulations, Pinnacle National had approximately \$50.4 million of net retained profits from the previous two years available for dividend payments to Pinnacle Financial.

Pinnacle Financial and its banking subsidiary are subject to various regulatory capital requirements administered by federal banking agencies. Failure to meet minimum capital requirements can initiate certain mandatory, and possibly additional discretionary actions, by regulators that, if undertaken, could have a direct material effect on the financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, Pinnacle Financial and its banking subsidiary must meet specific capital guidelines that involve quantitative measures of the assets, liabilities, and certain off-balance-sheet items as calculated under regulatory accounting practices. Pinnacle Financial's and its banking subsidiary capital amounts and classification are also subject to qualitative judgments by the regulators about components, risk weightings, and other factors.

Quantitative measures established by regulation to ensure capital adequacy require Pinnacle Financial and its banking subsidiaries to maintain minimum amounts and ratios of Total and Tier I capital to risk-weighted assets and of Tier I capital to average assets. Management believes, as of March 31, 2008, that Pinnacle Financial and its banking subsidiary met all capital adequacy requirements to which they are subject. To be categorized as well-capitalized, Pinnacle National must maintain minimum Total risk-based, Tier I risk-based, and Tier I leverage ratios as set forth in the following table. Pinnacle Financial and its banking subsidiaries actual capital amounts and ratios are presented in the following table (dollars in thousands):

| | Actual | | Minimum Capital Requirement | | Minimum To Be Well-Capitalized Under Prompt Corrective Action Provisions | |
|--|--------|-------|-----------------------------------|-------|---|-------|
| | Amount | Ratio | Amount | Ratio | Amount | Ratio |
| <i>At March 31, 2008</i> | | | | | | |
| Total capital to risk weighted assets: | | | | | | |

Total capital to risk weighted assets:

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| | | | | | | |
|---|------------|-------|------------|------|----------------|-------|
| Pinnacle Financial | \$ 330,975 | 10.4% | \$ 254,510 | 8.0% | not applicable | |
| Pinnacle National | \$ 323,346 | 10.2% | \$ 254,112 | 8.0% | \$ 317,641 | 10.0% |
| Tier I capital to risk weighted assets: | | | | | | |
| Pinnacle Financial | \$ 301,103 | 9.5% | \$ 127,255 | 4.0% | not applicable | |
| Pinnacle National | \$ 293,419 | 9.2% | \$ 127,056 | 4.0% | \$ 190,584 | 6.0% |
| Tier I capital to average assets (*): | | | | | | |
| Pinnacle Financial | \$ 301,103 | 8.6% | \$ 140,841 | 4.0% | not applicable | |
| Pinnacle National | \$ 293,419 | 8.3% | \$ 140,873 | 4.0% | \$ 176,092 | 5.0% |

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

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Note 9. Derivative Instruments

Financial derivatives are reported at fair value in other assets or other liabilities. The accounting for changes in the fair value of a derivative depends on whether it has been designated and qualifies as part of a hedging relationship. For derivatives not designated as hedges, the gain or loss is recognized in current earnings. Beginning in 2007, Pinnacle Financial entered into interest rate swaps (swaps) to facilitate customer transactions and meet their financing needs. Upon entering into these instruments to meet customer needs, Pinnacle Financial enters into offsetting positions in order to minimize the risk to Pinnacle Financial. These swaps qualify as derivatives, but are not designated as hedging instruments.

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

A summary of Pinnacle Financial's interest rate swaps is included in the following table (in thousands):

| | March 31, 2008 | |
|------------------------------------|----------------------------|-------------------------------------|
| | Notional Amount | Estimated Fair Value |
| Interest rate swap agreements: | | |
| Pay fixed / receive variable swaps | \$ 59,243 | \$ 2,609 |
| Pay variable / receive fixed swaps | 59,243 | (2,632) |
| Total | \$ 118,486 | \$ (23) |

Note 10. Business Segment Information

Pinnacle Financial has four reporting segments comprised of commercial banking, trust and investment services, mortgage origination and insurance services. Pinnacle Financial's primary segment is commercial banking which consists of commercial loan and deposit services as well as the activities of Pinnacle National's branch locations. Trust and investment services include trust services offered by Pinnacle National and all brokerage and investment activities associated with Pinnacle Asset Management, an operating unit within Pinnacle National. Mortgage origination is also a separate unit within Pinnacle National and focuses on the origination of residential mortgage loans for sale to investors in the secondary residential mortgage market. Insurance Services reflect the activities of Pinnacle National's wholly owned subsidiary, Miller and Loughry Insurance Services, Inc. Miller and Loughry is a general insurance agency located in Murfreesboro, Tennessee and is licensed to sell various commercial and consumer insurance products.

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The following tables present financial information for each reportable segment as of March 31, 2008 and 2007 and for the three months ended March 31, 2008 and 2007 (dollars in thousands):

| | Commercial Banking | Trust and Investment Services | Mortgage Origination | Insurance Services | Total Company |
|-----------------------------------|-------------------------------|--|---------------------------------|-------------------------------|--------------------------|
| <i>For the three months ended</i> | | | | | |
| <i>March 31, 2008:</i> | | | | | |
| Net interest income | \$ 27,285 | \$ | \$ 74 | \$ | \$ 27,359 |
| Provision for loan losses | 1,591 | | | | 1,591 |
| Noninterest income | 4,459 | 1,670 | 1,175 | 1,064 | 8,368 |
| Noninterest expense | 22,709 | 1,305 | 1,031 | 447 | 25,492 |
| Income tax expense | 2,106 | 144 | 86 | 243 | 2,579 |
| Net income | \$ 5,338 | \$ 221 | \$ 132 | 374 | 6,065 |
| End of period assets | \$ 3,884,042 | \$ | \$ | \$ 5,244 | \$ 3,889,286 |
| <i>For the three months ended</i> | | | | | |
| <i>March 31, 2007:</i> | | | | | |
| Net interest income | \$ 17,047 | \$ | \$ 35 | \$ | \$ 17,082 |
| Provision for loan losses | 788 | | | | 788 |
| Noninterest income | 2,648 | 1,114 | 586 | 643 | 5,026 |
| Noninterest expense | 11,397 | 800 | 487 | 440 | 13,124 |
| Income tax expense | 2,338 | 123 | 53 | 80 | 2,594 |
| Net income | \$ 5,207 | \$ 191 | \$ 81 | \$ 123 | \$ 5,602 |
| End of period assets | \$ 2,188,750 | \$ | \$ | \$ 4,382 | \$ 2,193,132 |

Table of Contents**ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

The following is a discussion of our financial condition at March 31, 2008 and December 31, 2007 and our results of operations for the three months ended March 31, 2008 and 2007. The purpose of this discussion is to focus on information about our financial condition and results of operations which is not otherwise apparent from the consolidated financial statements. The following discussion and analysis should be read along with our consolidated financial statements and the related notes included elsewhere herein.

Overview

General. Our rapid organic growth together with our merger with Mid-America Bancshares, Inc. (Mid-America), a two-bank holding company in Nashville, Tennessee, on November 30, 2007 and our expansion in the Knoxville, Tennessee market has had a material impact on Pinnacle Financial's financial condition and results of operations in 2008 as compared to 2007. This rapid growth along with the Mid-America merger and the Knoxville market expansion are discussed more fully below. Our fully diluted net income per share for the three months ended March 31, 2008 and 2007 was \$0.26 and \$0.34, respectively. At March 31, 2008, loans totaled \$2.867 billion, as compared to \$2.750 billion at December 31, 2007, while total deposits increased to \$2.967 billion at March 31, 2008 from \$2.925 billion at December 31, 2007.

Acquisition - Mid-America. On November 30, 2007, we consummated a merger with Mid-America. Pursuant to the merger agreement, Mid-America shareholders received a fixed exchange ratio of 0.4655 shares of our common stock and \$1.50 in cash for each share of Mid-America common stock, or approximately 6.7 million Pinnacle Financial shares and \$21.6 million in cash. We financed the cash portion of the merger consideration with the proceeds of a \$30 million trust preferred securities offering by an affiliated trust. The accompanying consolidated financial statements include the activities of the former Mid-America since November 30, 2007.

In accordance with SFAS Nos. 141 and 142, we have preliminarily recognized \$9.4 million as a core deposit intangible. This identified intangible is being amortized over ten years using an accelerated method which anticipates the life of the underlying deposits to which the intangible is attributable. For the three months ended March 31, 2008, approximately \$273,000 was recognized in the accompanying statement of income as other noninterest expense. Amortization expense associated with this identified intangible will approximate \$700,000 to \$1.1 million per year for the next ten years.

We also recorded other adjustments to the carrying value of Mid-America's assets and liabilities in order to reflect the fair value of those net assets acquired at November 30, 2007. The discounts and premiums related to financial assets and liabilities are being accreted and amortized into our 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 three months ended March 31, 2008, the accretion and amortization of the fair value discounts and premiums related to the acquired loans, certificates of deposit and FHLB advances increased net interest income by approximately \$1.111 million. Based on the estimated useful lives of the acquired loans, deposits and FHLB advances, we expect to recognize increases in net interest income related to accretion of these purchase accounting adjustments of \$2.9 million in subsequent years. We are in the process of finalizing the allocation of the purchase price to the acquired net assets noted above. Accordingly, the above allocations should be considered preliminary as of March 31, 2008.

During the three months ended March 31, 2008, we incurred merger integration expense related to the merger with Mid-America of \$3.106 million. These expenses were directly related to the merger, and consisted primarily of severance costs and costs to integrate processing systems and are reflected in the accompanying consolidated statement of income as merger related expense.

Knoxville expansion. During April of 2007, we announced a de novo expansion of our firm to the Knoxville MSA. At that time, we had hired several new associates from other financial institutions in that market and had negotiated a lease agreement for our main office facility with future plans to construct four additional offices over the next few years. In June of 2007, we opened our first full service branch facility in Knoxville. At March 31, 2008, our Knoxville facility had recorded \$159.0 million in loan balances and \$35.4 million in deposit balances. At March 31, 2008, we employed 23 associates in the Knoxville MSA. We incurred approximately \$549,000 in loan loss provision and approximately \$814,000 in noninterest expenses for compensation, occupancy and other expenses related to the

Knoxville expansion. As a result, we estimate that the Knoxville expansion lost approximately \$0.02 per fully diluted share during the first quarter of 2008.

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Results of Operations. Our net interest income increased to \$27.4 million for the first three months of 2008 compared to \$17.1 million for first three months of 2007, primarily due to increased volumes of earning assets as a result of the Mid-America acquisition. The net interest margin (the ratio of net interest income to average earning assets) for the three months ended March 31, 2008 was 3.37% compared to 3.64% for the same period in 2007.

Our provision for loan losses was \$1,591,000 for the first three months of 2008 compared to \$788,000 for the same period in 2007. The provision for loan losses increased primarily due to increases in loan volumes and charge-offs in 2008 compared to 2007.

Noninterest income for the three months ended March 31, 2008 compared to the same period in 2007 increased by \$3.34 million, or 66.5%. This increase is largely attributable to the fee businesses associated with the Mid-America acquisition, particularly with regard to service charges on deposit accounts, investment services commissions and other noninterest income. We also recorded during the first three months of 2008 approximately \$450,000 in insurance commissions received from one of our carriers due to favorable claims experience by that carrier.

Our continued growth in 2008 resulted in increased noninterest expense compared to 2007 due to the addition of Mid-America, our expansion into the Knoxville MSA, increases in salaries and employee benefits, equipment and occupancy expenses and other operating expenses. The number of full-time equivalent employees increased from 419.5 at March 31, 2007 to 686.0 at March 31, 2008. As a result, we experienced increases in compensation and employee benefit expense. In addition to incurring a full quarter of the Mid-America expense in 2008, we expect to add additional employees throughout 2008 which will also cause our compensation and employee benefit expense to increase in 2008 when compared to the comparable period in 2007. Additionally, our branch expansion efforts during the last few years and the addition of the eleven Mid-America branches will also increase noninterest expense. The increased operational expenses for the recently opened branches and the additional planned branch in Knoxville expected to open in the last half of 2008 will continue to result in increased noninterest expense in future periods. Our efficiency ratio (the ratio of noninterest expense to the sum of net interest income and noninterest income) was 71.4% for the first three months of 2008 compared to 59.4% for the same period in 2007. These calculations include the impact of approximately \$3,106,000 in Mid-America merger related charges incurred in the first quarter of 2008. The effective income tax expense rate for the three months ended March 31, 2008 was approximately 29.8% compared to an effective income tax expense rate for the three months ended March 31, 2007 of approximately 31.7%. The decrease in the effective rate for 2007 compared to 2006 was due to increased investments in bank qualified municipal securities and bank owned life insurance.

Net income for the first three months of 2008 was \$6.1 million compared to \$5.6 million for the same period in 2007, an increase of 8.3%.

Excluding the after-tax (rate of 39.23%) impact of merger related expenses in the first quarter of 2008, net income was \$8.0 million compared to \$5.6 million in the first quarter of 2007, an increase of 41.9%. As a result, diluted net income per common share, excluding merger related expenses was \$0.34 for the first three months of 2008 and 2007. For a reconciliation of these non-GAAP financial measures to their most directly comparable U.S. generally accepted accounting principles (GAAP) financial measure, see [Reconciliation of Non-GAAP financial measures](#) below.

Financial Condition. Loans increased \$116.9 million during the first three months of 2008. As we seek to increase our loan portfolio, we must also continue to monitor the risks inherent in our lending operations. If our allowance for loan losses is not sufficient to cover the estimated loan losses in our loan portfolio, increases to the allowance for loan losses would be required which would decrease our earnings.

We have successfully grown our total deposits to \$2.967 billion at March 31, 2008 compared to \$2.925 billion at December 31, 2007, an increase of \$41.7 million. In comparing the composition of the average balances of our deposits between the first quarter of 2008 with the first quarter of 2007, we have experienced increased growth in our higher cost certificate of deposit balances than in any other category. This increase in reliance on higher cost deposits has contributed to a reduced net interest margin between the two periods.

Capital and Liquidity. At March 31, 2008, our capital ratios, including our bank's capital ratios, met regulatory minimum capital requirements. Additionally, at March 31, 2008, our bank would be considered to be well-capitalized pursuant to banking

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regulations. As our bank grows it will require additional capital from us over that which can be earned through operations. We anticipate that we will continue to use various capital raising techniques in order to support the growth of our bank.

In the past, we have been successful in procuring additional capital from the capital markets (via public and private offerings of trust preferred securities and common stock). This additional capital was required to support our growth. As of March 31, 2008, we believe should we continue our rapid growth, should we acquire any other banks or should we expand into a new geographic market those matters could result in issuance of additional capital, including additional common shares.

Critical Accounting Estimates

The accounting principles we follow and our methods of applying these principles conform with U.S. generally accepted accounting principles and with general practices within the banking industry. In connection with the application of those principles, we have made judgments and estimates which, in the case of the determination of our allowance for loan losses, the application of SFAS No. 123 (revised 2004), Share Based Payments (SFAS No. 123(R)) and the assessment of impairment of the intangibles resulting from the Mid-America and Cavalry mergers have been critical to the determination of our financial position and results of operations.

Allowance for Loan Losses (allowance). Our management assesses the adequacy of the allowance prior to the end of each calendar quarter. This assessment includes procedures to estimate the allowance and test the adequacy and appropriateness of the resulting balance. The level of the allowance is based upon management's evaluation of the loan portfolios, past loan loss experience, known and inherent risks in the portfolio, adverse situations that may affect the borrower's ability to repay (including the timing of future payment), the estimated value of any underlying collateral, composition of the loan portfolio, economic conditions, industry and peer bank loan quality indications and other pertinent factors. This evaluation is inherently subjective as it requires material estimates including the amounts and timing of future cash flows expected to be received on impaired loans that may be susceptible to significant change. Loan losses are charged off when management believes that the full collectability of the loan is unlikely. 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. Allocation of the allowance may be made for specific loans, but the entire allowance is available for any loan that, in management's judgment, is deemed to be uncollectible.

Larger balance commercial and commercial real estate loans are impaired when, based on current information and events, it is probable that we will be unable to collect all amounts due according to the contractual terms of the loan agreement. Collection of all amounts due according to the contractual terms means that both the contractual interest payments and the contractual principal payments of a loan will be collected as scheduled in the loan agreement. An impairment allowance is recognized if the present value of expected future cash flows from the loan is less than the recorded investment in the loan (recorded investment in the loan is the principal balance plus any accrued interest, net deferred loan fees or costs and unamortized premium or discount, and does not reflect any direct write-down of the investment). The impairment is recognized through the allowance. Loans that are impaired are recorded at the present value of expected future cash flows discounted at the loan's effective interest rate, or if the loan is collateral dependent, impairment measurement is based on the fair value of the collateral, less estimated disposal costs. Income is recognized on impaired loans on a cash basis.

The level of allowance maintained is believed by management to be adequate to absorb probable losses in the portfolio at the balance sheet date. The allowance is increased by provisions charged to expense and decreased by charge-offs, net of recoveries of amounts previously charged-off.

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, the input from our independent loan reviewer, and reviews that may have been conducted by bank regulatory agencies as part of their usual examination process. We incorporate loan review results in the determination of whether or not it is probable that we will be able to collect all amounts due according to the contractual terms of a loan.

As part of management's quarterly assessment of the allowance, management divides the loan portfolio into four segments: commercial, commercial real estate, consumer and consumer real estate. Each segment is then analyzed such that an allocation of the allowance is estimated for each loan segment.

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The allowance allocation for commercial and commercial real estate loans 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 for industry and various peer bank groups. The estimated loan loss allocation rate for our internal system of credit risk grades for commercial and commercial real estate is based on management's experience with similarly graded loans, discussions with banking regulators and our internal loan review processes. We then weight the allocation methodologies for the commercial and commercial real estate portfolios and determine a weighted average allocation 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 management's experience. Additionally, consumer and consumer real estate loans are analyzed based on our actual loss rates, industry loss rates and loss rates of various peer bank groups. Consumer and consumer real estate loans are evaluated as a group by category (i.e. retail real estate, installment, etc.) rather than on an individual loan 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. The estimated loan loss allocation for all four 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 inherent credit losses which may exist, but have not yet been identified, as of the balance sheet date 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 four loan segments and the allowance allocation as determined by the processes noted above for each segment is increased or decreased based on the incremental assessment of these various environmental factors.

We then test the resulting allowance balance by comparing the balance in the allowance to historical trends and industry and peer information. Our management then evaluates the result of the procedures performed, including the result of our testing, and concludes on the appropriateness of the balance of the allowance in its entirety. The audit committee of our board of directors reviews and approves the assessment prior to the filing of quarterly and annual financial information.

We are in the process of reevaluating our quarterly allowance assessment process, particularly in the area of estimating loss allocation rates and the allocation of environmental factors. The results of the reevaluation are not yet completed and will be incorporated into our June 30, 2008 assessment. The impact of this reevaluation is unknown at this time.

Share Based Payments On January 1, 2006, we adopted SFAS No. 123(R), which addresses the accounting for share-based payment transactions in which a company receives employee services in exchange for equity instruments. SFAS No.123(R) eliminates the ability to account for share-based compensation transactions, as we formerly did, using the intrinsic value method as prescribed by Accounting Principles Board (APB) Opinion No. 25, Accounting for Stock Issued to Employees, and generally requires that such transactions be accounted for using a fair-value-based method and recognized as an expense.

We adopted SFAS No. 123(R) using the modified prospective method which requires the application of the accounting standard as of January 1, 2006. Application of SFAS No. 123(R) required us to assess numerous factors including the historical volatility of our stock price, anticipated option forfeitures and estimates concerning the length of time that our options would remain unexercised. Many of these assessments impact the fair value of the underlying stock option more significantly than others and changes to these assessments in future periods could be significant. We believe the assumptions we have incorporated into our stock option fair value assessments are reasonable.

Accounting for the Mid-America and Cavalry Acquisitions We recorded the assets and liabilities of Mid-America as of November 30, 2007 and Cavalry as of March 15, 2006, at estimated fair value. Arriving at these fair values required numerous assumptions regarding the economic life of assets, decay rates for liabilities and other factors. We engaged a third party to assist us in valuing certain of the financial assets and liabilities. We also engaged a real estate appraisal

firm to value the more significant properties that were acquired and engaged a firm to analyze the income tax implications of the assets and liabilities acquired as well as the deductibility of the various cash payments we and the former Mid-America and Cavalry made and will make as a result of these mergers. As a result, we consider the values we have assigned to the acquired assets and liabilities to be reasonable and consistent with the application of U.S. generally accepted accounting principles (GAAP). We are still in the process of obtaining and evaluating certain other information with respect to Mid-America. Accordingly, we may have to reassess our Mid-America

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purchase price allocations. We will conclude the allocation of the Mid-America purchase price to the acquired net assets during the remainder of 2008.

Long-lived assets, including purchased intangible assets subject to amortization, such as our 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 by the amount by which the carrying amount of the asset exceeds the fair value of the asset. Assets to be disposed of would be separately presented in the balance sheet and 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 are tested for impairment 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. Our annual assessment date is September 30. Should we determine in a future period that the goodwill recorded in connection with our acquisitions have been impaired, then a charge to our earnings will be recorded in the period such determination is made.

Results of Operations

Our results for the three months ended March 31, 2008 and 2007 were highlighted by the continued growth in loans and other earning assets and deposits, primarily as a result of the Mid-America acquisition and the Knoxville expansion, which resulted in increased revenues and expenses. The following is a summary of our results of operations (dollars in thousands):

| | <i>Three months ended March 31,</i> | | <i>2008-2007 Percent Increase</i> |
|---|---|-------------|---|
| | <i>2008</i> | <i>2007</i> | |
| Interest income | \$ 52,161 | \$ 33,739 | 54.6% |
| Interest expense | 24,802 | 16,657 | 48.9% |
| Net interest income | 27,359 | 17,082 | 60.2% |
| Provision for loan losses | 1,591 | 788 | 101.9% |
| Net interest income after provision for loan losses | 25,768 | 16,294 | 58.1% |
| Noninterest income | 8,367 | 5,026 | 66.5% |
| Noninterest expense | 25,491 | 13,124 | 94.2% |
| Income before income taxes | 8,644 | 8,196 | 5.5% |
| Income tax expense | 2,579 | 2,594 | (0.6)% |
| Net income | \$ 6,065 | \$ 5,602 | 8.3% |

Our results for the three months ended March 31, 2008 included merger related expense, of \$3.106 million. Excluding merger related expense from our net income resulted in diluted net income per common share for the three months ended March 31, 2008 of \$0.34. A comparison of these amounts to our results for the three months ended March 31, 2007 and a reconciliation of this non-GAAP financial measure follow (dollars in thousands):

Reconciliation of Non-GAAP financial measures:

| | <i>Three months ended March 31,</i> | |
|--|---|-------------|
| | <i>2008</i> | <i>2007</i> |

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| | | |
|---|----------|----------|
| Net income, as reported | \$ 6,065 | \$ 5,602 |
| Merger related expense, net of tax | 1,887 | |
| Net income excluding merger related expense | \$ 7,952 | \$ 5,602 |
| Fully-diluted net income per common share, as reported | \$ 0.26 | \$ 0.34 |
| Fully-diluted net income per common share, excluding merger related expense | \$ 0.34 | \$ 0.34 |

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The presentation of this non-GAAP financial information is not intended to be considered in isolation or as a substitute for any measure prepared in accordance with GAAP. Because non-GAAP financial measures presented are not measurements determined in accordance with GAAP and are susceptible to varying calculations, these non-GAAP financial measures, as presented, may not be comparable to other similarly titled measures presented by other companies.

Pinnacle Financial believes that this non-GAAP financial measure, excluding the impact of merger related expense, facilitates making period-to-period comparisons, is a meaningful indication of our operating performance, and provides investors with additional information to evaluate our past financial results and ongoing operational performance.

Pinnacle Financial's management and board utilizes this non-GAAP financial information to compare our operating performance between accounting periods and has utilized non-GAAP diluted earnings per share (excluding the merger related expenses) in establishing the performance targets of our 2008 Annual Cash Incentive Plan and in calculating whether we have met or will meet our earnings per share targets in our restricted stock award agreements.

Net Interest Income. Net interest income represents the amount by which interest earned on various earning assets exceeds interest paid on deposits and other interest bearing liabilities and is the most significant component of our earnings. For the three months ended March 31, 2008, we recorded net interest income of \$27.4 million, which resulted in a net interest margin of 3.37%. For the three months ended March 31, 2007, we recorded net interest income of \$17.1 million, which resulted in a net interest margin of 3.64%.

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The following table sets forth the amount of our average balances, interest income or interest expense for each category of interest-earning assets and interest-bearing liabilities and the average interest rate for total interest-earning assets and total interest-bearing liabilities, net interest spread and net interest margin for the three months ended March 31, 2008 and 2007 (dollars in thousands):

| <i>(dollars in thousands)</i> | <i>Three months ended March 31, 2008</i> | | | <i>Three months ended March 31, 2007</i> | | |
|--|--|-----------------|--------------------------|--|-----------------|--------------------------|
| | <i>Average Balances</i> | <i>Interest</i> | <i>Rates/ Yields</i> | <i>Average Balances</i> | <i>Interest</i> | <i>Rates/ Yields</i> |
| <i>Interest-earning assets:</i> | | | | | | |
| Loans | \$ 2,761,745 | \$ 45,392 | 6.61% | \$ 1,530,771 | \$ 28,977 | 7.68% |
| Securities: | | | | | | |
| Taxable | 367,125 | 4,637 | 5.12% | 272,669 | 3,346 | 4.98% |
| Tax-exempt (1) | 136,690 | 1,351 | 5.24% | 72,961 | 670 | 4.91% |
| Federal funds sold and other | 58,892 | 781 | 5.56% | 55,897 | 746 | 5.42% |
| Total interest-earning assets | 3,324,452 | 52,161 | 6.37% | 1,932,298 | 33,739 | 7.13% |
| <i>Nonearning assets</i> | | | | | | |
| Intangible assets | 258,807 | | | 122,728 | | |
| Other nonearning assets | 190,783 | | | 94,902 | | |
| Total assets | \$ 3,774,042 | | | \$ 2,149,928 | | |
| <i>Interest-bearing liabilities:</i> | | | | | | |
| Interest bearing deposits: | | | | | | |
| Interest checking | \$ 404,307 | \$ 2,129 | 2.12% | \$ 244,680 | \$ 1,957 | 3.24% |
| Savings and money market | 735,899 | 4,098 | 2.24% | 495,877 | 4,125 | 3.37% |
| Certificates of deposit | 1,372,899 | 14,859 | 4.35% | 624,092 | 7,456 | 4.84% |
| Total interest bearing deposits | 2,513,105 | 21,086 | 3.37% | 1,364,649 | 13,538 | 4.02% |
| Securities sold under agreements to repurchase | 169,146 | 832 | 1.98% | 157,180 | 1,712 | 4.42% |
| Federal Home Loan Bank advances and other borrowings | 143,802 | 1,426 | 3.99% | 40,241 | 531 | 5.36% |
| Subordinated debt | 82,476 | 1,458 | 7.11% | 51,548 | 876 | 6.89% |
| Total interest-bearing liabilities | 2,908,529 | 24,802 | 3.43% | 1,613,618 | 16,657 | 4.19% |
| <i>Noninterest-bearing deposits</i> | 368,413 | | | 269,864 | | |
| Total deposits and interest-bearing liabilities | 3,276,942 | 24,802 | 3.04% | 1,883,482 | 16,657 | 3.59% |

| | | | |
|----------------------------|--------------|--------------|-------|
| Other liabilities | 22,661 | 6,980 | |
| Stockholders equity | 474,439 | 259,466 | |
| | \$ 3,774,042 | \$ 2,149,928 | |
| Net interest income | \$ 27,359 | \$ 17,082 | |
| Net interest spread (2) | | 2.94% | 2.94% |
| Net interest margin (3) | | 3.37% | 3.64% |

(1) *Yields computed on tax-exempt instruments on a tax equivalent basis.*

(2) *Yields realized on interest-earning assets less the rates paid on interest-bearing liabilities.*

(3) *Net interest margin is the result of annualized net interest income calculated on a tax-equivalent basis divided by average interest-earning assets for the period.*

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As noted above, the net interest margin for the three months ended March 31, 2008 was 3.37% compared to a net interest margin of 3.64% for the same period in 2007. Our net interest margin for the three months ended March 31, 2008 was 0.27% less than our margin during the same time in the previous year. This was the result of our earning asset yields for the three months ended March 31, 2008 being 0.76% less than the earning asset yields for the previous year while our funding costs were only 0.55% less. Also impacting our net interest margin comparisons between the two periods was Mid-America which had more noncore deposits and a higher funding cost. Other matters related to our net interest income, net interest yields and rates, and net interest margin are presented below:

Our loan yields were 1.07% less during the first three months of 2008 when compared to the same period in 2007. A significant amount of our loan portfolio has variable rate pricing with a large portion of these loans tied to our prime lending rate. Our weighted average prime rate for the first three months of 2008 was 3.13% compared to 5.25% for the same period in 2007. Our prime lending rate moves in concert with the Federal Reserve's changes to its Federal funds rate.

We have been able to grow our funding base significantly. For asset/liability management purposes, we elected to allocate a greater proportion of such funds to our loan portfolio versus our securities and shorter-term investment portfolio during the three month period noted above. For the first three months of 2008, average loan balances were 83.1% of total interest-earning assets compared to 79.2% during the same period in 2007. Loans generally have higher yields than do securities and other shorter-term investments. This change in allocation reduced the decline in overall total interest earning asset yields between the two periods.

During the first three months of 2008, overall deposit rates were less than those rates for the comparable period in 2007 by 0.65%. Normally, interest rates paid on products such as interest checking, savings and money market accounts, securities sold under agreements to repurchase and Federal funds purchased will generally increase or decrease in a manner that is consistent with changes in the short-term rate environment. There was a significant decrease in the short term rate environment during the first three months of 2008 when compared with the first three months of 2007. As a result, the rates for those products experienced a large decrease between the two periods. However, another factor influencing our margin is competitor pricing. We routinely monitor the pricing of deposit products by our primary competitors. We believe that our markets are very competitive banking markets with new banks entering our markets continually. As a result, even though the short-term rate environment may allow for rate decreases in our short-term funding base; these decreases will be offset by competitive pressures.

During the first three months of 2008, the average balances of noninterest bearing deposit balances, interest bearing transaction accounts, savings and money market accounts and securities sold under agreements to repurchase amounted to 51.2% of our total funding compared to 62.0% during the same period in 2007. These funding sources generally have lower rates than do other funding sources, such as certificates of deposit and other borrowings. Additionally, noninterest bearing deposits comprised only 11.2% of total funding in 2008, compared to 14.3% in 2007. Maintaining our noninterest bearing deposit balances in relation to total funding is critical to maintaining and growing our net interest margin and receives a great deal of emphasis by management. Thus, the mix of our deposit base in 2008 was weighted more to higher cost time deposits and other wholesale funding sources which also contributed to our lower net interest margin in 2008.

Also impacting the net interest margin during the first three months of 2008 was pricing of our floating rate subordinated indebtedness. The interest rate charged on this indebtedness is generally higher than other funding sources. In October 2007, we issued an additional \$30 million in floating rate subordinated indebtedness to fund the cash component of the Mid-America purchase price. The rate we are required to pay on this indebtedness is 285 points over three-month LIBOR. This spread is higher than similar forms of subordinated indebtedness which were issued in previous periods.

During the three months ended March 31, 2008, the yield curve steepened which is advantageous for most banks, including us, as we use a significant amount of short-term funding to fund our balance sheet growth. This short-term funding comes in the form of checking accounts, savings accounts, money market accounts, short-term time deposits and securities sold under agreements to repurchase. Rates paid on these short-term deposits generally correlate to the Fed funds rate and short term treasury rates. During most of 2007, the Fed funds rate was higher than other longer term treasuries (i.e., an inverted yield curve). As a result, for most of 2007 depositors tended to maintain their funds in shorter-term deposit accounts where they could achieve a higher yield on their deposit balances and did not concern themselves with long-term products because there was not enough yield for them to justify the longer maturity. In a more traditional rate environment, depositors typically would either accept a lesser rate for more liquid deposit

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accounts or choose a higher rate for a longer time deposit. We believe a more normalized yield curve will be advantageous to us as our deposit base tends to prefer shorter term instruments.

On April 30, 2008, the Federal Reserve reduced the targeted Federal funds rate such that the targeted rate is now 2%. This reduction will, in all likelihood, compress our net interest margins in the near term as we will experience reduced yields on a significant portion of our earning asset base and will not be able to counter this impact via reduced funding costs quickly. Generally, we should be able to reduce our funding costs over an extended period of time following a Federal Reserve rate reduction. Traditionally, we maintain an asset sensitive balance sheet, thus when rates are stable to increasing our net interest margins should expand.

We believe we should be able to increase net interest income through overall growth in earning assets in 2008 compared to previous periods. The additional revenues provided by increased loan volumes should be sufficient to overcome any immediate increases in funding costs, and thus we should be able to increase our current net interest income. Our net interest margins will likely decrease due to increasingly competitive deposit pricing in our markets and further near-term rate reductions by the Federal Reserve. In the last few months of 2007 and first few months of 2008, the Federal Reserve reduced short-term rates dramatically. We have taken steps to counter the impact of these rate decreases on our floating rate assets (including prime rate loans) by reducing deposit rates to an appropriate level where we believe we can sustain our funding base. We believe it will take more time for our competition in our market to begin to price in the full impact of these rate decreases, and for competitive reasons we will not be able to counter the full impact of these rate decreases on our net interest margin. As a result, we believe our net interest margins in 2008 will be lower than in 2007.

Provision for Loan Losses. The provision for loan losses represents a charge to earnings necessary to establish an allowance for loan losses that, in our management's evaluation, should be adequate to provide coverage for the inherent losses on outstanding loans. The provision for loan losses amounted to \$1,591,000 and \$788,000 for the three months ended March 31, 2008 and 2007, respectively.

Based upon our evaluation of the loan portfolio, we believe the allowance for loan losses to be adequate to absorb our estimate of probable losses existing in the loan portfolio at March 31, 2008. A significant increase in loan growth and increased net-charge offs during the first three months of 2008 were the primary reasons for the increased provision expense in 2008 when compared to 2007.

Based upon management's assessment of the loan portfolio, we adjust our allowance for loan losses to an amount deemed appropriate to adequately cover probable losses in the loan portfolio. While our policies and procedures used to estimate the allowance for loan losses, as well as the resultant provision for loan losses charged to operations, are considered adequate by our management and are reviewed from time to time by regulators, they are necessarily approximate. There exist factors beyond our control, such as general economic conditions both locally and nationally, which may negatively impact, materially, the adequacy of our allowance for loan losses and, thus, the resulting provision for loan losses.

Noninterest Income. Our noninterest income is composed of several components, some of which vary significantly between quarterly and annual periods. Service charges on deposit accounts and other noninterest income generally reflect our growth, while investment services and fees from the origination of mortgage loans will often reflect market conditions and fluctuate from period to period. The opportunities for recognition of gains on loans and loan participations sold may also vary widely from quarter to quarter and year to year and may diminish over time as our lending and industry concentration limits increase.

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The following is the makeup of our noninterest income for the three months ended March 31, 2008 and 2007 (dollars in thousands):

| | <i>Three months ended March 31,</i> | | <i>2008-2007 Percent Increase (decrease)</i> |
|---|---|-------------|--|
| | <i>2008</i> | <i>2007</i> | |
| <i>Noninterest income:</i> | | | |
| Service charges on deposit accounts | \$ 2,574 | \$ 1,797 | 43.2% |
| Investment services | 1,268 | 735 | 72.5% |
| Insurance sales commissions | 1,064 | 637 | 67.0% |
| Gains on sales of loans and loan participations, net: | | | |
| Fees from the origination and sale of mortgage loans, net of sales commissions | 652 | 318 | 105.0% |
| Gains on loans and loan participations sold, net | 4 | 45 | (91.1)% |
| Trust fees | 505 | 420 | 20.2% |
| Other noninterest income: | | | |
| ATM and other consumer fees | 943 | 519 | 81.7% |
| Letters of credit fees | 86 | 60 | 43.3% |
| Bank-owned life insurance | 362 | 138 | 162.3% |
| Equity in earnings of Collateral Plus, LLC | 24 | 11 | 118.2% |
| Swap fees on customer loan transactions, net | 183 | | |
| Visa related gains | 203 | | |
| Other noninterest income | 499 | 346 | 44.2% |
| Total noninterest income | \$ 8,367 | \$ 5,026 | 66.5% |

Service charge income for the first three months of 2008 increased over that of the same period in 2007 due to the Mid-America acquisition, an increased number of customers utilizing overdraft protection products and an increased per item insufficient fund charge. Additionally, we have increased the number of deposit accounts subject to service charges. Also, the increase in service charges in 2008 when compared to 2007 was impacted by a decreased earnings credit rate provided by Pinnacle National to its commercial deposit customers.

Also included in noninterest income are commissions and fees from our financial advisory unit, Pinnacle Asset Management, a division of Pinnacle National. Our Mid-America acquisition had a significant impact on our investment services fees, as a significant amount of Mid-America's fee business was attributable to wealth management, particularly brokerage services. At March 31, 2008, Pinnacle Asset Management was receiving commissions and fees in connection with approximately \$859 million in brokerage assets held with Raymond James Financial Services, Inc. compared to \$617 million at March 31, 2007. We also offer trust services through Pinnacle National's trust division. At March 31, 2008, our trust department was receiving fees on approximately \$493 million in assets compared to \$400 million at March 31, 2008. We offer insurance services through Miller and Loughry Insurance and Services, Inc. which we believe will continue to increase our noninterest income in future periods. During the first three months of 2008, Miller and Loughry received approximately \$450,000 in fees from one of its insurance carriers due to favorable claims experience by that carrier. We do not anticipate any additional similar fees from this insurance carrier this year.

Additionally, mortgage related fees for the first quarter of 2008 also provided for a significant portion of the increase in noninterest income between the first three months of 2008 when compared to 2007. These mortgage fees are for loans originated in our market areas that are subsequently sold to third-party investors. All of these loan sales transfer

servicing rights to the buyer. Generally, mortgage origination fees increase in lower interest rate environments and decrease in rising interest rate environments. As a result, mortgage origination fees may fluctuate greatly in response to a changing rate environment. Also, impacting mortgage origination fees are the number of mortgage originators we have offering these products. These originators are largely commission-based employees. We have steadily increased the number of originators working for us over the years and plan to continue to increase our mortgage origination work force in 2008.

We also sell certain commercial loan participations to our correspondent banks. Such sales are primarily related to new lending transactions in excess of internal loan limits or industry concentration limits. At March 31, 2008 and pursuant to participation agreements with these correspondents, we had participated approximately \$113.7 million of originated loans to these other banks. These participation agreements have various provisions regarding collateral position, pricing and other matters. Many of these agreements provide that we pay the correspondent less than the loan's contracted interest rate. Pursuant to SFAS No. 140,

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Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities a replacement of *Financial Accounting Standards Board (FASB) Statement No. 125*, in those transactions whereby the correspondent is receiving a lesser amount of interest than the amount owed by the customer, we record a net gain along with a corresponding asset representing the present value of our net retained cash flows. The resulting asset is amortized over the term of the loan. Conversely, should a loan be paid prior to maturity, any remaining unamortized asset is charged as a reduction to gains on loan participations sold. We recorded gains, net of amortization expense related to the aforementioned retained cash flow asset, of \$4,000 and \$45,000 during the three months ended March 31, 2008 and 2007, respectively, related to the loan participation transactions. We intend to maintain relationships with our correspondents in order to sell participations in future loans to these or other correspondents primarily due to limitations on loans to a single borrower or industry concentrations. In general, our acquisitions and our growth have resulted in an increase in capital which has resulted in increased lending limits for such items as loans to a single borrower and loans to a single industry such that our need to participate such loans in the future may be reduced. In any event, the timing of participations may cause the level of gains, if any, to vary significantly. Included in other noninterest income are miscellaneous consumer fees, such as ATM revenues, merchant card and other electronic banking revenues. We experienced a significant increase in these revenues during the first three months of 2008 compared to the same time period in 2007 due primarily to the merger with Mid-America. Additionally, noninterest income from the cash surrender value of bank-owned life insurance increased significantly between the first three months of 2008 and the first three months of 2007. During the fourth quarter of 2007, we acquired approximately \$20 million in additional bank-owned life insurance. These policies insure numerous executives, managers and other personnel of our company. For these new policies, Pinnacle National is the sole beneficiary of these policies.

Also included in other noninterest income is \$183,000 in fees we receive when we originate an interest rate swap transaction between an individual commercial borrower and a third party provider. This amount will fluctuate significantly based on both borrower demand for this product and the interest rate environment. During the first quarter of 2008, we recorded \$145,000 in expense associated with the Visa litigation contingency. Additionally, we recorded \$140,000 in gains from the redemption of Visa stock and \$63,000 in gains from the reduction in the liability established for Visa related contingencies. Other noninterest income also increased by approximately \$233,000 during the first quarter of 2008 when compared to the same period in 2007. Most of this increase was due to the Mid-America transaction with most of these revenues being for loan late charges and other fees.

Noninterest Expense. Noninterest expense consists of salaries and employee benefits, equipment and occupancy expenses, and other operating expenses. The following is the makeup of our noninterest expense for the three months ended March 31, 2008 and 2007 (dollars in thousands):

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| | <i>Three months ended March 31,</i> | | <i>2008-2007 Percent Increase (decrease)</i> |
|---|---|-------------|--|
| | <i>2008</i> | <i>2007</i> | |
| <i>Noninterest expense:</i> | | | |
| Salaries and employee benefits: | | | |
| Salaries | \$ 8,726 | \$ 5,507 | 58.5% |
| Commissions | 637 | 391 | 62.9% |
| Other compensation, primarily incentives | 2,110 | 1,022 | 106.5% |
| Employee benefits and other | 2,394 | 1,347 | 77.7% |
| Total salaries and employee benefits | 13,867 | 8,267 | 67.7% |
| Equipment and occupancy | 4,276 | 2,165 | 97.5% |
| Marketing and business development | 376 | 252 | 49.2% |
| Postage and supplies | 648 | 454 | 42.7% |
| Amortization of core deposit intangible | 766 | 516 | 48.4% |
| Other noninterest expense: | | | |
| Other real estate | 61 | 5 | 1120.0% |
| Professional fees | 44 | 186 | (76.3)% |
| Legal, including borrower-related charges | 158 | 132 | 19.7% |
| Directors fees | 83 | 60 | 38.3% |
| Insurance, including FDIC assessments | 727 | 349 | 108.3% |
| Charitable contributions | 109 | 93 | 17.2% |
| Other noninterest expense | 1,271 | 645 | 97.1% |
| Total other noninterest expense | 2,453 | 1,470 | 66.9% |
| Merger related expense | 3,106 | | - |
| Total noninterest expense | \$ 25,491 | \$ 13,124 | 94.2% |

Expenses have generally increased between the above periods due to our merger with Mid-America, personnel additions occurring throughout each period, the continued development of our branch network and other expenses which increase in relation to our growth rate. We anticipate continued increases in our expenses in the future for such items as additional personnel, the opening of additional branches and other expenses which tend to increase in relation to our growth. Additionally, for the three months ended March 31, 2008 and 2007, approximately \$481,000 and \$467,000, respectively, of compensation expense related to stock options and restricted share awards is included in other incentive compensation expense.

At March 31, 2008, we employed 686.0 full time equivalent employees compared to 419.5 at March 31, 2007. We intend to continue to add employees to our work force for the foreseeable future, which will cause our salary and employee benefits costs to increase in future periods.

We believe that variable pay incentives are a valuable tool in motivating an employee base that is focused on providing our clients effective financial advice and increasing shareholder value. As a result, and unlike many other financial institutions, our employees have historically participated in our annual cash incentive plan. Under the plan, the targeted level of incentive payments requires the Company to achieve a certain soundness threshold and a targeted fully diluted earnings per share. To the extent that actual earnings per share are above or below targeted earnings per share, the aggregate incentive payments are increased or decreased. Additionally, our Human Resources and

Compensation Committee (the Committee) of the Board of Directors has the ability to change the parameters of the variable cash award at any time prior to final distribution of the awards in order to take into account current events and circumstances and maximize the benefit of the awards to our firm and to the associates.

Included in the salary and employee benefits amounts for the three months ended March 31, 2008 and 2007, were \$1,486,000 and \$590,000, respectively, related to variable cash awards. This expense will fluctuate from year to year and quarter to quarter based on the estimation of achievement of performance targets and the increase in the number of associates eligible to receive the award. Based on our current earnings forecast for 2008, for the three months ended March 31, 2008, we have anticipated a cash award to qualifying associates equal to 100% of their targeted award and consequently we have recorded the quarterly portion of this incentive expense assuming 100% of the targeted award. We will continue to review our anticipated 2008 cash incentive expense throughout 2008 which may require us to increase or decrease the anticipated award above or below the 100% amount at March 31, 2008 based on the new estimate. For the three months ended March 31, 2007, the anticipated award to be paid to associates equaled

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50% of their targeted award. The incentive plan for 2008 is structured similarly to prior year plans in that the award is based on the achievement of soundness and earnings objectives.

In connection with our merger with Mid-America, all former associates of Mid-America that were displaced by our merger were granted a retention bonus award provided they worked through a predetermined date. Also, those associates that continue as Pinnacle associates following the merger are eligible for a retention bonus should they continue their employment through December 31, 2008. We anticipate that this retention bonus award will approximate \$4.6 million and will be treated as a merger related expense in 2008, of which \$1.4 million was accrued during the first three months of 2008. Since these associates have agreed to a retention bonus award, they are not eligible to participate in any of our other cash or equity incentive award plans until 2009.

Equipment and occupancy expenses in the first quarter of 2008 were greater than the first quarter of 2007 by 97.5%. This increase is primarily attributable to our market expansion to Knoxville, Tennessee which began in the second quarter of 2007, our new branch facility in the Donelson area of Nashville which opened late in the first quarter of 2007, and a full quarter of expenses associated with the eleven Mid-America branches which were acquired on November 30, 2007. These additions contributed to the increase in our equipment and occupancy expenses between the two periods and will contribute to increases in expenses in the future as we construct new facilities, including new facilities currently planned in both the Nashville and Knoxville MSAs.

Marketing and other business development and postage and supplies expenses are higher in 2008 compared to 2007 due to increases in the number of customers and prospective customers; increases in the number of customer contact personnel and the corresponding increases in customer entertainment; and other business development expenses.

Included in noninterest expense for the first quarter of 2008 and 2007 is \$766,000 and \$516,000, respectively of amortization of the core deposit intangible. For Mid-America, this identified intangible is being amortized over ten years using an accelerated method which anticipates the life of the underlying deposits. For Cavalry, this identified intangible is being amortized over seven years using an accelerated method which anticipates the life of the underlying deposits. Amortization expense associated with these core deposit intangibles will approximate \$2.5 million to \$2.9 million per year for the next five years with lesser amounts for the remaining years.

Additionally, for the three months ended March 31, 2008, we incurred \$3.106 million of merger related expense directly associated with the Mid-America merger. The merger related charges consisted of integration costs incurred in connection with the merger, including approximately \$1.42 million of retention bonuses payable to Mid-America associates, \$876,000 in conversion related incentive payments and other personnel costs, \$637,000 in information technology conversion matters and \$148,000 in other integration charges. We anticipate additional merger related expenses associated with the Mid-America transaction in 2008 as we fully integrate this acquisition of approximately \$4.75 million.

Other noninterest expenses increased \$983,000 in the first quarter of 2008 when compared to the same quarter in 2007. Most of these increases are attributable to increased insurance and other noninterest expenses which include incidental variable costs related to deposit gathering and lending. Examples include expenses related to ATM networks, correspondent bank service charges, check losses, appraisal expenses, closing attorney expenses and other items which have increased significantly as a result of the Mid-America merger.

Our efficiency ratio (ratio of noninterest expense to the sum of net interest income and noninterest income) was 71.4% for the first three months of 2008 compared to 59.4% in 2007. The efficiency ratio for the first three months of 2008 includes the impact of merger related expenses of \$3.106 million. Excluding merger related expenses from the efficiency ratio would result in total noninterest expense of \$22.39 million compared to the sum of net interest income and noninterest income of \$35.73 million or an efficiency ratio of 62.7%. The efficiency ratio measures the amount of expense that is incurred to generate a dollar of revenue.

Financial Condition

Our consolidated balance sheet at March 31, 2008 reflects organic growth since December 31, 2007. Total assets grew to \$3.89 billion at March 31, 2008 from \$3.79 billion at December 31, 2007.

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Loans. The composition of loans at March 31, 2008 and at December 31, 2007 and the percentage (%) of each classification to total loans are summarized as follows (dollars in thousands):

| | <i>March 31, 2008</i> | | <i>December 31, 2007</i> | |
|-----------------------------------|-----------------------|----------------|--------------------------|----------------|
| | <i>Amount</i> | <i>Percent</i> | <i>Amount</i> | <i>Percent</i> |
| Commercial real estate Mortgage | \$ 771,926 | 26.9% | \$ 728,201 | 26.5% |
| Consumer real estate Mortgage | 584,104 | 20.4% | 562,721 | 20.5% |
| Construction and land development | 557,070 | 19.4% | 517,399 | 18.8% |
| Commercial and industrial | 859,364 | 30.0% | 838,161 | 30.5% |
| Consumer and other loans | 94,072 | 3.3% | 103,159 | 3.7% |
| Total loans | \$ 2,866,536 | 100.0% | \$ 2,749,641 | 100.0% |

Although the allocation of our loan portfolio did not change significantly during the three months ended March 31, 2008 we did experience an increase of 0.4% in the commercial real estate classification and a 0.6% increase in the construction and land development classification. A portion of this increase is attributable to the conversion of the Mid-America loan systems to Pinnacle National's loan accounting systems in which we reclassified several borrowers which were previously classified as commercial real estate and construction and land development. Additionally, we continue to have loan demand for our commercial real estate and construction lending products; we will continue to pursue quality real estate lending opportunities. Because these types of loans require that we maintain effective credit and construction monitoring systems, we have increased our resources in this area. We believe we can effectively manage this area of exposure through utilization of experienced professionals who are well-trained in this type of lending and who have significant experience in our geographic market.

We periodically analyze our commercial loan portfolio to determine if a concentration of credit risk exists to any one or more industries. We use broadly accepted industry classification systems in order to classify borrowers into various industry classifications. As a result, we have a credit exposure (loans outstanding plus unfunded commitments) exceeding 25% of Pinnacle National's total risk-based capital to borrowers in the following industries at March 31, 2008 and December 31, 2007 (dollars in thousands):

| | At March 31, 2008 | | | Total Exposure at December 31, 2007 |
|--|---------------------------|-----------------------------|-----------------------|--|
| | Outstanding | | | |
| | Principal Balances | Unfunded Commitments | Total exposure | |
| Trucking industry | \$ 86,903 | \$ 26,125 | \$ 113,028 | \$ 109,118 |
| Lessors of nonresidential buildings | 235,618 | 46,088 | 281,706 | 249,959 |
| Lessors of residential buildings | 111,488 | 12,508 | 123,996 | 135,413 |
| Land subdividers | 202,864 | 74,692 | 277,556 | 283,327 |
| New housing operative builders | 168,138 | 97,246 | 265,384 | 269,744 |
| New single family housing construction | 77,727 | 26,009 | 103,736 | 104,980 |

The following table classifies our fixed and variable rate loans at March 31, 2008 according to contractual maturities of (1) one year or less, (2) after one year through five years, and (3) after five years. The table also classifies our variable rate loans pursuant to the contractual repricing dates of the underlying loans (dollars in thousands):

Table of Contents*Amounts at March 31, 2008*

| | <i>Fixed Rates</i> | <i>Variable Rates</i> | <i>Totals</i> | <i>At March 31, 2008</i> | <i>At December 31, 2007</i> |
|--|------------------------|---------------------------|---------------|----------------------------------|---|
| <i>Based on contractual maturity:</i> | | | | | |
| Due within one year | \$ 241,065 | \$ 1,011,282 | \$ 1,252,347 | 43.7% | 44.5% |
| Due in one year to five years | 810,235 | 325,748 | 1,135,983 | 39.6% | 39.9% |
| Due after five years | 135,565 | 342,641 | 478,206 | 16.7% | 15.6% |
| Totals | \$ 1,186,865 | \$ 1,679,671 | \$ 2,866,536 | 100.0% | 100.0% |
| <i>Based on contractual repricing dates:</i> | | | | | |
| Daily floating rate | \$ | \$ 1,185,380 | \$ 1,185,380 | 41.4% | 40.0% |
| Due within one year | 241,065 | 394,953 | 636,018 | 22.2% | 21.2% |
| Due in one year to five years | 810,235 | 91,908 | 902,143 | 31.4% | 32.4% |
| Due after five years | 135,565 | 7,430 | 142,995 | 5.0% | 6.4% |
| Totals | \$ 1,186,865 | \$ 1,679,671 | \$ 2,866,536 | 100.0% | 100.0% |

The above information does not consider the impact of scheduled principal payments. Daily floating rate loans are tied to Pinnacle National's prime lending rate or a national interest rate index with the underlying loan rates changing in relation to changes in these indexes.

Non-Performing Assets. The specific economic and credit risks associated with our loan portfolio include, but are not limited to, a general downturn in the economy which could affect employment rates in our market area, general real estate market deterioration, interest rate fluctuations, deteriorated or non-existent collateral, title defects, inaccurate appraisals, financial deterioration of borrowers, fraud, and any violation of laws and regulations.

We attempt to reduce these economic and credit risks by adherence to loan to value guidelines for collateralized loans, by investigating the creditworthiness of the borrower and by monitoring the borrower's financial position. Also, we establish and periodically review our lending policies and procedures. Banking regulations limit our exposure by prohibiting loan relationships that exceed 15% of Pinnacle National's statutory capital in the case of loans that are not fully secured by readily marketable or other permissible types of collateral. Furthermore, we have an internal limit for aggregate credit exposure (loans outstanding plus unfunded commitments) to a single borrower of \$22 million. Our loan policy requires that our board of directors approve any relationships that exceed this internal limit.

We discontinue the accrual of interest income when (1) there is a significant deterioration in the financial condition of the borrower and full repayment of principal and interest is not expected or (2) the principal or interest is more than 90 days past due, unless the loan is both well-secured and in the process of collection. At March 31, 2008, we had \$17,124,000 in loans on nonaccrual compared to \$19,677,000 at December 31, 2007. The decrease in nonperforming loans between March 31, 2008 and December 31, 2007 was primarily related to borrower payments received during the three months ended March 31, 2008 and transfers of certain loans to other real estate owned.

At March 31, 2008, we owned \$3,567,000 in real estate which we had acquired, usually through foreclosure, from borrowers compared to \$1,673,000 at December 31, 2007. Substantially all of this amount relates to homes that are in various stages of construction for which we believe we have adequate collateral.

There was \$2.0 million of other loans 90 past due and still accruing interest at March 31, 2008 compared to \$1.61 million at December 31, 2007. At March 31, 2008 and at December 31, 2007, no loans were deemed to be restructured loans. The following table is a summary of our nonperforming assets at March 31, 2008 and December 31, 2007 (dollars in thousands):

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| | <i>At Mar. 31, 2008</i> | <i>At Dec. 31, 2007</i> |
|---|-----------------------------|-----------------------------|
| Nonaccrual loans (1) | \$ 17,124 | \$ 19,677 |
| Restructured loans | | |
| Other real estate owned | 3,567 | 1,673 |
| Total nonperforming assets | 20,691 | 21,350 |
| Accruing loans past due 90 days or more | 2,002 | 1,613 |
| Total nonperforming assets and accruing loans past due 90 days or more | \$ 22,693 | \$ 22,963 |
| Total loans outstanding | \$ 2,866,536 | \$ 2,749,641 |
| Ratio of nonperforming assets and accruing loans past due 90 days or more to total loans outstanding at end of period | 0.80% | 0.84% |
| Ratio of nonperforming assets and accruing loans past 90 days or more to total allowance for loan losses at end of period | 75.97% | 80.66% |

(1) Interest income that would have been recorded during the three months ended March 31, 2008 related to nonaccrual loans was \$482,000.

Potential problem assets, which are not included in nonperforming assets, amounted to approximately \$1.35 million or 0.05% of total loans outstanding at March 31, 2008. Potential problem assets represent those assets with a well-defined weakness and where information about possible credit problems of borrowers has caused management to have serious doubts about the borrower's ability to comply with present repayment terms. This definition is believed to be substantially consistent with the standards established by the OCC, Pinnacle National's primary regulator, for loans classified as substandard.

Allowance for Loan Losses (allowance). We maintain the allowance at a level that our management deems appropriate to adequately cover the inherent risks in the loan portfolio. As of March 31, 2008 and December 31, 2007, our allowance for loan losses was \$29,871,000 and \$28,470,000, respectively, which our management deemed to be adequate at each of the respective dates. The judgments and estimates associated with our ALL determination are described under *Critical Accounting Estimates* above. The following is a summary of changes in the allowance for loan losses for the three months ended March 31, 2008 and for the year ended December 31, 2007 and the ratio of the allowance for loan losses to total loans as of the end of each period (dollars in thousands):

| | <i>At Mar. 31, 2008</i> | <i>At Dec. 31, 2007</i> |
|--------------------------------|-----------------------------|-----------------------------|
| Balance at beginning of period | \$ 28,470 | \$ 16,118 |

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| | | |
|--|-----------|-----------|
| Provision for loan losses | 1,591 | 4,720 |
| Allowance from Mid-America acquisition | | 8,695 |
| Charged-off loans: | | |
| Commercial real estate Mortgage | | (22) |
| Consumer real estate Mortgage | (481) | (364) |
| Construction and land development | | (271) |
| Commercial and industrial | (102) | (326) |
| Consumer and other loans | (174) | (359) |
| Total charged-off loans | (757) | (1,342) |
| Recoveries of previously charged-off loans: | | |
| Commercial real estate Mortgage | | 125 |
| Consumer real estate Mortgage | | 1 |
| Construction and land development | 355 | 51 |
| Commercial and industrial | 100 | 102 |
| Consumer and other loans | 112 | |
| Total recoveries of previously charged-off loans | 567 | 279 |
| Net (charge-offs) recoveries | (190) | (1,063) |
| Balance at end of period | \$ 29,871 | \$ 28,470 |
| Ratio of allowance for loan losses to total loans outstanding at end of period | 1.04% | 1.04% |
| Ratio of net charge-offs (*) to average loans outstanding for the period | 0.03% | 0.06% |

(*) Net charge-offs for the three months ended March 31, 2008 have been annualized.

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As noted in our critical accounting policies, management assesses the adequacy of the allowance prior to the end of each calendar quarter. This assessment includes procedures to estimate the allowance and test the adequacy and appropriateness of the resulting balance. The level of the allowance is based upon management's evaluation of the loan portfolios, past loan loss experience, known and inherent risks in the portfolio, adverse situations that may affect the borrower's ability to repay (including the timing of future payment), the estimated value of any underlying collateral, composition of the loan portfolio, economic conditions, industry and peer bank loan quality indications and other pertinent factors. This evaluation is inherently subjective as it requires material estimates including the amounts and timing of future cash flows expected to be received on impaired loans that may be susceptible to significant change. Although the allowance increased by \$1.4 million between March 31, 2008 and December 31, 2007, the ratio of our allowance for loan losses to total loans outstanding remained unchanged at 1.04% at both March 31, 2008 and December 31, 2007. In the future, the allowance to total loans outstanding ratio will increase or decrease to the extent the factors that influence our quarterly allowance assessment in their entirety either improve or weaken.

Investments. Our investment portfolio, consisting primarily of Federal agency bonds, state and municipal securities and mortgage-backed securities, amounted to \$505.4 million and \$522.7 million at March 31, 2008 and December 31, 2007, respectively. Our investment portfolio serves many purposes including serving as a stable source of income, collateral for public funds and as a liquidity source. A statistical comparison of our entire investment portfolio at March 31, 2008 is as follows:

| | March 31, 2008 |
|-------------------------|---------------------------|
| Weighted average life | 6.6 years |
| Weighted average coupon | 4.95% |
| Tax equivalent yield | 5.37% |

Deposits and Other Borrowings. We had approximately \$2.97 billion of deposits at March 31, 2008 compared to \$2.93 billion at December 31, 2007. Our deposits consist of noninterest and interest-bearing demand accounts, savings accounts, money market accounts and time deposits. Additionally, we entered into agreements with certain customers to sell certain of our securities under agreements to repurchase the security the following day. These agreements (which are typically associated with comprehensive treasury management programs for our commercial clients and provide the client with short-term returns for their excess funds) amounted to \$171.2 million at March 31, 2008 and \$156.1 million at December 31, 2007. Additionally, at March 31, 2008, we had borrowed \$159.4 million in advances from the Federal Home Loan Bank of Cincinnati compared to \$92.8 million at December 31, 2007.

Traditionally, banks classify their funding base as either core funding or non-core funding. Core funding consists of all deposits other than time deposits issued in denominations of \$100,000 or greater while all other funding is deemed to be non-core. The following table represents the balances of our deposits and other fundings and the percentage of each type to the total at March 31, 2008 and December 31, 2007 (dollars in thousands):

| | March 31, 2008 | Percent | December 31, 2007 | Percent |
|---|---------------------------|----------------|----------------------------------|----------------|
| Core funding: | | | | |
| Noninterest-bearing deposit accounts | \$ 429,289 | 12.7% | \$ 400,120 | 12.1% |
| Interest-bearing demand accounts | 406,907 | 12.0% | 410,661 | 12.4% |
| Savings and money market accounts | 757,776 | 22.4% | 742,354 | 22.5% |
| Time deposit accounts less than \$100,000 | 358,738 | 10.6% | 371,881 | 11.3% |
| Total core funding | 1,952,710 | 57.6% | 1,925,016 | 58.2% |

Non-core funding:

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| | | | | |
|--|--------------|--------|--------------|--------|
| Time deposit accounts greater than \$100,000 | | | | |
| Public funds | 154,187 | 4.5% | 104,902 | 3.2% |
| Brokered deposits | 224,287 | 6.6% | 163,188 | 4.9% |
| Other time deposits | 635,841 | 18.8% | 732,213 | 22.2% |
| Securities sold under agreements to repurchase | 171,186 | 5.1% | 156,071 | 4.7% |
| Federal Home Loan Bank advances and other borrowings | 168,606 | 5.0% | 141,666 | 4.3% |
| Subordinated debt | 82,476 | 2.4% | 82,476 | 2.5% |
| Total non-core funding | 1,436,583 | 42.4% | 1,380,516 | 41.8% |
| Totals | \$ 3,389,293 | 100.0% | \$ 3,305,532 | 100.0% |

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The amount of time deposits as of March 31, 2008 amounted to \$1.373 million. The following table shows our time deposits in denominations of under \$100,000 and those of denominations of \$100,000 or greater by category based on time remaining until maturity of (1) three months or less, (2) over three but less than six months, (3) over six but less than twelve months and (4) over twelve months and the weighted average rate for each category (dollars in thousands):

| | Balances | Weighted Avg. Rate |
|--|-----------------|-------------------------------|
| <u><i>Denominations less than \$100,000</i></u> | | |
| Three months or less | \$ 122,951 | 4.39% |
| Over three but less than six months | 106,267 | 4.45% |
| Over six but less than twelve months | 88,204 | 4.04% |
| Over twelve months | 41,316 | 4.43% |
| | 358,738 | 4.33% |
| <u><i>Denomination \$100,000 and greater</i></u> | | |
| Three months or less | 442,457 | 3.87% |
| Over three but less than six months | 238,001 | 4.25% |
| Over six but less than twelve months | 224,260 | 4.26% |
| Over twelve months | 109,596 | 4.98% |
| | 1,014,314 | 4.17% |
| Totals | \$ 1,373,052 | 4.21% |

Subordinated debt and holding company line of credit. On December 29, 2003, we established PNFP Statutory Trust I; on September 15, 2005 we established PNFP Statutory Trust II; on September 7, 2006 we established PNFP Statutory Trust III and on October 31, 2007 we established PNFP Statutory Trust IV (Trust I ; Trust II ; Trust III , Trust IV or collectively, the Trusts). All are wholly-owned statutory business trusts. We are the sole sponsor of the Trusts and acquired each Trust's common securities for \$310,000; \$619,000; \$619,000 and \$928,000, respectively. The Trusts were created for the exclusive purpose of issuing 30-year capital trust preferred securities (Trust Preferred Securities) in the aggregate amount of \$10,000,000 for Trust I; \$20,000,000 for Trust II; \$20,000,000 for Trust III; and \$30,000,000 for Trust IV and using the proceeds to acquire junior subordinated debentures (Subordinated Debentures) issued by Pinnacle Financial. The sole assets of the Trusts are the Subordinated Debentures. At March 31, 2008, our \$2,476,000 investment in the Trusts is included in investments in unconsolidated subsidiaries in the accompanying consolidated balance sheets and our \$82,476,000 obligation is reflected as subordinated debt. The Trust I Preferred Securities bear a floating interest rate based on a spread over 3-month LIBOR (5.60% at March 31, 2008) which is set each quarter and matures on December 30, 2033. The Trust II Preferred Securities bear a fixed interest rate of 5.848% per annum through September 30, 2010 at which time the securities will bear a floating rate set each quarter based on a spread over 3-month LIBOR. The Trust II securities mature on September 30, 2035. The Trust III Preferred Securities bear a floating interest rate based on a spread over 3-month LIBOR (4.35% at March 31, 2008) which is set each quarter and mature on September 30, 2036. The Trust IV Preferred Securities bear a floating interest rate based on a spread over 3-month LIBOR (5.65% at March 31, 2008) which is set each quarter and mature on September 30, 2037.

Distributions are payable quarterly. The Trust Preferred Securities are subject to mandatory redemption upon repayment of the Subordinated Debentures at their stated maturity date or their earlier redemption in an amount equal to their liquidation amount plus accumulated and unpaid distributions to the date of redemption. We guarantee the

payment of distributions and payments for redemption or liquidation of the Trust Preferred Securities to the extent of funds held by the Trusts. Pinnacle Financial's obligations under the Subordinated Debentures together with the guarantee and other back-up obligations, in the aggregate, constitute a full and unconditional guarantee by Pinnacle Financial of the obligations of the Trusts under the Trust Preferred Securities.

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

Subject to approval by the Federal Reserve Bank of Atlanta, the Trust Preferred Securities may be redeemed prior to maturity at our option on or after September 17, 2008 for Trust I; on or after September 30, 2010 for Trust II; September 30, 2011 for Trust III and September 30, 2012 for Trust IV. The Trust Preferred Securities may also be redeemed at any time in whole (but not in part) in the event of unfavorable changes in laws or regulations that result in (1) the Trust becoming subject to federal income tax on income received on the Subordinated Debentures, (2) interest payable by the parent company on the Subordinated Debentures becoming non-deductible for federal tax purposes, (3) the requirement for the Trust to register under the Investment Company Act of 1940, as

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amended, or (4) loss of the ability to treat the Trust Preferred Securities as Tier I capital under the Federal Reserve capital adequacy guidelines.

The Trust Preferred Securities for the Trusts qualify as Tier I capital under current regulatory definitions subject to certain limitations. Debt issuance costs associated with Trust I of \$120,000 consisting primarily of underwriting discounts and professional fees are included in other assets in the accompanying consolidated balance sheet. These debt issuance costs are being amortized over ten years using the straight-line method. There were no debt issuance costs associated with Trust II, Trust III or Trust IV.

At March 31, 2008, we had a loan agreement related to a \$25 million line of credit with a regional bank. This line of credit will be used to support the growth of Pinnacle National. The balance owed pursuant to this line of credit at March 31, 2008 was \$9 million. The \$25 million line of credit has a one year term, contains customary affirmative and negative covenants regarding the operation of our business, a negative pledge on the common stock of Pinnacle National and is priced at 30-day LIBOR plus 125 basis points.

Capital Resources. At March 31, 2008 and December 31, 2007, our stockholders' equity amounted to \$477.2 million and \$466.6 million, respectively, or an increase of \$10.6 million. This increase was primarily attributable to \$9.98 million in comprehensive income, which was composed of \$6.06 million in net income together with \$3.91 of net unrealized holding gains associated with our available-for-sale portfolio.

Dividends. Pinnacle National is subject to restrictions on the payment of dividends to Pinnacle Financial under Federal banking laws and the regulations of the Office of the Comptroller of the Currency. Pinnacle Financial has not paid any dividends to date, nor does Pinnacle Financial anticipate paying dividends to its shareholders for the foreseeable future. Future dividend policy will depend on Pinnacle Financial's and Pinnacle National's earnings, capital position, financial condition, anticipated growth rates and other factors.

Market and Liquidity Risk Management

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

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

Earnings simulation model. We believe that interest rate risk is best measured by our earnings simulation modeling. Forecasted levels of earning assets, interest-bearing liabilities, and off-balance sheet financial instruments are combined with ALCO forecasts of interest rates for the next 12 months and are combined with other factors in order to produce various earnings simulations. To limit interest rate risk, we have guidelines for our earnings at risk which seek to limit the variance of net interest income to less than a 20 percent decline for a 300 basis point change up or down in rates from management's flat interest rate forecast over the next twelve months; to less than a 10 percent decline for a 200 basis point change up or down in rates from management's flat interest rate forecast over the next twelve months; and to less than a 5 percent decline for a 100 basis point change up or down in rates from management's flat interest rate forecast over the next twelve months. The results of our current simulation model would indicate that we are in compliance with our current guidelines at March 31, 2008.

Economic value of equity. Our economic value of equity model measures the extent that estimated economic values of our assets, liabilities and off-balance sheet items will change as a result of interest rate changes. Economic values are determined by discounting expected cash flows from assets, liabilities and off-balance sheet items, which establishes a base case economic value of equity. To help limit interest rate risk, we have a guideline stating that for an instantaneous 300 basis point change in interest rates up or down, the economic value of equity will not decrease by more than 30 percent from the base case; for a 200 basis point instantaneous change in interest rates up or down, the

economic value of equity should not decrease by more than 20 percent; and for a 100 basis point instantaneous change in interest rates up or down, the economic value of equity will not decrease by more than 10 percent. The results of our current economic value of equity model would indicate that we are in compliance with our current guidelines at March 31, 2008.

Each of the above analyses may not, on its own, be an accurate indicator of how our net interest income will be affected by changes in interest rates. Income associated with interest-earning assets and costs associated with interest-bearing liabilities may not be

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affected uniformly by changes in interest rates. In addition, the magnitude and duration of changes in interest rates may have a significant impact on net interest income. For example, although certain assets and liabilities may have similar maturities or periods of repricing, they may react in different degrees to changes in market interest rates. Interest rates on certain types of assets and liabilities fluctuate in advance of changes in general market rates, while interest rates on other types may lag behind changes in general market rates. In addition, certain assets, such as adjustable rate mortgage loans, have features (generally referred to as interest rate caps and floors) which limit changes in interest rates. Prepayment and early withdrawal levels also could deviate significantly from those assumed in calculating the maturity of certain instruments. The ability of many borrowers to service their debts also may decrease during periods of rising interest rates. ALCO reviews each of the above interest rate sensitivity analyses along with several different interest rate scenarios as part of its responsibility to provide a satisfactory, consistent level of profitability within the framework of established liquidity, loan, investment, borrowing, and capital policies. We may also use derivative financial instruments to improve the balance between interest-sensitive assets and interest-sensitive liabilities and as one tool to manage our interest rate sensitivity while continuing to meet the credit and deposit needs of our customers. Beginning in 2007, we entered into interest rate swaps (swaps) to facilitate customer transactions and meet their financing needs. These swaps qualify as derivatives, but are not designated as hedging instruments. At March 31, 2008 and December 31, 2007, we had not entered into any derivative contracts to assist managing our interest rate sensitivity.

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

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

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

In addition, Pinnacle National is a member of the Federal Home Loan Bank of Cincinnati (FHLB). As a result, Pinnacle National receives advances from the FHLB, pursuant to the terms of various borrowing agreements, which assist it in the funding of its home mortgage and commercial real estate loan portfolios. Pinnacle National has pledged under the borrowing agreements with the Federal Home Loan Bank of Cincinnati certain qualifying residential mortgage loans and, pursuant to a blanket lien, all qualifying commercial mortgage loans as collateral. At March 31, 2008, our bank subsidiaries had received advances from the Federal Home Loan Bank of Cincinnati totaling \$159.4 million at the following rates and maturities (dollars in thousands):

| | Amount | Interest Rates |
|------------|---------------|-----------------------|
| 2008 | \$ 40,000 | 3.61% |
| 2009 | 15,000 | 5.01% |
| 2010 | 12,926 | 4.56% |
| 2012 | 30,000 | 3.51% |
| Thereafter | 61,486 | 2.92% |

| | | |
|---------------------------------------|------------|-------|
| Total | \$ 159,412 | |
| <i>Weighted average interest rate</i> | | 3.54% |

Pinnacle National also has accommodations with upstream correspondent banks for unsecured short-term advances. These accommodations have various covenants related to their term and availability, and in most cases must be repaid within less than a month. At March 31, 2008, we had borrowed from correspondent banks \$194,000 under such agreements.

At March 31, 2008, brokered certificates of deposit approximated \$224.3 million which represented 6.6% of total fundings compared to \$163.2 million and 4.9% at December 31, 2007. We issue these brokered certificates through several different brokerage houses based on competitive bid. Typically, these funds are for varying maturities from nine months to two years and are issued at rates which are competitive to rates we would be required to pay to attract similar deposits from the local market as well as rates for Federal Home Loan Bank of Cincinnati advances of similar maturities. We consider these deposits to be a ready source of liquidity under current market conditions.

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At March 31, 2008, we had no significant commitments for capital expenditures. However, we are in the process of developing our branch network or other office facilities in the Nashville MSA and the Knoxville MSA. As a result, we anticipate that we will enter into contracts to buy property or construct branch facilities and/or lease agreements to lease facilities in the Nashville MSA and Knoxville MSA, including recently entering into agreements to relocate our downtown office facility in Nashville, Tennessee to a new facility projected to open in 2010.

Our management believes that we have adequate liquidity to meet all known contractual obligations and unfunded commitments, including loan commitments and reasonable borrower, depositor, and creditor requirements over the next twelve months.

Off-Balance Sheet Arrangements. At March 31, 2008, we had outstanding standby letters of credit of \$90.9 million and unfunded loan commitments outstanding of \$870.0 million. Because these commitments generally have fixed expiration dates and many will expire without being drawn upon, the total commitment level does not necessarily represent future cash requirements. If needed to fund these outstanding commitments, Pinnacle National has the ability to liquidate Federal funds sold or securities available-for-sale, or on a short-term basis to borrow and purchase Federal funds from other financial institutions.

Impact of Inflation

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

Recently Adopted Accounting Pronouncements

In September 2006, the FASB issued SFAS No. 157, Fair Value Measurements SFAS No. 157, which defines fair value, establishes a framework for measuring fair value in U.S. generally accepted accounting principles and expands disclosures about fair value measurements. SFAS No. 157 applies only to fair-value measurements that are already required or permitted by other accounting standards and is expected to increase the consistency of those measurements. The definition of fair value focuses on the exit price, i.e., the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date, not the entry price, i.e., the price that would be paid to acquire the asset or received to assume the liability at the measurement date. The statement emphasizes that fair value is a market-based measurement; not an entity-specific measurement. Therefore, the fair value measurement should be determined based on the assumptions that market participants would use in pricing the asset or liability. The effective date for SFAS No. 157 is for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years. Pinnacle Financial adopted SFAS No. 157 effective January 1, 2008. The adoption of SFAS No. 157 had no impact on our consolidated financial statements.

In February of 2007, the FASB issued Statement of Financial Accounting Standard No. 159 (SFAS 159), The Fair Value Option for Financial Assets and Financial Liabilities , which gives entities the option to measure eligible financial assets, and financial liabilities at fair value on an instrument by instrument basis, that are otherwise not permitted to be accounted for at fair value under other accounting standards. The election to use the fair value option is available when an entity first recognizes a financial asset or financial liability. Subsequent changes in fair value must be recorded in earnings. This statement was effective as of January 1, 2008, however it had no impact on the consolidated financial statements of Pinnacle Financial because it did not elect the fair value option for any financial instrument not presently being accounting for at fair value.

In June 2006, the Emerging Issues Task Force issued EITF No. 06-4, Accounting for Deferred Compensation and Postretirement Benefits Aspects of Endorsement Split-Dollar Life Insurance Arrangements. The EITF concluded that deferred compensation or postretirement benefit aspects of an endorsement split-dollar life insurance arrangement should be recognized as a liability by the employer and the obligation is not effectively settled by the purchase of a life insurance policy. The effective date was for fiscal years beginning after December 15, 2007. On January 1, 2008, we accounted for this EITF as a change in accounting principle and recorded a liability of \$985,000 along with a

corresponding adjustment of \$598,700 to beginning retained earnings, net of tax.

In December 2007, the SEC issued SAB 110, Share-Based Payment. SAB 110 allows eligible public companies to continue to use a simplified method for estimating the expense of stock options if their own historical experience isn't sufficient to provide a reasonable basis. Under SAB 107, Share-Based Payment, the simplified method was scheduled to expire for all grants made after December 31, 2007. The SAB describes disclosures that should be provided if a company is using the simplified method for all or a portion of its stock option grants beyond December 31, 2007. The provisions of this bulletin became effective on January 1, 2008.

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Pinnacle Financial continues to use the simplified method allowed by SAB 110 for determining the expected term component for share options granted during 2008.

Recent Accounting Pronouncements

In December 2007, the FASB issued SFAS 141R, Business Combinations. SFAS 141R clarifies the definitions of both a business combination and a business. All business combinations will be accounted for under the acquisition method (previously referred to as the purchase method). This standard defines the acquisition date as the only relevant date for recognition and measurement of the fair value of consideration paid. SFAS 141R requires the acquirer to expense all acquisition related costs. SFAS 141R will also require acquired loans to be recorded net of the allowance for loan losses on the date of acquisition. SFAS 141R defines the measurement period as the time after the acquisition date during which the acquirer may make adjustments to the provisional amounts recognized at the acquisition date. This period cannot exceed one year, and any subsequent adjustments made to provisional amounts are done retrospectively and restate prior period data. The provisions of this statement are effective for business combinations during fiscal years beginning after December 15, 2008. Pinnacle Financial has not determined the impact that SFAS 141R will have on its financial position and results of operations and believes that such determination will not be meaningful until Pinnacle Financial enters into a business combination.

In December 2007, the FASB issued SFAS No. 160, Noncontrolling Interests in consolidated financial statements An Amendment of ARB No. 51. SFAS No. 160 requires noncontrolling interests to be treated as a separate component of equity, not as a liability or other item outside of equity. Disclosure requirements include net income and comprehensive income to be displayed for both the controlling and noncontrolling interests and a separate schedule that shows the effects of any transactions with the noncontrolling interests on the equity attributable to the controlling interest. The provisions of this statement are effective for fiscal years beginning after December 15, 2008. This statement should be applied prospectively except for the presentation and disclosure requirements which shall be applied retrospectively for all periods presented. Pinnacle Financial does not expect the impact of SFAS No. 160 on its financial position, results of operations or cash flows to be material.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

The information required by this Item 3 is included on pages 40 through 42 of Part I Item 2 - Management's Discussion and Analysis of Financial Condition and Results of Operations.

ITEM 4. CONTROLS AND PROCEDURES

Evaluation of Disclosure Controls and Procedures

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

Changes in Internal Controls

There were no changes in Pinnacle Financial's internal control over financial reporting during Pinnacle Financial's fiscal quarter ended March 31, 2008 that have materially affected, or are reasonably likely to materially affect, Pinnacle Financial's internal control over financial reporting.

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PART II. OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

There are no material pending legal proceedings to which the Company is a party or of which any of their property is the subject.

ITEM 1A. RISK FACTORS

There have been no material changes to our risk factors as previously disclosed in Part I, Item IA of our Annual Report on Form 10-K for the fiscal year ended December 31, 2007.

ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

(a) Not applicable

(b) Not applicable

(c) The Company did not repurchase any shares of the Company's common stock during the quarter ended March 31, 2008.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

Not applicable

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

None

ITEM 5. OTHER INFORMATION

None

ITEM 6. EXHIBITS

| | |
|------|--|
| 31.1 | Certification pursuant to Rule 13a-14(a)/15d-14(a) |
| 31.2 | Certification pursuant to Rule 13a-14(a)/15d-14(a) |
| 32.1 | Certification pursuant to 18 USC Section 1350 Sarbanes-Oxley Act of 2002 |
| 32.2 | Certification pursuant to 18 USC Section 1350 Sarbanes-Oxley Act of 2002 |

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SIGNATURES

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

PINNACLE FINANCIAL PARTNERS,
INC

/s/ M. Terry Turner
M. Terry Turner
President and Chief Executive Officer

May 9, 2008

/s/ Harold R. Carpenter
Harold R. Carpenter
Chief Financial Officer
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