

PINNACLE FINANCIAL PARTNERS INC

Form 10-Q

October 25, 2012

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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 September 30, 2012  
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  
(State or other jurisdiction of incorporation or  
organization)

62-1812853  
(I.R.S. Employer Identification No.)

150 Third Avenue South, Suite 900, Nashville, Tennessee 37201  
(Address of principal executive offices)

(Zip Code)

(615) 744-3700  
(Registrant's telephone number, including  
area code)  
Not Applicable  
(Former name, former address and former  
fiscal year, if changes since last report)

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

Yes ☒

No ☐

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate website, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for shorter period that the registrant was required to submit and post such files).

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Yes ☒

No ☐

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

Large Accelerated Filer ☐

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 October 23, 2012 there were 34,694,003 shares of common stock, \$1.00 par value per share, issued and outstanding.

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Pinnacle Financial Partners, Inc.  
Report on Form 10-Q  
September 30, 2012

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FORWARD-LOOKING STATEMENTS

Certain of the statements in this quarterly report may constitute forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. The words “expect,” “anticipate,” “goal,” “objective,” “intend,” “plan,” “believe,” “should,” “seek,” “estimate” and expressions are intended to identify such forward-looking statements, but other statements not based on historical information may also be considered forward-looking. All forward-looking statements are subject to risks, uncertainties and other factors that may cause the actual results, performance or achievements of Pinnacle Financial to differ materially from any results expressed or implied by such forward-looking statements. Such risks include, without limitation, (i) deterioration in the financial condition of borrowers resulting in significant increases in loan losses and provisions for those losses; (ii) continuation of the historically low, short-term interest rate environment; (iii) the inability of Pinnacle Financial to grow its loan portfolio in the Nashville-Davidson-Murfreesboro-Franklin MSA (“the Nashville MSA”) and the Knoxville MSA; (iv) changes in loan underwriting, credit review or loss reserve policies associated with economic conditions, examination conclusions, or regulatory developments; (v) effectiveness of Pinnacle Financial’s asset management activities in improving, resolving or liquidating lower-quality assets; (vi) increased competition with other financial institutions; (vii) greater than anticipated adverse conditions in the national or local economies including the Nashville MSA and the Knoxville MSA, particularly in commercial and residential real estate markets; (viii) rapid fluctuations or unanticipated changes in interest rates; (ix) the results of regulatory examinations; (x) the development of any new market other than Nashville or Knoxville; (xi) a merger or acquisition; (xii) any matter that would cause Pinnacle Financial to conclude that there was impairment of any asset, including intangible assets; (xiii) the ability to attract additional financial advisors or to attract customers from other financial institutions and conversely, the inability to realize the economic benefits of newly hired financial advisors; (xiv) further deterioration in the valuation of other real estate owned and increased expenses associated therewith; (xv) inability to comply with regulatory capital requirements, including those resulting from recently proposed changes to capital calculation methodologies and required capital maintenance levels; and (xvi) changes in state and federal legislation, regulations or policies applicable to banks and other financial service providers, including regulatory or legislative developments arising out of current unsettled conditions in the economy, including implementation of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the “Dodd-Frank Act”). A more detailed description of these and other risks is contained in “Item 1A. Risk Factors” of the Company’s Annual Report on Form 10-K filed with the Securities and Exchange Commission on March 2, 2012. Many of such factors are beyond Pinnacle Financial’s ability to control or predict, and readers are cautioned not to put undue reliance on such forward-looking statements. Pinnacle Financial disclaims any obligation to update or revise any forward-looking statements contained in this quarterly report, whether as a result of new information, future events or otherwise.

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Item 1.

## Part I. Financial Information

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

	September 30, 2012	December 31, 2011
<b>ASSETS</b>		
Cash and noninterest-bearing due from banks	\$70,730,026	\$63,015,997
Interest-bearing due from banks	76,678,278	108,422,470
Federal funds sold and other	730,583	724,573
Cash and cash equivalents	148,138,887	172,163,040
Securities available-for-sale, at fair value	738,705,182	894,962,246
Securities held-to-maturity (fair value of \$586,813 and \$2,369,118 at September 30, 2012 and December 31, 2011, respectively)	574,843	2,329,917
Mortgage loans held-for-sale	39,245,780	35,363,038
Loans	3,525,164,123	3,291,350,857
Less allowance for loan losses	(69,092,075 )	(73,974,675 )
Loans, net	3,456,072,048	3,217,376,182
Premises and equipment, net	74,536,714	77,127,361
Other investments	25,871,346	44,653,840
Accrued interest receivable	15,774,555	15,243,366
Goodwill	244,044,967	244,076,492
Core deposits and other intangible assets	5,786,703	7,842,267
Other real estate owned	21,816,528	39,714,415
Other assets	100,818,517	113,098,540
Total assets	\$4,871,386,070	\$4,863,950,704
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
Deposits:		
Noninterest-bearing	\$844,480,484	\$717,378,933
Interest-bearing	673,083,495	637,203,420
Savings and money market accounts	1,606,698,275	1,585,260,139
Time	595,024,885	714,496,974
Total deposits	3,719,287,139	3,654,339,466
Securities sold under agreements to repurchase	134,786,974	131,591,412
Federal Home Loan Bank advances	190,887,031	226,068,796
Subordinated debt and other borrowings	106,783,292	97,476,000
Accrued interest payable	1,570,473	2,233,330
Other liabilities	45,246,690	42,097,132
Total liabilities	4,198,561,599	4,153,806,136
Stockholders' equity:		
	-	69,096,828

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Preferred stock, no par value; 10,000,000 shares authorized; 71,250 shares issued and outstanding at December 31, 2011

Common stock, par value \$1.00; 90,000,000 shares authorized; 34,691,659 shares and 34,354,960 shares issued and outstanding at September 30, 2012 and December 31, 2011, respectively

	34,691,659	34,354,960
Common stock warrants	-	3,348,402
Additional paid-in capital	543,042,267	536,227,537
Retained earnings	75,656,530	49,783,584
Accumulated other comprehensive income, net of taxes	19,434,015	17,333,257
Total stockholders' equity	672,824,471	710,144,568
Total liabilities and stockholders' equity	\$4,871,386,070	\$4,863,950,704

See accompanying notes to consolidated financial statements.

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	2011	2012	2011
Interest income:				
Loans, including fees	\$40,405,396	\$38,571,893	\$118,331,163	\$115,830,529
Securities:				
Taxable	3,973,717	5,952,599	13,356,957	18,792,778
Tax-exempt	1,621,541	1,819,642	4,972,539	5,593,341
Federal funds sold and other	440,254	543,496	1,557,831	1,684,376
Total interest income	46,440,908	46,887,630	138,218,490	141,901,024
Interest expense:				
Deposits	3,986,328	7,138,053	13,112,653	24,869,045
Securities sold under agreements to repurchase	99,379	204,107	370,405	931,120
Federal Home Loan Bank advances and other borrowings	1,422,845	1,189,742	4,114,008	3,929,119
Total interest expense	5,508,552	8,531,902	17,597,066	29,729,284
Net interest income	40,932,356	38,355,728	120,621,424	112,171,740
Provision for loan losses	1,412,575	3,632,440	3,080,892	16,358,767
Net interest income after provision for loan losses	39,519,781	34,723,288	117,540,532	95,812,973
Noninterest income:				
Service charges on deposit accounts	2,531,707	2,361,803	7,295,045	6,953,466
Investment services	1,676,601	1,698,886	4,934,262	4,844,398
Insurance sales commissions	987,222	1,001,716	3,415,945	3,055,194
Gain on mortgage loans sold, net	1,978,935	1,295,278	4,930,190	2,693,913
(Loss) gain on sale of investment securities, net	(49,784 )	376,509	162,733	827,708
Trust fees	767,042	753,551	2,332,716	2,253,474
Other noninterest income	2,537,863	2,592,170	7,217,879	7,585,231
Total noninterest income	10,429,586	10,079,913	30,288,770	28,213,384
Noninterest expense:				
Salaries and employee benefits	19,470,535	19,015,217	58,500,279	55,462,370
Equipment and occupancy	5,156,131	4,942,917	15,217,897	15,009,641
Other real estate expense	2,399,232	5,079,127	10,179,572	13,238,853
Marketing and other business development	834,661	751,094	2,359,760	2,271,267
Postage and supplies	637,906	509,279	1,816,925	1,544,253
Amortization of intangibles	683,430	715,514	2,055,564	2,147,323
Other noninterest expense	4,396,465	4,662,073	13,183,603	15,059,685
Total noninterest expense	33,578,360	35,675,221	103,313,600	104,733,392
Income before income taxes	16,371,007	9,127,980	44,515,702	19,292,965
Income tax expense (benefit)	5,021,882	(16,973,019)	14,361,979	(16,684,605 )
Net income	11,349,125	26,100,999	30,153,723	35,977,570
Preferred stock dividends	-	1,213,889	1,660,868	3,602,083
Accretion on preferred stock discount	-	349,817	2,153,172	983,448

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Net income available to common stockholders	\$ 11,349,125	\$ 24,537,293	\$ 26,339,683	\$ 31,392,039
Per share information:				
Basic net income per common share available to common stockholders	\$0.33	\$0.74	\$0.78	\$0.94
Diluted net income per common share available to common stockholders	\$0.33	\$0.72	\$0.76	\$0.92
Weighted average shares outstanding:				
Basic	33,939,248	33,372,980	33,879,186	33,398,029
Diluted	34,523,076	33,993,914	34,473,895	34,037,739

See accompanying notes to consolidated financial statements.



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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	2011	2012	2011
Net income:	\$ 11,349,125	\$ 26,100,999	\$ 30,153,723	\$ 35,977,570
Other comprehensive income, net of tax:				
Increase (decrease) in net gains on securities available-for-sale, net of deferred tax expense (benefit)	1,941,547	(1,352,934 )	2,100,758	9,922,126
Total comprehensive income	\$ 13,290,672	\$ 24,748,065	\$ 32,254,481	\$ 45,899,696

See accompanying notes to consolidated financial statements.

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

	Preferred			Common	Additional		Accumulated	
	Stock	Common	Stock	Stock	Paid-in	Retained	Other	Stock
	Amount	Shares	Amount	Warrants	Capital	Earnings	Comp. Income, net	Equity
Balances, December 31, 2010	\$90,788,682	33,870,380	\$33,870,380	\$3,348,402	\$530,829,019	\$12,996,202	\$5,624,600	\$677,000
Exercise of employee common stock options and related tax benefits	-	131,923	131,923	-	833,107	-	-	965,000
Issuance of restricted common shares, net of forfeitures	-	287,565	287,565	-	(287,565 )	-	-	-
Issuance of salary stock units	-	37,151	37,151	-	487,072	-	-	524,000
Restricted shares withheld for taxes	-	(20,092 )	(20,092 )	-	(270,697 )	-	-	(290,000)
Compensation expense for restricted shares	-	-	-	-	2,428,988	-	-	2,429,000
Compensation expense for stock options	-	-	-	-	951,956	-	-	952,000
Accretion on preferred stock discount	983,448	-	-	-	-	(983,448 )	-	-
Preferred dividends paid	-	-	-	-	-	(3,562,498 )	-	(3,562,000)
Net income	-	-	-	-	-	35,977,570	-	35,978,000
Other comprehensive income	-	-	-	-	-	-	9,922,126	9,922,000
Balances, September 30, 2011	\$91,772,130	34,306,927	\$34,306,927	\$3,348,402	\$534,971,880	\$44,427,826	\$15,546,726	\$724,000

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Balances, December 31, 2011	\$69,096,828	34,354,960	\$34,354,960	\$3,348,402	\$536,227,537	\$49,783,584	\$17,333,257	\$710,000,000
Exercise of employee common stock options and related tax benefits	-	230,718	230,718	-	1,297,396	-	-	1,528,112
Repurchase of preferred stock	(71,250,000)	-	-	-	-	-	-	(71,250,000)
Issuance of restricted common shares, net of forfeitures	-	95,890	95,890	-	(95,890)	-	-	-
Issuance of salary stock units	-	57,508	57,508	-	942,565	-	-	1,000,073
Restricted shares withheld for taxes	-	(47,417)	(47,417)	-	(741,427)	-	-	(788,261)
Compensation expense for restricted shares	-	-	-	-	2,489,334	-	-	2,489,334
Compensation expense for stock options	-	-	-	-	329,350	-	-	329,350
Cancellation of outstanding warrants	-	-	-	(3,348,402)	2,593,402	-	-	(755,000)
Accretion on preferred stock discount	2,153,172	-	-	-	-	(2,153,172)	-	-
Preferred dividends paid	-	-	-	-	-	(2,127,605)	-	(2,127,605)
Net income	-	-	-	-	-	30,153,723	-	30,153,723
Other comprehensive income	-	-	-	-	-	-	2,100,758	2,100,758
Balances, September 30, 2012	\$-	34,691,659	\$34,691,659	\$-	\$543,042,267	\$75,656,530	\$19,434,015	\$672,825,471

See accompanying notes to consolidated financial statements.

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

	Nine Months ended September 30,	
	2012	2011
Operating activities:		
Net income	\$30,153,723	\$35,977,570
Adjustments to reconcile net income to net cash provided by operating activities:		
Net amortization/accretion of premium/discount on securities	5,697,121	5,474,970
Depreciation and amortization	7,548,657	8,221,400
Provision for loan losses	3,080,892	16,358,767
Gain on mortgage loans sold, net	(4,930,190 )	(2,693,913 )
Gain on sale of investment securities, net	(162,733 )	(827,708 )
Gain (loss) on sale of premises	171,623	(955 )
Stock-based compensation expense	3,818,757	3,905,168
Deferred tax expense (benefit)	2,128,122	(20,236,438 )
Losses on dispositions of other real estate and other investments	9,313,372	11,242,202
Excess tax benefit from stock compensation	(31,524 )	(10,010 )
Mortgage loans held for sale:		
Loans originated	(354,271,377)	(249,141,853)
Loans sold	355,189,000	244,202,474
Decrease in other assets	25,787,538	23,679,693
Increase in other liabilities	2,486,701	11,020,121
Net cash provided by operating activities	85,979,682	87,171,488
Investing activities:		
Activities in securities available-for-sale:		
Purchases	(43,610,007 )	(252,396,360)
Sales	35,420,503	158,418,558
Maturities, prepayments and calls	162,369,154	179,823,239
Activities in securities held-to-maturity:		
Maturities, prepayments and calls	1,755,000	1,719,998
Increase (decrease) in loans, net	(250,553,288)	(79,929,662 )
Purchases of software, premises and equipment	(2,852,918 )	(1,662,017 )
Decrease (increase) in other investments	18,503,170	(393,304 )
Net cash (used in) provided by investing activities	(78,968,386 )	5,580,452
Financing activities:		
Net increase (decrease) in deposits	64,947,672	(120,365,027)
Net increase (decrease) in securities sold under agreements to repurchase	3,195,562	(17,340,629 )
Advances from Federal Home Loan Bank:		
Issuances	495,000,000	50,000,000
Payments/maturities	(530,124,164)	(10,218,835 )
Increase in other borrowings	9,307,292	-
Exercise of common stock options and stock appreciation rights	739,270	674,241
Excess tax benefit from stock compensation	31,524	10,010
Preferred dividends paid	(2,127,605 )	(3,562,498 )

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Repurchase of preferred shares outstanding	(71,250,000 )	-
Repurchase of outstanding warrants	(755,000 )	-
Net cash used in financing activities	(31,035,449 )	(100,802,738)
Net decrease in cash and cash equivalents	(24,024,153 )	(8,050,798 )
Cash and cash equivalents, beginning of period	172,163,040	188,586,181
Cash and cash equivalents, end of period	\$ 148,138,887	\$ 180,535,383

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 Bank. Pinnacle Bank is a commercial bank headquartered in Nashville, Tennessee. Pinnacle Bank provides a full range of banking services in its primary market areas of the Nashville-Davidson-Murfreesboro-Franklin, Tennessee and Knoxville, Tennessee Metropolitan Statistical Areas.

Effective September 4, 2012, Pinnacle National converted from a national bank to a Tennessee state bank and its legal name changed from Pinnacle National Bank to Pinnacle Bank. As a result of the charter conversion, the bank's primary regulator changed from the Office of the Comptroller of the Currency (OCC) to the Tennessee Department of Financial Institutions (TDFI) and the Federal Deposit Insurance Corporation (FDIC).

Basis of Presentation — The accompanying unaudited consolidated financial statements have been prepared in accordance with instructions to Form 10-Q and therefore do not include all information and footnotes necessary for a fair presentation of financial position, results of operations, and cash flows in conformity with U.S. generally accepted accounting principles (U.S. GAAP). All adjustments consisting of normally recurring accruals that, in the opinion of management, are necessary for a fair presentation of the financial position and results of operations for the periods covered by the report have been included. The accompanying unaudited consolidated financial statements should be read in conjunction with the Pinnacle Financial consolidated financial statements and related notes appearing in the 2011 Annual Report previously filed on Form 10-K.

These consolidated financial statements include the accounts of Pinnacle Financial and its wholly-owned subsidiaries. PNFP Statutory Trust I, PNFP Statutory Trust II, PNFP Statutory Trust III, and PNFP Statutory Trust IV are affiliates of Pinnacle Financial and are included in these consolidated financial statements pursuant to the equity method of accounting. Significant intercompany transactions and accounts are eliminated in consolidation.

Use of Estimates — The preparation of financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities as of the balance sheet date and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. Material estimates that are particularly susceptible to significant change in the near term include the determination of the allowance for loan losses, any potential impairment of intangible assets, including goodwill and the valuation of deferred tax assets, other real estate owned, and our investment portfolio, including other-than-temporary impairment. These financial statements should be read in conjunction with Pinnacle Financial's Annual Report on Form 10-K for the year ended December 31, 2011. There have been no significant changes to Pinnacle Financial's significant accounting policies as disclosed in Pinnacle Financial's Annual Report on Form 10-K for the year ended December 31, 2011.

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

during the first quarter of fiscal 2012 and was applied prospectively.

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

In September 2011, the FASB issued ASU No. 2011-8, Intangibles — Goodwill and Other, regarding testing goodwill for impairment. The new guidance provides an entity the option to first perform a qualitative assessment to determine whether it is more likely than not that the fair value of a reporting unit is less than its carrying amount. If an entity determines that this is the case, it is required to perform the currently prescribed two-step goodwill impairment test to identify potential goodwill impairment and measure the amount of goodwill impairment loss to be recognized for that reporting unit (if any). Based on the qualitative assessment, if an entity determines that the fair value of a reporting unit is more than its carrying amount, the two-step goodwill impairment test is not required. The new guidance was adopted by Pinnacle Financial beginning January 1, 2012 and was used in our annual assessment as of September 30, 2012. The results of our qualitative assessment indicated that the fair value of our reporting units was more than its carrying value, and accordingly, the two-step goodwill impairment test was not performed.

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

Cash Flow Information — Supplemental cash flow information addressing certain cash and noncash transactions for each of the nine months ended September 30, 2012 and 2011 was as follows:

	For the nine months ended September 30,	
	2012	2011
Cash Transactions:		
Interest paid	\$ 18,317,526	\$ 32,356,615
Income taxes paid, net	5,699,106	1,638,414
Noncash Transactions:		
Loans charged-off to the allowance for loan losses	11,265,378	27,201,443
Loans foreclosed upon and transferred to other real estate owned	8,489,792	26,689,198

Income Per Common Share — Basic net income per common share available to common stockholders (EPS) is computed by dividing net income available to common stockholders by the weighted average common shares outstanding for the period. Weighted average common shares outstanding also include salary stock units issued to the named executive officers. Diluted EPS reflects the dilution that could occur if securities or other contracts to issue common stock were exercised or converted. The difference between basic and diluted weighted average shares outstanding is attributable to common stock options, common stock appreciation rights, warrants and restricted shares with time-based vesting criteria. The dilutive effect of outstanding options, common stock appreciation rights, warrants and restricted shares with time-based vesting criteria is reflected in diluted EPS by application of the treasury stock method.

For the three and nine months ended September 30, 2012, approximately 584,000 and 595,000 shares associated with dilutive stock options, stock appreciation rights, and restricted shares with time-based vesting criteria were included in the net income per share calculation, respectively. For the three and nine months ended September 30, 2011, there were approximately 621,000 and 640,000 shares associated with dilutive stock options, stock appreciation rights, and time-based restricted shares with time-based vesting criteria outstanding to purchase common shares that were included in the net income per share calculation, respectively.

The following is a summary of the basic and diluted net income per share calculations for the three and nine months ended September 30, 2012 and 2011:

	For the three months ended September 30,		For the nine months ended September 30,	
	2012	2011	2012	2011
Basic net income per share calculation:				
Numerator - Net income available to common stockholders	\$ 11,349,125	\$ 24,537,293	\$ 26,339,683	\$ 31,392,039
Denominator - Average common shares outstanding	33,939,248	33,372,980	33,879,186	33,398,029
Basic net income per share available to common stockholders	\$0.33	\$0.74	\$0.78	\$0.94



## Diluted net income per share calculation:

Numerator – Net income available to common stockholders	\$ 11,349,125	\$ 24,537,293	\$ 26,339,683	\$ 31,392,039
Denominator - Average common shares outstanding	33,939,248	33,372,980	33,879,186	33,398,029
Dilutive shares contingently issuable	583,828	620,934	594,709	639,710
Average diluted common shares outstanding	34,523,076	33,993,914	34,473,895	34,037,739
Diluted net income per share available to common stockholders	\$0.33	\$0.72	\$0.76	\$0.92

## Note 2. Participation in U.S. Treasury Capital Purchase Program (CPP)

On December 12, 2008, Pinnacle Financial issued 95,000 shares of preferred stock to the U.S. Treasury (the Treasury) for \$95 million pursuant to the CPP. For the time the CPP preferred stock was outstanding, the CPP preferred stock was non-voting, other than having class voting rights on certain matters, and paid cumulative dividends quarterly at a rate of 5% per annum. Pinnacle Financial redeemed the preferred shares issued to the Treasury under the CPP in two payments. During the fourth quarter of 2011, Pinnacle Financial redeemed 23,750 of the preferred shares in a transaction totaling approximately \$23.9 million. During the second quarter of 2012, Pinnacle Financial completed the redemption of the remaining 71,250 preferred shares outstanding to the Treasury in a transaction totaling \$71.6 million which included accrued but unpaid dividends of \$346,000. Concurrently, Pinnacle Financial accelerated the accretion of the remaining preferred stock discount of approximately \$1.66 million during the second quarter of 2012.

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Additionally, Pinnacle Financial issued warrants to purchase 534,910 shares of common stock to the Treasury as a condition to its participation in the CPP. The warrants had an exercise price of \$26.64 each, were immediately exercisable and expired 10 years from the date of issuance. On June 16, 2009, Pinnacle Financial completed the sale of 8,855,000 shares of its common stock in a public offering, resulting in net proceeds to Pinnacle Financial of approximately \$109 million. As a result, and pursuant to the terms of the warrants, the number of shares issuable upon exercise of the warrants was reduced by 50%, or 267,455 shares. During the third quarter of 2012, Pinnacle Financial repurchased all of the remaining outstanding warrants held by the Treasury for \$755,000.

Note 3. Securities

The amortized cost and fair value of securities available-for-sale and held-to-maturity at September 30, 2012 and December 31, 2011 are summarized as follows (in thousands):

	September 30, 2012			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Securities available-for-sale:				
U.S. government agency securities	\$ 11,267	\$ 89	\$ -	\$ 11,356
Mortgage-backed securities	501,082	23,484	-	524,566
State and municipal securities	175,725	15,690	2	191,413
Corporate notes and other	9,768	1,602	-	11,370
	\$ 697,842	\$ 40,865	\$ 2	\$ 738,705
Securities held-to-maturity:				
State and municipal securities	\$ 575	\$ 12	\$ -	\$ 587
	\$ 575	\$ 12	\$ -	\$ 587
	December 31, 2011			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Securities available-for-sale:				
U.S. Government agency securities	\$ 41,978	\$ 344	\$ 9	\$ 42,313
Mortgage-backed securities	623,684	22,254	371	645,567
State and municipal securities	182,206	13,768	22	195,952
Corporate notes and other	9,687	1,443	-	11,130
	\$ 857,555	\$ 37,809	\$ 402	\$ 894,962

Securities held-to-maturity:

State and municipal securities	\$ 2,330	\$ 39	\$ -	\$ 2,369
	\$ 2,330	\$ 39	\$ -	\$ 2,369

At September 30, 2012, approximately \$633.3 million of securities within Pinnacle Financial's investment portfolio were either pledged to secure public funds and other deposits or securities sold under agreements to repurchase.

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The amortized cost and fair value of debt securities as of September 30, 2012 by contractual maturity are shown below. Actual maturities may differ from contractual maturities of mortgage-backed securities since the mortgages underlying the securities may be called or prepaid with or without penalty. Therefore, these securities are not included in the maturity categories in the following summary (in thousands):

	September 30, 2012			
	Available-for-sale		Held-to-maturity	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
Due in one year or less	\$4,071	\$4,129	\$200	\$202
Due in one year to five years	39,790	41,341	375	385
Due in five years to ten years	103,442	114,608	-	-
Due after ten years	49,457	54,061	-	-
Mortgage-backed securities	501,082	524,566	-	-
	\$697,842	\$738,705	\$575	\$587

At September 30, 2012 and December 31, 2011, included in securities were the following available-for-sale investments with unrealized losses. The information below classifies these investments according to the term of the unrealized losses of less than twelve months or twelve months or longer (in thousands):

	Investments with an Unrealized Loss of less than 12 months		Investments with an Unrealized Loss of 12 months or longer		Total Investments with an Unrealized Loss	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
At September 30, 2012:						
U.S. government agency securities	\$-	\$-	\$-	\$-	\$-	\$-
Mortgage-backed securities	-	-	-	-	-	-
State and municipal securities	625	1	330	1	955	2
Corporate notes	-	-	-	-	-	-
Total temporarily-impaired securities	\$625	\$1	\$330	\$1	\$955	\$2
At December 31, 2011:						
U.S. government agency securities	\$5,452	\$9	\$-	\$-	\$5,452	\$9
Mortgage-backed securities	41,598	341	17,826	30	59,424	371
State and municipal securities	1,967	17	1,205	5	3,172	22
Corporate notes	-	-	-	-	-	-
Total temporarily-impaired securities	\$49,017	\$367	\$19,031	\$35	\$68,048	\$402

The applicable date for determining when securities are in an unrealized loss position is September 30, 2012. As such, it is possible that a security had a market value that exceeded its amortized cost on other days during the past twelve-month period, but is in the "Investments with an Unrealized Loss of less than 12 months" category above.

As shown in the tables above, at September 30, 2012, Pinnacle Financial had approximately \$2,000 in unrealized losses on \$955,000 of available-for-sale securities. Any unrealized losses associated with these investment securities are driven by changes in interest rates and are not due to the credit quality of the securities. These securities will continue to be monitored as a part of our ongoing impairment analysis, but are expected to perform even if the rating agencies reduce the credit rating of the bond issuers. Management evaluates the financial performance of the issuers on a quarterly basis to determine if it is probable that the issuers can make all contractual principal and interest payments. Because Pinnacle Financial currently does not intend to sell those securities that have an unrealized loss at September 30, 2012, and it is not more-likely-than-not that Pinnacle Financial will be required to sell the securities before recovery of their amortized cost bases, which may be maturity, Pinnacle Financial does not consider these securities to be other-than-temporarily impaired at September 30, 2012.

Periodically, available-for-sale securities may be sold or the composition of the portfolio realigned to improve yields, quality or marketability, or to implement changes in investment or asset/liability strategy, including maintaining collateral requirements, and raising funds for liquidity purposes. Additionally, if an available-for-sale security loses its investment grade, tax-exempt status, the underlying credit support is terminated or collection otherwise becomes uncertain based on factors known to management, Pinnacle Financial will consider selling the security, but will review each security on a case-by-case basis as these factors become known. The table below shows the fair value of securities that have been sold during 2012 and the amount of gain or loss recognized on those securities as well as any other-than-temporary impairment identified during 2012 (in thousands).

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For the quarter ended,	Fair Value of securities sold		Gain recognized	Loss recognized	Net	Other-than-temporary impairment (OTTI)	Gain(loss) on the sale of securities, net of OTTI
March 31, 2012	\$ 14,360	(1)	\$ 148	\$ -	\$ 148	\$ 34	(2) \$ 114
June 30, 2012	18,273	(3)	99	-	99	-	99
September 30, 2012	2,791	(4)	7	-	7	57	(4) (50 )

- (1) During the first quarter of 2012, Pinnacle Financial sold these securities due to their relatively short terms until maturity and a weighted average coupon of 0.50%.
- (2) During the first quarter of 2012, Pinnacle Financial determined four mortgage-backed securities were OTTI because of management's intent to sell them in the second quarter of 2012. The decision to sell was based on their relative underperformance compared to expectations.
- (3) During the second quarter of 2012, Pinnacle Financial sold the four securities previously identified as OTTI in the first quarter. Additionally, two securities issued by municipalities in the state of California, which management believed could be adversely affected by state budgetary issues, were also sold during the second quarter.
- (4) During the third quarter of 2012, Pinnacle Financial determined one security was OTTI due to its distinct underperformance relative to the interest rate environment. Pinnacle Financial recognized approximately \$57,000 in OTTI and the bond was subsequently sold for a gain of approximately \$7,000.

The carrying values of Pinnacle Financial's investment securities could decline in the future if the financial condition of issuers deteriorates and management determines it is probable that Pinnacle Financial will not recover the entire amortized cost bases of the securities. As a result, there is a risk that other-than-temporary impairment charges may occur in the future.

## Note 4.

## Loans and Allowance for Loan Losses

For financial reporting purposes, Pinnacle Financial classifies its loan portfolio based on the underlying collateral utilized to secure each loan. This classification is consistent with those utilized in the Quarterly Report of Condition and Income filed with the Federal Deposit Insurance Corporation (FDIC).

The information presented herein for December 31, 2011, has been reclassified from the presentation in our Annual Report on Form 10-K for the year ended December 31, 2011 to conform to the September 30, 2012 presentation. Troubled debt restructurings previously included in accruing loans are now presented separately.

Commercial loans receive risk ratings by the assigned financial advisor that are subject to validation by our independent loan review department. Risk ratings are categorized as pass, special mention, substandard, substandard-impaired or doubtful-impaired. Pinnacle Financial believes that our categories follow those outlined by Pinnacle Bank's primary regulator. At September 30, 2012, approximately 75% of our loan portfolio was analyzed as a commercial loan type with a specifically assigned risk rating in the allowance for loan loss assessment. Consumer loans and small business loans are generally not assigned an individual risk rating but are evaluated as either accrual

or nonaccrual based on the performance of the loan. However, certain consumer real estate-mortgage loans and certain consumer and other loans receive a specific risk rating due to the loan proceeds being used for commercial purposes even though the collateral may be of a consumer loan nature.

Risk ratings are subject to continual review by the loan officer. At least annually, our credit policy requires that every risk rated loan of \$500,000 or more is subject to a formal credit risk review process. Each loan grade is also subject to review by our independent loan review department. Currently, our independent loan review department targets reviews of at least 70% of our risk rated portfolio annually. Included in the 70% coverage are independent loan reviews of loans in targeted higher-risk portfolio segments such as certain commercial and industrial loans, land loans and/or loan types in certain geographies.

The following table presents our loan balances by primary loan classification and the amount within each risk rating category. Pass rated loans include all credits other than those included in special mention, substandard, substandard-nonaccrual and doubtful-nonaccrual which are defined as follows:

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Special mention loans have potential weaknesses that deserve management's close attention. If left uncorrected, these potential weaknesses may result in deterioration of the repayment prospects for the asset or in Pinnacle Financial's credit position at some future date.

Substandard loans are inadequately protected by the current sound worth and paying capacity of the obligor or of the collateral pledged, if any. Assets so classified must have a well-defined weakness or weaknesses that jeopardize collection of the debt. Substandard loans are characterized by the distinct possibility that Pinnacle Financial will sustain some loss if the deficiencies are not corrected.

Substandard-nonaccrual loans are substandard loans that have been placed on nonaccrual status.

Doubtful-nonaccrual loans have all the characteristics of substandard-nonaccrual loans with the added characteristic that the weaknesses make collection or liquidation in full, on the basis of currently existing facts, conditions and values, highly questionable and improbable. All doubtful-nonaccrual loans are on nonaccrual status.

The following table outlines the amount of each loan classification categorized into each risk rating category as of September 30, 2012 and December 31, 2011 (in thousands):

	Commercial real estate - mortgage	Consumer real estate - mortgage	Construction and land development	Commercial and industrial	Consumer and other	Total
September 30, 2012						
Accruing loans						
Pass	\$ 1,062,132	\$ 643,667	\$ 254,763	\$ 1,226,386	\$ 84,890	\$ 3,271,838
Special Mention	16,997	6,351	32,545	26,629	-	82,522
Substandard (1)	56,393	14,293	19,251	20,204	2	110,143
Total	1,135,522	664,311	306,559	1,273,219	84,892	3,464,503
Impaired loans						
Nonperforming loans						
Substandard-nonaccrual	14,983	10,250	5,857	4,810	287	36,187
Doubtful-nonaccrual	-	298	-	86	-	384
Total nonperforming loans	14,983	10,548	5,857	4,896	287	36,571
Troubled debt restructurings(2)						
Pass	4,812	3,821	72	693	121	9,519
Special Mention	-	-	-	-	-	-
Substandard	11,819	2,210	300	242	-	14,571
Total troubled debt restructurings	16,631	6,031	372	935	121	24,090
Total impaired loans	31,614	16,579	6,229	5,831	408	60,661
Total loans	\$ 1,167,136	\$ 680,890	\$ 312,788	\$ 1,279,050	\$ 85,300	\$ 3,525,164
December 31, 2011						
Accruing loans						
Pass	\$ 994,059	\$ 643,924	\$ 204,696	\$ 1,098,898	\$ 63,218	\$ 3,004,795
Special Mention	19,403	15,225	27,553	17,029	649	79,859
Substandard (1)	72,160	18,235	28,957	16,073	1	135,426
Total	1,085,622	677,384	261,206	1,132,000	63,868	3,220,080
Impaired loans						
Nonperforming loans						



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Substandard-nonaccrual	9,962	11,990	12,965	11,194	551	46,662
Doubtful-nonaccrual	-	497	-	696	-	1,193
Total nonperforming loans	9,962	12,487	12,965	11,890	551	47,855
Troubled debt restructurings(2)						
Pass	193	3,631	77	949	242	5,092
Special Mention	-	-	-	-	-	-
Substandard	15,185	2,243	-	896	-	18,324
Total troubled debt restructurings	15,378	5,874	77	1,845	242	23,416
Total impaired loans	25,340	18,361	13,042	13,735	793	71,271
Total loans	\$ 1,110,962	\$ 695,745	\$ 274,248	\$ 1,145,735	\$ 64,661	\$ 3,291,351

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- (1) Potential problem loans represent those loans with a well-defined weakness and where information about possible credit problems of borrowers has caused management to have doubts about the borrower's ability to comply with present repayment terms. This definition is believed to be substantially consistent with the standards established by Pinnacle Bank's primary regulators for loans classified as substandard, excluding the impact of substandard nonperforming loans and substandard troubled debt restructurings. Potential problem loans, which are not included in nonperforming assets, amounted to approximately \$110.1 million at September 30, 2012, compared to \$135.4 million at December 31, 2011.
- (2) Troubled debt restructurings are presented as an impaired loan; however, they continue to accrue interest at contractual rates.

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At September 30, 2012 and December 31, 2011, all loans classified as nonaccrual were deemed to be impaired. The principal balances of these nonaccrual loans amounted to \$36.6 million and \$47.9 million at September 30, 2012 and December 31, 2011, respectively, and are included in the table above. For the nine months ended September 30, 2012, the average balance of nonaccrual loans was \$40.1 million as compared to \$63.9 million for the twelve months ended December 31, 2011. At the date such loans were placed on nonaccrual status, Pinnacle Financial reversed all previously accrued interest income against current year earnings. Had these nonaccruing loans been on accruing status, interest income would have been higher by \$415,000 and \$1.5 million, respectively, for the three and nine months ended September 30, 2012 compared to \$678,000 and \$7.6 million, respectively, for the three and nine months ended September 30, 2011, respectively.

The following table details the recorded investment, unpaid principal balance and related allowance and average recorded investment of our nonaccrual loans at September 30, 2012 and December 31, 2011 by loan classification and the amount of interest income recognized on a cash basis throughout the quarter and year-to-date period then ended, respectively, on these loans that remain on the balance sheets (in thousands):

	At September 30, 2012			For the nine months ended September 30, 2012	
	Recorded investment	Unpaid principal balance	Related allowance(1)	Average recorded investment	Interest income recognized
Collateral dependent nonaccrual loans:					
Commercial real estate – mortgage	\$ 14,020	\$ 14,620	\$ -	\$ 16,325	\$ -
Consumer real estate – mortgage	8,228	8,571	-	10,875	-
Construction and land development	2,890	3,032	-	3,313	-
Commercial and industrial	2,710	2,895	-	3,464	-
Consumer and other	-	-	-	-	-
Total	27,848	29,118	-	33,977	-
Cash flow dependent nonaccrual loans:					
Commercial real estate – mortgage	963	1,027	218	1,075	-
Consumer real estate – mortgage	2,320	2,466	526	6,988	-
Construction and land development	2,967	3,060	192	4,230	-
Commercial and industrial	2,186	2,399	1,071	2,728	-
Consumer and other	287	310	65	522	-
Total	8,723	9,262	2,072	15,543	-

Total nonaccrual loans	\$ 36,571	\$ 38,380	\$ 2,072	\$ 49,520	\$ -
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At December 31, 2011

For the year ended  
December 31, 2011Collateral dependent  
nonaccrual loans:

Commercial real estate – mortgage	\$ 9,345	\$ 12,099	\$ -	\$ 12,450	\$ 5
Consumer real estate – mortgage	9,248	9,961	-	10,140	-
Construction and land development	6,917	9,093	-	9,288	37
Commercial and industrial	3,036	3,546	-	3,689	-
Consumer and other	-	-	-	-	-
Total	28,546	34,699	-	35,567	42

Cash flow dependent  
nonaccrual loans:

Commercial real estate – mortgage	617	661	57	792	-
Consumer real estate – mortgage	3,239	4,902	301	5,005	-
Construction and land development	6,048	6,822	1,264	7,074	-
Commercial and industrial	8,854	11,041	2,767	11,497	-
Consumer and other	551	856	51	857	-
Total	19,309	24,282	4,440	25,225	-
Total nonaccrual loans	\$ 47,855	\$ 58,981	\$ 4,440	\$ 60,792	\$ 42

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

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Pinnacle Financial's policy is that once a loan is placed on nonaccrual status each subsequent payment is reviewed on a case-by-case basis to determine if the payment should be applied to interest or principal pursuant to regulatory guidelines. Pinnacle Financial recognized no interest income from cash payments received on nonaccrual loans during the nine months ended September 30, 2012 and \$42,000 of interest income during the year ended December 31, 2011.

Impaired loans also include loans that Pinnacle Bank has elected to formally restructure when, due to the weakening credit status of a borrower, the restructuring may facilitate a repayment plan that seeks to minimize the potential losses that Pinnacle Bank may have to otherwise incur. If on nonaccruing status as of the date of restructuring, the loans are included in nonperforming loans. Loans that have been restructured that were performing as of the restructure date and continue to perform in accordance with the restructured terms are reported separately as troubled debt restructurings.

At September 30, 2012 and December 31, 2011, there were \$24.1 million and \$23.4 million, respectively, of troubled debt restructurings that were performing as of their restructure date and which are accruing interest. These troubled debt restructurings are considered impaired loans pursuant to U.S. GAAP. Troubled commercial loans are restructured by specialists within our Special Assets Group, and all restructurings are approved by committees and credit officers separate and apart from the normal loan approval process. These specialists are charged with reducing Pinnacle Financial's overall risk and exposure to loss in the event of a restructuring by obtaining some or all of the following: improved documentation, additional guaranties, increase in curtailments, reduction in collateral release terms, additional collateral or other similar strategies.

The following table outlines the amount of each troubled debt restructuring categorized by loan classification during the nine months ended September 30, 2012 and September 30, 2011 (in thousands):

	September 30, 2012			September 30, 2011		
	Number of contracts	Pre Modification Outstanding Recorded Investment	Post Modification Outstanding Recorded Investment, net of related allowance	Number of contracts	Pre Modification Outstanding Recorded Investment	Post Modification Outstanding Recorded Investment, net of related allowance
Commercial real estate – mortgage	6	\$ 6,264	\$ 4,523	6	\$ 11,888	\$ 11,881
Consumer real estate – mortgage	3	694	643	8	3,153	3,044
Construction and land development	1	360	333	-	-	-
Commercial and industrial	1	59	50	15	3,146	2,700
Consumer and other	1	39	34	-	-	-
	12	\$ 7,416	\$ 5,583	29	\$ 18,187	\$ 17,265

During the twelve months ended September 30, 2012, two commercial real estate loans totaling \$3.2 million, eight commercial and industrial loans totaling \$873,000 and two consumer loans totaling \$153,000 which were previously

classified as troubled debt restructurings subsequently defaulted.

In addition to the loan metrics above, Pinnacle Financial analyzes its commercial loan portfolio to determine if a concentration of credit risk exists to any industries. Pinnacle Financial utilizes broadly accepted industry classification systems in order to classify borrowers into various industry classifications. Pinnacle Financial has a credit exposure (loans outstanding plus unfunded lines of credit) exceeding 25% of Pinnacle Bank's total risk-based capital to borrowers in the following industries at September 30, 2012 with the comparative exposures for December 31, 2011 (in thousands):

At September 30, 2012				Total Exposure at December 31, 2011
	Outstanding Principal Balances	Unfunded Commitments	Total exposure	
Lessors of nonresidential buildings	\$ 371,707	\$ 42,107	\$ 413,814	\$ 509,003
Lessors of residential buildings	175,563	14,627	190,190	177,414
Land subdividers	101,102	15,338	116,440	119,106

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The table below presents past due balances at September 30, 2012 and December 31, 2011, by loan classification and segment allocated between performing and nonperforming status (in thousands):

September 30, 2012	30-89 days past due and performing	90 days or more past due and performing	Total past due and performing	Nonperforming(1)	Current and performing	Total Loans
Commercial real estate:						
Owner-occupied	\$2,733	\$-	\$2,733	\$ 10,833	\$589,167	\$602,733
All other	468	-	468	4,150	559,785	564,403
Consumer real estate – mortgage	7,096	-	7,096	10,548	663,246	680,890
Construction and land development	980	162	1,142	5,857	305,789	312,788
Commercial and industrial	603	-	603	4,896	1,273,551	1,279,050
Consumer and other	275	-	275	287	84,738	85,300
	\$12,155					