

PINNACLE FINANCIAL PARTNERS INC  
Form 10-Q  
August 01, 2014  
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 June 30, 2014

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

(Address of principal executive offices) 37201 (Zip Code)

(615) 744-3700

(Registrant's telephone number, including area code)

Not Applicable

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

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

Yes  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).

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 July 31, 2014 there were 35,610,952 shares of common stock, \$1.00 par value per share, issued and outstanding.



Pinnacle Financial Partners, Inc.  
Report on Form 10-Q  
June 30, 2014

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## FORWARD-LOOKING STATEMENTS

Certain of the statements in this quarterly report on Form 10-Q may constitute forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. The words "expect," "anticipate," "goal," "objective," "intend," "plan," "believe," "should," "seek," "estimate" and similar 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; (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-Davidson-Murfreesboro-Franklin MSA and the Knoxville MSA, particularly in commercial and residential real estate markets; (viii) rapid fluctuations or unanticipated changes in interest rates on loans or deposits; (ix) the results of regulatory examinations; (x) the ability to retain large, uninsured deposits; (xi) the development of any new market other than Nashville or Knoxville; (xii) a merger or acquisition; (xiii) any matter that would cause Pinnacle Financial to conclude that there was impairment of any asset, including intangible assets; (xiv) reduced ability to attract additional financial advisors (or failure of such advisors to cause their clients to switch to Pinnacle Financial) or otherwise to attract customers from other financial institutions; (xv) further deterioration in the valuation of other real estate owned and increased expenses associated therewith; (xvi) inability to comply with regulatory capital requirements, including those resulting from changes to capital calculation methodologies and required capital maintenance levels; (xvii) risks associated with litigation, including the applicability of insurance coverage; (xviii) approval of the declaration of any dividend by Pinnacle Financial's board of directors; (xix) the vulnerability of our network and online banking portals to unauthorized access, computer viruses, phishing schemes, spam attacks, human error, natural disasters, power loss and other security breaches; (xx) the possibility of increased compliance costs as a result of increased regulatory oversight and the development of additional banking products for our corporate and consumer clients; and (xxi) 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. A more detailed description of these and other risks is contained in Pinnacle Financial's most recent annual report on Form 10-K filed with the Securities and Exchange Commission on February 25, 2014 and Pinnacle Financial's most recent quarterly report on Form 10-Q filed with the Securities and Exchange Commission on May 2, 2014. Many of such factors are beyond Pinnacle Financial's ability to control or predict, and readers are cautioned not to put undue reliance on such forward-looking statements. Pinnacle Financial disclaims any obligation to update or revise any forward-looking statements contained in this report, whether as a result of new information, future events or otherwise.

## Item 1. Part I. Financial Information

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

|                                                                                                                                                                                  | June 30, 2014   | December 31,<br>2013 |
|----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|-----------------|----------------------|
| <b>ASSETS</b>                                                                                                                                                                    |                 |                      |
| Cash and noninterest-bearing due from banks                                                                                                                                      | \$91,575,519    | \$79,785,004         |
| Interest-bearing due from banks                                                                                                                                                  | 114,865,408     | 124,509,486          |
| Federal funds sold and other                                                                                                                                                     | 4,667,086       | 4,644,247            |
| Cash and cash equivalents                                                                                                                                                        | 211,108,013     | 208,938,737          |
| Securities available-for-sale, at fair value                                                                                                                                     | 743,528,294     | 693,456,314          |
| Securities held-to-maturity (fair value of \$38,290,464 and \$38,817,467 at June 30, 2014 and December 31, 2013, respectively)                                                   | 38,537,545      | 39,795,649           |
| Mortgage loans held-for-sale                                                                                                                                                     | 24,591,553      | 12,850,339           |
| Loans                                                                                                                                                                            | 4,315,561,552   | 4,144,493,486        |
| Less allowance for loan losses                                                                                                                                                   | (66,888,250 )   | (67,969,693 )        |
| Loans, net                                                                                                                                                                       | 4,248,673,302   | 4,076,523,793        |
| Premises and equipment, net                                                                                                                                                      | 72,534,086      | 72,649,574           |
| Other investments                                                                                                                                                                | 33,496,695      | 33,226,195           |
| Accrued interest receivable                                                                                                                                                      | 15,921,099      | 15,406,389           |
| Goodwill                                                                                                                                                                         | 243,550,227     | 243,651,006          |
| Core deposits and other intangible assets                                                                                                                                        | 3,365,399       | 3,840,750            |
| Other real estate owned                                                                                                                                                          | 12,946,465      | 15,226,136           |
| Other assets                                                                                                                                                                     | 140,538,915     | 148,210,975          |
| Total assets                                                                                                                                                                     | \$5,788,791,593 | \$5,563,775,857      |
| <b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>                                                                                                                                      |                 |                      |
| Deposits:                                                                                                                                                                        |                 |                      |
| Noninterest-bearing                                                                                                                                                              | \$1,324,358,420 | \$1,167,414,487      |
| Interest-bearing                                                                                                                                                                 | 900,576,170     | 884,294,802          |
| Savings and money market accounts                                                                                                                                                | 1,950,235,361   | 1,962,714,398        |
| Time                                                                                                                                                                             | 476,343,393     | 519,049,037          |
| Total deposits                                                                                                                                                                   | 4,651,513,344   | 4,533,472,724        |
| Securities sold under agreements to repurchase                                                                                                                                   | 62,272,670      | 70,465,326           |
| Federal Home Loan Bank advances                                                                                                                                                  | 170,556,327     | 90,637,328           |
| Subordinated debt and other borrowings                                                                                                                                           | 97,408,292      | 98,658,292           |
| Accrued interest payable                                                                                                                                                         | 661,273         | 792,703              |
| Other liabilities                                                                                                                                                                | 41,997,702      | 46,041,823           |
| Total liabilities                                                                                                                                                                | 5,024,409,608   | 4,840,068,196        |
| Stockholders' equity:                                                                                                                                                            |                 |                      |
| Preferred stock, no par value, 10,000,000 shares authorized;<br>no shares issued and outstanding                                                                                 | -               | -                    |
| Common stock, par value \$1.00; 90,000,000 shares authorized;<br>35,601,495 and 35,221,941 shares issued and outstanding<br>at June 30, 2014 and December 31, 2013, respectively | 35,601,495      | 35,221,941           |
| Additional paid-in capital                                                                                                                                                       | 555,428,349     | 550,212,135          |

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|                                                    |                 |                 |
|----------------------------------------------------|-----------------|-----------------|
| Retained earnings                                  | 170,155,642     | 142,298,199     |
| Accumulated other comprehensive loss, net of taxes | 3,196,499       | (4,024,614 )    |
| Total stockholders' equity                         | 764,381,985     | 723,707,661     |
| Total liabilities and stockholders' equity         | \$5,788,791,593 | \$5,563,775,857 |

See accompanying notes to consolidated financial statements (unaudited).

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

|                                                      | Three Months Ended |              | Six Months Ended |              |
|------------------------------------------------------|--------------------|--------------|------------------|--------------|
|                                                      | June 30,           |              | June 30,         |              |
|                                                      | 2014               | 2013         | 2014             | 2013         |
| Interest income:                                     |                    |              |                  |              |
| Loans, including fees                                | \$45,089,706       | \$42,149,149 | \$88,785,364     | \$83,663,362 |
| Securities:                                          |                    |              |                  |              |
| Taxable                                              | 3,628,264          | 3,650,766    | 7,348,543        | 7,321,700    |
| Tax-exempt                                           | 1,563,612          | 1,483,965    | 3,161,409        | 3,140,373    |
| Federal funds sold and other                         | 282,822            | 260,440      | 559,880          | 575,212      |
| Total interest income                                | 50,564,404         | 47,544,320   | 99,855,196       | 94,700,647   |
| Interest expense:                                    |                    |              |                  |              |
| Deposits                                             | 2,481,762          | 2,955,985    | 5,077,002        | 6,368,381    |
| Securities sold under agreements to repurchase       | 31,329             | 70,823       | 61,844           | 148,639      |
| Federal Home Loan Bank advances and other borrowings | 824,912            | 918,762      | 1,582,134        | 1,826,403    |
| Total interest expense                               | 3,338,003          | 3,945,570    | 6,720,980        | 8,343,423    |
| Net interest income                                  | 47,226,401         | 43,598,750   | 93,134,216       | 86,357,224   |
| Provision for loan losses                            | 254,348            | 2,774,048    | 741,986          | 4,946,452    |
| Net interest income after provision for loan losses  | 46,972,053         | 40,824,702   | 92,392,230       | 81,410,772   |
| Noninterest income:                                  |                    |              |                  |              |
| Service charges on deposit accounts                  | 2,965,644          | 2,540,866    | 5,756,612        | 5,021,110    |
| Investment services                                  | 2,164,410          | 1,895,398    | 4,292,244        | 3,688,038    |
| Insurance sales commissions                          | 1,144,871          | 1,107,696    | 2,529,792        | 2,501,000    |
| Gain on mortgage loans sold, net                     | 1,668,604          | 1,948,531    | 2,903,475        | 3,803,942    |
| Loss on sale of investment securities                | -                  | (25,241 )    | -                | (25,241 )    |
| Trust fees                                           | 1,071,848          | 880,204      | 2,217,599        | 1,824,536    |
| Other noninterest income                             | 3,582,067          | 2,978,266    | 7,630,084        | 6,414,691    |
| Total noninterest income                             | 12,597,444         | 11,325,720   | 25,329,806       | 23,228,076   |
| Noninterest expense:                                 |                    |              |                  |              |
| Salaries and employee benefits                       | 21,772,469         | 20,570,753   | 43,522,429       | 40,143,109   |
| Equipment and occupancy                              | 5,822,662          | 5,204,159    | 11,531,692       | 10,317,209   |
| Other real estate expense                            | 226,006            | 1,390,606    | 877,158          | 2,111,568    |
| Marketing and other business development             | 1,064,990          | 987,171      | 1,973,891        | 1,777,842    |
| Postage and supplies                                 | 544,194            | 517,667      | 1,104,808        | 1,109,155    |
| Amortization of intangibles                          | 237,676            | 248,186      | 475,351          | 769,173      |
| Other noninterest expense                            | 4,233,931          | 1,943,190    | 8,062,459        | 7,073,683    |
| Total noninterest expense                            | 33,901,928         | 30,861,732   | 67,547,788       | 63,301,739   |
| Income before income taxes                           | 25,667,569         | 21,288,690   | 50,174,248       | 41,337,109   |
| Income tax expense                                   | 8,497,589          | 6,978,160    | 16,637,146       | 13,578,452   |
| Net income                                           | 17,169,980         | 14,310,530   | 33,537,102       | 27,758,657   |
| Per share information:                               |                    |              |                  |              |
| Basic net income per common share                    | \$0.49             | \$0.42       | \$0.97           | \$0.81       |
| Diluted net income per common share                  | \$0.49             | \$0.42       | \$0.96           | \$0.81       |
| Weighted average shares outstanding:                 |                    |              |                  |              |

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|         |            |            |            |            |
|---------|------------|------------|------------|------------|
| Basic   | 34,697,888 | 34,172,274 | 34,650,377 | 34,080,281 |
| Diluted | 35,081,702 | 34,431,054 | 35,024,859 | 34,319,796 |

See accompanying notes to consolidated financial statements (unaudited).

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

|                                                                                                                    | Three Months Ended |               | Six Months Ended |               |
|--------------------------------------------------------------------------------------------------------------------|--------------------|---------------|------------------|---------------|
|                                                                                                                    | June 30,           |               | June 30,         |               |
|                                                                                                                    | 2014               | 2013          | 2014             | 2013          |
| Net income                                                                                                         | \$ 17,169,980      | \$ 14,310,530 | \$ 33,537,102    | \$ 27,758,657 |
| Other comprehensive income (loss), net of tax:                                                                     |                    |               |                  |               |
| Change in fair value on available-for-sale securities, net of tax                                                  | 5,104,719          | (13,933,693)  | 10,050,631       | (16,204,604)  |
| Change in fair value of cash flow hedges, net of tax                                                               | (1,535,212)        | 3,347,367     | (2,829,518)      | 3,347,367     |
| Net loss on sale of investment securities reclassified from other comprehensive income into net income, net of tax | -                  | 15,339        | -                | 15,339        |
| Total comprehensive income                                                                                         | \$ 20,739,487      | \$ 3,739,543  | \$ 40,758,215    | \$ 14,916,759 |

See accompanying notes to consolidated financial statements (unaudited).

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

|                                                                             | Common Stock |              | Additional<br>Paid-in<br>Capital | Retained<br>Earnings | Accumulated<br>Other Comp.<br>Income<br>(Loss), net | Total<br>Stockholders'<br>Equity |
|-----------------------------------------------------------------------------|--------------|--------------|----------------------------------|----------------------|-----------------------------------------------------|----------------------------------|
|                                                                             | Shares       | Amount       |                                  |                      |                                                     |                                  |
| Balances, December 31, 2012                                                 | 34,696,597   | \$34,696,597 | \$543,760,439                    | \$87,386,689         | \$13,227,634                                        | \$679,071,359                    |
| Exercise of employee<br>common stock<br>options and related tax<br>benefits | 123,239      | 123,239      | 1,282,323                        | -                    | -                                                   | 1,405,562                        |
| Issuance of restricted common<br>shares,<br>net of forfeitures              | 293,441      | 293,441      | (293,441 )                       | -                    | -                                                   | -                                |
| Restricted shares withheld for<br>taxes                                     | (39,514 )    | (39,514 )    | (781,156 )                       | -                    | -                                                   | (820,670 )                       |
| Compensation expense for<br>restricted shares                               | -            | -            | 1,983,339                        | -                    | -                                                   | 1,983,339                        |
| Compensation expense for<br>stock options                                   | -            | -            | 12,470                           | -                    | -                                                   | 12,470                           |
| Net income                                                                  | -            | -            | -                                | 27,758,657           | -                                                   | 27,758,657                       |
| Other comprehensive loss                                                    | -            | -            | -                                | -                    | (12,841,898)                                        | (12,841,898 )                    |
| Balances, June 30, 2013                                                     | 35,073,763   | \$35,073,763 | \$545,963,974                    | \$115,145,346        | \$385,736                                           | \$696,568,819                    |
| Balances, December 31, 2013                                                 | 35,221,941   | \$35,221,941 | \$550,212,135                    | \$142,298,199        | \$(4,024,614 )                                      | \$723,707,661                    |
| Exercise of employee<br>common stock<br>options and related tax<br>benefits | 175,442      | 175,442      | 4,664,969                        | -                    | -                                                   | 4,840,411                        |
| Common stock dividends paid                                                 | -            | -            | -                                | (5,679,659 )         | -                                                   | (5,679,659 )                     |
| Issuance of restricted common<br>shares,<br>net of forfeitures              | 259,197      | 259,197      | (259,197 )                       | -                    | -                                                   | -                                |
| Restricted shares withheld for<br>taxes                                     | (55,085 )    | (55,085 )    | (1,771,041 )                     | -                    | -                                                   | (1,826,126 )                     |
| Compensation expense for<br>restricted shares                               | -            | -            | 2,581,483                        | -                    | -                                                   | 2,581,483                        |
| Net income                                                                  | -            | -            | -                                | 33,537,102           | -                                                   | 33,537,102                       |
| Other comprehensive income                                                  | -            | -            | -                                | -                    | 7,221,113                                           | 7,221,113                        |
| Balances, June 30, 2014                                                     | 35,601,495   | \$35,601,495 | \$555,428,349                    | \$170,155,642        | \$3,196,499                                         | \$764,381,985                    |

See accompanying notes to consolidated financial statements (unaudited).

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

|                                                                                                           | Six Months Ended<br>June 30, |               |
|-----------------------------------------------------------------------------------------------------------|------------------------------|---------------|
|                                                                                                           | 2014                         | 2013          |
| Operating activities:                                                                                     |                              |               |
| Net income                                                                                                | \$33,537,102                 | \$27,758,657  |
| Adjustments to reconcile net income to net cash provided by operating activities:                         |                              |               |
| Net amortization/accretion of premium/discount on securities                                              | 2,154,065                    | 2,373,927     |
| Depreciation and amortization                                                                             | 4,598,989                    | 4,622,942     |
| Provision for loan losses                                                                                 | 741,986                      | 4,946,452     |
| Gain on mortgage loans sold, net                                                                          | (2,903,475 )                 | (3,803,942 )  |
| Loss on sale of investment securities                                                                     | -                            | 25,241        |
| Stock-based compensation expense                                                                          | 2,581,483                    | 1,995,809     |
| Deferred tax benefit (expense)                                                                            | (136,855 )                   | 67,794        |
| Losses on dispositions of other real estate and other investments                                         | 141,913                      | 1,877,964     |
| Excess tax benefit from stock compensation                                                                | (1,166,463 )                 | (140,181 )    |
| Mortgage loans held for sale:                                                                             |                              |               |
| Loans originated                                                                                          | (153,548,739)                | (226,714,093) |
| Loans sold                                                                                                | 144,711,000                  | 243,750,000   |
| (Decrease) increase in other assets                                                                       | (1,504,523 )                 | 10,576,616    |
| Decrease in other liabilities                                                                             | (4,207,922 )                 | (12,608,365 ) |
| Net cash provided by operating activities                                                                 | 24,998,561                   | 54,728,821    |
| Investing activities:                                                                                     |                              |               |
| Activities in securities available-for-sale:                                                              |                              |               |
| Purchases                                                                                                 | (96,556,556 )                | (128,922,089) |
| Sales                                                                                                     | 1,273,528                    | 1,213,584     |
| Maturities, prepayments and calls                                                                         | 59,975,601                   | 77,932,668    |
| Activities in securities held-to-maturity:                                                                |                              |               |
| Purchases                                                                                                 | -                            | (2,045,030 )  |
| Maturities, prepayments and calls                                                                         | 864,028                      | 2,325,000     |
| Increase in loans, net                                                                                    | (171,994,156)                | (221,126,597) |
| Purchases of software, premises and equipment                                                             | (3,265,513 )                 | (3,388,292 )  |
| Purchase of bank owned life insurance                                                                     | -                            | (30,000,000 ) |
| Increase in other investments                                                                             | (178,118 )                   | (3,325,587 )  |
| Net cash used in investing activities                                                                     | (209,881,186)                | (307,336,343) |
| Financing activities:                                                                                     |                              |               |
| Net increase in deposits                                                                                  | 118,040,619                  | 81,390,021    |
| Net (decrease) increase in securities sold under agreements to repurchase                                 | (8,192,656 )                 | 2,678,252     |
| Advances from Federal Home Loan Bank:                                                                     |                              |               |
| Issuances                                                                                                 | 410,000,000                  | 324,038,282   |
| Payments/maturities                                                                                       | (330,047,151)                | (74,091,731 ) |
| Decrease in other borrowings                                                                              | (1,250,000 )                 | (6,250,000 )  |
| Exercise of common stock options and stock appreciation rights,<br>net of repurchase of restricted shares | 3,014,285                    | 584,892       |
| Excess tax benefit from stock compensation                                                                | 1,166,463                    | 140,181       |
| Common stock dividends paid                                                                               | (5,679,659 )                 | -             |

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|                                                |               |               |
|------------------------------------------------|---------------|---------------|
| Net cash provided by financing activities      | 187,051,901   | 328,489,897   |
| Net decrease in cash and cash equivalents      | 2,169,276     | 75,882,375    |
| Cash and cash equivalents, beginning of period | 208,938,737   | 165,288,669   |
| Cash and cash equivalents, end of period       | \$211,108,013 | \$241,171,044 |

See accompanying notes to consolidated financial statements (unaudited).

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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.

**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 2013 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, 2013. 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, 2013.

**Recently Adopted Accounting Pronouncements** — In February 2013, the FASB issued Accounting Standards Update 2013-02, "Comprehensive Income (Topic 220): Reporting of Amounts Reclassified Out of Accumulated Other Comprehensive Income" which provides disclosure guidance on amounts reclassified out of AOCI by component. The adoption did not have any impact on our financial position or results of operations but has impacted our financial statement disclosure. As shown on the statement of comprehensive income for the three and six months ended June 30, 2014, Pinnacle Financial did not reclassify any net losses out of other comprehensive income into loss on the sale of investment securities, net of tax, compared to reclassifications of net losses for the three and six months ended June 30, 2013, of approximately \$15,000, net of tax.

Cash Flow Information — Supplemental cash flow information addressing certain cash and noncash transactions for each of the six months ended June 30, 2014 and 2013 was as follows:

|                                                                         | For the six months ended |             |
|-------------------------------------------------------------------------|--------------------------|-------------|
|                                                                         | June 30,<br>2014         | 2013        |
| Cash Transactions:                                                      |                          |             |
| Interest paid                                                           | \$6,886,261              | \$8,701,479 |
| Income taxes paid, net                                                  | 14,100,000               | 15,600,009  |
| Noncash Transactions:                                                   |                          |             |
| Loans charged-off to the allowance for loan losses                      | 3,268,626                | 11,377,491  |
| Loans foreclosed upon and transferred to other real estate owned        | 1,672,459                | 1,780,131   |
| Available-for-sale securities transferred to held-to-maturity portfolio | -                        | 39,959,647  |

Income Per Common Share — Basic net income per common 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 is attributable to common stock options, common stock appreciation rights, restricted share awards, and restricted share unit awards. The dilutive effect of outstanding options, common stock appreciation rights, restricted share awards, and restricted share unit awards is reflected in diluted EPS by application of the treasury stock method.

The following is a summary of the basic and diluted net income per share calculations for the three and six months ended June 30, 2014 and 2013:

|                                                 | For the three months ended |              | For the six months ended |              |
|-------------------------------------------------|----------------------------|--------------|--------------------------|--------------|
|                                                 | June 30,<br>2014           | 2013         | June 30,<br>2014         | 2013         |
| Basic net income per share calculation:         |                            |              |                          |              |
| Numerator - Net income                          | \$17,169,980               | \$14,310,530 | \$33,537,102             | \$27,758,657 |
| Denominator - Average common shares outstanding | 34,697,888                 | 34,172,274   | 34,650,377               | 34,080,281   |
| Basic net income per share                      | \$0.49                     | \$0.42       | \$0.97                   | \$0.81       |
| Diluted net income per share calculation:       |                            |              |                          |              |
| Numerator - Net income                          | \$17,169,980               | \$14,310,530 | \$33,537,102             | \$27,758,657 |
| Denominator - Average common shares outstanding | 34,697,888                 | 34,172,274   | 34,650,377               | 34,080,281   |
| Dilutive shares contingently issuable           | 383,814                    | 258,780      | 374,482                  | 239,515      |
| Average diluted common shares outstanding       | 35,081,702                 | 34,431,054   | 35,024,859               | 34,319,796   |
| Diluted net income per share                    | \$0.49                     | \$0.42       | \$0.96                   | \$0.81       |

## Note 2. Securities

The amortized cost and fair value of securities available-for-sale and held-to-maturity at June 30, 2014 and December 31, 2013 are summarized as follows (in thousands):

|                                   | Amortized<br>Cost | Gross<br>Unrealized<br>Gains | Gross<br>Unrealized<br>Losses | Fair<br>Value |
|-----------------------------------|-------------------|------------------------------|-------------------------------|---------------|
| June 30, 2014:                    |                   |                              |                               |               |
| Securities available-for-sale:    |                   |                              |                               |               |
| U.S. Treasury securities          | \$-               | \$ -                         | \$ -                          | \$-           |
| U.S. government agency securities | 117,053           | 19                           | 6,148                         | 110,924       |
| Mortgage-backed agency securities | 452,580           | 11,608                       | 4,250                         | 459,938       |
| State and municipal securities    | 138,382           | 8,066                        | 328                           | 146,120       |
| Asset-backed securities           | 15,380            | -                            | 150                           | 15,230        |
| Corporate notes and other         | 10,207            | 1,109                        | -                             | 11,316        |
|                                   | \$733,602         | \$ 20,802                    | \$ 10,876                     | \$743,528     |
| Securities held-to-maturity:      |                   |                              |                               |               |
| State and municipal securities    | \$38,538          | \$ 120                       | \$ 368                        | \$38,290      |
|                                   | \$38,538          | \$ 120                       | \$ 368                        | \$38,290      |
| December 31, 2013:                |                   |                              |                               |               |
| Securities available-for-sale:    |                   |                              |                               |               |
| U.S. Treasury securities          | \$-               | \$ -                         | \$ -                          | \$-           |
| U.S. government agency securities | 117,282           | 13                           | 13,422                        | 103,873       |
| Mortgage-backed agency securities | 411,967           | 9,771                        | 8,802                         | 412,936       |
| State and municipal securities    | 143,763           | 5,504                        | 856                           | 148,411       |
| Asset-backed securities           | 17,262            | -                            | 255                           | 17,007        |
| Corporate notes and other         | 10,218            | 1,018                        | 7                             | 11,229        |
|                                   | \$700,492         | \$ 16,306                    | 23,342                        | \$693,456     |
| Securities held-to-maturity:      |                   |                              |                               |               |
| State and municipal securities    | \$39,796          | \$ 72                        | \$ 1,051                      | \$38,817      |
|                                   | \$39,796          | \$ 72                        | \$ 1,051                      | \$38,817      |

At June 30, 2014, approximately \$619.1 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.

The amortized cost and fair value of debt securities as of June 30, 2014 by contractual maturity are shown below. Actual maturities may differ from contractual maturities of mortgage- and asset-backed securities since the mortgages and assets 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):

|                                   | Available-for-sale |               | Held-to-maturity  |               |
|-----------------------------------|--------------------|---------------|-------------------|---------------|
|                                   | Amortized<br>Cost  | Fair<br>Value | Amortized<br>Cost | Fair<br>Value |
| June 30, 2014:                    |                    |               |                   |               |
| Due in one year or less           | \$4,124            | \$4,161       | \$658             | \$660         |
| Due in one year to five years     | 33,208             | 34,896        | 8,184             | 8,107         |
| Due in five years to ten years    | 125,395            | 128,613       | 12,578            | 12,632        |
| Due after ten years               | 102,915            | 100,690       | 17,118            | 16,891        |
| Mortgage-backed agency securities | 452,580            | 459,938       | -                 | -             |
| Asset-backed securities           | 15,380             | 15,230        | -                 | -             |
|                                   | \$733,602          | \$743,528     | \$38,538          | \$38,290      |





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At June 30, 2014 and December 31, 2013, the following investments had unrealized losses. The table 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 June 30, 2014:                     |                                                            |                   |                                                            |                   |                                           |                   |
| U.S. Treasury securities              | \$-                                                        | \$ -              | \$-                                                        | \$ -              | \$-                                       | \$ -              |
| U.S. government agency securities     | 903                                                        | 2                 | 101,152                                                    | 6,146             | 102,055                                   | 6,148             |
| Mortgage-backed agency securities     | 69,147                                                     | 515               | 109,845                                                    | 3,735             | 178,992                                   | 4,250             |
| State and municipal securities        | 3,098                                                      | 13                | 31,228                                                     | 683               | 34,326                                    | 696               |
| Asset-backed securities               | -                                                          | -                 | 15,230                                                     | 150               | 15,230                                    | 150               |
| Corporate notes                       | 500                                                        | -                 | 157                                                        | -                 | 657                                       | -                 |
| Total temporarily-impaired securities | \$73,648                                                   | \$ 530            | \$257,612                                                  | \$ 10,714         | \$331,260                                 | \$ 11,244         |

At December 31, 2013:

|                                       |           |          |           |           |           |           |
|---------------------------------------|-----------|----------|-----------|-----------|-----------|-----------|
| U.S. Treasury securities              | \$-       | \$ -     | \$-       | \$ -      | \$-       | \$ -      |
| U.S. government agency securities     | 8,742     | 22       | 92,869    | 13,400    | 101,611   | 13,422    |
| Mortgage-backed agency securities     | 157,262   | 3,913    | 42,903    | 4,889     | 200,165   | 8,802     |
| State and municipal securities        | 46,282    | 1,351    | 3,798     | 555       | 50,080    | 1,906     |
| Asset-backed securities               | -         | -        | 17,006    | 255       | 17,006    | 255       |
| Corporate notes                       | 946       | 6        | 159       | 2         | 1,105     | 8         |
| Total temporarily-impaired securities | \$213,232 | \$ 5,292 | \$156,735 | \$ 19,101 | \$369,967 | \$ 24,393 |

The applicable dates for determining when securities are in an unrealized loss position are June 30, 2014 and December 31, 2013. 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 periods ended June 30, 2014 and December 31, 2013, but is in the "Investments with an Unrealized Loss of less than 12 months" category above.

As shown in the tables above, at June 30, 2014, Pinnacle Financial had approximately \$11.2 million in unrealized losses on \$331.3 million of securities. The unrealized losses associated with these investment securities are driven by changes in interest rates and the unrealized loss is recorded as a component of equity. 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. If a shortfall in future cash flows is identified, a credit loss will be deemed to have occurred and will be recognized as a charge to earnings and a new cost basis for the security will be established.

Because Pinnacle Financial currently does not intend to sell those securities that have an unrealized loss at June 30, 2014, 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 June 30, 2014.

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 or 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 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. There is also a risk that other-than-temporary impairment charges may occur in the future if management's intention to hold these securities to maturity and/or recovery changes.

### Note 3. 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).

Commercial loans receive risk ratings by the assigned financial advisor subject to validation by Pinnacle Financial's independent loan review department. Risk ratings are categorized as pass, special mention, substandard, substandard-nonaccrual or doubtful-nonaccrual. Pinnacle Financial believes that its categories follow those used by Pinnacle Bank's primary regulators. At June 30, 2014, 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 individual loans. 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 procedures require that every risk rated loan of \$500,000 or more be subject to a formal credit risk review process. Each loan's risk rating is also subject to review by our independent loan review department, which reviews a substantial portion of our risk rated portfolio annually. Included in the coverage are independent loan reviews of loans in targeted higher-risk portfolio segments.

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:

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.



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The following table outlines the amount of each loan classification categorized into each risk rating category as of June 30, 2014 and December 31, 2013 (in thousands):

|                                             | Commercial real estate mortgage | Consumer real estate mortgage | Construction and land development | Commercial and industrial | Consumer and other | Total        |
|---------------------------------------------|---------------------------------|-------------------------------|-----------------------------------|---------------------------|--------------------|--------------|
| June 30, 2014                               |                                 |                               |                                   |                           |                    |              |
| Accruing loans                              |                                 |                               |                                   |                           |                    |              |
| Pass                                        | \$ 1,417,022                    | \$ 672,747                    | \$ 253,501                        | \$ 1,634,704              | \$ 168,287         | \$ 4,146,261 |
| Special Mention                             | 16,291                          | 2,667                         | 26,739                            | 23,163                    | 146                | 69,006       |
| Substandard <sup>(1)</sup>                  | 17,268                          | 12,932                        | 11,550                            | 35,162                    | 154                | 77,066       |
| Total                                       | 1,450,581                       | 688,346                       | 291,790                           | 1,693,029                 | 168,587            | 4,292,333    |
| Impaired loans                              |                                 |                               |                                   |                           |                    |              |
| Nonaccrual loans                            |                                 |                               |                                   |                           |                    |              |
| Substandard-nonaccrual                      | 6,754                           | 6,239                         | 978                               | 1,387                     | 320                | 15,678       |
| Doubtful-nonaccrual                         | -                               | -                             | -                                 | -                         | -                  | -            |
| Total nonaccrual loans                      | 6,754                           | 6,239                         | 978                               | 1,387                     | 320                | 15,678       |
| Troubled debt restructurings <sup>(2)</sup> |                                 |                               |                                   |                           |                    |              |
| Pass                                        | -                               | 66                            | 107                               | 263                       | 83                 | 519          |
| Special Mention                             | -                               | 820                           | -                                 | -                         | 200                | 1,020        |
| Substandard                                 | -                               | 3,057                         | -                                 | 2,955                     | -                  | 6,012        |
| Total troubled debt restructurings          | -                               | 3,943                         | 107                               | 3,218                     | 283                | 7,551        |
| Total impaired loans                        | 6,754                           | 10,182                        | 1,085                             | 4,605                     | 603                | 23,229       |
| Total loans                                 | \$ 1,457,335                    | \$ 698,528                    | \$ 292,875                        | \$ 1,697,634              | \$ 169,190         | \$ 4,315,562 |

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 nonaccrual loans and troubled debt restructurings. Potential problem loans, which are not included in nonaccrual loans, amounted to approximately \$77.1 million at June 30, 2014, compared to \$65.0 million at December 31, 2013.

(1)

(2) Troubled debt restructurings are presented as an impaired loan; however, they continue to accrue interest at contractual rates.

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|                                             | Commercial<br>real estate -<br>mortgage | Consumer<br>real estate<br>mortgage | Construction<br>and land<br>development | Commercial<br>and<br>industrial | Consumer<br>and other | Total        |
|---------------------------------------------|-----------------------------------------|-------------------------------------|-----------------------------------------|---------------------------------|-----------------------|--------------|
| December 31, 2013                           |                                         |                                     |                                         |                                 |                       |              |
| Accruing loans                              |                                         |                                     |                                         |                                 |                       |              |
| Pass                                        | \$ 1,332,387                            | \$ 670,412                          | \$ 275,876                              | \$ 1,557,923                    | \$ 143,032            | \$ 3,979,630 |
| Special Mention                             | 8,282                                   | 1,824                               | 31,835                                  | 20,065                          | -                     | 62,006       |
| Substandard <sup>(1)</sup>                  | 20,296                                  | 14,107                              | 7,297                                   | 23,174                          | 154                   | 65,028       |
| Total                                       | 1,360,965                               | 686,343                             | 315,008                                 | 1,601,162                       | 143,186               | 4,106,664    |
| Impaired loans                              |                                         |                                     |                                         |                                 |                       |              |
| Nonaccrual loans                            |                                         |                                     |                                         |                                 |                       |              |
| Substandard-nonaccrual                      | 9,017                                   | 5,289                               | 1,070                                   | 2,565                           | 242                   | 18,183       |
| Doubtful-nonaccrual                         | -                                       | -                                   | -                                       | -                               | -                     | -            |
| Total nonaccrual loans                      | 9,017                                   | 5,289                               | 1,070                                   | 2,565                           | 242                   | 18,183       |
| Troubled debt restructurings <sup>(2)</sup> |                                         |                                     |                                         |                                 |                       |              |
| Pass                                        | 2,564                                   | 1,666                               | 113                                     | 320                             | 276                   | 4,939        |
| Special Mention                             | -                                       | -                                   | -                                       | -                               | -                     | -            |
| Substandard                                 | 10,889                                  | 2,318                               | -                                       | 1,500                           | -                     | 14,707       |
| Total troubled debt<br>restructurings       | 13,453                                  | 3,984                               | 113                                     | 1,820                           | 276                   | 19,646       |
| Total impaired loans                        | 22,470                                  | 9,273                               | 1,183                                   | 4,385                           | 518                   | 37,829       |
| Total loans                                 | \$ 1,383,435                            | \$ 695,616                          | \$ 316,191                              | \$ 1,605,547                    | \$ 143,704            | \$ 4,144,493 |

- 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 nonaccrual loans and troubled debt restructurings. Potential problem loans, which are not included in nonaccrual loans, amounted to approximately \$77.1 million at June 30, 2014, compared to \$65.0 million at December 31, 2013.
- (1) Pinnacle Bank's primary regulators for loans classified as substandard, excluding the impact of nonaccrual loans and troubled debt restructurings. Potential problem loans, which are not included in nonaccrual loans, amounted to approximately \$77.1 million at June 30, 2014, compared to \$65.0 million at December 31, 2013.
- (2) Troubled debt restructurings are presented as an impaired loan; however, they continue to accrue interest at contractual rates.

At June 30, 2014 and December 31, 2013, all loans classified as nonaccrual were deemed to be impaired. The principal balances of these nonaccrual loans amounted to \$15.7 million and \$18.2 million at June 30, 2014 and December 31, 2013, respectively, and are included in the tables above. For the six months ended June 30, 2014, the average balance of nonaccrual loans was \$16.1 million as compared to \$21.5 million for the twelve months ended December 31, 2013. At the date such loans were placed on nonaccrual status, Pinnacle Financial reversed all previously accrued interest income against current year earnings. Had these nonaccrual loans been on accruing status, interest income would have been higher by \$416,000 for the six months ended June 30, 2014 and by \$573,000 for the six months ended June 30, 2013.

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The following table details the recorded investment, unpaid principal balance and related allowance and average recorded investment of our nonaccrual loans at June 30, 2014 and December 31, 2013 by loan classification and the amount of interest income recognized on a cash basis throughout the fiscal year-to-date period then ended, respectively, on these loans that remain on the balance sheets (in thousands):

|                                        | At June 30, 2014    |                          |                                  | For the six months ended<br>June 30, 2014 |                            |
|----------------------------------------|---------------------|--------------------------|----------------------------------|-------------------------------------------|----------------------------|
|                                        | Recorded investment | Unpaid principal balance | Related allowance <sup>(1)</sup> | Average recorded investment               | Interest income recognized |
| Collateral dependent nonaccrual loans: |                     |                          |                                  |                                           |                            |
| Commercial real estate – mortgage      | \$4,814             | \$5,407                  | \$ -                             | \$4,913                                   | \$ -                       |
| Consumer real estate – mortgage        | 2,336               | 2,416                    | -                                | 2,366                                     | -                          |
| Construction and land development      | 545                 | 545                      | -                                | 545                                       | -                          |
| Commercial and industrial              | 1,018               | 1,161                    | -                                | 1,053                                     | -                          |
| Consumer and other                     | -                   | -                        | -                                | -                                         | -                          |
| Total                                  | \$8,713             | \$9,529                  | \$ -                             | \$8,877                                   | \$ -                       |
| Cash flow dependent nonaccrual loans:  |                     |                          |                                  |                                           |                            |
| Commercial real estate – mortgage      | \$1,940             | \$2,145                  | \$ 190                           | \$1,967                                   | \$ -                       |
| Consumer real estate – mortgage        | 3,903               | 4,185                    | 1,089                            | 4,045                                     | -                          |
| Construction and land development      | 433                 | 512                      | 16                               | 443                                       | -                          |
| Commercial and industrial              | 369                 | 375                      | 145                              | 469                                       | -                          |
| Consumer and other                     | 320                 | 338                      | 126                              | 333                                       | -                          |
| Total                                  | \$6,965             | \$7,555                  | \$ 1,566                         | \$7,257                                   | \$ -                       |
| Total nonaccrual loans                 | \$15,678            | \$17,084                 | \$ 1,566                         | \$16,134                                  | \$ -                       |

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|                                        | At December 31, 2013:             |                                |                                     | For the year ended<br>December 31, 2013 |                                  |
|----------------------------------------|-----------------------------------|--------------------------------|-------------------------------------|-----------------------------------------|----------------------------------|
|                                        | Recorded<br>investment<br>balance | Unpaid<br>principal<br>balance | Related<br>allowance <sup>(1)</sup> | Average<br>recorded<br>investment       | Interest<br>income<br>recognized |
| Collateral dependent nonaccrual loans: |                                   |                                |                                     |                                         |                                  |
| Commercial real estate – mortgage      | \$7,035                           | \$7,481                        | \$ -                                | \$6,522                                 | \$ -                             |
| Consumer real estate – mortgage        | 2,162                             | 2,209                          | -                                   | 2,234                                   | -                                |
| Construction and land development      | 545                               | 545                            | -                                   | 938                                     | -                                |
| Commercial and industrial              | 1,828                             | 1,901                          | -                                   | 3,911                                   | -                                |
| Consumer and other                     | -                                 | -                              | -                                   | -                                       | -                                |
| Total                                  | \$11,570                          | \$12,136                       | \$ -                                | \$13,605                                | \$ -                             |
| Cash flow dependent nonaccrual loans:  |                                   |                                |                                     |                                         |                                  |
| Commercial real estate – mortgage      | \$1,982                           | \$2,166                        | \$ 142                              | \$2,448                                 | \$ -                             |
| Consumer real estate – mortgage        | 3,127                             | 3,334                          | 722                                 | 3,405                                   | -                                |
| Construction and land development      | 525                               | 609                            | 33                                  | 568                                     | -                                |
| Commercial and industrial              | 737                               | 1,029                          | 218                                 | 1,216                                   | -                                |
| Consumer and other                     | 242                               | 252                            | 72                                  | 242                                     | -                                |
| Total                                  | \$6,613                           | \$7,390                        | \$ 1,187                            | \$7,879                                 | \$ -                             |
| Total nonaccrual loans                 | \$18,183                          | \$19,526                       | \$ 1,187                            | \$21,484                                | \$ -                             |

- (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.

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 three and six months ended June 30, 2014 or during the year ended December 31, 2013.

Impaired loans also include loans that Pinnacle Bank has elected to formally restructure 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 otherwise incur. If on nonaccrual status as of the date of restructuring, the loans are included in nonaccrual 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 June 30, 2014 and December 31, 2013, there were \$7.6 million and \$19.6 million, respectively, of troubled debt restructurings that were performing as of their restructure date and which were 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.

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The following table outlines the amount of each troubled debt restructuring categorized by loan classification made during the three and six months ended June 30, 2014 and 2013 (dollars in thousands):

|                                   | Three months ended June 30,<br>2014                                              |                                  |                                                                                   | Six months ended June 30,<br>2014                                                |                                  |                                                                                   |
|-----------------------------------|----------------------------------------------------------------------------------|----------------------------------|-----------------------------------------------------------------------------------|----------------------------------------------------------------------------------|----------------------------------|-----------------------------------------------------------------------------------|
|                                   | Pre<br>Modification<br>Outstanding<br>Investment,<br>net of related<br>allowance | Post<br>Modification<br>Recorded | Post<br>Modification<br>Outstanding<br>Investment,<br>net of related<br>allowance | Pre<br>Modification<br>Outstanding<br>Investment,<br>net of related<br>allowance | Post<br>Modification<br>Recorded | Post<br>Modification<br>Outstanding<br>Investment,<br>net of related<br>allowance |
| Commercial real estate – mortgage | -                                                                                | \$ -                             | \$ -                                                                              | -                                                                                | \$ -                             | \$ -                                                                              |
| Consumer real estate – mortgage   | -                                                                                | -                                | -                                                                                 | -                                                                                | -                                | -                                                                                 |
| Construction and land development | -                                                                                | -                                | -                                                                                 | -                                                                                | -                                | -                                                                                 |
| Commercial and industrial         | 1                                                                                | 75                               | 59                                                                                | 7                                                                                | 2,955                            | 2,099                                                                             |
| Consumer and other                | -                                                                                | -                                | -                                                                                 | -                                                                                | -                                | -                                                                                 |
|                                   | 1                                                                                | \$ 75                            | \$ 59                                                                             | 7                                                                                | \$ 2,955                         | \$ 2,099                                                                          |
|                                   | Three months ended June 30,<br>2013                                              |                                  |                                                                                   | Six months ended June 30,<br>2013                                                |                                  |                                                                                   |
|                                   | Pre<br>Modification<br>Outstanding<br>Investment,<br>net of related<br>allowance | Post<br>Modification<br>Recorded | Post<br>Modification<br>Outstanding<br>Investment,<br>net of related<br>allowance | Pre<br>Modification<br>Outstanding<br>Investment,<br>net of related<br>allowance | Post<br>Modification<br>Recorded | Post<br>Modification<br>Outstanding<br>Investment,<br>net of related<br>allowance |
| Commercial real estate – mortgage | -                                                                                | \$ -                             | \$ -                                                                              | -                                                                                | \$ -                             | \$ -                                                                              |
| Consumer real estate – mortgage   | -                                                                                | -                                | -                                                                                 | 1                                                                                | 428                              | 355                                                                               |
| Construction and land development | 1                                                                                | 51                               | 44                                                                                | 1                                                                                | 51                               | 44                                                                                |
| Commercial and industrial         | 1                                                                                | 1,500                            | 1,290                                                                             | 1                                                                                | 1,500                            | 1,290                                                                             |
| Consumer and other                | -                                                                                | -                                | -                                                                                 | 1                                                                                | 193                              | 164                                                                               |
|                                   | 2                                                                                | \$ 1,551                         | \$ 1,334                                                                          | 4                                                                                | \$ 2,172                         | \$ 1,853                                                                          |

During the three months ended June 30, 2014 and 2013, Pinnacle Financial did not have any troubled debt restructurings that subsequently defaulted within twelve months of the restructuring. During the six months ended June 30, 2014, Pinnacle Financial did not have any troubled debt restructurings that subsequently defaulted within twelve months of the restructuring. During the six months ended June 30, 2013, two consumer real estate loans totaling \$1.0 million which were previously classified as a troubled debt restructuring subsequently defaulted due to their lack of performance, within twelve months of the restructuring. A default of a troubled debt restructuring is defined as an occurrence which violates the terms of the receivable's restructured contract.



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Pinnacle Financial analyzes its commercial loan portfolio to determine if a concentration of credit risk exists to any industry. 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 June 30, 2014 with the comparative exposures for December 31, 2013 (in thousands):

At June 30, 2014:

|                                     | Outstanding<br>Principal<br>Balances | Unfunded<br>Commitments | Total<br>exposure | Total<br>Exposure<br>at<br>December<br>31, 2013 |
|-------------------------------------|--------------------------------------|-------------------------|-------------------|-------------------------------------------------|
| Lessors of nonresidential buildings | \$477,902                            | \$ 73,210               | \$551,112         | \$515,240                                       |
| Lessors of residential buildings    | 245,782                              | 33,609                  | 279,391           | 270,773                                         |

The table below presents past due balances at June 30, 2014 and December 31, 2013, by loan classification and segment allocated between accruing and nonaccrual status (in thousands):

|                                   | 30-89<br>days past<br>due and<br>accruing | 90 days<br>or more<br>past due<br>and<br>accruing | Total<br>past due<br>and<br>accruing | Nonaccrual <sup>(1)</sup> | Current<br>and<br>accruing | Total<br>Loans |
|-----------------------------------|-------------------------------------------|---------------------------------------------------|--------------------------------------|---------------------------|----------------------------|----------------|
| June 30, 2014                     |                                           |                                                   |                                      |                           |                            |                |
| Commercial real estate:           |                                           |                                                   |                                      |                           |                            |                |
| Owner-occupied                    | \$ 914                                    | \$ 280                                            | \$ 1,194                             | \$ 6,754                  | \$694,903                  | \$702,851      |
| All other                         | 21                                        | -                                                 | 21                                   | -                         | 754,463                    | 754,484        |
| Consumer real estate – mortgage   | 5,402                                     | -                                                 | 5,402                                | 6,239                     | 686,887                    | 698,528        |
| Construction and land development | 5,083                                     | -                                                 | 5,083                                | 978                       | 286,814                    | 292,875        |
| Commercial and industrial         | 3,581                                     | 51                                                | 3,632                                | 1,387                     | 1,692,615                  | 1,697,634      |
| Consumer and other                | 3,561                                     | 318                                               | 3,879                                | 320                       | 164,991                    | 169,190        |
|                                   | \$18,562                                  | \$ 649                                            | \$19,211                             | \$ 15,678                 | \$4,280,673                | \$4,315,562    |
| December 31, 2013                 |                                           |                                                   |                                      |                           |                            |                |
| Commercial real estate:           |                                           |                                                   |                                      |                           |                            |                |
| Owner-occupied                    | \$2,534                                   | \$-                                               | \$2,534                              | \$7,750                   | \$669,014                  | \$679,298      |
| All other                         | 27                                        | 2,232                                             | 2,259                                | 1,267                     | 700,611                    | 704,137        |
| Consumer real estate – mortgage   | 2,215                                     | -                                                 | 2,215                                | 5,289                     | 688,112                    | 695,616        |
| Construction and land development | 4,839                                     | -                                                 | 4,839                                | 1,070                     | 310,282                    | 316,191        |
| Commercial and industrial         | 1,847                                     | 825                                               | 2,672                                | 2,565                     | 1,600,310                  | 1,605,547      |
| Consumer and other                | 1,488                                     | 289                                               | 1,777                                | 242                       | 141,685                    | 143,704        |
|                                   | \$12,950                                  | \$3,346                                           | \$16,296                             | \$18,183                  | \$4,110,014                | \$4,144,493    |

(1) Approximately \$10.7 million and \$10.9 million of nonaccrual loans as of June 30, 2014 and December 31, 2013, respectively, were performing pursuant to their contractual terms at those dates.

The following table shows the allowance allocation by loan classification and accrual status at June 30, 2014 and December 31, 2013 (in thousands):

|                                   | Accruing Loans |                   | Impaired Loans   |                   | Troubled Debt Restructurings <sup>(1)</sup> |                   | Total Allowance for Loan Losses |                   |
|-----------------------------------|----------------|-------------------|------------------|-------------------|---------------------------------------------|-------------------|---------------------------------|-------------------|
|                                   |                |                   | Nonaccrual Loans |                   | June                                        |                   | June                            |                   |
|                                   | June 30, 2014  | December 31, 2013 | June 30, 2014    | December 31, 2013 | June 30, 2014                               | December 31, 2013 | June 30, 2014                   | December 31, 2013 |
| Commercial real estate –mortgage  | \$19,149       | \$19,298          | \$190            | \$142             | \$-                                         | \$1,932           | \$19,339                        | \$21,372          |
| Consumer real estate – mortgage   | 6,292          | 7,090             | 1,089            | 722               | 827                                         | 543               | 8,208                           | 8,355             |
| Construction and land development | 6,376          | 7,186             | 16               | 33                | 22                                          | 16                | 6,414                           | 7,235             |
| Commercial and industrial         | 26,663         | 24,660            | 145              | 218               | 675                                         | 256               | 27,483                          | 25,134            |
| Consumer and other                | 1,751          | 1,521             | 126              | 72                | 59                                          | 39                | 1,936                           | 1,632             |
| Unallocated                       | -              | -                 | -                | -                 | -                                           | -                 | 3,508                           | 4,242             |
|                                   | \$60,231       | \$59,755          | \$1,566          | \$1,187           | \$1,583                                     | \$2,786           | \$66,888                        | \$67,970          |

- (1) Troubled debt restructurings of \$7.6 million and \$19.6 million as of June 30, 2014 and December 31, 2013, respectively, are classified as impaired loans pursuant to U.S. GAAP; however, these loans continue to accrue interest at contractual rates.

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The following table details the changes in the allowance for loan losses from December 31, 2012 to December 31, 2013 to June 30, 2014 by loan classification and the allocation of the allowance for loan losses (in thousands):

|                                                    | Commercial<br>real estate –<br>mortgage | Consumer<br>real estate –<br>mortgagedevelopment | Construction<br>and land<br>development | Commercial<br>and<br>industrial | Commercial<br>Consumer<br>and other | Unallocated | Total       |
|----------------------------------------------------|-----------------------------------------|--------------------------------------------------|-----------------------------------------|---------------------------------|-------------------------------------|-------------|-------------|
| Allowance for Loan Losses:                         |                                         |                                                  |                                         |                                 |                                     |             |             |
| Balance at December 31, 2012                       | \$19,634                                | \$8,762                                          | \$9,164                                 | \$24,738                        | \$1,094                             | \$6,025     | \$69,417    |
| Charged-off loans                                  | (4,123)                                 | (2,250)                                          | (1,351)                                 | (8,159)                         | (1,369)                             | -           | (17,252)    |
| Recovery of previously<br>charged-off loans        | 500                                     | 1,209                                            | 1,464                                   | 4,531                           | 244                                 | -           | 7,948       |
| Provision for loan losses                          | 5,361                                   | 634                                              | (2,042)                                 | 4,024                           | 1,663                               | (1,783)     | 7,857       |
| Balance at December 31, 2013                       | \$21,372                                | \$8,355                                          | \$7,235                                 | \$25,134                        | \$1,632                             | \$4,242     | \$67,970    |
| Collectively evaluated for<br>impairment           | \$19,298                                | \$7,090                                          | \$7,186                                 | \$24,660                        | \$1,521                             |             | \$59,755    |
| Individually evaluated for<br>impairment           | 2,074                                   | 1,265                                            | 49                                      | 474                             | 111                                 |             | 3,973       |
| Loans acquired with<br>deteriorated credit quality | -                                       | -                                                | -                                       | -                               | -                                   |             | -           |
| Balance at December 31, 2013                       | \$21,372                                | \$8,355                                          | \$7,235                                 | \$25,134                        | \$1,632                             |             | \$67,970    |
| Loans:                                             |                                         |                                                  |                                         |                                 |                                     |             |             |
| Collectively evaluated for<br>impairment           | \$1,360,965                             | \$686,343                                        | \$315,008                               | \$1,601,162                     | \$143,186                           |             | \$4,106,664 |
| Individually evaluated for<br>impairment           | 22,470                                  | 9,273                                            | 1,183                                   | 4,385                           | 518                                 |             | 37,829      |
| Loans acquired with<br>deteriorated credit quality | -                                       | -                                                | -                                       | -                               | -                                   |             | -           |
| Balance at December 31, 2013                       | \$1,383,435                             | \$695,616                                        | \$316,191                               | \$1,605,547                     | \$143,704                           |             | \$4,144,493 |

|                                                 | Consumer                          |                                   |                                   |                           |                      |                    |                  |
|-------------------------------------------------|-----------------------------------|-----------------------------------|-----------------------------------|---------------------------|----------------------|--------------------|------------------|
|                                                 | Commercial real estate - mortgage | Commercial real estate - mortgage | Construction and land development | Commercial and industrial | Commercial and other | Consumer and other | UnallocatedTotal |
| Allowance for Loan Losses:                      |                                   |                                   |                                   |                           |                      |                    |                  |
| Balance at December 31, 2013                    | \$21,372                          | \$8,355                           | \$7,235                           | \$25,134                  | \$1,632              | \$4,242            | \$67,970         |
| Charged-off loans                               | (393)                             | (418)                             | (7)                               | (1,777)                   | (674)                | -                  | (3,269)          |
| Recovery of previously charged-off loans        | 216                               | 126                               | 240                               | 624                       | 239                  | -                  | 1,445            |
| Provision for loan losses                       | (1,856)                           | 145                               | (1,054)                           | 3,502                     | 739                  | (734)              | 742              |
| Balance at June 30, 2014                        | \$19,339                          | \$8,208                           | \$6,414                           | \$27,483                  | \$1,936              | \$3,508            | \$66,888         |
| Collectively evaluated for impairment           | \$19,149                          | \$6,292                           | \$6,376                           | \$26,663                  | \$1,751              |                    | \$63,739         |
| Individually evaluated for impairment           | 190                               | \$1,916                           | 38                                | 820                       | 185                  |                    | 3,149            |
| Loans acquired with deteriorated credit quality | -                                 | \$-                               | -                                 | -                         | -                    |                    | -                |
| Balance at June 30, 2014                        | \$19,339                          | \$8,208                           | \$6,414                           | \$27,483                  | \$1,936              |                    | \$66,888         |
| Loans:                                          |                                   |                                   |                                   |                           |                      |                    |                  |
| Collectively evaluated for impairment           | \$1,450,581                       | \$688,346                         | \$291,790                         | \$1,693,029               | \$168,587            |                    | \$4,292,333      |
| Individually evaluated for impairment           | \$6,754                           | \$10,182                          | \$1,085                           | \$4,605                   | \$603                |                    | \$23,229         |
| Loans acquired with deteriorated credit quality | \$-                               | \$-                               | \$-                               | \$-                       | \$-                  |                    | \$-              |
| Balance at June 30, 2014                        | \$1,457,335                       | \$698,528                         | \$292,875                         | \$1,697,634               | \$169,190            |                    | \$4,315,562      |

The adequacy of the allowance for loan losses is assessed at the end of each calendar quarter. The level of the allowance is based upon evaluation of the loan portfolio, current asset quality trends, known and inherent risks in the portfolio, adverse situations that may affect the borrowers' ability to repay (including the timing of future payment), the estimated value of any underlying collateral, composition of the loan portfolio, economic conditions, historical loss experience, industry and peer bank loan quality indications and other pertinent factors, including regulatory recommendations.

At June 30, 2014, Pinnacle Financial had granted loans and other extensions of credit amounting to approximately \$8.7 million to current directors, executive officers, and their related entities, of which \$6.2 million had been drawn upon. At December 31, 2013, Pinnacle Financial had granted loans and other extensions of credit amounting to approximately \$11.2 million to directors, executive officers, and their related entities, of which approximately \$8.9 million had been drawn upon. These loans and extensions of credit were made in the ordinary course of business on substantially the same terms, including interest rates and collateral, as those prevailing at the time for comparable loans to persons not related to Pinnacle Bank and did not involve more than the normal risk of collectability or present other unfavorable features. None of these loans to directors, executive officers, and their related entities were impaired at June 30, 2014 or December 31, 2013.

#### Residential Lending

At June 30, 2014, Pinnacle Financial had approximately \$24.6 million of mortgage loans held-for-sale compared to approximately \$12.9 million at December 31, 2013. During the first quarter of 2014, Pinnacle Financial began delivering loans on a mandatory basis to its approved investors. Mandatory delivery requires that Pinnacle Financial deliver an individual loan contract to the investor or compensate the investor in the event the loan does not ultimately close. Mandatory delivery exposes Pinnacle Financial to interest rate risk between the initial rate-lock and the ultimate sale of the loan to its approved investors. Pinnacle Financial enters into a short-term economic hedging relationship on a loan-by-loan basis to mitigate this interest rate exposure. Pinnacle Financial has not entered into any forward commitments with investors for future bulk loan sales. All of these loan sales transfer servicing rights to the buyer. During the six months ended June 30, 2014, Pinnacle Financial recognized \$2.9 million in gains on the sale of these loans, net of commissions paid, compared to \$3.8 million during the six months ended June 30, 2013.

These mortgage loans held-for-sale are originated internally and are primarily to borrowers in Pinnacle Bank's geographic markets. These sales are typically on a mandatory basis to investors that follow conventional government sponsored entities (GSE) and the Department of Housing and Urban Development/U.S. Department of Veterans Affairs (HUD/VA) guidelines.

Each purchaser has specific guidelines and criteria for sellers of loans, and the risk of credit loss with regard to the principal amount of the loans sold is generally transferred to the purchasers upon sale. While the loans are sold without recourse, the purchase agreements require Pinnacle Bank to make certain representations and warranties regarding the existence and sufficiency of file documentation and the absence of fraud by borrowers or other third parties such as appraisers in connection with obtaining the loan. If it is determined that the loans sold were in breach of these representations or warranties, Pinnacle Bank has obligations to either repurchase the loan for the unpaid principal balance and related investor fees or make the purchaser whole for the economic benefits of the loan. To date, repurchase activity pursuant to the terms of these representations and warranties has been insignificant to Pinnacle Bank.

#### Note 4. Income Taxes

Accounting Standards Codification (ASC) 740, Income Taxes, defines the threshold for recognizing the benefits of tax return positions in the financial statements as "more-likely-than-not" to be sustained by the taxing authority. As of June 30, 2014, Pinnacle Financial had no unrecognized tax benefits related to Federal or State income tax matters and

does not currently anticipate any material increase or decrease in unrecognized tax benefits relative to any tax positions taken prior to June 30, 2014. As of June 30, 2014, Pinnacle Financial has accrued no interest and no penalties related to uncertain tax positions.

Pinnacle Financial's effective tax rate for the three and six months ended June 30, 2014 was 33.1% and 33.2% compared to 32.8% for the three and six months ended June 30, 2013. The effective tax rate differs from the Federal income tax statutory rate of 35% and state income tax rate of 6.50% primarily due to our investments in bank qualified municipal securities, bank-owned life insurance, and tax savings from our captive insurance subsidiary, PNFPI Insurance Inc., offset in part by meals and entertainment and executive compensation expense, portions of which are non-deductible.

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#### Note 5. 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, and 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. At June 30, 2014, these commitments amounted to \$1.2 billion.

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. At June 30, 2014, these commitments amounted to \$65.7 million.

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 only amounts drawn upon would be reflected in the future. 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 commitments. At June 30, 2014, and December 31, 2013, Pinnacle Financial had accrued \$1.4 million for the inherent risks associated with these off-balance sheet commitments.

During the fourth quarter of 2011, a customer of Pinnacle Bank filed a putative class action lawsuit (styled John Higgins, et al, v. Pinnacle Financial Partners, Inc., d/b/a Pinnacle National Bank) in Davidson County, Tennessee Circuit Court against Pinnacle Bank and Pinnacle Financial, on his own behalf, as well as on behalf of a purported class of Pinnacle Bank's customers within the State of Tennessee alleging that Pinnacle Bank's method of ordering debit card transactions had caused customers of Pinnacle Bank to incur higher overdraft charges than had a different method been used. In April 2014, an order was entered giving final approval to the settlement, and providing a release of claims against Pinnacle Bank and Pinnacle Financial. The order is now final and non-appealable. The settlement of this matter did not have a material adverse effect on Pinnacle Financial's consolidated financial condition, operating results, or cash flows.

Various legal claims also arise from time to time in the normal course of business. In the opinion of management, the resolution of these claims outstanding at June 30, 2014 will not have a material impact on Pinnacle Financial's consolidated financial condition, operating results or cash flows.





## Note 6. Stock Options, Stock Appreciation Rights and Restricted Shares

At Pinnacle Financial's annual shareholders' meeting on April 15, 2014, the shareholders of Pinnacle Financial voted in favor of a proposal that adopted Pinnacle Financial's 2014 Equity Incentive Plan (the "2014 Plan"). The issuance of Pinnacle Financial's 2014 Plan proposal addressed the following matters:

- Consolidation of the two existing equity incentive plans, the Pinnacle Financial Partners, Inc. 2004 Amended and Restated Equity Incentive Plan (the "2004 Plan") and the Mid-America Bancshares, Inc. 2006 Omnibus Equity Incentive Plan (the "Mid-America Plan") including approximately 396,000 shares in the aggregate that remained available for issuance under those two plans at that date; and
- (i) Increased the maximum number of shares of common stock that may be issued to associates and directors by an additional 930,000 shares.
- (ii)

The 2014 Plan also permits Pinnacle Financial to reissue awards currently outstanding under the 2004 Plan and the Mid-America Plan that are subsequently forfeited, settled in cash or expired unexercised and returned to the 2014 Plan. Total shares available for issuance under the 2014 Plan were approximately 1.4 million shares as of June 30, 2014, inclusive of shares returned to the plan during the six months ended June 30, 2014.

Common Stock Options and Stock Appreciation Rights

As of June 30, 2014, there were 821,651 stock options and 4,159 stock appreciation rights outstanding to purchase common shares. A summary of the stock option and stock appreciation rights activity within the equity incentive plans during the six months ended June 30, 2014 and information regarding expected vesting, contractual terms remaining, intrinsic values and other matters is as follows:

|                                                    | Number     | Weighted-<br>Average<br>Exercise<br>Price | Weighted-<br>Average<br>Contractual<br>Term<br>(in years) | Aggregate<br>Intrinsic<br>Value<br>(000's) |     |
|----------------------------------------------------|------------|-------------------------------------------|-----------------------------------------------------------|--------------------------------------------|-----|
| Outstanding at December 31, 2013                   | 1,002,500  | \$ 25.77                                  | 2.48                                                      | \$ 7,097                                   | (1) |
| Granted                                            | -          |                                           |                                                           |                                            |     |
| Exercised                                          | (174,920 ) |                                           |                                                           |                                            |     |
| Stock appreciation rights exercised <sup>(3)</sup> | (1,370 )   |                                           |                                                           |                                            |     |
| Forfeited                                          | (400 )     |                                           |                                                           |                                            |     |
| Outstanding at June 30, 2014                       | 825,810    | \$ 26.68                                  | 2.20                                                      | \$ 10,495                                  | (2) |
| Options exercisable at June 30, 2014               | 825,810    | \$ 26.68                                  | 2.20                                                      | \$ 10,495                                  | (2) |

- (1) The aggregate intrinsic value is calculated as the difference between the exercise price of the underlying awards and the quoted closing price of Pinnacle Financial common stock of \$32.53 per common share at December 31, 2013 for the approximately 931,425 options and stock appreciation rights that were in-the-money at December 31, 2013.

(2) The aggregate intrinsic value is calculated as the difference between the exercise price of the underlying awards and the quoted closing price of Pinnacle Financial common stock of \$39.48 per common share at June 30, 2014 for the approximately 825,810 options and stock appreciation rights that were in-the-money at June 30, 2014.

(3) During the six months ended June 30, 2014, 1,370 SARS were converted into 522 common shares upon exercise.

During the six months ended June 30, 2014, Pinnacle Financial recorded no stock option compensation expense compared to \$13,000 during the six months ended June 30, 2013. Compensation costs related to unvested stock options granted under Pinnacle Financial's equity incentive plan had been fully recognized and all outstanding option

awards are fully vested.

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Restricted Share Awards

Additionally, the recently adopted 2014 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 June 30, 2014 under this plan.

A summary of activity for unvested restricted share awards for the six months ended June 30, 2014 is as follows:

|                                                                 | Number    | Grant Date<br>Weighted-Average<br>Cost |
|-----------------------------------------------------------------|-----------|----------------------------------------|
| Unvested at December 31, 2013                                   | 821,695   | \$ 19.18                               |
| Shares awarded                                                  | 97,018    | 32.35                                  |
| Conversion of restricted share units to restricted share awards | 186,943   | 31.68                                  |
| Restrictions lapsed and shares released to associates/directors | (199,403) | 19.14                                  |
| Shares forfeited <sup>(1)</sup>                                 | (24,764 ) | 20.71                                  |
| Unvested at June 30, 2014                                       | 881,489   | \$ 23.25                               |

- (1) Represents shares forfeited due to employee termination and/or retirement. No shares were forfeited due to failure to meet performance targets.

Pinnacle Financial grants restricted share awards to associates, executive management and outside directors with a combination of time and, in the case of executive management, performance vesting criteria. The following table outlines restricted stock grants that were made, grouped by similar vesting criteria, during the six months ended June 30, 2014:

| Grant Year                              | Group <sup>(1)</sup> | Vesting Period in years | Shares awarded | Restrictions Lapsed and shares released to participants | Shares Forfeited by participants <sup>(5)</sup> | Shares Unvested |
|-----------------------------------------|----------------------|-------------------------|----------------|---------------------------------------------------------|-------------------------------------------------|-----------------|
| Time Based Awards <sup>(2)</sup>        |                      |                         |                |                                                         |                                                 |                 |
| 2014                                    | Associates           | 5                       | 84,819         | -                                                       | 1,527                                           | 83,292          |
| Performance Based Awards <sup>(3)</sup> |                      |                         |                |                                                         |                                                 |                 |
| 2014                                    | Leadership team      | 5                       | 186,943        | -                                                       | 3,096                                           | 183,847         |
| Outside Director Awards <sup>(4)</sup>  |                      |                         |                |                                                         |                                                 |                 |
| 2014                                    | Outside directors    | 1                       | 12,199         | -                                                       | -                                               | 12,199          |

- (1) Groups include employees (referred to as associates above), the leadership team which includes our named executive officers and other key senior leadership members, and outside directors. When the restricted shares are awarded, a participant receives voting rights and forfeitable dividend rights with respect to the shares, but is not able to transfer the shares until the restrictions have lapsed. Once the restrictions lapse, the participant is taxed on the value of the award and may elect to sell some shares to pay the applicable income taxes associated with the award. For time-based restricted share awards, dividends paid on shares for which the forfeiture restrictions do not lapse will be recouped by the Company at the time of termination. For performance-based awards, dividends are placed into escrow until the forfeiture restrictions on such shares lapse.

- (2) The forfeiture restrictions on these restricted share awards lapse in equal annual installments on the anniversary date of the grant.
- (3) The forfeiture restrictions on these restricted share awards lapse in separate equal installments should Pinnacle Financial achieve certain earnings and soundness targets over each year of the subsequent vesting period. Restricted share awards are issued to the outside members of the board of directors in accordance with their board compensation plan. Restrictions lapse on the one year anniversary date of the award based on each individual
- (4) board member meeting their attendance goals for the various board and board committee meetings to which each member was scheduled to attend. These shares represent forfeitures resulting from recipients for whom employment terminated during the
- (5) year-to-date period ended June 30, 2014. Any dividends paid on shares for which the forfeiture restrictions do not lapse will be recouped by the Company at the time of termination.

Compensation expense associated with the time-based restricted share awards is recognized over the time period that the restrictions associated with the awards lapse on a straight-line basis based on the total grant date fair value. Compensation expense associated with performance-based restricted share awards is recognized over the time period that the restrictions associated with the awards are anticipated to lapse based on a schedule consistent with the nature of the award. For the three and six months ended June 30, 2014, Pinnacle Financial recognized approximately \$1.2 million and \$2.4 million in compensation costs attributable to restricted share awards, compared to \$1.0 million and \$2.0 million for the three and six months ended June 30, 2013.

#### Restricted Share Units

Pinnacle Financial granted restricted share units to the senior executive officers and other members of the leadership team in the first quarter of 2014. The senior executive officers' restricted share unit award included a range from 58,404 units at the target compensation level to 102,209 units at the maximum compensation level. These restricted share units will convert to a number of restricted share awards based on the achievement of certain performance metrics. The Leadership Team restricted share unit award of 29,087 units was granted at a target level of performance. For both senior executive officers and the Leadership Team, approximately one-third of these awards are eligible for conversion to restricted share awards based on the achievement of certain predetermined goals for each of the fiscal years ended December 31, 2014, 2015 and 2016, respectively. Once converted to restricted share awards, the restrictions on these shares will lapse in 2018 and 2019 in 50% increments based on the attainment of certain soundness targets in fiscal 2017 and 2018, respectively. The performance metrics and soundness criteria for each of the impacted fiscal years were established concurrently with the restricted share unit grants in January 2014 by the Human Resources and Compensation Committee of Pinnacle Financial's board of directors (HRCC). These restricted share units are being expensed based on the requisite service period of the underlying tranche of the award. Each period, the number of shares that is expected to lapse to the recipient is reevaluated and the associated compensation expense is adjusted accordingly. For the three and six months ended June 30, 2014, Pinnacle Financial recognized expense associated with the first tranche of this award totaling \$83,000 and \$155,000, respectively. The expense is being accrued at the maximum compensation level for the senior executive officers and the target compensation level for the Leadership Team.

#### Note 7. Regulatory Matters

Pursuant to Tennessee banking law, Pinnacle Bank may not, without the prior consent of the Commissioner of the TDFI, pay any dividends to Pinnacle Financial in a calendar year in excess of the total of Pinnacle Bank's retained net income for that year plus the retained net income for the preceding two years. During the six months ended June 30, 2014, Pinnacle Bank paid \$8.97 million in dividends to Pinnacle Financial. As of June 30, 2014, Pinnacle Bank could not pay in excess of \$90.7 million of additional dividends to Pinnacle Financial in 2014 without prior approval of the Commissioner of the TDFI. Pinnacle Financial initiated payment of a quarterly dividend of \$0.08 per share of common stock in the fourth quarter of 2013 and has since declared three subsequent dividend payments. The amount and timing of all future dividend payments, if any, is subject to Board discretion and will depend on Pinnacle Financial's earnings, capital position, financial condition and other factors, including new regulatory capital requirements, as they become known to us.

Pinnacle Financial and Pinnacle Bank 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 Pinnacle Bank 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.

Quantitative measures established by regulation to ensure capital adequacy require Pinnacle Financial and Pinnacle Bank to maintain minimum amounts and ratios of Total and Tier I capital to risk-weighted assets and for Pinnacle Bank of Tier I capital to average assets. Management believes, as of June 30, 2014, that Pinnacle Financial and Pinnacle Bank met all capital adequacy requirements to which they are subject. To be categorized as well-capitalized under applicable banking regulations, Pinnacle Financial and Pinnacle Bank must maintain minimum total risk-based, Tier I risk-based, and Tier I leverage ratios as set forth in the following table and not be subject to a written agreement, order or directive to maintain a higher capital level. Pinnacle Financial's and Pinnacle Bank's actual capital amounts and ratios are presented in the following table (in thousands):

|                                         | Actual<br>Amount | Ratio  | Minimum<br>Capital<br>Requirement<br>Amount | Ratio | Minimum<br>To Be<br>Well-Capitalized<br>Amount | Ratio  |
|-----------------------------------------|------------------|--------|---------------------------------------------|-------|------------------------------------------------|--------|
| At June 30, 2014                        |                  |        |                                             |       |                                                |        |
| Total capital to risk weighted assets:  |                  |        |                                             |       |                                                |        |
| Pinnacle Financial                      | \$657,333        | 13.4 % | \$393,991                                   | 8.0 % | \$493,150                                      | 10.0 % |
| Pinnacle Bank                           | \$627,449        | 12.8 % | \$196,447                                   | 8.0 % | \$295,077                                      | 10.0 % |
| Tier I capital to risk weighted assets: |                  |        |                                             |       |                                                |        |
| Pinnacle Financial                      | \$595,690        | 12.1 % | \$196,995                                   | 4.0 % | \$295,890                                      | 6.0 %  |
| Pinnacle Bank                           | \$565,975        | 11.5 % | \$196,447                                   | 4.0 % | \$295,077                                      | 6.0 %  |
| Tier I capital to average assets (*):   |                  |        |                                             |       |                                                |        |
| Pinnacle Financial                      | \$595,690        | 11.0 % | \$217,121                                   | 4.0 % | \$N/                                           | A N/ A |
| Pinnacle Bank                           | \$565,975        | 10.5 % | \$216,416                                   | 4.0 % | \$270,520                                      | 5.0 %  |

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

In July 2013, the Federal Reserve Board and the FDIC approved final rules that substantially amend the regulatory risk-based capital rules applicable to Pinnacle Bank and Pinnacle Financial. The final rules implement the regulatory capital reforms of the Basel Committee on Banking Supervision reflected in "Basel III: A Global Regulatory Framework for More Resilient Banks and Banking Systems" (Basel III) and changes required by the Dodd-Frank Act.

Under these rules, the leverage and risk-based capital ratios of bank holding companies may not be lower than the leverage and risk-based capital ratios for insured depository institutions. The final rules implementing the Basel III regulatory capital reforms will become effective as to Pinnacle Financial and Pinnacle Bank on January 1, 2015, and include new minimum risk-based capital and leverage ratios. Moreover, these rules refine the definition of what constitutes "capital" for purposes of calculating those ratios, including the definitions of Tier 1 capital and Tier 2 capital.

The new minimum capital level requirements applicable to bank holding companies and banks subject to the rules are:

- (i) a new common equity Tier 1 capital ratio of 4.5%;
- (ii) a Tier 1 risk-based capital ratio of 6% (increased from 4%);
- (iii) a total risk-based capital ratio of 8% (unchanged from current rules);
- (iv) a Tier 1 leverage ratio of 4% for all institutions.

The rules also establish a "capital conservation buffer" of 2.5% (to be phased in over three years) above the new regulatory minimum risk-based capital ratios, and result in the following minimum ratios once the capital conservation buffer is fully phased in:

- (i) a common equity Tier 1 risk-based capital ratio of 7.0%,
- (ii) a Tier 1 risk-based capital ratio of 8.5%, and
- (iii) a total risk-based capital ratio of 10.5%.

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The capital conservation buffer requirement is to be phased in beginning in January 2016 at 0.625% of risk-weighted assets and will increase each year until fully implemented in January 2019. An institution will be subject to limitations on paying dividends, engaging in share repurchases and paying discretionary bonuses if capital levels fall below minimum levels plus the buffer amounts. These limitations establish a maximum percentage of eligible retained income that could be utilized for such actions.

Under these new rules, Tier 1 capital will generally consist of common stock (plus related surplus) and retained earnings, limited amounts of minority interest in the form of additional Tier 1 capital instruments, and non-cumulative preferred stock and related surplus, subject to certain eligibility standards, less goodwill and other specified intangible assets and other regulatory deductions. Cumulative preferred stock and trust preferred securities issued after May 19, 2010, will no longer qualify as Tier 1 capital, but such securities issued prior to May 19, 2010, including in the case of bank holding companies with less than \$15.0 billion in total assets, trust preferred securities issued prior to that date, will continue to count as Tier 1 capital subject to certain limitations. The definition of Tier 2 capital is generally unchanged for most banking organizations, subject to certain new eligibility criteria.

Common equity Tier 1 capital will generally consist of common stock (plus related surplus) and retained earnings plus limited amounts of minority interest in the form of common stock, less goodwill and other specified intangible assets and other regulatory deductions.

The final rules allow banks and their holding companies with less than \$250 billion in assets a one-time opportunity to opt-out of a requirement to include unrealized gains and losses in accumulated other comprehensive income in their capital calculation. Pinnacle Financial expects that it will opt-out of this requirement.

#### Note 8. 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.

#### Non-hedge derivatives

Pinnacle Financial enters 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 with a large U.S. financial institution in order to minimize the risk to Pinnacle Financial. These swaps are 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 Pinnacle Financial, and results in credit risk to Pinnacle Financial. When the fair value of a derivative instrument contract is negative, Pinnacle Financial owes the customer or counterparty and therefore, has no credit risk.

A summary of Pinnacle Financial's interest rate swaps related to customers as of June 30, 2014 and December 31, 2013 is included in the following table (in thousands):

|                                    | June 30, 2014   |                      | December 31, 2013 |                      |
|------------------------------------|-----------------|----------------------|-------------------|----------------------|
|                                    | Notional Amount | Estimated Fair Value | Notional Amount   | Estimated Fair Value |
| Interest rate swap agreements:     |                 |                      |                   |                      |
| Pay fixed / receive variable swaps | \$257,823       | \$13,490             | \$294,486         | \$13,296             |



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|                                    |           |           |           |           |
|------------------------------------|-----------|-----------|-----------|-----------|
| Pay variable / receive fixed swaps | 257,823   | (13,878 ) | 294,486   | (13,670 ) |
| Total                              | \$515,646 | \$(388 )  | \$588,972 | \$(374 )  |

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## Hedge derivatives

During the second quarter of 2013, Pinnacle Financial entered into a forward cash flow hedge relationship to manage future interest rate exposure. The hedging strategy converts the LIBOR based variable interest rate on forecasted borrowings to a fixed interest rate and protects Pinnacle Financial from floating interest rate variability. The terms of the individual contracts within the relationship are as follows (in thousands):

|                    | Forecasted      |               |          |                       | June 30, 2014        |                                                           | December 31, 2013    |                                                           |
|--------------------|-----------------|---------------|----------|-----------------------|----------------------|-----------------------------------------------------------|----------------------|-----------------------------------------------------------|
|                    | Notional Amount | Receive Rate  | Pay Rate | Term <sup>(1)</sup>   | Asset/ (Liabilities) | Unrealized Gain in Accumulated Other Comprehensive Income | Asset/ (Liabilities) | Unrealized Gain in Accumulated Other Comprehensive Income |
| Interest Rate Swap | \$ 33,000       | 3 month LIBOR | 1.428%   | April 2015-April 2018 | \$ 101               | \$ 61                                                     | \$ 463               | \$ 281                                                    |
| Interest Rate Swap | 33,000          | 3 month LIBOR | 1.857%   | Oct. 2015-April 2019  | 236                  | \$ 143                                                    | 837                  | 509                                                       |
| Interest Rate Swap | 33,000          | 3 month LIBOR | 1.996%   | Oct. 2015-Oct. 2019   | 256                  | \$ 156                                                    | 1,007                | 612                                                       |
| Interest Rate Swap | 33,000          | 3 month LIBOR | 2.265%   | April 2016-April 2020 | 304                  | \$ 185                                                    | 1,172                | 712                                                       |
| Interest Rate Swap | 34,000          | 3 month LIBOR | 2.646%   | April 2016-April 2022 | 353                  | \$ 215                                                    | 1,818                | 1,105                                                     |
| Interest Rate Swap | 34,000          | 3 month LIBOR | 2.523%   | Oct. 2016-Oct. 2020   | 316                  | \$ 192                                                    | 1,307                | 795                                                       |
|                    | \$ 200,000      |               |          |                       | \$ 1,566             | \$ 952                                                    | \$ 6,604             | \$ 4,014                                                  |

(1) No cash will be exchanged prior to the term.

During the second quarter of 2014, Pinnacle Financial entered into four additional interest rate swap agreements as part of the management of interest rate risk. Pinnacle Financial designated the interest rate swaps as cash flow hedges intended to protect against the variability of cash flows using the first payments received method on a rolling portfolio of selected LIBOR based loans to customers. The swaps hedge the interest rate risk, wherein Pinnacle Financial receives a fixed rate of interest from a counterparty and pays a variable rate, based on one month LIBOR. The terms of the respective swaps range from seven to ten years and start on July 1, 2014. The swaps were entered into with a counterparty that met Pinnacle Financial's credit standards and the agreements contain collateral provisions protecting the at-risk party. Pinnacle Financial believes that the credit risk inherent in the contract is not significant. The terms of the individual contracts within the relationship are as follows (in thousands):

|                    | Forecasted      |               |              |                       | June 30, 2014        |                                                           | December 31, 2013    |                                                           |
|--------------------|-----------------|---------------|--------------|-----------------------|----------------------|-----------------------------------------------------------|----------------------|-----------------------------------------------------------|
|                    | Notional Amount | Pay Rate      | Receive Rate | Term <sup>(1)</sup>   | Asset/ (Liabilities) | Unrealized Gain in Accumulated Other Comprehensive Income | Asset/ (Liabilities) | Unrealized Gain in Accumulated Other Comprehensive Income |
| Interest Rate Swap | \$ 27,500       | 1 month LIBOR | 2.09%        | July 2014 - July 2021 | \$ 151               | \$ 92                                                     | \$ 0                 | \$ 0                                                      |
| Interest Rate Swap | 25,000          | 1 month LIBOR | 2.27%        | July 2014 - July 2022 | 86                   | 52                                                        | 0                    | 0                                                         |

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|                    |            |               |      |                        |       |        |      |      |
|--------------------|------------|---------------|------|------------------------|-------|--------|------|------|
| Interest Rate Swap | 30,000     | 1 month LIBOR | 2.42 | July 2014 - July %2023 | 114   | 69     | 0    | 0    |
| Interest Rate Swap | 27,500     | 1 month LIBOR | 2.50 | July 2014 - July %2024 | 31    | 19     | 0    | 0    |
|                    | \$ 110,000 |               |      |                        | \$382 | \$ 232 | \$ 0 | \$ 0 |

(1) No cash will be exchanged prior to the term.

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All of the cash flow hedges were determined to be effective during the period presented, and therefore, no amount of ineffectiveness has been included in net income. The aggregate fair value of the swaps is recorded in other assets with changes in fair value recorded in accumulated other comprehensive (loss) income, net of tax. If a hedge was deemed to be ineffective, the amount included in accumulated other comprehensive (loss) income would be reclassified into a line item within the consolidated statement of income that impacts operating results. The hedge would no longer be considered effective if a portion of the hedge becomes ineffective, the item hedged is no longer in existence or Pinnacle Financial discontinues hedge accounting. Pinnacle Financial expects the hedges to remain fully effective during the remaining terms of the swaps.

#### Note 9. Fair Value of Financial Instruments

FASB ASC 820, Fair Value Measurements and Disclosures, which defines fair value, establishes a framework for measuring fair value in U.S. GAAP and expands disclosures about fair value 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.

#### Valuation Hierarchy

FASB ASC 820 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 assets and liabilities measured at fair value, as well as the general classification of such assets and liabilities pursuant to the valuation hierarchy.

#### Assets

Securities available-for-sale – Where quoted prices are available for identical securities 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 financial products. If quoted market prices are not available, then fair values are estimated by using pricing models that use observable inputs or quoted prices of securities with similar characteristics and are classified within Level 2 of the valuation hierarchy. In certain cases where there is limited activity or less transparency around inputs to the valuation and more complex pricing models or discounted cash flows are used, securities are classified within Level 3 of the valuation hierarchy.

Other equity investments – Included in other investments are other equity investments in certain nonpublic private equity funds. The valuation of nonpublic private equity investments requires management judgment due to the absence of observable 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 and 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 investments are included in Level 3 of the valuation hierarchy as these funds are not widely traded and the underlying investments of such funds are often privately-held and/or start-up companies for which market values are not readily available.

Other assets – Included in other assets are certain assets carried at fair value, including interest rate swap agreements, the cash flow hedge and interest rate locks associated with the mortgage loan pipeline. The carrying amount of interest rate swap agreements is based on Pinnacle Financial's pricing models that utilize observable market inputs. The fair value of the cash flow hedge is determined by calculating the difference between the discounted fixed rate cash flows and the discounted variable rate cash flows. The fair value of the mortgage loan pipeline is based upon the projected sales price of the underlying loans, taking into account market interest rates and other market factors at the measurement date, net of the projected fallout rate. Pinnacle Financial reflects these assets within Level 2 of the valuation hierarchy as these assets are valued using similar transactions that occur in the market.

Nonaccrual loans – A loan is classified as nonaccrual 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. Nonaccrual 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 less selling costs if the loan is collateral dependent. If the recorded investment in the nonaccrual loan exceeds the measure of fair value, a valuation allowance may be established as a component of the allowance for loan losses or the difference may be recognized as a charge-off. Nonaccrual loans are classified within Level 3 of the hierarchy due to the unobservable inputs used in determining their fair value such as collateral values and the borrower's underlying financial condition.

Other real estate owned – Other real estate owned (OREO) represents real estate foreclosed upon by Pinnacle Bank through loan defaults by customers or acquired by deed in lieu of foreclosure. Substantially all of these amounts relate to lots, homes and development projects that are either completed or are in various stages of construction for which Pinnacle Financial believes it has adequate collateral. Upon foreclosure, the property is recorded at the lower of cost or fair value, based on appraised value, less selling costs estimated as of the date acquired with any loss recognized as a charge-off through the allowance for loan losses. Additional OREO losses for subsequent valuation downward adjustments are determined on a specific property basis and are included as a component of noninterest expense along with holding costs. Any gains or losses realized at the time of disposal are also reflected in noninterest expense, as applicable. OREO is included in Level 3 of the valuation hierarchy due to the lack of observable market inputs into the determination of fair value. Appraisal values are property-specific and sensitive to the changes in the overall economic environment.

#### Liabilities

Other liabilities – Pinnacle Financial has certain liabilities carried at fair value including certain interest rate swap agreements to facilitate customer transactions. The fair value of these liabilities is based on Pinnacle Financial's pricing models that utilize observable market inputs and is reflected within Level 2 of the valuation hierarchy.



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The following tables present financial instruments measured at fair value on a recurring basis as of June 30, 2014 and December 31, 2013, by caption on the consolidated balance sheets and by FASB ASC 820 valuation hierarchy (as described above) (in thousands):

|                                                | Total<br>carrying<br>value in the<br>consolidated<br>balance sheet | Quoted<br>market<br>prices<br>in an<br>active<br>market<br>(Level<br>1) | Models<br>with<br>significant<br>observable<br>market<br>parameters<br>(Level 2) | Models with<br>significant<br>unobservable<br>market<br>parameters<br>(Level 3) |
|------------------------------------------------|--------------------------------------------------------------------|-------------------------------------------------------------------------|----------------------------------------------------------------------------------|---------------------------------------------------------------------------------|
| June 30, 2014                                  |                                                                    |                                                                         |                                                                                  |                                                                                 |
| Investment securities available-for-sale:      |                                                                    |                                                                         |                                                                                  |                                                                                 |
| U.S. Treasury securities                       | \$ -                                                               | \$ -                                                                    | \$ -                                                                             | \$ -                                                                            |
| U.S. government agency securities              | 110,924                                                            | -                                                                       | 110,924                                                                          | -                                                                               |
| Mortgage-backed securities                     | 459,938                                                            | -                                                                       | 459,938                                                                          | -                                                                               |
| State and municipal securities                 | 146,120                                                            | -                                                                       | 146,120                                                                          | -                                                                               |
| Agency-backed securities                       | 15,230                                                             | -                                                                       | 15,230                                                                           | -                                                                               |
| Corporate notes and other                      | 11,316                                                             | -                                                                       | 11,316                                                                           | -                                                                               |
| Total investment securities available-for-sale | \$ 743,528                                                         | \$ -                                                                    | \$ 743,528                                                                       | \$ -                                                                            |
| Other equity investments                       | 7,186                                                              | -                                                                       | -                                                                                | 7,186                                                                           |
| Other assets                                   | 16,073                                                             | -                                                                       | 16,073                                                                           | -                                                                               |
| Total assets at fair value                     | \$ 766,787                                                         | \$ -                                                                    | \$ 759,601                                                                       | \$ 7,186                                                                        |
| Other liabilities                              | \$ 13,878                                                          | \$ -                                                                    | \$ 13,878                                                                        | \$ -                                                                            |
| Total liabilities at fair value                | \$ 13,878                                                          | \$ -                                                                    | \$ 13,878                                                                        | \$ -                                                                            |
| December 31, 2013                              |                                                                    |                                                                         |                                                                                  |                                                                                 |
| Investment securities available-for-sale:      |                                                                    |                                                                         |                                                                                  |                                                                                 |
| U.S. government agency securities              | \$ 103,873                                                         | \$ -                                                                    | \$ 103,873                                                                       | \$ -                                                                            |
| Mortgage-backed securities                     | 412,936                                                            | -                                                                       | 412,936                                                                          | -                                                                               |
| State and municipal securities                 | 148,411                                                            | -                                                                       | 148,411                                                                          | -                                                                               |
| Agency-backed securities                       | 17,007                                                             | -                                                                       | 17,007                                                                           | -                                                                               |
| Corporate notes and other                      | 11,229                                                             | -                                                                       | 11,229                                                                           | -                                                                               |
| Total investment securities available-for-sale | 693,456                                                            | -                                                                       | 693,456                                                                          | -                                                                               |
| Other equity investments                       | 6,701                                                              | -                                                                       | -                                                                                | 6,701                                                                           |
| Other assets                                   | 19,900                                                             | -                                                                       | 19,900                                                                           | -                                                                               |
| Total assets at fair value                     | \$ 720,057                                                         | \$ -                                                                    | \$ 713,356                                                                       | \$ 6,701                                                                        |
| Other liabilities                              | \$ 13,670                                                          | \$ -                                                                    | \$ 13,670                                                                        | \$ -                                                                            |
| Total liabilities at fair value                | \$ 13,670                                                          | \$ -                                                                    | \$ 13,670                                                                        | \$ -                                                                            |

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The following table presents assets measured at fair value on a nonrecurring basis as of June 30, 2014 and December 31, 2013 (in thousands):

|                                      | Total carrying value in the consolidated balance sheet | Quoted market prices in an active market (Level 1) | Models with significant observable market parameters (Level 2) | Models with significant unobservable market parameters (Level 3) | Total net losses for the year-to-date period then ended |
|--------------------------------------|--------------------------------------------------------|----------------------------------------------------|----------------------------------------------------------------|------------------------------------------------------------------|---------------------------------------------------------|
| June 30, 2014                        |                                                        |                                                    |                                                                |                                                                  |                                                         |
| Other real estate owned              | \$ 12,946                                              | \$ -                                               | \$ -                                                           | \$ 12,946                                                        | \$ 566                                                  |
| Nonaccrual loans, net <sup>(1)</sup> | 14,112                                                 | -                                                  | -                                                              | 14,112                                                           | 102                                                     |
| Total                                | \$ 27,058                                              | \$ -                                               | \$ -                                                           | \$ 27,058                                                        | \$ 668                                                  |
| December 31, 2013                    |                                                        |                                                    |                                                                |                                                                  |                                                         |
| Other real estate owned              | \$ 15,226                                              | \$ -                                               | \$ -                                                           | \$ 15,226                                                        | \$ 2,258                                                |
| Nonaccrual loans, net <sup>(1)</sup> | 16,996                                                 | -                                                  | -                                                              | 16,996                                                           | 2,921                                                   |
| Total                                | \$ 32,222                                              | \$ -                                               | \$ -                                                           | \$ 32,222                                                        | \$ 5,179                                                |

(1) Amount is net of a valuation allowance of \$1.6 million at June 30, 2014 and \$1.2 million at December 31, 2013 as required by ASC 310-10, "Receivables."

In the case of the investment securities portfolio, Pinnacle Financial monitors the portfolio to ascertain when transfers between levels have been affected. The nature of the remaining assets and liabilities is such that transfers in and out of any level are expected to be rare. For the six months ended June 30, 2014, there were no transfers between Levels 1, 2 or 3.

The table below includes a rollforward of the balance sheet amounts for the three and six months ended June 30, 2014 (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), 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 (in thousands):

|                                                                                                                           | For the six months ended June 30, |                   |              |                   |
|---------------------------------------------------------------------------------------------------------------------------|-----------------------------------|-------------------|--------------|-------------------|
|                                                                                                                           | 2014                              | 2013              |              |                   |
|                                                                                                                           | Other assets                      | Other liabilities | Other assets | Other liabilities |
| Fair value, January 1                                                                                                     | \$6,701                           | \$ -              | \$4,681      | \$ -              |
| Total realized gains (losses) included in income                                                                          | 92                                | -                 | (320 )       | -                 |
| Change in unrealized gains/losses included in other comprehensive income for assets and liabilities still held at June 30 | -                                 | -                 | -            | -                 |
| Purchases                                                                                                                 | 393                               | -                 | 1,365        | -                 |
| Issuances                                                                                                                 | -                                 | -                 | -            | -                 |
| Settlements                                                                                                               | -                                 | -                 | -            | -                 |
| Transfers out of Level 3                                                                                                  | -                                 | -                 | -            | -                 |
| Fair value, June 30                                                                                                       | 7,186                             | -                 | 5,726        | -                 |



|                                                                                                                                                 |      |    |   |         |   |    |   |
|-------------------------------------------------------------------------------------------------------------------------------------------------|------|----|---|---------|---|----|---|
| Total realized gains (losses) included in income related to financial assets and liabilities still on the consolidated balance sheet at June 30 | \$92 | \$ | - | \$(320) | ) | \$ | - |
|-------------------------------------------------------------------------------------------------------------------------------------------------|------|----|---|---------|---|----|---|

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The following methods and assumptions were used by Pinnacle Financial in estimating its fair value disclosures for financial instruments that are not measured at fair value. In cases where quoted market prices are not available, fair values are based on estimates using discounted cash flow models. Those models are significantly affected by the assumptions used, including the discount rates, estimates of future cash flows and borrower creditworthiness. The fair value estimates presented herein are based on pertinent information available to management as of June 30, 2014 and December 31, 2013. Such amounts have not been revalued for purposes of these consolidated financial statements since those dates and, therefore, current estimates of fair value may differ significantly from the amounts presented herein.

**Securities held-to-maturity** - Estimated fair values for investment securities are based on quoted market prices where available. If quoted market prices are not available, then fair values are estimated by using pricing models that use observable inputs or quoted prices of securities with similar characteristics.

**Loans, net** - The fair value of our loan portfolio includes a credit risk factor in the determination of the fair value of our loans. This credit risk assumption is intended to approximate the fair value that a market participant would realize in a hypothetical orderly transaction. Our loan portfolio is initially fair valued using a segmented approach. We divide our loan portfolio into the following categories: variable rate loans, impaired loans and all other loans. The results are then adjusted to account for credit risk.

For variable-rate loans that reprice frequently and have no significant change in credit risk, fair values approximate carrying values. Fair values for impaired loans are estimated using discounted cash flow models or based on the fair value of the underlying collateral. For other loans, fair values are estimated using discounted cash flow models, using current market interest rates offered for loans with similar terms to borrowers of similar credit quality. The values derived from the discounted cash flow approach for each of the above portfolios are then further discounted to incorporate credit risk to determine the exit price.

**Mortgage loans held-for-sale** - Mortgage loans held-for-sale are carried at the lower of cost or fair value. The estimate of fair value is based on pricing models and other information.

**Deposits, securities sold under agreements to repurchase, Federal Home Loan Bank (FHLB) advances, subordinated debt and other borrowings** - The carrying amounts of demand deposits, savings deposits, securities sold under agreements to repurchase, floating rate advances from the FHLB, floating rate subordinated debt and other borrowings, and floating rate loans approximate their fair values due to having no stated maturity. Fair values for certificates of deposit, fixed rate advances from the FHLB and fixed rate subordinated debt are estimated using discounted cash flow models, using current market interest rates offered on certificates, advances and other borrowings with similar remaining maturities. For fixed rate subordinated debt, the maturity is assumed to be as of the earliest date that the indebtedness will be repriced.

**Off-balance sheet instruments** - The fair values of Pinnacle Financial's off-balance-sheet financial instruments are based on fees charged to enter into similar agreements. However, commitments to extend credit do not represent a significant value to Pinnacle Financial until such commitments are funded.

The following table presents the carrying amounts, estimated fair value and placement in the fair value hierarchy of Pinnacle Financial's financial instruments at June 30, 2014 and December 31, 2013. This table excludes financial instruments for which the carrying amount approximates fair value. For short-term financial assets such as cash and cash equivalents, the carrying amount is a reasonable estimate of fair value due to the relatively short time between the origination of the instrument and its expected realization. For financial liabilities such as non-interest bearing demand, interest-bearing demand, and savings deposits, the carrying amount is a reasonable estimate of fair value due to these products having no stated maturity (in thousands).

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| (dollars in thousands)                                      | Carrying/<br>Notional<br>Amount | Estimated<br>Fair<br>Value <sup>(1)</sup> | Quoted<br>market<br>prices<br>in an<br>active<br>market<br>(Level<br>1) | Models<br>with<br>significant<br>observable<br>market<br>parameters<br>(Level 2) | Models with<br>significant<br>unobservable<br>market<br>parameters<br>(Level 3) |
|-------------------------------------------------------------|---------------------------------|-------------------------------------------|-------------------------------------------------------------------------|----------------------------------------------------------------------------------|---------------------------------------------------------------------------------|
| June 30, 2014                                               |                                 |                                           |                                                                         |                                                                                  |                                                                                 |
| Financial assets:                                           |                                 |                                           |                                                                         |                                                                                  |                                                                                 |
| Securities held-to-maturity                                 | \$38,538                        | \$38,290                                  | \$ -                                                                    | \$ 38,290                                                                        | \$ -                                                                            |
| Loans, net                                                  | 4,248,673                       | 4,178,982                                 | -                                                                       | -                                                                                | 4,178,982                                                                       |
| Mortgage loans held-for-sale                                | 24,592                          | 25,049                                    | -                                                                       | 25,049                                                                           | -                                                                               |
| Financial liabilities:                                      |                                 |                                           |                                                                         |                                                                                  |                                                                                 |
| Deposits and securities sold under agreements to repurchase | 4,713,786                       | 4,435,305                                 | -                                                                       | -                                                                                | 4,435,305                                                                       |
| Federal Home Loan Bank advances                             | 170,556                         | 170,407                                   | -                                                                       | -                                                                                | 170,407                                                                         |
| Subordinated debt and other borrowings                      | 97,408                          | 76,620                                    | -                                                                       | -                                                                                | 76,620                                                                          |
| Off-balance sheet instruments:                              |                                 |                                           |                                                                         |                                                                                  |                                                                                 |
| Commitments to extend credit <sup>(2)</sup>                 | 1,244,584                       | 1,085                                     | -                                                                       | -                                                                                | 1,085                                                                           |
| Standby letters of credit <sup>(3)</sup>                    | 65,687                          | 286                                       | -                                                                       | -                                                                                | 286                                                                             |
| December 31, 2013                                           |                                 |                                           |                                                                         |                                                                                  |                                                                                 |
| Financial assets:                                           |                                 |                                           |                                                                         |                                                                                  |                                                                                 |
| Securities held-to-maturity                                 | \$39,796                        | \$38,817                                  | \$ -                                                                    | \$ 38,817                                                                        | \$ -                                                                            |
| Loans, net                                                  | 4,076,524                       | 4,021,675                                 | -                                                                       | -                                                                                | 4,021,675                                                                       |
| Mortgage loans held for sale                                | 12,850                          | 12,999                                    | -                                                                       | 12,999                                                                           | -                                                                               |
| Financial liabilities:                                      |                                 |                                           |                                                                         |                                                                                  |                                                                                 |
| Deposits and securities sold under agreements to repurchase | 4,603,938                       | 4,378,805                                 | -                                                                       | -                                                                                | 4,378,805                                                                       |
| Federal Home Loan Bank advances                             | 90,637                          | 90,652                                    | -                                                                       | -                                                                                | 90,652                                                                          |
| Subordinated debt and other borrowings                      | 98,658                          | 73,083                                    | -                                                                       | -                                                                                | 73,083                                                                          |
| Off-balance sheet instruments:                              |                                 |                                           |                                                                         |                                                                                  |                                                                                 |
| Commitments to extend credit <sup>(2)</sup>                 | 1,206,528                       | 1,040                                     | -                                                                       | -                                                                                | 1,040                                                                           |
| Standby letters of credit <sup>(3)</sup>                    | 69,231                          | 331                                       | -                                                                       | -                                                                                | 331                                                                             |

- (1) Estimated fair values are consistent with an exit-price concept. The assumptions used to estimate the fair values are intended to approximate those that a market-participant would realize in a hypothetical orderly transaction. At the end of each quarter, Pinnacle Financial evaluates the inherent risks of the outstanding off-balance sheet commitments. In making this evaluation, Pinnacle Financial evaluates the credit worthiness of the borrower, the collateral supporting the commitments and any other factors similar to those used to evaluate the inherent risks of
- (2) our loan portfolio. Additionally, Pinnacle Financial evaluates the probability that the outstanding commitment will eventually become a funded loan. As a result, at June 30, 2014 and December 31, 2013, Pinnacle Financial included in other liabilities \$1.4 million representing the inherent risks associated with these off-balance sheet commitments.
- (3)

At June 30, 2014 and December 31, 2013, the fair value of Pinnacle Financial's standby letters of credit was \$286,000 and \$331,000, respectively. This amount represents the unamortized fee associated with these standby letters of credit and is included in the consolidated balance sheet of Pinnacle Financial and is believed to approximate fair value. This fair value will decrease over time as the existing standby letters of credit approach their expiration dates.

## Note 10. Variable Interest Entities

Under ASC 810, Pinnacle Financial is deemed to be the primary beneficiary and required to consolidate a variable interest entity (VIE) if it has a variable interest in the VIE that provides it with a controlling financial interest. For such purposes, the determination of whether a controlling financial interest exists is based on whether a single party has both the power to direct the activities of the VIE that most significantly impact the VIEs economic performance and the obligation to absorb losses of the VIE or the right to receive benefits from the VIE that could potentially be significant to the VIE. ASC 810 requires continual reconsideration of conclusions reached regarding which interest holder is a VIEs primary beneficiary and disclosures surrounding those VIEs which have not been consolidated. The consolidation methodology provided in this footnote for the quarter ended June 30, 2014, and the year ended December 31, 2013, has been prepared in accordance with ASC 810.

At June 30, 2014, Pinnacle Financial did not have any consolidated VIEs to disclose but did have several nonconsolidated VIEs. As discussed more fully in its Annual Report on Form 10-K for the fiscal year ended December 31, 2013, Pinnacle Financial has the following non-consolidated variable interest entities: low income housing partnerships, trust preferred issuances and accruing restructured commercial loans.

The following table summarizes VIEs that are not consolidated by Pinnacle Financial as of June 30, 2014 and December 31, 2013 (in thousands):

| Type                                    | June 30, 2014                    |                      |  | December 31, 2013                |                      |  | Balance Sheet Classification |
|-----------------------------------------|----------------------------------|----------------------|--|----------------------------------|----------------------|--|------------------------------|
|                                         | Assets Recognized (maximum loss) | Liability Recognized |  | Assets Recognized (maximum loss) | Liability Recognized |  |                              |
| Low income housing partnerships         | \$7,858                          | \$ -                 |  | \$7,945                          | \$ -                 |  | Other assets<br>Subordinated |
| Trust preferred issuances               | N/ A                             | 82,476               |  | N/ A                             | 82,476               |  | debt                         |
| Commercial troubled debt restructurings | 3,218                            | -                    |  | 15,273                           | -                    |  | Loans                        |
| Managed discretionary trusts            | N/ A                             | N/ A                 |  | N/ A                             | N/ A                 |  | N/ A                         |

## ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following is a discussion of our financial condition at June 30, 2014 and December 31, 2013 and our results of operations for the three and six months ended June 30, 2014 and 2013. 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

Our diluted net income per common share for the three and six months ended June 30, 2014 was \$0.49 and \$0.96 compared to \$0.42 and \$0.81 for the same periods in 2013. At June 30, 2014, loans had increased to \$4.315 billion, as compared to \$4.144 billion at December 31, 2013, and total deposits increased to \$4.652 billion at June 30, 2014 from \$4.533 billion at December 31, 2013.

**Results of Operations.** Our net interest income increased \$3.6 million to \$47.2 million for the second quarter of 2014 compared to \$43.6 million for the second quarter of 2013. Our net interest income increased \$6.8 million to \$93.1 million for the six months ended June 30, 2014 compared to \$86.4 million for the same period in the prior year. The net interest margin (the ratio of net interest income to average earning assets) for the three and six months ended June 30, 2014 was 3.71% and 3.73% compared to 3.77% and 3.83% for the same periods in 2013.

Our provision for loan losses was \$254,000 and \$742,000 for the three and six months ended June 30, 2014 compared to \$2.8 million and \$4.9 million for the same periods in 2013. Our provision expense correlates with the growth in our net loans offset by an overall reduction in the amount of our allowance for loan losses as a result of improvements in our loan portfolio. Net charge-offs were \$890,000 and \$1.8 million for the three and six months ended June 30, 2014, compared to \$3.5 million and \$5.7 million in the prior year. Our allowance for loan losses as a percentage of total loans decreased from 1.64% at December 31, 2013 to 1.55% at June 30, 2014, as a result of improving credit metrics within our loan portfolio.

Noninterest income increased by \$1.3 million and \$2.1 million during the three and six months ended June 30, 2014, compared to the same periods in the prior year. We have experienced increases for the three and six months periods ended June 30, 2014, in each of our wealth management lines of business (trust, insurance agency and investment services) as compared to the same periods in 2013. These increases were offset by a reduction in income related to gains on residential mortgage loans sold largely due to the reduction in mortgage refinancing activity in 2014 as compared to 2013. Other noninterest income includes miscellaneous consumer fees, such as ATM revenues, other consumer fees (primarily interchange), interest rate swap fee transactions for commercial borrowers, and gains from the sale of commercial loans that occur from time to time.

Noninterest expense increased by \$3.0 million and \$4.2 million during the three and six months ended June 30, 2014, as compared to the three and six months ended June 30, 2013, primarily as a result of increased salaries and employment benefits resulting from annual merit increases awarded in the first quarter of 2014. Costs associated with the disposal and maintenance of other real estate owned (OREO) decreased by \$1.2 million for both the three and six months ended June 30, 2014, when compared to the same periods in 2013. The reduction in OREO expense is the result of the normalization of property valuations as well as reduction of OREO inflows.

During the three and six months ended June 30, 2014, Pinnacle Financial recorded income tax expense of \$8.5 million and \$16.6 million, respectively, compared to \$7.0 million and \$13.6 million for the three and six months ended June 30, 2013. Pinnacle Financial's effective tax rate for the six months ended June 30, 2014 and 2013 of 33.2% and 32.8%, respectively, and differs from the combined federal and state income tax statutory rate primarily due to investments in bank qualified municipal securities, our real estate investment trust, and bank owned life insurance offset in part by a limitation related to deductibility of meals and entertainment expense and executive compensation. Our efficiency ratio (the ratio of noninterest expense to the sum of net interest income and noninterest income) was 56.7% and 57.0%, respectively, for the three and six months ended June 30, 2014, compared to 56.2% and 57.8% for the same periods in 2013. Net income for the three and six months ended June 30, 2014 was \$17.2 million and \$33.5

million, respectively, compared to \$14.3 million and \$27.8 million for the same periods in 2013.

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Financial Condition. Net loans increased \$172.1 million, or 4.2% during the six months ended June 30, 2014. Total deposits were \$4.652 billion at June 30, 2014, compared to \$4.533 billion at December 31, 2013, an increase of \$119.0 million, or 2.6%. At June 30, 2014, our capital ratios, including our bank's capital ratios, exceeded those levels necessary to be considered well-capitalized under applicable regulatory guidelines. From time to time we may be required to support the capital needs of our bank (Pinnacle Bank).

#### Critical Accounting Estimates

The accounting principles we follow and our methods of applying these principles conform with U.S. GAAP and with general practices within the banking industry. There have been no significant changes to our Critical Accounting Policies as described in our Annual Report on Form 10-K for the year ended December 31, 2013.

#### Results of Operations

The following is a summary of our results of operations (dollars in thousands, except per share data):

|                                                     | Three months ended |          | 2014-2013                   |   | Six months ended |          | 2014-2013                   |   |
|-----------------------------------------------------|--------------------|----------|-----------------------------|---|------------------|----------|-----------------------------|---|
|                                                     | June 30,           |          | Percent Increase (Decrease) |   | June 30,         |          | Percent Increase (Decrease) |   |
|                                                     | 2014               | 2013     |                             |   | 2014             | 2013     |                             |   |
| Interest income                                     | \$50,564           | \$47,544 | 6.4                         | % | \$99,855         | \$94,700 | 5.4                         | % |
| Interest expense                                    | 3,338              | 3,945    | (15.4)                      | % | 6,721            | 8,343    | (19.4)                      | % |
| Net interest income                                 | 47,226             | 43,599   | 8.3                         | % | 93,134           | 86,357   | 7.8                         | % |
| Provision for loan losses                           | 254                | 2,774    | (90.8)                      | % | 742              | 4,946    | (85.0)                      | % |
| Net interest income after provision for loan losses | 46,972             | 40,825   | 15.1                        | % | 92,392           | 81,411   | 13.5                        | % |
| Noninterest income                                  | 12,597             | 11,326   | 11.2                        | % | 25,330           | 23,228   | 9.0                         | % |
| Noninterest expense                                 | 33,902             | 30,862   | 9.9                         | % | 67,548           | 63,302   | 6.7                         | % |
| Net income before income taxes                      | 25,667             | 21,289   | 20.6                        | % | 50,174           | 41,337   | 21.4                        | % |
| Income tax expense                                  | 8,498              | 6,978    | 21.8                        | % | 16,637           | 13,578   | 22.5                        | % |
| Net income                                          | \$17,169           | \$14,311 | 20.0                        | % | \$33,537         | \$27,759 | 20.8                        | % |
| Basic net income per common share                   | \$0.49             | \$0.42   | 16.7                        | % | \$0.97           | \$0.81   | 19.8                        | % |
| Diluted net income per common share                 | \$0.49             | \$0.42   | 16.7                        | % | \$0.96           | \$0.81   | 18.5                        | % |

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 revenues. Net interest income totaled \$47.2 million and \$93.1 million for the three and six months ended June 30, 2014, an increase of \$3.6 million and \$6.8 million, respectively, from the levels recorded in the same periods of 2013. We were able to increase net interest income during the six months ended June 30, 2014 compared to the same period in 2013 due primarily to our focus on growing our loan portfolio as average loans for the six months ended June 30, 2014 were 11.4% greater than average balances for the same period in 2013 and reducing our funding costs between the two periods.

The following tables set 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 interest-earning assets and interest-bearing liabilities, net interest spread and net interest margin for the three and six months ended June 30, 2014 and 2013 (dollars in thousands):



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|                                                 | Three months ended<br>June 30, 2014 |          |                  | Three months ended<br>June 30, 2013 |          |                  |
|-------------------------------------------------|-------------------------------------|----------|------------------|-------------------------------------|----------|------------------|
|                                                 | Average<br>Balances                 | Interest | Rates/<br>Yields | Average<br>Balances                 | Interest | Rates/<br>Yields |
| Interest-earning assets:                        |                                     |          |                  |                                     |          |                  |
| Loans <sup>(1)</sup>                            | \$ 4,251,900                        | \$45,090 | 4.27 %           | \$ 3,845,476                        | \$42,149 | 4.41 %           |
| Securities:                                     |                                     |          |                  |                                     |          |                  |
| Taxable                                         | 609,884                             | 3,628    | 2.39 %           | 575,611                             | 3,651    | 2.54 %           |
| Tax-exempt <sup>(2)</sup>                       | 172,552                             | 1,563    | 4.85 %           | 170,358                             | 1,484    | 4.66 %           |
| Federal funds sold and other                    | 153,253                             | 283      | 0.87 %           | 119,089                             | 260      | 1.04 %           |
| Total interest-earning assets                   | \$ 5,187,589                        | \$50,564 | 3.97 %           | \$ 4,710,534                        | \$47,544 | 4.10 %           |
| Nonearning assets                               |                                     |          |                  |                                     |          |                  |
| Intangible assets                               | 247,081                             |          |                  | 248,439                             |          |                  |
| Other nonearning assets                         | 238,945                             |          |                  | 251,627                             |          |                  |
| Total assets                                    | \$ 5,673,615                        |          |                  | \$ 5,210,600                        |          |                  |
| Interest-bearing liabilities:                   |                                     |          |                  |                                     |          |                  |
| Interest-bearing deposits:                      |                                     |          |                  |                                     |          |                  |
| Interest checking                               | \$ 911,878                          | \$391    | 0.17 %           | \$ 790,043                          | \$536    | 0.27 %           |
| Savings and money market                        | 1,913,453                           | 1,392    | 0.29 %           | 1,581,868                           | 1,381    | 0.35 %           |
| Time                                            | 490,892                             | 699      | 0.57 %           | 578,764                             | 1,039    | 0.72 %           |
| Total interest-bearing deposits                 | 3,316,223                           | 2,482    | 0.30 %           | 2,950,675                           | 2,956    | 0.40 %           |
| Securities sold under agreements to repurchase  | 59,888                              | 31       | 0.21 %           | 129,550                             | 71       | 0.22 %           |
| Federal Home Loan Bank advances                 | 224,432                             | 187      | 0.33 %           | 293,581                             | 223      | 0.31 %           |
| Subordinated debt and other borrowings          | 99,015                              | 638      | 2.58 %           | 102,573                             | 695      | 2.72 %           |
| Total interest-bearing liabilities              | 3,699,558                           | 3,338    | 0.36 %           | 3,476,379                           | 3,945    | 0.46 %           |
| Noninterest-bearing deposits                    | 1,202,740                           | -        | -                | 1,012,718                           | -        | -                |
| Total deposits and interest-bearing liabilities | \$4,902,298                         | \$3,338  | 0.27 %           | \$4,489,097                         | \$3,945  | 0.35 %           |
| Other liabilities                               | 14,228                              |          |                  | 21,944                              |          |                  |
| Stockholders' equity                            | 757,089                             |          |                  | 699,559                             |          |                  |
| Total liabilities and stockholders' equity      | \$ 5,673,615                        |          |                  | \$ 5,210,600                        |          |                  |
| Net interest income                             |                                     | \$47,226 |                  |                                     | \$43,599 |                  |
| Net interest spread <sup>(3)</sup>              |                                     |          | 3.61 %           |                                     |          | 3.64 %           |
| Net interest margin <sup>(4)</sup>              |                                     |          | 3.71 %           |                                     |          | 3.77 %           |

1. Average balances of nonaccrual loans are included in the above amounts.

2. Yields based on the carrying value of those tax exempt instruments are shown on a fully tax equivalent basis.

Yields realized on interest-bearing assets less the rates paid on interest-bearing liabilities. The net interest spread calculation excludes the impact of demand deposits. Had the impact of demand deposits been included, the net interest spread for the three months ended June 30, 2014 would have been 3.69% compared to a net interest spread of 3.75% for the three months ended June 30, 2013.

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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|                                                 | Six months ended<br>June 30, 2014 |          |                  | Six months ended<br>June 30, 2013 |          |                  |
|-------------------------------------------------|-----------------------------------|----------|------------------|-----------------------------------|----------|------------------|
|                                                 | Average<br>Balances               | Interest | Rates/<br>Yields | Average<br>Balances               | Interest | Rates/<br>Yields |
| Interest-earning assets:                        |                                   |          |                  |                                   |          |                  |
| Loans <sup>(1)</sup>                            | \$4,191,430                       | \$88,785 | 4.28 %           | \$3,764,033                       | \$83,663 | 4.49 %           |
| Securities:                                     |                                   |          |                  |                                   |          |                  |
| Taxable                                         | 591,708                           | 7,349    | 2.50 %           | 556,885                           | 7,322    | 2.65 %           |
| Tax-exempt <sup>(2)</sup>                       | 173,873                           | 3,161    | 4.90 %           | 173,240                           | 3,140    | 4.88 %           |
| Federal funds sold and other                    | 149,082                           | 560      | 0.90 %           | 118,290                           | 575      | 1.14 %           |
| Total interest-earning assets                   | \$5,106,093                       | \$99,855 | 3.99 %           | \$4,612,448                       | \$94,700 | 4.19 %           |
| Nonearning assets                               |                                   |          |                  |                                   |          |                  |
| Intangible assets                               | 247,220                           |          |                  | 248,688                           |          |                  |
| Other nonearning assets                         | 240,951                           |          |                  | 240,787                           |          |                  |
| Total assets                                    | \$5,594,264                       |          |                  | \$5,101,923                       |          |                  |
| Interest-bearing liabilities:                   |                                   |          |                  |                                   |          |                  |
| Interest-bearing deposits:                      |                                   |          |                  |                                   |          |                  |
| Interest checking                               | \$916,431                         | \$821    | 0.17 %           | \$782,631                         | \$1,142  | 0.29 %           |
| Savings and money market                        | 1,932,514                         | 2,819    | 0.29 %           | 1,607,151                         | 3,005    | 0.38 %           |
| Time                                            | 499,364                           | 1,437    | 0.57 %           | 583,873                           | 2,221    | 0.77 %           |
| Total interest-bearing deposits                 | 3,348,309                         | 5,077    | 0.30 %           | 2,973,655                         | 6,368    | 0.43 %           |
| Securities sold under agreements to repurchase  | 61,187                            | 62       | 0.21 %           | 130,141                           | 149      | 0.23 %           |
| Federal Home Loan Bank advances                 | 154,498                           | 310      | 0.33 %           | 196,822                           | 414      | 0.42 %           |
| Subordinated debt and other borrowings          | 98,834                            | 1,272    | 2.58 %           | 104,663                           | 1,412    | 2.72 %           |
| Total interest-bearing liabilities              | 3,662,828                         | 6,721    | 0.36 %           | 3,405,281                         | 8,343    | 0.49 %           |
| Noninterest-bearing deposits                    | 1,165,946                         | -        | 0.00 %           | 982,951                           | -        | -                |
| Total deposits and interest-bearing liabilities | \$4,828,774                       | \$6,721  | 0.27 %           | \$4,388,232                       | \$8,343  | 0.38 %           |
| Other liabilities                               | 16,533                            |          |                  | 19,759                            |          |                  |
| Stockholders' equity                            | 748,957                           |          |                  | 693,932                           |          |                  |
| Total liabilities and stockholders' equity      | \$5,594,264                       |          |                  | \$5,101,923                       |          |                  |
| Net interest income                             |                                   | \$93,134 |                  |                                   | \$86,357 |                  |
| Net interest spread <sup>(3)</sup>              |                                   |          | 3.63 %           |                                   |          | 3.70 %           |
| Net interest margin <sup>(4)</sup>              |                                   |          | 3.73 %           |                                   |          | 3.83 %           |

1. Average balances of nonaccrual loans are included in the above amounts.

2. Yields based on the carrying value of those tax exempt instruments are shown on a fully tax equivalent basis.

Yields realized on interest-bearing assets less the rates paid on interest-bearing liabilities. The net interest spread calculation excludes the impact of demand deposits. Had the impact of demand deposits been included, the net interest spread for the six months ended June 30, 2014 would have been 3.72% compared to a net interest spread of 3.81% for the six months ended June 30, 2013.

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.

For the three months ended June 30, 2014 and 2013, our net interest margin was 3.71% and 3.77%, respectively. For the six months ended June 30, 2014 and 2013, our net interest margin was 3.73% and 3.83%, respectively. A reduction in loan yields between the second quarter of 2013 and the second quarter of 2014 was the primary reason for the decline in the margin. During the three and six months ended June 30, 2014, total funding rates were less than those rates for the same period in the prior year by 8 and 10 basis points, respectively. The net decrease was largely caused by the continued shift in our deposit mix, as we increased our checking accounts (both interest bearing and non-interest bearing) and concurrently reduced balances of higher-cost time deposits. We will continue to seek opportunities to reduce the cost of specific deposit accounts where we believe the amount we are currently paying for those funds exceeds market pricing. However, we believe future decreases in our funding costs will become more limited compared to recent periods.

Additionally, lower levels of nonaccrual loans positively impacted our net interest margin during the three and six months ended June 30, 2014 when compared to the same periods in 2013. Average nonaccrual loans were \$15.9 million and \$16.1 million for the three and six months ended June 30, 2014, which was a decrease from \$22.3 million and \$22.1 million of average nonaccrual loans for the three and six months ended June 30, 2013.

We continue to deploy various asset liability management strategies to manage our risk to interest rate fluctuations. We currently believe that short term rates will remain low for an extended period of time. We believe margin expansion over both the short and the long term will be challenging due to continued pressure on earning asset yields during this extended period of low interest rates. Loan pricing for creditworthy borrowers is very competitive in our markets and has limited our ability to increase pricing on new and renewed loans over the last several quarters, and we anticipate that this challenging competitive environment will continue throughout the remainder of 2014.

We continue to believe our net interest income should increase throughout 2014 compared to 2013 due to an increase in average earning asset volumes, primarily loans. We anticipate funding these increased earning assets primarily by growing our core deposits, with limited wholesale funding to fund the shortfall, if any.

**Provision for Loan Losses.** The provision for loan losses represents a charge to earnings necessary to establish an allowance for loan losses that, in management's evaluation, should be adequate to provide coverage for the inherent losses on outstanding loans. 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 inherent in the loan portfolio. Our allowance for loan losses as a percentage of total loans decreased from 1.64% at December 31, 2013 to 1.55% at June 30, 2014. Our allowance for loan losses as a percentage of our nonaccrual loans has increased from 373.8% at December 31, 2013 to 426.6% at June 30, 2014.

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 June 30, 2014. 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 management, they are necessarily approximate and imprecise. There are factors beyond our control, such as conditions in the local and national economy, local real estate market, or particular industry or borrower-specific conditions, which may materially negatively impact our asset quality and the adequacy of our allowance for loan losses and, thus, the resulting provision for loan losses.

The provision for loan losses amounted to \$254,000 and \$742,000 for the three and six months ended June 30, 2014 and 2013, respectively, and \$2.8 million and \$4.9 million for the three and six months ended June 30, 2013, respectively. Provision expense is impacted by the absolute level of loans, loan growth, the credit quality of the loan portfolio and the amount of net charge-offs.

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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 customer growth trends, while fees from our wealth management departments, the origination of mortgage loans and gains and losses on the sale of securities will often reflect market conditions and fluctuate from period to period.

The following is a summary of our noninterest income for the three and six months ended June 30, 2014 and 2013 (dollars in thousands):

|                                                   | Three months ended |          | 2014-2013 |       | Six months ended |          | 2014-2013  |        |         |    |
|---------------------------------------------------|--------------------|----------|-----------|-------|------------------|----------|------------|--------|---------|----|
|                                                   | June 30,           |          | Percent   |       | June 30,         |          | Percent    |        |         |    |
|                                                   | 2014               | 2013     | Increase  |       | 2014             | 2013     | (Decrease) |        |         |    |
| Noninterest income:                               |                    |          |           |       |                  |          |            |        |         |    |
| Service charges on deposit accounts               | \$2,966            | \$2,541  | 16.7      | %     | \$5,757          | \$5,021  | 14.65      | %      |         |    |
| Investment services                               | 2,164              | 1,895    | 14.2      | %     | 4,292            | 3,688    | 16.38      | %      |         |    |
| Insurance sales commissions                       | 1,145              | 1,108    | 3.4       | %     | 2,530            | 2,501    | 1.15       | %      |         |    |
| Gains on mortgage loans sold, net                 | 1,669              | 1,949    | (14.4     | %)    | 2,903            | 3,804    | (23.67     | %)     |         |    |
| Gain (loss) on sale of investment securities, net | -                  | (25      | )         | 100.0 | %                | -        | (25        | )      | (100.00 | %) |
| Trust fees                                        | 1,072              | 880      | 21.8      | %     | 2,218            | 1,825    | 21.54      | %      |         |    |
| Other noninterest income:                         |                    |          |           |       |                  |          |            |        |         |    |
| ATM and other consumer fees                       | 1,856              | 1,888    | (1.7      | %)    | 4,081            | 3,695    | 10.45      | %      |         |    |
| Bank-owned life insurance                         | 620                | 701      | (11.6     | %)    | 1,235            | 971      | 27.19      | %      |         |    |
| Loan swap fees                                    | 89                 | (77      | )         | 215.6 | %                | 118      | 397        | (70.28 | %)      |    |
| Other equity investments                          | (38                | )        | 1         | 100.0 | %                | 92       | 168        | (45.24 | %)      |    |
| Other noninterest income                          | 1,055              | 465      | 126.3     | %     | 2,104            | 1,183    | 77.75      | %      |         |    |
| Total other noninterest income                    | 3,582              | 2,978    | 20.3      | %     | 7,630            | 6,414    | 18.95      | %      |         |    |
| Total noninterest income                          | \$12,598           | \$11,326 | 11.2      | %     | \$25,330         | \$23,228 | 9.04       | %      |         |    |

The increase in service charges on deposit accounts in the first six months of 2014 compared to the first six months of 2013 is primarily related to increased analysis fees due to an increase in the volume and number of commercial checking accounts.

Income from our wealth management groups (investments, insurance and trust) are also included in noninterest income. For the three and six months ended June 30, 2014, commissions and fees from investment services at our financial advisory unit, Pinnacle Asset Management, a division of Pinnacle Bank, increased by \$269,000 and \$604,000 as compared to the three and six months ended June 30, 2013. At June 30, 2014, Pinnacle Asset Management was receiving commissions and fees in connection with approximately \$1.7 billion in brokerage assets held with Raymond James Financial Services, Inc. compared to \$1.4 billion at June 30, 2013. Insurance commissions were approximately \$1.1 million and \$2.5 million, respectively, for both the three and six months ended June 30, 2014 and 2013. Included in insurance income for the first six months of 2014 was \$243,000 of contingent income received based on 2013 sales production compared to \$334,000 recorded in the first six months of 2013. Additionally, at June 30, 2014, our trust department was receiving fees on approximately \$1.6 billion of managed and custodied assets compared to \$1.4 billion at June 30, 2013, resulting in an increase of 21.5% between the year-to-date periods presented.

Gains on mortgage loans sold, net, consists of fees from the origination and sale of mortgage loans. These mortgage fees are for loans originated in both the Middle Tennessee and Knoxville markets 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 more robust housing markets and decrease in rising interest rate

environments and more challenging housing markets. Mortgage origination fees will fluctuate from quarter to quarter as the rate environment changes. Gains on mortgage loans sold, net, were \$1.7 million and \$2.9 million for the three and six months ended June 30, 2014 as compared to \$1.9 million and \$3.8 million for the same periods in the prior year as a result of decreased demand in the market.

Over the last several years, the reduced interest rates have provided home owners the opportunity to refinance their existing mortgages at low rates; however, as interest rates rise, we anticipate that our mortgage originations will continue to decrease from those levels realized in recent years. The fees from the origination and sale of mortgage loans have been netted against the commission expense associated with these originations.

Included in other noninterest income are ATM and other consumer fees, gains from bank-owned life insurance, swap fees earned for the facilitation of derivative transactions for our clients, changes in the fair value of our other equity investments and other items. Other noninterest income included changes in the cash surrender value of bank-owned life insurance which was \$620,000 and \$1.2 million for the three and six months ended June 30, 2014 compared to \$701,000 and \$971,000 for the three and six months ended June 30, 2013. The increase in earnings on these bank-owned life insurance policies resulted primarily from the 2013 purchase of approximately \$38 million in additional bank-owned life insurance with terms similar to our existing policies. The assets that support these policies are administered by the life insurance carriers and the income we receive (i.e., increases or decreases in the cash surrender value of the policies) on these policies is dependent upon the returns the insurance carriers are able to earn on the underlying investments that support the policies. Earnings on these policies generally are not taxable.

Also, during the first six months of 2014 we recognized approximately \$92,000 in gains in the market value of our other equity investments compared to \$168,000 in the prior year's comparable period.

**Noninterest Expense.** Noninterest expense consists of salaries and employee benefits, equipment and occupancy expenses, other real estate expenses, and other operating expenses. The following is a summary of our noninterest expense for the three and six months ended June 30, 2014 and 2013 (in thousands):

|                                           | Three months ended |          | 2014-2013<br>Percent<br>Increase<br>(Decrease) |    | Six months ended |          | 2014-2013<br>Percent<br>Increase<br>(Decrease) |    |
|-------------------------------------------|--------------------|----------|------------------------------------------------|----|------------------|----------|------------------------------------------------|----|
|                                           | June 30,<br>2014   | 2013     |                                                |    | June 30,<br>2014 | 2013     |                                                |    |
| Noninterest expense:                      |                    |          |                                                |    |                  |          |                                                |    |
| Salaries and employee benefits:           |                    |          |                                                |    |                  |          |                                                |    |
| Salaries                                  | \$12,164           | \$11,515 | 5.6                                            | %  | \$24,619         | \$22,958 | 7.23                                           | %  |
| Commissions                               | 1,327              | 1,175    | 12.9                                           | %  | 2,664            | 2,294    | 16.13                                          | %  |
| Cash incentives and related payroll taxes | 3,575              | 3,775    | (5.3)                                          | )% | 6,950            | 6,625    | 4.91                                           | %  |
| Employee benefits and other               | 4,706              | 4,106    | 14.6                                           | %  | 9,289            | 8,266    | 12.38                                          | %  |
| Total salaries and employee benefits      | 21,772             | 20,571   | 5.8                                            | %  | 43,522           | 40,143   | 8.42                                           | %  |
| Equipment and occupancy                   | 5,823              | 5,204    | 11.9                                           | %  | 11,532           | 10,317   | 11.77                                          | %  |
| Other real estate expense                 | 226                | 1,391    | (83.8)                                         | )% | 877              | 2,112    | (58.47)                                        | )% |
| Marketing and business development        | 1,065              | 987      | 7.9                                            | %  | 1,974            | 1,778    | 11.02                                          | %  |
| Postage and supplies                      | 544                | 518      | 5.1                                            | %  | 1,105            | 1,109    | (0.38)                                         | )% |
| Amortization of intangibles               | 238                | 248      | (4.2)                                          | )% | 475              | 769      | (38.19)                                        | )% |
| Other noninterest expense                 | 4,234              | 1,943    | 117.9                                          | %  | 8,062            | 7,074    | 13.97                                          | %  |
| Total noninterest expense                 | \$33,902           | \$30,862 | 9.9                                            | %  | \$67,547         | \$63,302 | 6.71                                           | %  |

Total salaries and employee benefits expenses increased approximately 8.4% for the first six months of 2014 over the same period in 2013. The increase in salaries is the result of our annual merit increases being effective January 1 as well as the overall increase in our associate base. At June 30, 2014, our associate base had expanded to 748.5 full-time equivalent associates as compared to 732.5 at June 30, 2013. We expect that total salaries and employee benefits expense will continue to increase in 2014 when compared to comparable periods in 2013 as a result of our hiring of additional experienced financial advisors in the first half of 2014.



We believe that cash and equity 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, all of our non-commissioned associates participate in our annual cash incentive plan and all of our associates participate in our equity compensation plans. As compared to 2013, cash incentives increased by \$325,000 to \$7.0 million for the six months ended June 30, 2014. Under the annual cash incentive plan, the targeted level of incentive payments requires achievement of a certain soundness threshold, a revenue component and a targeted level of earnings (subject to certain adjustments). To the extent that the soundness threshold is met and revenues and earnings are above or below the targeted amount, the aggregate incentive payments are increased or decreased. Historically, we have paid between 0% and 125% of our targeted incentives. We currently believe that our performance for fiscal 2014 will exceed our targets and we are currently accruing incentive costs for the cash incentive plan in 2014 above target levels at the upper end of award level, which is 122% of targeted awards.

Employee benefits include items such as payroll taxes, health insurance, and employer match for the 401(k) program. Additionally, included in employee benefits and other expense for the three and six months ended June 30, 2014, were approximately \$1.4 million and \$2.6 million, respectively, of compensation expenses related to restricted share awards and performance unit awards compared to \$1.0 million and \$2.0 million for the three and six months ended June 30, 2013, respectively. We provide a broad-based equity incentive plan for all associates. We believe that equity incentives provide an excellent vehicle for all associates to become meaningful stockholders of Pinnacle Financial over an extended period of time and create a stockholder-centric culture throughout our organization. We expect that compensation expense associated with equity awards for the remainder of 2014 will continue to exceed the same expenses for the comparable periods in 2013 as a result of, among other factors, the additional associates we have hired in 2014.

Equipment and occupancy expenses for the three and six months ended June 30, 2014, increased \$619,000 and \$1.2 million, respectively, as compared to the same periods in the prior year. We expanded our retail operations in the second quarter of 2013 in the Knoxville market with the opening of our Cedar Bluff location and also increased our leased space at our corporate headquarters in downtown Nashville, Tennessee, in the first quarter of 2014. During the second quarter of 2014, we began construction of our fifth Knoxville market location. We anticipate opening this location late in the fourth quarter of 2014. In future periods, these expansions may lead to higher equipment and occupancy expenses as well as related increases in salaries and benefits expense.

At June 30, 2014, we had \$12.9 million in OREO assets compared to \$15.2 million at December 31, 2013. Other real estate expense was \$226,000 and \$877,000, respectively, for the three and six months ended June 30, 2014, compared to \$1.4 million and \$2.1 million, respectively, for the same periods in the prior year. Approximately \$234,000 of the other real estate expense incurred during the six months ended June 30, 2014, were realized losses on dispositions and holding losses due to reduced valuations of OREO properties compared to \$1.6 million for the same period in the prior year. The remaining other real estate expense consisted of carrying costs to maintain or improve the properties.

The decrease in intangible amortization expense between the three and six months ended June 30, 2014 as compared to the same periods in June 30, 2013 was attributable to the final amortization of the core deposit intangible associated with the 2006 acquisition of Cavalry Bancorp in the second quarter of 2013. The remaining expense for the amortization of intangibles relates primarily to the intangible acquired in the Mid-America merger in November 2007. This core deposit 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. Amortization expense associated with this core deposit intangible will approximate \$700,000 to \$860,000 per year for the next three years with amounts declining each year for the remaining amortization period. Additionally, in connection with our acquisition of Miller Loughry Beach, an insurance brokerage firm, in July of 2008, we recorded a customer list intangible of \$1,270,000 which is being amortized over 20 years on an accelerated basis. Amortization of the customer list intangible amounted to \$23,000 and \$45,000 for the three and six months ended June 30, 2014 and \$24,000 and \$48,000, respectively, for the three and six months ended June 30, 2013, respectively.



Total other noninterest expenses increased by \$2.3 million and \$989,000, respectively, during the three and six months ended June 30, 2014 when compared to 2013. During the second quarter of 2013, we reversed a \$2.0 million allowance for off-balance sheet exposures related to a letter of credit which funded during the second quarter of 2013. A corresponding specific allowance was recorded as a component of the allowance for loan losses. This \$2.0 million allowance reversal was partially offset for the six month period ended June 30, 2013 by an approximate \$877,000 prepayment penalty we incurred due to the prepayment of \$35.0 million in FHLB advances in the first quarter of 2013.

Our efficiency ratio (ratio of noninterest expense to the sum of net interest income and noninterest income) was 56.7% and 57.0%, respectively, for the three and six months ended June 30, 2014 compared to 56.2% and 57.8%, respectively, for the three and six months ended June 30, 2013. The efficiency ratio measures the amount of expense that is incurred to generate a dollar of revenue.

**Income Taxes.** During the three and six months ended June 30, 2014, we recorded income tax expense of \$8.5 million and \$16.6 million respectively, compared to \$7.0 million and \$13.6 million, respectively, for the three and six months ended June 30, 2013. Our income tax expense for the year-to-date period ended June 30, 2014 reflects an effective income tax rate of 33.2% compared to 32.8% for the year-to-date period ended June 30, 2013 which is principally impacted by our investments in municipal securities, our real estate investment trust and bank-owned life insurance offset in part by meals and entertainment expense and executive compensation, portions of which are non-deductible.

#### Financial Condition

Our consolidated balance sheet at June 30, 2014 reflects an increase in total loans outstanding to \$4.315 billion at June 30, 2014 compared to \$4.144 billion at December 31, 2013. Total deposits increased by \$118.0 million between December 31, 2013 and June 30, 2014. Total assets were \$5.789 billion at June 30, 2014 compared to \$5.564 billion at December 31, 2013.

**Loans.** The composition of loans at June 30, 2014 and at December 31, 2013 and the percentage (%) of each classification to total loans are summarized as follows (dollars in thousands):

|                                   | June 30, 2014 |         | December 31, 2013 |         |
|-----------------------------------|---------------|---------|-------------------|---------|
|                                   | Amount        | Percent | Amount            | Percent |
| Commercial real estate – mortgage | \$1,457,335   | 33.8 %  | \$1,383,435       | 33.4 %  |
| Consumer real estate – mortgage   | 698,528       | 16.2 %  | 695,616           | 16.8 %  |
| Construction and land development | 292,875       | 6.8 %   | 316,191           | 7.6 %   |
| Commercial and industrial         | 1,697,634     | 39.3 %  | 1,605,547         | 38.7 %  |
| Consumer and other                | 169,190       | 3.9 %   | 143,704           | 3.5 %   |
| Total loans                       | \$4,315,562   | 100.0 % | \$4,144,493       | 100.0 % |

The primary changes within the composition of our loan portfolio at June 30, 2014 as compared to December 31, 2013 reflect increased loan demand in the commercial and industrial and commercial real estate segments. We believe that loan growth in the second half of 2014 within the commercial real estate segment will outpace loan payoffs in that segment of the portfolio resulting in an increase in the percentage of commercial real estate loans as a percentage of total loans. The commercial real estate – mortgage category includes owner-occupied commercial real estate loans. At June 30, 2014, approximately 48.2% of the outstanding principal balance of our commercial real estate mortgage loans was secured by owner-occupied properties. Owner-occupied commercial real estate is similar in many ways to our commercial and industrial lending in that these loans are generally made to businesses on the basis of the cash flows of the business rather than on the valuation of the real estate. Growth in the consumer and other segment is primarily the result of increased indirect automobile lending.

The following table classifies our fixed and variable rate loans at June 30, 2014 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):

|                                       | Amounts at June 30, 2014 |                |              | Percentage       |   |
|---------------------------------------|--------------------------|----------------|--------------|------------------|---|
|                                       | Fixed Rates              | Variable Rates | Totals       | At June 30, 2014 |   |
| Based on contractual maturity:        |                          |                |              |                  |   |
| Due within one year                   | \$ 174,153               | \$ 771,681     | \$ 945,834   | 21.9             | % |
| Due in one year to five years         | 1,010,704                | 924,665        | 1,935,369    | 44.8             | % |
| Due after five years                  | 610,655                  | 823,704        | 1,434,359    | 33.3             | % |
| Totals                                | \$ 1,795,512             | \$ 2,520,050   | \$ 4,315,562 | 100.0            | % |
| Based on contractual repricing dates: |                          |                |              |                  |   |
| Daily floating rate (*)               | \$-                      | \$ 1,319,546   | \$ 1,319,546 | 30.6             | % |
| Due within one year                   | 174,153                  | 425,751        | 599,904      | 13.9             | % |
| Due in one year to five years         | 1,010,704                | 493,927        | 1,504,631    | 34.9             | % |
| Due after five years                  | 610,655                  | 280,826        | 891,481      | 20.6             | % |
| Totals                                | \$ 1,795,512             | \$ 2,520,050   | \$ 4,315,562 | 100.0            | % |

The above information does not consider the impact of scheduled principal payments.

(\*) Daily floating rate loans are tied to Pinnacle Bank's prime lending rate or a national interest rate index with the underlying loan rates changing in relation to changes in these indexes. Interest rate floors are currently in effect on approximately \$465.8 million of our daily floating rate loan portfolio and on approximately \$866.0 million of the remaining variable rate loan portfolio at varying maturities. The weighted average rate of the floors for the daily floating rate portfolio is 4.43% compared to the average coupon of 3.74% for this portfolio. The weighted average rate of the floors for the remaining variable rate portfolio is 4.08% compared to the average coupon rate of 3.28% for this portfolio. As a result, interest income on these loans will not adjust until the contractual rate on the underlying loan exceeds the interest rate floor.

Accruing Loans in Past Due Status. The following table is a summary of our accruing loans that were past due at least 30 days but less than 89 days and 90 days or more past due as of June 30, 2014 and December 31, 2013 (dollars in thousands):

|                                               | June 30, | December  |
|-----------------------------------------------|----------|-----------|
|                                               | 2014     | 31,       |
|                                               |          | 2013      |
| Accruing loans past due 30 to 89 days:        |          |           |
| Commercial real estate – mortgage             | \$935    | \$ 2,561  |
| Consumer real estate – mortgage               | 5,402    | 2,215     |
| Construction and land development             | 5,083    | 4,839     |
| Commercial and industrial                     | 3,581    | 1,847     |
| Consumer and other                            | 3,561    | 1,488     |
| Total accruing loans past due 30 to 89 days   | \$18,562 | \$ 12,950 |
| Accruing loans past due 90 days or more:      |          |           |
| Commercial real estate – mortgage             | \$280    | \$ 2,232  |
| Consumer real estate – mortgage               | -        | -         |
| Construction and land development             | -        | -         |
| Commercial and industrial                     | 51       | 825       |
| Consumer and other                            | 318      | 289       |
| Total accruing loans past due 90 days or more | \$649    | \$ 3,346  |

Ratios:

|                                                                        |      |   |      |   |
|------------------------------------------------------------------------|------|---|------|---|
| Accruing loans past due 30 to 89 days as a percentage of total loans   | 0.43 | % | 0.31 | % |
| Accruing loans past due 90 days or more as a percentage of total loans | 0.02 | % | 0.08 | % |
| Total accruing loans in past due status as a percentage of total loans | 0.45 | % | 0.39 | % |

Potential Problem Loans. Potential problem loans, which are not included in nonperforming assets, amounted to approximately \$77.1 million or 1.8% of total loans at June 30, 2014, compared to \$65.0 million or 1.6% of total loans at December 31, 2013. 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 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 Pinnacle Bank's primary regulators, for loans classified as substandard, excluding the impact of substandard nonaccrual loans and substandard troubled debt restructurings. Troubled debt restructurings are not included in potential problem loans. Approximately \$7.8 million of potential problem loans were past due at least 30 days but less than 90 days as of June 30, 2014.

Nonperforming Assets and Troubled Debt Restructurings. At June 30, 2014, we had \$28.6 million in nonperforming assets compared to \$33.4 million at December 31, 2013. Included in nonperforming assets were \$15.7 million in nonaccrual loans and \$12.9 million in OREO at June 30, 2014 and \$18.2 million in nonaccrual loans and \$15.2 million in OREO assets at December 31, 2013. At June 30, 2014 and December 31, 2013, there were \$7.6 million and \$19.6 million, respectively, of troubled debt restructurings, all of which were accruing as of the restructured date and remain on accrual status but are considered impaired loans pursuant to U.S. GAAP.

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The following table is a summary of our nonperforming assets and troubled debt restructurings at June 30, 2014 and December 31, 2013 (dollars in thousands):

|                                                                                                                                              | At<br>December<br>31, 2013 | Payments,<br>Sales and<br>Reductions <sup>(1)</sup> | Foreclosures <sup>(2)</sup> | Inflows <sup>(3)</sup> | At<br>June 30,<br>2014 |
|----------------------------------------------------------------------------------------------------------------------------------------------|----------------------------|-----------------------------------------------------|-----------------------------|------------------------|------------------------|
| <b>Nonperforming assets:</b>                                                                                                                 |                            |                                                     |                             |                        |                        |
| <b>Nonaccrual loans:</b>                                                                                                                     |                            |                                                     |                             |                        |                        |
| Commercial real estate – mortgage                                                                                                            | \$ 9,017                   | \$ (1,601 )                                         | \$ (1,572 )                 | \$ 910                 | \$ 6,754               |
| Consumer real estate – mortgage                                                                                                              | 5,289                      | (1,026 )                                            | (100 )                      | 2,076                  | 6,239                  |
| Construction and land development                                                                                                            | 1,070                      | (92 )                                               | -                           | -                      | 978                    |
| Commercial and industrial                                                                                                                    | 2,565                      | (2,741 )                                            | -                           | 1,559                  | 1,387                  |
| Consumer and other                                                                                                                           | 242                        | (1,933 )                                            | -                           | 2,015                  | 320                    |
| Total nonaccrual loans <sup>(4)</sup>                                                                                                        | 18,183                     | (7,393 )                                            | (1,672 )                    | 6,550                  | 15,678                 |
| Other real estate owned                                                                                                                      | 15,226                     | (3,979 )                                            | 1,672                       | 27                     | 12,946                 |
| Total nonperforming assets                                                                                                                   | 33,409                     | (11,372 )                                           | -                           | 6,587                  | 28,624                 |
| <b>Troubled debt restructurings:</b>                                                                                                         |                            |                                                     |                             |                        |                        |
| Commercial real estate – mortgage                                                                                                            | 13,453                     | (13,453 )                                           | -                           | -                      | -                      |
| Consumer real estate – mortgage                                                                                                              | 3,984                      | (41 )                                               | -                           | -                      | 3,943                  |
| Construction and land development                                                                                                            | 113                        | (6 )                                                | -                           | -                      | 107                    |
| Commercial and industrial                                                                                                                    | 1,820                      | (1,557 )                                            | -                           | 2,955                  | 3,218                  |
| Consumer and other                                                                                                                           | 276                        | (6 )                                                | -                           | 13                     | 283                    |
| Total troubled debt restructurings                                                                                                           | 19,646                     | (15,063 )                                           | -                           | 2,968                  | 7,551                  |
| Total nonperforming assets and troubled debt restructurings                                                                                  | \$ 53,055                  | \$ (26,435 )                                        | \$ -                        | \$ 9,555               | \$ 36,175              |
| <b>Ratios:</b>                                                                                                                               |                            |                                                     |                             |                        |                        |
| Nonaccrual loans to total loans                                                                                                              | 0.44                       | %                                                   |                             |                        | 0.36 %                 |
| Nonperforming assets to total loans plus other real estate owned                                                                             | 0.88                       | %                                                   |                             |                        | 0.66 %                 |
| Nonperforming assets plus troubled debt restructurings to total loans and other real estate owned                                            | 1.28                       | %                                                   |                             |                        | 0.84 %                 |
| Nonperforming assets, potential problem loans and troubled debt restructurings to Pinnacle Bank Tier I capital and allowance for loan losses | 19.02                      | %                                                   |                             |                        | 17.89 %                |
| Classified asset ratio (Pinnacle Bank) <sup>(5)</sup>                                                                                        | 18.50                      | %                                                   |                             |                        | 18.10 %                |
| Allowance for loan loss coverage ratio                                                                                                       | 373.8                      | %                                                   |                             |                        | 426.6 %                |

Payments, sales and reductions in nonaccrual loans are primarily attributable to payments we have collected from borrowers, charge-offs of recorded balances and nonaccrual loans that have been returned to accruing status during the six months ended June 30, 2014. Payments, sales and reductions in other real estate owned represent either the (1) sale, disposition or valuation adjustment on properties which had previously been foreclosed upon or acquired by deed in lieu of foreclosure. Payments, sales and reductions in troubled debt restructurings are those loans which were previously restructured whereby the borrower has reduced the outstanding balance of the loan or re-defaulted on the terms of the loan and therefore been charged-off.

(2) Foreclosures in nonaccrual loans and troubled debt restructurings are representative of transfers of balances to OREO during the six months ended June 30, 2014.

Inflows in nonaccrual loans are attributable to loans where we have discontinued the accrual of interest at some (3) point during the six months ended June 30, 2014. These concessions can be in the form of a reduced interest rate, extended maturity date or other matters.

(4)

Approximately \$10.7 million and \$10.9 million as of June 30, 2014 and December 31, 2013, respectively, of nonaccrual loans included above are currently paying pursuant to their contractual terms.

(5) Classified assets as a percentage of Tier 1 capital plus allowance for loan losses.

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At June 30, 2014, we owned \$12.9 million in other real estate assets which we had acquired (usually through foreclosure) from borrowers, compared to \$15.2 million at December 31, 2013, substantially all of which is located within our principal markets. We segment our OREO into three categories: developed lots, undeveloped land, and other. The other category primarily consists of office buildings and existing homes. The following table shows the classification of our OREO (dollars in thousands):

|                  | June 30,<br>2014 | December<br>31,<br>2013 |
|------------------|------------------|-------------------------|
| Developed lots   | \$508            | \$ 1,296                |
| Undeveloped land | 10,556           | 11,564                  |
| Other            | 1,882            | 2,366                   |
|                  | \$12,946         | \$ 15,226               |

Allowance for Loan Losses (allowance). We maintain the allowance for loan losses at a level that our management deems appropriate to adequately cover the probable losses inherent in our loan portfolio as of the balance sheet date. As of June 30, 2014 and December 31, 2013, our allowance for loan losses was approximately \$66.9 million and \$68.0 million, respectively, which our management deemed to be adequate at each of the respective dates. The judgments and estimates associated with our allowance determination are described under Critical Accounting Estimates in our Annual Report on Form 10-K for the year ended December 31, 2013.

The following table sets forth, based on management's best estimate, the allocation of the allowance to categories of loans as well as the unallocated portion as of June 30, 2014 and December 31, 2013 and the percentage of loans in each category to total loans (dollars in thousands):

|                                   | June 30, 2014 |         | December 31,<br>2013 |         |
|-----------------------------------|---------------|---------|----------------------|---------|
|                                   | Amount        | Percent | Amount               | Percent |
| Commercial real estate - mortgage | \$19,339      | 33.8 %  | \$21,372             | 33.4 %  |
| Consumer real estate - mortgage   | 8,208         | 16.2 %  | 8,355                | 16.8 %  |
| Construction and land development | 6,414         | 6.8 %   | 7,235                | 7.6 %   |
| Commercial and industrial         | 27,483        | 39.3 %  | 25,134               | 38.7 %  |
| Consumer and other                | 1,936         | 3.9 %   | 1,632                | 3.5 %   |
| Unallocated                       | 3,508         | NA      | 4,242                | NA      |
| Total allowance for loan losses   | \$66,888      | 100.0 % | \$67,970             | 100.0 % |

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The following is a summary of changes in the allowance for loan losses for the year-to-date period ended June 30, 2014 and for the year ended December 31, 2013 and the ratio of the allowance for loan losses to total loans as of the end of each period (dollars in thousands):

|                                                                                           | Six<br>months<br>ended<br>June 30,<br>2014 | Year<br>ended<br>December<br>31, 2013 |  |  |
|-------------------------------------------------------------------------------------------|--------------------------------------------|---------------------------------------|--|--|
| Balance at beginning of period                                                            | \$67,970                                   | \$69,417                              |  |  |
| Provision for loan losses                                                                 | 742                                        | 7,857                                 |  |  |
| Charged-off loans:                                                                        |                                            |                                       |  |  |
| Commercial real estate – mortgage                                                         | (393 )                                     | (4,123 )                              |  |  |
| Consumer real estate – mortgage                                                           | (418 )                                     | (2,250 )                              |  |  |
| Construction and land development                                                         | (7 )                                       | (1,351 )                              |  |  |
| Commercial and industrial                                                                 | (1,777 )                                   | (8,159 )                              |  |  |
| Consumer and other loans                                                                  | (674 )                                     | (1,369 )                              |  |  |
| Total charged-off loans                                                                   | (3,269 )                                   | (17,252 )                             |  |  |
| Recoveries of previously charged-off loans:                                               |                                            |                                       |  |  |
| Commercial real estate – mortgage                                                         | 216                                        | 500                                   |  |  |
| Consumer real estate – mortgage                                                           | 126                                        | 1,209                                 |  |  |
| Construction and land development                                                         | 240                                        | 1,464                                 |  |  |
| Commercial and industrial                                                                 | 624                                        | 4,531                                 |  |  |
| Consumer and other loans                                                                  | 239                                        | 244                                   |  |  |
| Total recoveries of previously charged-off loans                                          | 1,445                                      | 7,948                                 |  |  |
| Net charge-offs                                                                           | (1,824 )                                   | (9,304 )                              |  |  |
| Balance at end of period                                                                  | \$66,888                                   | \$67,970                              |  |  |
| Ratio of allowance for loan losses to total loans outstanding at end of period            | 1.55 %                                     | 1.64 %                                |  |  |
| Ratio of net charge-offs to average total loans outstanding for the period <sup>(1)</sup> | 0.09 %                                     | 0.24 %                                |  |  |

(1) Net charge-offs for the year-to-date period ended June 30, 2014 have been annualized.

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, the views of our regulators, adverse situations that may affect the borrower's ability to repay (including the timing of future payments), 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. For further discussion regarding our allowance for loan losses, refer to our Annual Report on Form 10-K as of and for the year ended December 31, 2013.



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Investments. Our investment portfolio, consisting primarily of U.S. Treasuries, Federal agency bonds, mortgage-backed securities, and state and municipal securities amounted to \$782.1 million and \$733.3 million at June 30, 2014 and December 31, 2013, respectively. Our investment portfolio serves many purposes including serving as a stable source of income, as collateral for public funds deposits and as a potential liquidity source. A summary of our investment portfolio at June 30, 2014 and December 31, 2013 follows:

|                         | June 30, 2014 | December 31, 2013 |
|-------------------------|---------------|-------------------|
| Weighted average life   | 4.64 years    | 5.22 years        |
| Effective duration      | 3.08%         | 4.61%             |
| Weighted average coupon | 3.37%         | 3.50%             |
| Tax equivalent yield    | 2.93%         | 3.15%             |

Deposits and Other Borrowings. We had approximately \$4.652 billion of deposits at June 30, 2014 compared to \$4.533 billion at December 31, 2013. 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 securities under agreements to repurchase the security the following day. These agreements (which are typically associated with comprehensive treasury management programs for our clients and provide them with short-term returns for their excess funds) amounted to \$62.3 million at June 30, 2014 and \$70.5 million at December 31, 2013. Additionally, at June 30, 2014 and December 31, 2013, Pinnacle Bank had borrowed \$170.6 million and \$90.6 million, respectively, in advances from the FHLB. At June 30, 2014, Pinnacle Bank also had approximately \$815.0 million in additional availability with the FHLB.

Generally, we have classified our funding base as either core funding or non-core funding. Core funding consists of all deposits other than time deposits issued in denominations greater than \$250,000. All other funding is deemed to be non-core. The following table represents the balances of our deposits and other funding and the percentage of each type to the total at June 30, 2014 and December 31, 2013 (dollars in thousands):

|                                                    | June 30,<br>2014 | Percent | December<br>31,<br>2013 | Percent |
|----------------------------------------------------|------------------|---------|-------------------------|---------|
| Core funding:                                      |                  |         |                         |         |
| Noninterest-bearing deposit accounts               | \$1,324,358      | 26.58 % | \$1,167,763             | 24.35 % |
| Interest-bearing demand accounts                   | 887,319          | 17.81 % | 870,662                 | 18.16 % |
| Savings and money market accounts                  | 1,671,108        | 33.54 % | 1,655,087               | 34.52 % |
| Time deposit accounts less than \$250,000          | 362,960          | 7.29 %  | 408,520                 | 8.52 %  |
| Total core funding                                 | 4,245,745        | 85.23 % | 4,102,032               | 85.54 % |
| Non-core funding:                                  |                  |         |                         |         |
| Relationship based non-core funding:               |                  |         |                         |         |
| Reciprocating NOW deposits <sup>(1)</sup>          | 13,257           | 0.27 %  | 13,633                  | 0.28 %  |
| Reciprocating money market accounts <sup>(1)</sup> | 279,128          | 5.60 %  | 309,276                 | 6.45 %  |
| Reciprocating time deposits                        | 38,141           | 0.77 %  | 32,689                  | 0.68 %  |
| Other time deposits                                | 75,242           | 1.51 %  | 77,838                  | 1.62 %  |
| Securities sold under agreements to repurchase     | 62,273           | 1.25 %  | 70,465                  | 1.47 %  |
| Total relationship based non-core funding          | 468,041          | 9.40 %  | 503,901                 | 10.51 % |
| Wholesale funding:                                 |                  |         |                         |         |
| Brokered deposits                                  | -                | 0.00 %  | -                       | 0.00 %  |
| Federal Home Loan Bank advances                    | 170,556          | 3.42 %  | 90,637                  | 1.89 %  |
| Holding company loan                               | 14,932           | 0.30 %  | 16,182                  | 0.34 %  |
| Subordinated debt – Pinnacle Financial             | 82,476           | 1.66 %  | 82,476                  | 1.72 %  |
| Total wholesale funding                            | 267,964          | 5.38 %  | 189,295                 | 3.95 %  |
| Total non-core funding                             | 736,005          | 14.77 % | 693,196                 | 14.46 % |

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|        |             |         |             |         |
|--------|-------------|---------|-------------|---------|
| Totals | \$4,981,750 | 100.00% | \$4,795,228 | 100.00% |
|--------|-------------|---------|-------------|---------|

The reciprocating categories consist of deposits we receive from a bank network (the CDARS network) in (1) connection with deposits of our customers in excess of our FDIC coverage limit that we place with the CDARS network.

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Our funding policies impose limits on the amount of non-core funding we can utilize. Periodically, we may exceed our policy limitations, at which time management will develop plans to bring our core funding ratios back within compliance. At June 30, 2014 and December 31, 2013, we were in compliance with our core funding policies. As noted in the table above, our core funding as a percentage of total funding decreased slightly from 85.54% at December 31, 2013 to 85.23% at June 30, 2014.

Continuing to grow our core deposit base is a key strategic objective of our firm. We have numerous commercial and affluent consumer depositors that maintain significant balances in their transaction and money market accounts. These deposits are subject to significant fluctuations from time to time for such purposes as distributions to owners, taxes, business acquisitions, etc. As a result, our core funding ratios may also fluctuate meaningfully based on these factors.

The amount of time deposits as of June 30, 2014 amounted to \$476.3 million. The following table shows our time deposits in denominations of \$250,000 and less and in denominations greater than \$250,000 by category based on time remaining until maturity and the weighted average rate for each category (in thousands):

|                                      | Balances   | Weighted<br>Avg.<br>Rate |   |
|--------------------------------------|------------|--------------------------|---|
| Denominations less than \$250,000    |            |                          |   |
| Three months or less                 | \$ 105,626 | 0.42                     | % |
| Over three but less than six months  | 96,281     | 0.41                     | % |
| Over six but less than twelve months | 107,350    | 0.46                     | % |
| Over twelve months                   | 91,845     | 0.92                     | % |
|                                      | \$401,102  | 0.54                     | % |
| Denominations \$250,000 and greater  |            |                          |   |
| Three months or less                 | \$ 15,557  | 0.39                     | % |
| Over three but less than six months  | 19,103     | 0.53                     | % |
| Over six but less than twelve months | 27,099     | 0.54                     | % |
| Over twelve months                   | 13,482     | 1.24                     | % |
|                                      | \$75,241   | 0.63                     | % |
| Totals                               | \$476,343  | 0.56                     | % |

Subordinated debt and other borrowings. We have four wholly-owned subsidiaries that are statutory business trusts. We are the sole sponsor of the Trusts and acquired each Trust's common securities. The Trusts were created for the exclusive purpose of issuing 30-year capital trust preferred securities and using the proceeds to acquire junior subordinated debentures (Subordinated Debentures) issued by ourselves. The sole assets of the Trusts are the Subordinated Debentures. At June 30, 2014, our \$2,476,000 investment in the Trusts is included in other investments in the accompanying consolidated balance sheets and our \$82,476,000 obligation is reflected as subordinated debt.

|           | Date Established   | Maturity           | Common Securities | Subordinated Debentures | Floating Interest Rate | Interest Rate at June 30, 2014 |   |
|-----------|--------------------|--------------------|-------------------|-------------------------|------------------------|--------------------------------|---|
| Trust I   | December 29, 2003  | December 30, 2033  | \$310,000         | \$10,000,000            | Libor + 2.80%          | 3.03                           | % |
| Trust II  | September 15, 2005 | September 30, 2035 | 619,000           | 20,000,000              | Libor + 1.40%          | 1.63                           | % |
| Trust III | September 7, 2006  | September 30, 2036 | 619,000           | 20,000,000              | Libor + 1.65%          | 1.88                           | % |
| Trust IV  | October 31, 2007   | September 30, 2037 | 928,000           | 30,000,000              | Libor + 2.85%          | 3.08                           | % |

The Trust Preferred Securities bear a floating interest rate based on a spread over 3-month LIBOR which is set each quarter. 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. Our obligations under the Subordinated Debentures together with the guarantee and other back-up obligations, in the aggregate, constitute a full and unconditional guarantee by ourselves 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 and preferred shares will be restricted.

The Trust Preferred Securities may be redeemed prior to maturity at our option. 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 amended, or (4) loss of the ability to treat the trust preferred securities as "Tier I capital" under the Federal Reserve capital adequacy guidelines. Under current Federal Reserve regulations, the trust preferred securities qualify as Tier 1 capital. The Federal Reserve published final Basel III capital regulations in June 2013 which continued the treatment of preferred securities as Tier I capital for holding companies under \$15.0 billion in assets.

On June 15, 2012, we entered into a loan agreement with a bank for \$25 million. Our borrowings under the Loan Agreement currently bear interest at 2.975%. The applicable margin under the Loan Agreement ranges from 2.25% (225 basis points) to 3.00% (300 basis points) depending on the total aggregate principal amount outstanding under the Loan Agreement.

We began making quarterly principal payments of \$625,000 on September 30, 2012, and the loan matures on June 15, 2017. We are also permitted to prepay all or a portion of the principal amount outstanding under the Loan Agreement without penalty (in minimum aggregate amounts of \$100,000) at any time so long as no event of default or unexpired event of default has occurred and is continuing. As of June 30, 2014 we had prepaid \$5.0 million on this loan. At June 30, 2014, the balance owed on this loan was \$14.9 million.



On October 2, 2013, the Loan Agreement was amended to permit Pinnacle Financial to pay dividends on its capital stock so long as no event of default was then existing or would be caused by the payment of such dividends.

Capital Resources. At June 30, 2014 and December 31, 2013, our stockholders' equity amounted to \$764.4 million and \$723.7 million, respectively, an increase of approximately \$40.7 million. Substantially all of this increase is attributable to our net income and increases in the unrealized gain on available-for-sale securities.

Dividends. Pursuant to Tennessee banking law, our bank may not, without the prior consent of the TDFI, pay any dividends to us in a calendar year in excess of the total of our bank's retained net profits for that year plus the retained net profits for the preceding two years. During the six months ended June 30, 2014, our bank paid dividends of \$8.97 million to us. As of June 30, 2014, our bank could not pay in excess of \$90.7 million of additional dividends to us without prior TDFI approval.

At June 30, 2014, we had approximately \$27.3 million of cash at the holding company substantially all of which could be used to support our bank. Although we do not anticipate our bank needing any additional capital from us currently, we believe we have various capital raising techniques available to us to provide for the capital needs of our bank, if necessary.

We believe our current cash balance will support our minimum cash needs for at least the next eighteen months without any additional dividends from our bank. However, we intend to continue to receive dividends from our bank to support our cash flow needs as well as maintain an adequate cash reserve to support our future cash requirements. During the six months ended June 30, 2014, we paid \$8.5 million in dividends to common shareholders. On July 15, 2014, our Board of Directors declared a \$0.08 quarterly cash dividend to common shareholders which should approximate \$2.8 million in aggregate dividend payments that will be paid on August 29, 2014 to common shareholders of record as of the close of business on August 8, 2014. The amount and timing of all future dividend payments, if any, is subject to Board discretion and will depend on our earnings, capital position, financial condition and other factors, including new regulatory capital requirements, as they become known to us.

#### 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 as well as maintain our profitability within certain policy guidelines regardless of whether interest rates are increasing or decreasing. Measurements which we use to help us manage interest rate sensitivity include an earnings simulation model and an economic value of equity ("EVE") model.

Our interest rate sensitivity modeling incorporates a number of assumptions for both earnings simulation and EVE, including loan and deposit re-pricing characteristics, the rate of loan prepayments, etc. ALCO periodically reviews these assumptions for accuracy based on historical data and future expectations. The base scenario assumes rates remain flat and is the scenario to which all others are compared in order to measure the change in net interest income and EVE. Policy limits are applied to the results of certain modeling scenarios. While the primary policy scenarios focus on a twelve month time frame, longer time horizons are also modeled. All policy scenarios assume a static balance sheet.

Earnings simulation model. We believe interest rate risk is best measured by our earnings simulation modeling. Earning assets, interest-bearing liabilities and off-balance sheet financial instruments are combined with 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 policy guidelines for our earnings at risk which seek to limit the variance of net interest income in both gradual and instantaneous changes to interest rates. For changes up or down in rates from management's flat interest rate forecast over the next twelve months, our policy guidelines limit the decline in net interest income as follows:

- +/- 10.0% for a gradual change of 400 points; +/-20.0% for an instantaneous change of 400 basis points
- +/- 7.5% for a gradual change of 300 points; +/- 15.0% for an instantaneous change of 300 basis points
- +/- 5.0% for a gradual change of 200 points; +/- 10.0% for an instantaneous change of 200 basis points
- +/- 2.5% for a gradual change of 100 points; +/- 5.0% for an instantaneous change of 100 basis points

At June 30, 2014, our earnings simulation model indicated we were in compliance with our policy guidelines for both the gradual and instantaneous interest rate changes.

Economic value of equity model. Our EVE 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, from our base case. To help limit interest rate risk, we have stated policy guidelines for an instantaneous basis point change in interest rates, such that our EVE should not decrease from our base case by more than the following:

- +/- 400 basis point change in interest rates, EVE shall not decrease by more than 40 percent
- +/- 300 basis point change in interest rates, EVE shall not decrease by more than 30 percent
- +/- 200 basis point change in interest rates, EVE shall not decrease by more than 20 percent
- +/- 100 basis point change in interest rates, EVE shall not decrease by more than 10 percent

At June 30, 2014, our EVE model indicated we were in compliance with our policy guidelines noted above except for the down 100, down 200, and down 300 interest rate scenarios. In the current low interest rate environment, we have elected to monitor these matters without any specific remedial actions as noncompliance with the down rate scenarios are not particularly meaningful at this time.

Another commonly analyzed scenario is a most-likely earnings simulation scenario that projects the expected change in rates based on a forward yield curve adopted by management using expected balance sheet volumes also forecasted by management. Separate growth assumptions are developed for loans, investments, deposits, etc. Other interest rate scenarios analyzed by management may include delayed rate shocks, yield curve steepening or flattening, or other variations in rate movements to further analyze or stress our balance sheet under these various interest rate scenarios.

Based on information gathered from these various modeling scenarios, management believes that at June 30, 2014, our balance sheet would likely be liability sensitive pursuant to parallel shifts in interest rates in a rising interest rate environment of less than 100 basis points, while our balance sheet is likely to be somewhat neutral in a rising rate environment of between 100 and 200 basis points and likely asset sensitive in a rising rate environment of greater than

200 basis points and becoming more asset sensitive as rates continue to increase. At this time, we do not believe that an evaluation of the interest rate sensitivity of our balance sheet in a decreasing interest rate environment is particularly beneficial.



The liability sensitivity position at the 100 basis point increment level is primarily attributable to the fact that our loan floors will prevent the rise in yields on our loan portfolio at these levels from out-pacing the potential rise in deposit costs. We become asset-sensitive as we break through interest rate floors placed on variable and floating rate loans at a higher level of interest rate increases.

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 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. We may also enter into interest rate swaps to facilitate customer transactions and meet their financing needs.

ALCO may determine that the firm should over time work toward being more or less asset or liability sensitive depending on the underlying balance sheet circumstances and the firm's conclusions as to anticipated interest rate fluctuations in future periods. At present, ALCO has determined that its "most likely" rate scenario considers an initial rise in short- and mid-term interest rates in mid- to late-2015 and that such rates will continue to increase over several quarters while the longer end of the rate curve will rise only slightly. The firm's "most likely" rate forecast has been basically consistent for several quarters and is based on information we acquire from a third party provider which includes a consensus forecast of numerous economists. As a result and in preparing for an eventual rise in interest rates, we have implemented the following strategies over the past few quarters:

- Reduced our exposure to fixed rate investment securities in relation to total assets from approximately 20% as of December 31, 2010 to a current position of approximately 13% of total assets. This should assist us in becoming more asset sensitive over time.

- Executed a series of cash flow hedges involving approximately \$200 million in FHLB borrowings to commence in the second quarter of 2015 at pre-established fixed rates. Fixed rate liabilities also provide for a more asset sensitive balance sheet.

- Participated in interest rate swaps whereby our customers pay a fixed rate which we remit to our counter party while we receive, in return, a floating rate on these commercial loans. These loans amounted to approximately \$258 million at June 30, 2014. Floating rate loans promote an asset sensitive balance sheet.

- Reduced the difference between the weighted average floor rate on floating and variable rate commercial loans and the weighted average contract rate on these type of loans from 0.84% at December 31, 2013 to 0.72% at June 30, 2014. This reduction results in requiring a lesser increase in shorter-term rates for the floors to be overcome, thus making these loans more asset sensitive over time.

We believe market forces will also assist us in achievement of neutrality in our balance sheet position over time, however we may also implement a series of actions designed to accelerate our achievement of neutrality or asset sensitivity as conditions warrant.

**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.

To assist in determining the adequacy of our liquidity, we perform a variety of liquidity stress tests including idiosyncratic, systemic and combined scenarios for both moderate and severe events. Liquidity is defined as the ability to convert assets into cash or cash equivalents without significant loss and to raise additional funds by increasing liabilities. Liquidity management involves maintaining our ability to meet the daily cash flow requirements of our customers, both depositors and borrowers. We maintain a minimum liquid asset balance to ensure our ability to meet our obligations. The size of the minimum liquid asset balance is determined through liquidity stress testing.

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, our bank is a member of the FHLB. As a result, our bank is eligible to receive 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. Additionally, Pinnacle Financial recognized a discount on FHLB advances in conjunction with previous acquisitions. The remaining discount was \$124,000 at June 30, 2014. Under the borrowing agreements with the FHLB, our bank has pledged certain qualifying residential mortgage loans and, pursuant to a blanket lien, all qualifying commercial mortgage loans as collateral. At June 30, 2014, our bank had received advances from the FHLB totaling \$170.4 million at the following rates and maturities (dollars in thousands):

| Scheduled Maturities           | Amount     | Interest Rates <sup>(1)</sup> |   |
|--------------------------------|------------|-------------------------------|---|
| 2014                           | \$ 155,000 | 0.19                          | % |
| 2015                           | -          | -                             |   |
| 2016                           | 15,000     | 2.35                          | % |
| 2017                           | -          | -                             |   |
| 2018                           | 9          | 2.00                          | % |
| Thereafter                     | 423        | 2.44                          | % |
| Total                          | \$ 170,432 |                               |   |
| Weighted average interest rate |            | 0.38                          | % |

(1)

Some FHLB advances include variable interest rates and could increase in the future. The table reflects rates in effect as of June 30, 2014.

Our bank also has accommodations with upstream correspondent banks available for unsecured short-term advances which aggregate \$155.0 million. These accommodations have various covenants related to their term and availability, and in most cases must be repaid within a month. There were no outstanding borrowings at June 30, 2014, or during the quarter then ended under these agreements. Our bank also has approximately \$1.1 billion in available Federal Reserve discount window lines of credit.

At June 30, 2014, excluding reciprocating time deposits issued through the CDARS network, we had no brokered certificates of deposit. Historically, we have issued brokered certificates through several different brokerage houses based on competitive bid. Typically, these funds have been for varying maturities of up to two years and were issued at rates which were competitive to rates we would be required to pay to attract similar deposits within our local markets as well as rates for FHLB advances of similar maturities. Although we consider these deposits to be a ready source of liquidity under current market conditions, we do not anticipate that these deposits will represent a significant percentage of our total funding in 2014 as we seek to maintain a higher level of core deposits.

At June 30, 2014, we had no significant commitments for capital expenditures, although we have initiated construction of a new retail location in the Knoxville MSA. 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.

Federal regulators are in the process of defining additional liquidity guidelines for certain banks in the United States. We anticipate that ultimately some of these liquidity guidelines may be imposed on banks like ours such that an increase in the absolute level of liquidity on our balance sheet could be required. Consequently, this could result in lower net interest margins for us in future periods.

**Off-Balance Sheet Arrangements.** At June 30, 2014, we had outstanding standby letters of credit of \$65.7 million and unfunded loan commitments outstanding of \$1.2 billion. 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 Bank has the ability to liquidate Federal funds sold 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. GAAP 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.

#### Recent Accounting Pronouncements

There are currently no new accounting standards that have been issued that will have a significant impact on the Company's financial position, results of operations or cash flows upon adoption.

### ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

The information required by this Item 3 is included on pages 38 through 59 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 June 30, 2014 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

Various legal proceedings to which Pinnacle Financial or a subsidiary of Pinnacle Financial is a party arise from time to time in the normal course of business. Except as described below, there are no material pending legal proceedings to which Pinnacle Financial or a subsidiary of Pinnacle Financial is a party or of which any of their property is the subject.

During the fourth quarter of 2011, a customer of Pinnacle Bank filed a putative class action lawsuit (styled John Higgins, et al, v. Pinnacle Financial Partners, Inc., d/b/a Pinnacle National Bank) in Davidson County, Tennessee Circuit Court against Pinnacle Bank and Pinnacle Financial, on his own behalf, as well as on behalf of a purported class of Pinnacle Bank's customers within the State of Tennessee alleging that Pinnacle Bank's method of ordering debit card transactions had caused customers of Pinnacle Bank to incur higher overdraft charges than had a different method been used. In April 2014, an order was entered giving final approval to the settlement, and providing a release of claims against Pinnacle Bank and Pinnacle Financial. The order is now final and non-appealable. The settlement of this matter did not have a material adverse effect on Pinnacle Financial's consolidated financial condition, operating results, or cash flows.

ITEM 1A. RISK FACTORS

Investing in Pinnacle Financial involves various risks which are particular to our company, our industry and our market area. We believe all significant risks to investors in Pinnacle Financial have been outlined in Part I, Item 1A of our Annual Report on Form 10-K for the fiscal year ended December 31, 2013. However, other risks may prove to be important in the future, and new risks may emerge at any time. We cannot predict with certainty all potential developments which could materially affect our financial performance or condition. There has been no material change to our risk factors as previously disclosed in the above described Annual Report on Form 10-K.

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

| Period                          | Total<br>Number of<br>Shares<br>Repurchased<br>(1) | Average<br>Price<br>Paid Per<br>Share | Total<br>Number of<br>Shares<br>Purchased<br>as Part of<br>Publicly<br>Announced<br>Plans or<br>Programs | Maximum<br>Number (or<br>Approximate<br>Dollar Value)<br>of Shares<br>That May Yet<br>Be Purchased<br>Under the<br>Plans or<br>Programs |
|---------------------------------|----------------------------------------------------|---------------------------------------|----------------------------------------------------------------------------------------------------------|-----------------------------------------------------------------------------------------------------------------------------------------|
| April 1, 2014 to April 30, 2014 | 97                                                 | \$ 37.78                              | -                                                                                                        | -                                                                                                                                       |
| May 1, 2014 to May 31, 2014     | 2,001                                              | 33.55                                 | -                                                                                                        | -                                                                                                                                       |
| June 1, 2014 to June 30, 2014   | 895                                                | 34.54                                 | -                                                                                                        | -                                                                                                                                       |
| Total                           | 2,993                                              | \$ 33.93                              | -                                                                                                        | -                                                                                                                                       |

During the quarter ended June 30, 2014, 10,389 shares of restricted stock previously awarded to certain of our (1) associates vested. We withheld 2,993 shares to satisfy tax withholding requirements associated with the vesting of these restricted shares.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

Not applicable

ITEM 4. MINE SAFETY DISCLOSURES

Not applicable

ITEM 5. OTHER INFORMATION

None

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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
- 101.INS XBRL Instance Document
- 101.SCHXBRL Schema Document
- 101.CALXBRL Calculation Linkbase Document
- 101.LABXBRL Label Linkbase Document
- 101.PRE XBRL Presentation Linkbase Document
- 101.DEF XBRL Definition Linkbase Document

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.

August 1, 2014 /s/ M. Terry Turner  
M. Terry Turner  
President and Chief Executive Officer

August 1, 2014 /s/ Harold R. Carpenter  
Harold R. Carpenter  
Chief Financial Officer