PAM TRANSPORTATION SERVICES INC
Form 10-K
March 14, 2008

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-K

ý Annual Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

For the Fiscal Year Ended December 31, 2007
or

o Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

Commission File No. 0-15057

P.A.M. TRANSPORTATION SERVICES, INC.
(Exact name of registrant as specified in its charter)

Delaware (State or other jurisdiction of incorporation or organization)	71-0633135 (I.R.S. Employer Identification No.)

297 West Henri De Tonti Blvd, Tontitown, Arkansas 72770
(Address of principal executive offices) (Zip Code)

(479) 361-9111
Registrant's telephone number, including area code

Securities registered pursuant to section 12(b) of the Act:

Title of each class	Name of each exchange on which registered
Common Stock, $.01 par value	The NASDAQ Stock Market, LLC

Securities registered pursuant to section 12(g) of the Act: None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.
Yes o No þ

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act.
Yes o No þ

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 þ No o

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (Section 229.405 of this chapter) is not contained herein, and will not be contained, to the best of the registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. þ

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company (as defined in Rule 12b-2 of the Exchange Act):

Large accelerated filer o	Accelerated filer þ
Non-accelerated filer o	Smaller reporting company o

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act).
Yes o No þ

The aggregate market value of the common stock of the registrant held by non-affiliates of the registrant computed by reference to the average of the closing bid and asked prices of the common stock as of the last business day of the registrant's most recently completed second quarter was $88,311,474. Solely for the purposes of this response, executive officers, directors and beneficial owners of more than five percent of the registrant's common stock are considered the affiliates of the registrant at that date.

The number of shares outstanding of the issuer's common stock, as of March 10, 2008: 9,709,607 shares of $.01 par value common stock.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the registrant's definitive Proxy Statement for its Annual Meeting of Stockholders to be held in 2008 are incorporated by reference in answer to Part III of this report, with the exception of information regarding executive officers required under Item 10 of Part III, which information is included in Part I, Item 1.

FORWARD-LOOKING STATEMENTS

This Report contains forward-looking statements, including statements about our operating and growth strategies, our expected financial position and operating results, industry trends, our capital expenditure and financing plans and similar matters. Such forward-looking statements are found throughout this Report, including under Item 1, Business, Item 1A, Risk Factors, Item 7, Management's Discussion and Analysis of Financial Condition and Results of Operations, and Item 7A, Quantitative and Qualitative Disclosures About Market Risk. In those and other portions of this Report, the words "believe," "may," "will," "estimate," "continue," "anticipate," "intend," "expect," "project" a expressions, as they relate to us, our management, and our industry are intended to identify forward-looking statements. We have based these forward-looking statements largely on our current expectations and projections about future events and financial trends affecting our business. Actual results may differ materially. Some of the risks, uncertainties and assumptions about P.A.M. that may cause actual results to differ from these forward-looking statements are described under the headings "Risk Factors," "Management's Discussion and Analysis of Financial Condition and Results of Operations," and "Quantitative and Qualitative Disclosures About Market Risk."

All forward-looking statements attributable to us, or to persons acting on our behalf, are expressly qualified in their entirety by this cautionary statement.

We undertake no obligation to publicly update or revise any forward-looking statements, whether as a result of new information, future events or otherwise. In light of these risks and uncertainties, the forward-looking events and circumstances discussed in this Report might not transpire.

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PART I

Item 1. Business.

Unless the context otherwise requires, all references in this Annual Report on Form 10-K to “P.A.M.,” the “Company,” “we,” “our,” or “us” mean P.A.M. Transportation Services, Inc. and its subsidiaries.

We are a truckload dry van carrier transporting general commodities throughout the continental United States, as well as in certain Canadian provinces. We also provide transportation services in Mexico under agreements with Mexican carriers. Our freight consists primarily of automotive parts, consumer goods, such as general retail store merchandise, and manufactured goods, such as heating and air conditioning units.

P.A.M. Transportation Services, Inc. is a holding company organized under the laws of the State of Delaware in June 1986 which conducts operations through the following wholly owned subsidiaries: P.A.M. Transport, Inc., T.T.X., Inc., P.A.M. Dedicated Services, Inc., P.A.M. Logistics Services, Inc., Choctaw Express, Inc., Choctaw Brokerage, Inc., Transcend Logistics, Inc., Allen Freight Services, Inc., Decker Transport Co., Inc., East Coast Transport and Logistics, LLC, S & L Logistics, Inc., P.A.M. International, Inc., P.A.M. Canada, Inc. and McNeill Express, Inc. Our operating authorities are held by P.A.M. Transport, Inc., P.A.M. Dedicated Services, Inc., Choctaw Express, Inc., Choctaw Brokerage, Inc., Allen Freight Services, Inc., T.T.X., Inc., Decker Transport Co., Inc., East Coast Transport and Logistics, LLC, and McNeill Express, Inc.

We are headquartered and maintain our primary terminal and maintenance facilities and our corporate and administrative offices in Tontitown, Arkansas, which is located in northwest Arkansas, a major center for the trucking industry and where the support services (including warranty repair services) for most major truck and trailer equipment manufacturers are readily available.

In order to conform to industry practice, the Company began to classify fuel surcharges charged to customers as revenue rather than as a reduction of operating supplies expense as had been presented in reports prior to the period ended June 30, 2004. During 2006, the Company began to separately display as a line item “Fuel expense” for amounts paid for fuel which previously had been aggregated with other operating supplies and included in the line item “Operating supplies”. These reclassifications have had no effect on operating income, net income or earnings per share. The Company has made corresponding reclassifications to comparative periods shown.

Segment Financial Information

The Company's operations are all in the motor carrier segment and are aggregated into a single operating segment in accordance with the aggregation criteria presented in SFAS 131.

Operations

Our operations can generally be classified into truckload services or brokerage and logistics services. Truckload services include those transportation services in which we utilize company owned trucks or owner-operator owned trucks for the pickup and delivery of freight. The brokerage and logistics services consists of services such as transportation scheduling, routing, mode selection, transloading and other value added services related to the transportation of freight which may or may not involve the usage of company owned or owner-operator owned equipment. Both our truckload operations and our brokerage and logistics operations have similar economic characteristics and are impacted by virtually the same economic factors as discussed elsewhere in this Report. Truckload services operating revenues, before fuel surcharges represented 90.4%, 87.8%, and 88.0% of total operating revenues for the years ended December 31, 2007, 2006, and 2005, respectively. The remaining operating revenues, before fuel surcharge for the same periods were generated by brokerage and logistics services, representing 9.6%, 12.2%, and 12.0%, respectively. Approximately 99% of the Company's revenues are generated by operations conducted in the United States and all of the Company's assets are located or based in the United States.

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Business and Growth Strategy

Our strategy focuses on the following elements:

Maintaining Dedicated Fleets in High Density Lanes. We strive to maximize utilization and increase revenue per truck while minimizing our time and empty miles between loads. In this regard, we seek to provide dedicated equipment to our customers where possible and to concentrate our equipment in defined regions and disciplined traffic lanes. Dedicated fleets in high density lanes enable us to:

- maintain more consistent equipment capacity;
- provide a high level of service to our customers, including time-sensitive delivery schedules;
- attract and retain drivers; and
- maintain a sound safety record as drivers travel familiar routes.

Providing Superior and Flexible Customer Service. Our wide range of services includes dedicated fleet services, logistics services, "just-in-time" delivery, two-man driving teams, cross-docking and consolidation programs, specialized trailers, and Internet-based customer access to delivery status. These services, combined with a decentralized regional operating strategy, allow us to quickly and reliably respond to the diverse needs of our customers, and provide an advantage in securing new business. We also maintain ISO 9002 certification to ensure that we operate in accordance with approved quality assurance standards.

Many of our customers depend on us to make delivery on a "just-in-time" basis, meaning that parts or raw materials are scheduled for delivery as they are needed on the manufacturer's production line. The need for this service is a product of modern manufacturing and assembly methods that are designed to drastically decrease inventory levels and handling costs. Such requirements place a premium on the freight carrier's delivery performance and reliability.

Employing Stringent Cost Controls. We focus intently on controlling our costs while not sacrificing customer service. We maintain this balance by scrutinizing all expenditures, minimizing non-driver personnel, operating a late-model fleet of trucks and trailers to minimize maintenance costs, and adopting new technology only when proven and cost justified.

Making Strategic Acquisitions. We continually evaluate strategic acquisition opportunities, focusing on those that complement our existing business or that could profitably expand our business or services. Our operational integration strategy is to centralize administrative functions of acquired businesses at our headquarters, while maintaining the localized operations of acquired businesses. We believe that allowing acquired businesses to continue to operate under their pre-acquisition names and in their original regions allows such businesses to maintain driver loyalty and customer relationships.

Industry

According to the American Trucking Association's "American Trucking Trends 2007-2008" report, the trucking industry transported approximately 70% of the total volume of freight transported in the United States during 2006, which equates to an all-time high carrying load of 10.7 billion tons, and $645.6 billion in revenue, representing 83.8% of the nation's freight bill. The truckload industry is highly fragmented and is impacted by several economic and business factors, many of which are beyond the control of individual carriers. The state of the economy, coupled with equipment capacity levels, can impact freight rates. Volatility of various operating expenses, such as fuel and insurance, make the predictability of profit levels uncertain. Availability, attraction, retention and compensation for drivers affect operating costs, as well as equipment utilization. In addition, the capital requirements for equipment, coupled with potential uncertainty of used equipment values, impact the ability of many carriers to expand their operations. The current operating environment is characterized by the following:

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- Price increases by truck and trailer equipment manufacturers, rising fuel costs, and intense competition for drivers.

- In the last few years, many less profitable or undercapitalized carriers have been forced to consolidate or to exit the industry.

Competition

The trucking industry is highly competitive and includes thousands of carriers, none of which dominates the market in which the Company operates. The Company's market share is less than 1% and we compete primarily with other irregular route medium- to long-haul truckload carriers, with private carriage conducted by our existing and potential customers, and, to a lesser extent, with the railroads. Increased competition has resulted from deregulation of the trucking industry. We compete on the basis of quality of service and delivery performance, as well as price. Many of the other irregular route long-haul truckload carriers have substantially greater financial resources, own more equipment or carry a larger total volume of freight.

Marketing and Significant Customers

Our marketing emphasis is directed to that portion of the truckload market which is generally service-sensitive, as opposed to being solely price competitive. We seek to become a “core carrier” for our customers in order to maintain high utilization and capitalize on recurring revenue opportunities. Our marketing efforts are diversified and designed to gain access to dedicated fleet services (including those in Mexico and Canada), domestic regional freight traffic, and cross-docking and consolidation programs.

Our marketing efforts are conducted by a sales staff of 12 employees who are located in our major markets and supervised from our headquarters. These individuals work to improve profitability by maintaining an even flow of freight traffic (taking into account the balance between originations and destinations in a given geographical area) and high utilization, and minimizing movement of empty equipment.

Our five largest customers, for which we provide carrier services covering a number of geographic locations, accounted for approximately 56%, 59% and 57% of our total revenues in 2007, 2006 and 2005, respectively. General Motors Corporation accounted for approximately 38%, 41% and 39% of our revenues in 2007, 2006 and 2005, respectively.

We also provide transportation services to other manufacturers who are suppliers for automobile manufacturers. Approximately 49%, 52% and 52% of our revenues were derived from transportation services provided to the automobile industry during 2007, 2006 and 2005, respectively. This portion of our business, however, is spread over 18 assembly plants and over 60 suppliers/vendors located throughout North America, which we believe reduces the risk of a material loss of business.

Revenue Equipment

At December 31, 2007, we operated a fleet of 2,055 trucks and 4,882 trailers. We operate late-model, well-maintained premium trucks to help attract and retain drivers, promote safe operations, minimize maintenance and repair costs, and improve customer service by minimizing service interruptions caused by breakdowns. We evaluate our equipment decisions based on factors such as initial cost, useful life, warranty terms, expected maintenance costs, fuel economy, driver comfort, customer needs, manufacturer support, and resale value. Our current policy is to replace most of our trucks at 500,000 miles, which normally occurs 30 to 48 months after purchase.

We historically have contracted with owner-operators to provide and operate a small portion of our truck fleet. Owner-operators provide their own trucks and are responsible for all associated expenses, including financing costs, fuel, maintenance, insurance, and taxes. We believe that a combined fleet complements our recruiting efforts and offers greater flexibility in responding to fluctuations in shipper demand. At December 31, 2007 the Company's truck fleet included 55 owner-operator trucks.

During 1999, the U.S. Environmental Protection Agency (“EPA”) proposed a three-phase strategy to reduce engine emissions from heavy-duty vehicles through a combination of advanced emissions control technologies and diesel fuel with a reduced sulfur content. Each phase and its effect on the Company’s operations, if known, are described below.

The first phase (Phase I) mandated new engine emission standards for all model year 2004 heavy-duty trucks, however, through agreements with heavy-duty diesel engine manufacturers, the effective date was accelerated to October 1, 2002. Therefore, effective October 1, 2002, all newly manufactured truck engines had to comply with the new engine emission standards. All truck engines manufactured prior to October 1, 2002 were not subject to these new standards. As of December 31, 2007, the majority of our Company-owned truck fleet consisted of trucks with engines that comply with these emission standards. The Company has experienced a reduction in fuel efficiency and increased depreciation expense due to the higher cost of trucks with these new engines.

In the second phase (Phase II), effective January 1, 2007, the EPA mandated a new set of more stringent emissions standards for vehicles powered by diesel fuel engines manufactured in 2007 through 2009. These new engines have been designed for and require the use of a more costly type of fuel known as ultra-low-sulfur-diesel (“ULSD”) which, according to EPA estimates, will cost from $0.04 to $0.05 more per gallon due to increased refining costs. The EPA has also mandated that refiners and importers nationwide must ensure that at least 80% of the volume of the highway diesel fuel they produce or import is ULSD-compliant by June 1, 2006, however, the EPA does not require service stations and truck stops to sell ULSD fuel. Therefore, it is possible that ULSD fuel might not be available in a particular area in which the Company operates. A majority of the Company’s current truck fleet can be fueled with either ULSD or low-sulfur diesel (“LSD”) but additional future purchases of trucks which contain 2007 or later diesel engines will require the use of ULSD fuel which may result in lower fuel economy as the process that removes sulfur can also reduce the energy content of the fuel. As of December 31, 2007, 163 trucks in our Company-owned truck fleet consisted of trucks with engines that comply with the Phase II emission standards and require the use of ULSD. During 2008, the Company expects to take delivery of 550 new trucks, all of which will contain engines compliant with the Phase II emission standards requiring the use of ULSD. As compared to our current Company-owned truck fleet which contain primarily Phase I diesel engines, trucks powered by the Phase II compliant diesel engines have a higher purchase price and as a result, we expect that depreciation expense will increase as we continue to replace older trucks with trucks powered by the Phase II diesel engines. We also expect that these engines will result in higher maintenance costs and be less fuel efficient. To the extent we are unable to offset these anticipated increased costs with rate increases charged to customers or offsetting cost savings in other areas, our results of operations would be adversely affected.

During the third phase (Phase III), effective in 2010, final emission standards become effective and LSD fuel will no longer be available for highway use. The EPA requires that by June 1, 2010 all diesel fuel imported or produced must be ULSD-compliant as it phases out low-sulfur-diesel fuel availability by December 1, 2010 when all highway diesel fuel must be ULSD fuel. We are unable at this time to determine the increase in acquisition and operating costs of trucks powered by the Phase III compliant engines but we expect that the engines produced under the final standards will be less fuel-efficient and have higher acquisition and maintenance costs than either the 2002 or 2007 engines.

Technology

We have installed Qualcomm Omnitracs™ display units in all of our trucks. The Omnitracs system is a satellite-based global positioning and communications system that allows fleet managers to communicate directly with drivers. Drivers can provide location status and updates directly to our computer which increases productivity and convenience. The Omnitracs system provides us with accurate estimated time of arrival information, which optimizes load selection and service levels to our customers. In order to optimize our truck-to-trailer ratio, we have also installed Qualcomm TrailerTracs™ tracking units in all of our trailers. The TrailerTracs system is a trailer tracking product that enables us to more efficiently track the location of trailers in our inventory. During 2006, the Company began replacing its tethered TrailerTracs units, which were unable to transmit data unless connected to Qualcomm-equipped trucks, with more advanced untethered TrailerTracs units which are able to operate and transmit data independent of a truck connection. At December 31, 2007, substantially all of the Company's trailer fleet has been fitted with these new untethered devices.

Our computer system manages the information provided by the Qualcomm devices to provide us real-time information regarding the location, status and load assignment of all of our equipment, which permits us to better meet delivery schedules, respond to customer inquiries and match equipment with the next available load. Our system also provides electronically to our customers real-time information regarding the status of freight shipments and anticipated arrival times. This system provides our customers flexibility and convenience by extending supply chain visibility through electronic data interchange, the Internet and e-mail.

Maintenance

We have a strictly enforced comprehensive preventive maintenance program for our trucks and trailers. Inspections and various levels of preventive maintenance are performed at set mileage intervals on both trucks and trailers. A maintenance and safety inspection is performed on all vehicles each time they return to a terminal.

Our trucks carry full warranty coverage for at least three years or 350,000 miles. Extended warranties are negotiated with the truck manufacturer and manufacturers of major components, such as engine, transmission and differential manufacturers, for up to four years or 500,000 miles. Trailers carry full warranties by the manufacturer and major component manufacturers for up to five years.

Employees

At December 31, 2007, we employed 3,181 persons, of whom 2,667 were drivers, 178 were maintenance personnel, 178 were employed in operations, 17 were employed in marketing, 71 were employed in safety and personnel, and 70 were employed in general administration and accounting. None of our employees are represented by a collective bargaining unit and we believe that our employee relations are good.

Drivers

At December 31, 2007, we utilized 2,667 company drivers in our operations. We also had 55 owner-operators under contract compensated on a per mile basis. Our drivers are compensated on the basis of miles driven, loading and unloading, extra stops and layovers in transit. Drivers can earn bonuses by recruiting other qualified drivers who become employed by us and both cash and non-cash prizes are awarded for consecutive periods of safe, accident-free driving. All of our drivers are recruited, screened, drug tested and trained and are subject to the control and supervision of our operations and safety departments. Our driver training program stresses the importance of safety and reliable, on-time delivery. Drivers are required to report to their driver managers daily and at the earliest possible moment when any condition en route occurs that might delay their scheduled delivery time.

In addition to strict application screening and drug testing, before being permitted to operate a vehicle our drivers must undergo classroom instruction on our policies and procedures, safety techniques as taught by the Smith System of Defensive Driving, the proper operation of equipment, and must pass both written and road tests. Instruction in defensive driving and safety techniques continues after hiring, with seminars at several of our terminals. At December 31, 2007, we employed 71 persons on a full-time basis in our driver recruiting, training and safety instruction programs.

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Intense competition in the trucking industry for qualified drivers over the last several years, along with difficulties and added expense in recruiting and retaining qualified drivers, has had a negative impact on the industry. Our operations have also been impacted and from time to time we have experienced under-utilization and increased expenses due to a shortage of qualified drivers. We place a high priority on the recruitment and retention of an adequate supply of qualified drivers.

Executive Officers of the Registrant

Our executive officers are as follows:

Name	Age	Position	Years of service
Robert W. Weaver	58	President and Chief Executive Officer	25
W. Clif Lawson	54	Executive Vice President and Chief Operating Officer	23
Larry J. Goddard	49	Vice President - Finance, Chief Financial Officer, Secretary and Treasurer	20

Each of our executive officers has held his present position with the Company for at least the last five years. The Company has entered into an employment agreement with Robert W. Weaver that expires on July 10, 2009. The Company has the option to extend the employment agreement for two consecutive years following the July 10, 2009 expiration date for an additional one year at a time. The Company has also entered into employment agreements with both W. Clif Lawson and Larry J. Goddard which each expire on June 1, 2010. The Company has the option to extend these employment agreements for one additional year following the June 1, 2010 expiration date.

Internet Web Site

The Company maintains a web site where additional information concerning its business can be found. The address of that web site is www.pamt.com. The Company makes available free of charge on its Internet web site its Annual Report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, and amendments to those reports filed or furnished pursuant to Section 13(a) or 15(d) of the Securities Exchange Act of 1934 (the “Exchange Act”) as soon as reasonably practicable after it electronically files or furnishes such materials to the Securities and Exchange Commission.

Seasonality

Our revenues do not exhibit a significant seasonal pattern due primarily to our varied customer mix. Operating expenses can be somewhat higher in the winter months primarily due to decreased fuel efficiency and increased maintenance costs associated with inclement weather. In addition, the automobile plants for which we transport a large amount of freight typically utilize scheduled shutdowns of two weeks in July and one week in December and the volume of freight we ship is reduced during such scheduled plant shutdowns.

Regulation

We are a common and contract motor carrier regulated by various federal and state agencies. We are subject to safety requirements prescribed by the U.S. Department of Transportation (“DOT”). Such matters as weight and dimension of equipment are also subject to federal and state regulations. All of our drivers are required to obtain national driver’s licenses pursuant to the regulations promulgated by the DOT. Also, DOT regulations impose mandatory drug and alcohol testing of drivers. We believe that we are in compliance in all material respects with applicable regulatory requirements relating to our trucking business and operate with a “satisfactory” rating (the highest of three grading categories) from the DOT.

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The Federal Motor Carrier Safety Administration ("FMCSA"), a separate administration within the DOT charged with regulating motor carrier safety, issued a final rule on April 24, 2003 ("2003 rule") that made several changes to the regulations that govern truck drivers' hours-of-service ("HOS"). These new federal regulations became effective on January 4, 2004. On July 16, 2004, the U.S. Circuit Court of Appeals for the District of Columbia (the "Court") rejected these new hours of service rules for truck drivers that had been in place since January 2004 because it agreed that the FMCSA had failed to address the impact of the rules on the health of drivers as required by Congress. In addition, the Court's ruling noted other areas of concern including the increase in driving hours from 10 hours to 11 hours, the exception that allows drivers in trucks with sleeper berths to split their required rest periods, the new rule allowing drivers to reset their 70-hour clock to 0 hours after 34 consecutive hours off duty, and the decision by the FMCSA not to require the use of electronic onboard recorders to monitor driver compliance. However, to avoid industry disruption and burden on the state enforcement, Congress enacted section 7(f) of the Surface Transportation Extension Act of 2004. This section provided that the 2003 rule would remain in effect until a new rule addressed the Court's issues or until September 30, 2005, whichever occurred first. On January 24, 2005, the FMCSA re-proposed its April 2003 HOS rules, adding references to how the rules would affect driver health, but made no other changes to the regulations. The FMCSA sought public comments by March 10, 2005 on what changes to the rule, if any, were necessary to respond to the concerns raised by the court, and to provide data or studies that would support changes to, or continued use of, the 2003 rule. On August 25, 2005, the FMCSA published a final HOS rule ("2005 rule") that retained most of the provisions of the 2003 rule with the most significant exception being that of requiring drivers that utilize the sleeper berth provision to take at least eight consecutive hours in the sleeper berth during their ten hours off-duty. Under the 2003 rule, drivers were allowed to split their ten hour off-duty time in the sleeper berth into two periods, provided neither period was less than two hours.

The 2005 rule was later challenged in court on several grounds and in July 2007 the Court vacated the 11-hour driving time and 34-hour restart provisions stating that the FMCSA methodologies, used in the studies regarding how the 2003 rules affected driver health, were not disclosed in time for public comment and that the explanation for some of its critical elements were not provided. In an order filed on September 28, 2007, the Court granted a 90-day stay of the mandate and directed that issuance of the mandate be withheld until December 27, 2007. In an effort to prevent disruption to enforcement and compliance with HOS rules when the stay expires, as well as possible effects on timely delivery of essential goods and services, the FMCSA issued an interim final rule ("IFR") effective December 27, 2007 which allows commercial motor vehicle drivers up to 11 hours of driving time within a 14-hour, non-extendable window from the start of the workday, following 10 consecutive hours off duty (11-hour limit). This IFR also allows motor carriers and drivers to restart calculations of the weekly on-duty time limits after the driver has at least 34 consecutive hours off duty (34-hour restart provision). The FMCSA expects to issue a final rule in 2008.

In general, more restrictive sleeper berth provisions may impact multiple-stop shipments and those shipments incurring delays in loading or unloading. Improper planning on such shipments could result in delivery delays and equipment utilization inefficiencies.

Our motor carrier operations are also subject to environmental laws and regulations, including laws and regulations dealing with underground fuel storage tanks, the transportation of hazardous materials and other environmental matters, and our operations involve certain inherent environmental risks. We maintain four bulk fuel storage and fuel islands. Our operations involve the risks of fuel spillage or seepage, environmental damage, and hazardous waste disposal, among others. We have instituted programs to monitor and control environmental risks and assure compliance with applicable environmental laws. As part of our safety and risk management program, we periodically perform internal environmental reviews so that we can achieve environmental compliance and avoid environmental risk. We transport a minimum amount of environmentally hazardous substances and, to date, have experienced no significant claims for hazardous materials shipments. If we should fail to comply with applicable regulations, we could be subject to substantial fines or penalties and to civil and criminal liability.

Company operations conducted in industrial areas, where truck terminals and other industrial activities are conducted, and where groundwater or other forms of environmental contamination have occurred, potentially expose us to claims that we contributed to the environmental contamination.

We believe we are currently in material compliance with applicable laws and regulations and that the cost of compliance has not materially affected results of operations.

In addition to environmental regulations directly affecting our business, we are also subject to the effects of new truck engine design requirements implemented by the EPA. See "Revenue Equipment" above.

Item 1A. Risk Factors.

Set forth below and elsewhere in this Report and in other documents we file with the SEC are risks and uncertainties that could cause our actual results to differ materially from the results contemplated by the forward-looking statements contained in this Report.

Our business is subject to general economic and business factors that are largely beyond our control, any of which could have a material adverse effect on our operating results.

These factors include significant increases or rapid fluctuations in fuel prices, excess capacity in the trucking industry, surpluses in the market for used equipment, interest rates, fuel taxes, license and registration fees, insurance premiums, self-insurance levels, and difficulty in attracting and retaining qualified drivers and independent contractors.

We are also affected by recessionary economic cycles and downturns in customers' business cycles, particularly in market segments and industries, such as the automotive industry, where we have a significant concentration of customers. Economic conditions may adversely affect our customers and their ability to pay for our services.

We operate in a highly competitive and fragmented industry, and our business may suffer if we are unable to adequately address downward pricing pressures and other factors that may adversely affect our ability to compete with other carriers.

Numerous competitive factors could impair our ability to maintain our current profitability. These factors include, but are not limited to, the following:

- we compete with many other truckload carriers of varying sizes and, to a lesser extent, with less-than-truckload carriers and railroads, some of which have more equipment and greater capital resources than we do;

- some of our competitors periodically reduce their freight rates to gain business, especially during times of reduced growth rates in the economy, which may limit our ability to maintain or increase freight rates, maintain our margins or maintain significant growth in our business;

- many customers reduce the number of carriers they use by selecting so-called "core carriers" as approved service providers, and in some instances we may not be selected;

- many customers periodically accept bids from multiple carriers for their shipping needs, and this process may depress freight rates or result in the loss of some of our business to competitors;

- the trend toward consolidation in the trucking industry may create other large carriers with greater financial resources and other competitive advantages relating to their size and with whom we may have difficulty competing;

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- advances in technology require increased investments to remain competitive, and our customers may not be willing to accept higher freight rates to cover the cost of these investments;

- competition from Internet-based and other logistics and freight brokerage companies may adversely affect our customer relationships and freight rates; and

- economies of scale that may be passed on to smaller carriers by procurement aggregation providers may improve their ability to compete with us.

We are highly dependent on our major customers, the loss of one or more of which could have a material adverse effect on our business.

A significant portion of our revenue is generated from our major customers. For 2007, our top five customers, based on revenue, accounted for approximately 56% of our revenue, and our largest customer, General Motors Corporation, accounted for approximately 38% of our revenue. We also provide transportation services to other manufacturers who are suppliers for automobile manufacturers. As a result, concentration of our business within the automobile industry is greater than the concentration in a single customer. Approximately 49% of our revenues for 2007 were derived from transportation services provided to the automobile industry.

Generally, we do not have long-term contractual relationships with our major customers, and we cannot assure that our customer relationships will continue as presently in effect. A reduction in or termination of our services by our major customers could have a material adverse effect on our business and operating results.

Ongoing insurance and claims expenses could significantly reduce our earnings.

Our future insurance and claims expenses might exceed historical levels, which could reduce our earnings. The Company is self insured for health and workers compensation insurance coverage up to certain limits. If medical costs continue to increase, or if the severity or number of claims increase, and if we are unable to offset the resulting increases in expenses with higher freight rates, our earnings could be materially and adversely affected.

We may be unable to successfully integrate businesses we acquire into our operations.

Integrating businesses we acquire may involve unanticipated delays, costs or other operational or financial problems. Successful integration of the businesses we acquire depends on a number of factors, including our ability to transition acquired companies to our management information systems. In integrating businesses we acquire, we may not achieve expected economies of scale or profitability or realize sufficient revenues to justify our investment. We also face the risk that an unexpected problem at one of the companies we acquire will require substantial time and attention from senior management, diverting management's attention from other aspects of our business. We cannot be certain that our management and operational controls will be able to support us as we grow.

Difficulty in attracting drivers could affect our profitability and ability to grow.

Periodically, the transportation industry experiences difficulty in attracting and retaining qualified drivers, including independent contractors, resulting in intense competition for drivers. We have from time to time experienced under-utilization and increased expenses due to a shortage of qualified drivers. If we are unable to continue to attract drivers and contract with independent contractors, we could be required to further adjust our driver compensation package or let trucks sit idle, which could adversely affect our growth and profitability.

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If we are unable to retain our key employees, our business, financial condition and results of operations could be harmed.

We are highly dependent upon the services of the following key employees: Robert W. Weaver, our President and Chief Executive Officer; W. Clif Lawson, our Executive Vice President and Chief Operating Officer; and Larry J. Goddard, our Vice President and Chief Financial Officer. We do not maintain key-man life insurance on any of these executives. The loss of any of their services could have a material adverse effect on our operations and future profitability. We must continue to develop and retain a core group of managers if we are to realize our goal of expanding our operations and continuing our growth. We cannot assure that we will be able to do so.

We have significant ongoing capital requirements that could affect our profitability if we are unable to generate sufficient cash from operations.

The trucking industry is capital intensive. If we are unable to generate sufficient cash from operations in the future, we may have to limit our growth, enter into financing arrangements, or operate our revenue equipment for longer periods, any of which could have a material adverse affect on our profitability.

Our operations are subject to various environmental laws and regulations, the violation of which could result in substantial fines or penalties.

We are subject to various environmental laws and regulations dealing with the handling of hazardous materials, underground fuel storage tanks, and discharge and retention of storm-water. We operate in industrial areas, where truck terminals and other industrial activities are located, and where groundwater or other forms of environmental contamination could occur. We also maintain bulk fuel storage and fuel islands at four of our facilities. Our operations involve the risks of fuel spillage or seepage, environmental damage, and hazardous waste disposal, among others. If we are involved in a spill or other accident involving hazardous substances, or if we are found to be in violation of applicable laws or regulations, it could have a materially adverse effect on our business and operating results. If we should fail to comply with applicable environmental regulations, we could be subject to substantial fines or penalties and to civil and criminal liability.

We operate in a highly regulated industry and increased costs of compliance with, or liability for violation of, existing or future regulations could have a material adverse effect on our business.

The U.S. Department of Transportation and various state agencies exercise broad powers over our business, generally governing such activities as authorization to engage in motor carrier operations, safety, and financial reporting. We may also become subject to new or more restrictive regulations relating to fuel emissions, drivers' hours in service, and ergonomics. Compliance with such regulations could substantially impair equipment productivity and increase our operating expenses.

The EPA adopted new emissions control regulations, which require progressive reductions in exhaust emissions from diesel engines through 2010. In part to offset the costs of compliance with the new EPA engine design requirements, some manufacturers have increased new equipment prices and eliminated or sharply reduced the price of repurchase or trade-in commitments. If new equipment prices were to increase, or if the price of repurchase commitments by equipment manufacturers were to decrease more than anticipated, we may be required to increase our depreciation and financing costs and/or retain some of our equipment longer, which may result in an increase in maintenance expenses. To the extent we are unable to offset any such increases in expenses with rate increases or cost savings, our results of operations would be adversely affected. If our fuel or maintenance expenses were to increase as a result of our use of the new, EPA-compliant engines, and we are unable to offset such increases with fuel surcharges or higher freight rates, our results of operations would be adversely affected. Further, our business and operations could be adversely impacted if we experience problems with the reliability of the new engines. Although we have not experienced any significant reliability issues with these engines to date, the expenses associated with the trucks containing these engines have been slightly elevated, primarily as a result of lower fuel efficiency and higher depreciation.

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Item 1B. Unresolved Staff Comments.

None.

Item 2. Properties.

Our executive offices and primary terminal facilities, which we own, are located in Tontitown, Arkansas. These facilities are located on approximately 49.3 acres and consist of 114,403 square feet of office space and maintenance and storage facilities.

Our subsidiaries lease facilities in Jacksonville, Florida; Breese and Effingham, Illinois; Parsippany and Paulsboro, New Jersey; North Jackson, Ohio; Oklahoma City, Oklahoma; and Laredo and El Paso, Texas. Our terminal facilities in Columbia, Mississippi; Irving, Texas; North Little Rock, Arkansas; and Willard, Ohio are owned. The leased facilities are leased primarily on contractual terms ranging from one to five years. As of December 31, 2007, the following provides a summary of the ownership and types of activities conducted at each location:

Location	Own/ Lease	Dispatch Office	Maintenance Facility	Safety Training
Tontitown, Arkansas	Own	Yes	Yes	Yes
North Little Rock, Arkansas	Own	Yes	Yes	No
Jacksonville, Florida	Lease	Yes	Yes	Yes
Breese, Illinois	Lease	Yes	No	No
Effingham, Illinois	Lease	No	Yes	No
Columbia, Mississippi	Own	No	No	No
Parsippany, New Jersey	Lease	No	No	No
Paulsboro, New Jersey	Lease	Yes	No	No
North Jackson, Ohio	Lease	Yes	Yes	Yes
Willard, Ohio	Own	Yes	Yes	Yes
Oklahoma City, Oklahoma	Lease	Yes	Yes	Yes
El Paso, Texas	Lease	Yes	Yes	No
Irving, Texas	Own	Yes	Yes	Yes
Laredo, Texas	Lease	Yes	Yes	No

We also have access to trailer drop and relay stations in various other locations across the country. We lease certain of these facilities on a month-to-month basis from an affiliate of our largest shareholder.

We believe that all of the properties that we own or lease are suitable for their purposes and adequate to meet our needs.

Item 3. Legal Proceedings.

During 2007, the Company experienced an adverse settlement and was found partly liable for an environmental remediation claim dating back to 1986 and was ordered to pay approximately $300,000 in damages.

The nature of our business routinely results in litigation, primarily involving claims for personal injuries and property damage incurred in the transportation of freight. We believe that all such routine litigation is adequately covered by insurance and that adverse results in one or more of those cases would not have a material adverse effect on our financial condition.

Item 4. Submission of Matters to a Vote of Security Holders.

No matters were submitted to a vote of our security holders during the fourth quarter ended December 31, 2007.

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PART II

Item 5. Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities.

Our common stock is traded on the NASDAQ Global Market under the symbol PTSI. The following table sets forth, for the quarters indicated, the range of the high and low sales prices per share for our common stock as reported on the NASDAQ Global Market.

Calendar Year Ended December 31, 2007

	High	Low
First Quarter	$25.19	$19.29
Second Quarter	22.48	16.98
Third Quarter	19.31	17.43
Fourth Quarter	18.69	13.80

Calendar Year Ended December 31, 2006

	High	Low
First Quarter	$25.18	$17.51
Second Quarter	28.96	23.24
Third Quarter	31.50	23.78
Fourth Quarter	26.68	20.90

As of February 29, 2008, there were approximately 166 holders of record of our common stock.

Dividends

We have never declared or paid any cash dividends on our common stock. The policy of our Board of Directors is to retain earnings for the expansion and development of our business and the payment of our debt service obligations. Future dividend policy and the payment of dividends, if any, will be determined by the Board of Directors in light of circumstances then existing, including our earnings, financial condition and other factors deemed relevant by the Board of Directors.

Repurchases of Common Stock

On April 11, 2005, the Company announced that its Board of Directors had authorized the Company to repurchase up to 600,000 shares of its common stock during the six month period ending October 11, 2005. These 600,000 shares were all repurchased by September 30, 2005. On September 6, 2005, the Company announced that its Board of Directors had authorized the Company to extend the stock repurchase program until September 6, 2006 and to include up to an additional 900,000 shares of its common stock. The Company repurchased 458,600 shares of these additional shares prior to the September 6, 2006 program expiration date.

On May 30, 2007, the Company announced that its Board of Directors had authorized the Company to repurchase up to 600,000 shares of its common stock during the twelve month period following the announcement. Subsequent to the date of the announcement and through the remainder of 2007, the Company repurchased 471,500 shares of its common stock, with 422,700 shares being repurchased during the fourth quarter of 2007.

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The following table summarizes the Company's common stock repurchases during the fourth quarter of 2007. No shares were purchased during the quarter other than through this program, and all purchases were made by or on behalf of the Company and not by any “affiliated purchaser”.

Period	Total number of shares purchased	Average price paid per share	Total number of shares purchased as part of publicly announced plans or programs	Maximum number of shares that may yet be purchased under the plans or programs
October 1-31, 2007	3,300	$16.47	3,300	547,900
November 1-30, 2007	308,100	15.07	308,100	239,800
December 1-31, 2007	111,300	15.46	111,300	128,500
Total	422,700	$15.18	422,700	128,500

Securities Authorized for Issuance Under Equity Compensation Plans

See Part III, Item 12, “Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters” of this Annual Report for a presentation of compensation plans under which equity securities of the Company are authorized for issuance.

Performance Graph

Set forth below is a line graph comparing the yearly percentage change in the cumulative total stockholder return on our common stock against the cumulative total return of the CRSP Total Return Index for the Nasdaq Stock Market (U.S. companies) and the CRSP Total Return Index for the Nasdaq Trucking and Transportation Stocks for the period of five years commencing December 31, 2002 and ending December 31, 2007. The graph assumes that the value of the investment in our common stock and in each index was $100 on December 31, 2002 and that all dividends were reinvested.

Item 6. Selected Financial Data.

The following selected financial and operating data should be read in conjunction with the Consolidated Financial Statements and notes thereto included elsewhere in this Report.

	Year Ended December 31,				
	2007	2006	2005	2004	2003
	(in thousands, except earnings per share amounts)				
Statement of Operations Data:					
Operating revenues:					
Operating revenues, before fuel surcharge	$ 351,701	$ 351,373	$ 326,353	$ 309,475	$ 293,547
Fuel surcharge (1)	57,140	48,896	34,527	15,591	7,491
Total operating revenues	408,841	400,269	360,880	325,066	301,038
Operating expenses:					
Salaries, wages and benefits	135,606	127,539	122,005	119,519	119,350
Fuel expense (2)	114,242	97,286	81,017	55,645	42,883
Rent and purchased transportation	38,718	43,844	39,074	38,938	35,287
Depreciation and amortization	38,759	33,929	31,376	30,016	26,601
Operating supplies (1)(2)	30,845	25,682	23,114	21,718	20,358
Operating taxes and licenses	17,520	16,421	15,776	15,488	14,710
Insurance and claims	17,591	16,389	15,992	15,820	13,500
Communications and utilities	3,113	2,642	2,648	2,690	2,540
Other	7,130	5,426	6,205	5,131	4,755
(Gain) loss on sale or disposal of property	(48)	47	147	915	368
Total operating expenses	403,476	369,205	337,354	305,880	280,352
Operating income	5,365	31,064	23,526	19,186	20,686
Non-operating income	1,707	448	477	464	276
Interest expense	(2,453)	(1,475)	(1,881)	(1,758)	(1,667)
Income before income taxes	4,619	30,037	22,122	17,892	19,295
Income taxes	1,966	12,073	8,983	7,304	7,805
Net income	$ 2,653	$ 17,964	$ 13,139	$ 10,588	$ 11,490
Earnings per common share:					
Basic	$ 0.26	$ 1.74	$ 1.20	$ 0.94	$ 1.02
Diluted	$ 0.26	$ 1.74	$ 1.20	$ 0.94	$ 1.01
Average common shares outstanding – Basic	10,238	10,296	10,966	11,298	11,291
Average common shares outstanding – Diluted(3)	10,239	10,302	10,976	11,324	11,326

(1) In order to conform to industry practice, during 2004 the Company began to classify fuel surcharges charged to customers as revenue rather than as a reduction of operating supplies expense. This reclassification has no effect on net operating income, net income or earnings per share. The Company has made corresponding reclassifications to comparative periods shown.

(2) Because of the increased impact of fuel costs on the Company's results of operations in recent years, during 2006 the Company began to separately display as a line item "Fuel expense" for amounts paid for fuel which had previously been aggregated with other operating supplies and included in the line item "Operating supplies". This reclassification has no effect on net operating income, net income or earnings per share. The Company has made corresponding reclassifications to comparative periods shown.

(3) Diluted income per share for 2007, 2006, 2005, 2004 and 2003 assumes the exercise of stock options to purchase an aggregate of 19,213, 55,738, 22,297, 62,224 and 77,758 shares of common stock, respectively.

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	At December 31,				
	2007	2006	2005	2004	2003
Balance Sheet Data:			(in thousands)		
Total assets	$ 319,904	$ 314,246	$ 293,441	$ 285,349	$ 264,849
Long-term debt, excluding current portion	44,172	21,205	39,693	23,225	26,740
Stockholders' equity	179,377	185,028	164,762	168,543	156,875

	Year Ended December 31,				
	2007	2006	2005	2004	2003
Operating Data:					
Operating ratio (1)	98.5%	91.2%	92.8%	93.8%	92.9%
Average number of truckloads per week	7,849	7,200	6,946	7,278	7,105
Average miles per trip	647	659	680	664	701
Total miles traveled (in thousands)	246,801	229,810	228,624	235,894	242,890
Average miles per truck	118,483	123,156	125,479	127,124	131,934
Average revenue, before fuel surcharge per truck per day	$ 695	$ 778	$ 740	$ 684	$ 653
Average revenue, before fuel surcharge per loaded mile	$ 1.38	$ 1.43	$ 1.33	$ 1.19	$ 1.13
Empty mile factor	6.5%	5.9%	5.5%	4.7%	4.5%
At end of period:					
Total company-owned/leased trucks	2,055(2)	1,998(3)	1,792(4)	1,857(5)	1,913(6)
Average age of trucks (in years)	1.75	1.55	1.43	1.70	1.94
Total trailers	4,882	4,540	4,406	4,257	4,175
Average age of trailers (in years)	4.44	4.16	3.92	4.69	5.15
Number of employees	3,181	3,062	3,035	2,736	2,765

(1) Total operating expenses, net of fuel surcharge as a percentage of operating revenues, before fuel surcharge.
(2) Includes 55 owner operator trucks; (3) Includes 49 owner operator trucks; (4) Includes 50 owner operator trucks.
(5) Includes 85 owner operator trucks; (6) Includes 103 owner operator trucks.

The Company has not declared or paid any cash dividends during any of the periods presented above.

Item 7. Management’s Discussion and Analysis of Financial Condition and Results of Operations.

Business Overview

The Company's administrative headquarters are in Tontitown, Arkansas. From this location we manage operations conducted through wholly owned subsidiaries based in various locations around the United States and Canada. The operations of these subsidiaries can generally be classified into either truckload services or brokerage and logistics services. Truckload services include those transportation services in which we utilize company owned trucks or owner-operator owned trucks. Brokerage and logistics services consist of services such as transportation scheduling, routing, mode selection, transloading and other value added services related to the transportation of freight which may or may not involve the usage of company owned or owner-operator owned equipment. Both our truckload operations and our brokerage/logistics operations have similar economic characteristics and are impacted by virtually the same economic factors as discussed elsewhere in this Report. All of the Company's operations are in the motor carrier segment.

For both operations, substantially all of our revenue is generated by transporting freight for customers and is predominantly affected by the rates per mile received from our customers, equipment utilization, and our percentage of non-compensated miles. These aspects of our business are carefully managed and efforts are continuously underway to achieve favorable results. Truckload services revenues, excluding fuel surcharges, represented 90.4%, 87.8%, and 88.0% of total revenues, excluding fuel surcharges for the twelve months ended December 31, 2007, 2006, and 2005, respectively.

The main factors that impact our profitability on the expense side are costs incurred in transporting freight for our customers. Currently our most challenging costs include fuel, driver recruitment, training, wage and benefit costs, independent broker costs (which we record as purchased transportation), insurance, and maintenance and capital equipment costs.

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In discussing our results of operations we use revenue, before fuel surcharge, (and fuel expense, net of surcharge), because management believes that eliminating the impact of this sometimes volatile source of revenue allows a more consistent basis for comparing our results of operations from period to period. During 2007, 2006 and 2005, approximately $57.1 million, $48.9 million and $34.5 million, respectively, of the Company's total revenue was generated from fuel surcharges. We also discuss certain changes in our expenses as a percentage of revenue, before fuel surcharge, rather than absolute dollar changes. We do this because we believe the high variable cost nature of certain expenses makes a comparison of changes in expenses as a percentage of revenue more meaningful than absolute dollar changes.

Results of Operations - Truckload Services

The following table sets forth, for truckload services, the percentage relationship of expense items to operating revenues, before fuel surcharges, for the periods indicated. Fuel costs are shown net of fuel surcharges.

	Years Ended December 31,		
	2007	2006	2005
Operating revenues, before fuel surcharge	100.0%	100.0%	100.0%
Operating expenses:			
Salaries, wages and benefits	42.0	40.6	41.8
Fuel expense, net of fuel surcharge	18.2	16.0	16.6
Rent and purchased transportation	2.5	1.7	1.2
Depreciation and amortization	12.2	11.0	10.9
Operating supplies	9.7	8.3	8.0
Operating taxes and licenses	5.5	5.3	5.5
Insurance and claims	5.5	5.3	5.5
Communications and utilities	0.9	0.8	0.9
Other	2.0	1.6	1.8
Loss on sale or disposal of property	0.0	0.0	0.1
Total operating expenses	98.5	90.6	92.3
Operating income	1.5	9.4	7.7
Non-operating income	0.5	0.1	0.1
Interest expense	(0.7)	(0.4)	(0.5)
Income before income taxes	1.3%	9.1%	7.3%

2007 Compared to 2006

For the year ended December 31, 2007, truckload services revenue, before fuel surcharges, increased 3.0% to $317.9 million as compared to $308.7 million for the year ended December 31, 2006. The increase was primarily due to an 11.6% increase in the average size of the Company's truck fleet from 1,866 units in 2006 to 2,083 units in 2007. However, a 4.1% decrease in the average rate per total mile charged to customers from approximately $1.34 during 2006 to approximately $1.29 during 2007 and a decrease in the average daily miles traveled per unit from 509 miles in

2006 to 488 miles in 2007 partially offset revenue growth attributable to fleet growth.

Salaries, wages and benefits increased from 40.6% of revenues, before fuel surcharges, in 2006 to 42.0% of revenues, before fuel surcharges, in 2007 which represents an increase from $125.4 million in 2006 to $133.5 million in 2007. The increase relates primarily to an increase in driver wages as the number of company driver compensated miles increased from 229.8 million miles in 2006 to 246.8 million miles in 2007. Also contributing to the increase was an increase in driver lease expense and amounts recorded for employee health insurance expense. Driver lease expense, which is a component of salaries, wages and benefits, increased from $6.2 million in 2006 to $7.8 million in 2007, as the average number of owner operators under contract increased from 45 during 2006 to 57 during 2007. Employee health insurance expense increased from $4.3 million in 2006 to $6.3 million in 2007 as a result of healthcare cost increases, in general, and to an increase in the number and severity of health claims reported during 2007 as compared to 2006. Partially offsetting the increases discussed above was a decrease in amounts accrued for employee bonus plans during 2007 as compared to 2006.

Fuel expense increased from 16.0% of revenues, before fuel surcharges, in 2006 to 18.2% of revenues, before fuel surcharges, in 2007 which represents an increase from $49.4 million during 2006 to $57.8 million during 2007. The increase was primarily due to higher fuel prices as the average price paid per gallon of diesel fuel increased from $2.55 per gallon during 2006 to $2.76 per gallon during 2007. During periods of rising fuel prices the Company is often able to partially offset fuel cost increases through the use of fuel surcharges charged to customers. The Company collected fuel surcharges of approximately $47.8 million during 2006 compared to fuel surcharge collections of $56.4 million during 2007.

Rent and purchased transportation increased from 1.7% of revenues, before fuel surcharges, in 2006 to 2.5% of revenues, before fuel surcharges, in 2007. The increase relates primarily to an increase in amounts paid to third party transportation service providers for intermodal services.

Depreciation and amortization increased from 11.0% of revenues, before fuel surcharges, in 2006 to 12.2% of revenues, before fuel surcharges, in 2007 representing an increase from $33.9 million during 2006 to $38.7 million during 2007. Depreciation expense increased primarily due to an increase in the average size of the Company-owned truck fleet from 1,820 trucks during 2006 to 2,027 trucks during 2007. To a lesser extent, a larger trailer fleet and higher new trailer prices also contributed to the increase.

Operating supplies and expenses increased from 8.3% of revenues, before fuel surcharges, in 2006 to 9.7% of revenues, before fuel surcharges, in 2007. The increase relates primarily to an increase in amounts paid to third party driver training schools, driver layover pay, and for truck repairs expense.

Operating taxes and licenses increased from 5.3% of revenues, before fuel surcharges, in 2006 to 5.5% of revenues, before fuel surcharges, in 2007. Operating taxes and licenses, which consists primarily of fuel taxes, increased from $16.4 million during 2006 to $17.5 million during 2007. Fuel tax expense is primarily affected by the number of gallons of diesel fuel purchased which is primarily a factor of the number of miles traveled and the miles-per-gallon ("mpg") achieved. During 2007, a decrease in the average mpg to 5.91 from an average mpg of 5.94 during 2006 combined with an increase in the number of miles traveled to 246.8 million in 2007 from 229.8 million miles in 2006, resulted in an increase in the number of diesel fuel gallons purchased.

Insurance and claims expense increased from 5.3% of revenues, before fuel surcharges, in 2006 to 5.5% of revenues, before fuel surcharges, in 2007. The increase represents an increase from $16.4 million during 2006 to $17.6 million during 2007. The increase relates primarily to an increase in auto liability insurance premiums which are determined based on a negotiated rate-per-mile ("NRPM") with the Company's insurance carrier. During 2007, the number of miles used to calculate the premiums increased to 246.8 million miles from 229.8 million miles which translated into increased auto liability insurance expense. During October 2007 the Company's auto liability insurance policy was renewed at a rate which represented a 5.5% reduction in the NRPM and since that time this lower rate-per-mile has helped to partially offset the increase in auto liability insurance expense associated with the increase in miles traveled during 2007 as compared to 2006.

Other expenses increased from 1.6% of revenues, before fuel surcharges, in 2006 to 2.0% of revenues, before fuel surcharges, in 2007. The increase relates primarily to an increase in amounts paid for outsourcing shop employees at the Company's terminals during 2007 as compared to 2006. Also contributing to the increase was a one-time expense accrual of approximately $300,000 during December 2007 to settle a 1986 environmental remediation claim in which the Company was found partly liable for remediation.

The truckload services division operating ratio, which measures the ratio of operating expenses, net of fuel surcharges, to operating revenues, before fuel surcharges, increased to 98.6% for 2007 from 90.6% for 2006.

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2006 Compared to 2005

For the year ended December 31, 2006, truckload services revenue, before fuel surcharges, increased 7.5% to $308.7 million as compared to $287.1 million for the year ended December 31, 2005. The increase was primarily due to a 6.9% increase in the average rate per total mile charged to customers from approximately $1.26 during 2005 to approximately $1.34 during 2006. Also contributing to the increase was a slight increase in the average size of the Company's truck fleet from 1,822 units in 2005 to 1,866 units in 2006, however, a decrease in the average daily miles traveled per unit from 519 miles in 2005 to 509 miles in 2006 partially offset revenue growth attributable to our fleet growth.

Salaries, wages and benefits decreased from 41.8% of revenues, before fuel surcharges, in 2005 to 40.6% of revenues, before fuel surcharges, in 2006. The decrease relates primarily to a decrease in driver lease expense, which is a component of salaries, wages and benefits, as the average number of owner operators under contract decreased from 66 during 2005 to 45 during 2006. The decrease associated with driver lease expense was partially offset by an increase in amounts paid to the corresponding company driver replacement, and in other costs normally absorbed by the owner operator such as repairs and fuel. The settlement of claims for amounts less than the estimated reserve under the Company's self-insured workers' compensation plan also contributed to the decrease. Although to a lesser degree, the effect of higher revenues without a corresponding increase in those wages with fixed cost characteristics, such as general and administrative wages, also contributed to the decrease in salaries, wages and benefits as a percentage of revenues, before fuel surcharges. Partially offsetting the decreases discussed above was an increase in amounts accrued for employee bonus plans and an increase in driver pay as a result of the modified driver pay plans implemented in January 2006. Management anticipates that salaries, wages and benefits will increase to the extent the Company is unable to pass the additional costs to customers in the form of rate increases.

Fuel expense decreased from 16.6% of revenues, before fuel surcharges, in 2005 to 16.0% of revenues, before fuel surcharges, in 2006. Fuel costs, net of fuel surcharges, increased from $47.6 million during 2005 to $49.4 million during 2006 primarily due to higher fuel prices. During periods of rising fuel prices the Company is often able to recoup a portion of the increase through fuel surcharges passed along to its customers. The Company collected approximately $34.5 million in fuel surcharges during 2005 and $48.9 million during 2006. Fuel costs were also affected by the replacement of owner operators with Company drivers as discussed above.

Rent and purchased transportation increased from 1.2% of revenues, before fuel surcharges, in 2005 to 1.7% of revenues, before fuel surcharges, in 2006. The increase relates primarily to an increase in amounts paid to third party transportation service providers for intermodal services.

Depreciation and amortization increased from 10.9% of revenues, before fuel surcharges, in 2005 to 11.0% of revenues, before fuel surcharges, in 2006. Depreciation expense increased from $31.3 million during 2005 to $33.9 million during 2006 primarily due to an increase in the size of the Company-owned truck fleet from 1,742 trucks in service at the end of 2005 to 1,949 trucks in service at the end of 2006. To a lesser extent, a larger trailer fleet and higher new trailer prices also contributed to the increase.

Operating supplies and expenses increased from 8.0% of revenues, before fuel surcharges, in 2005 to 8.3% of revenues, before fuel surcharges, in 2006. The increase relates to an increase in amounts paid to third party driver training schools and for truck repairs expense. Truck repairs expense increased in part as a result of the replacement of owner operators with Company drivers as discussed above.

Operating taxes and licenses decreased from 5.5% of revenues, before fuel surcharges, in 2005 to 5.3% of revenues, before fuel surcharges, in 2006. Operating taxes and licenses, which consists primarily of fuel taxes, increased slightly from $15.8 million during 2005 to $16.4 million during 2006. Fuel tax expense is primarily affected by both the number of miles traveled and the miles-per-gallon (mpg) achieved. During 2006 the Company experienced a lower mpg of 5.94 as compared to a mpg of 6.11 during 2005 as the Company continued the replacement of older trucks with new trucks containing the less efficient EPA-compliant engines originally mandated for all engines produced after October 1, 2002. Also contributing to the increase was an increase in the number of miles traveled from 228.6 million in 2005 to 229.8 million in 2006.

Insurance and claims expense decreased from 5.5% of revenues, before fuel surcharges, in 2005 to 5.3% of revenues, before fuel surcharges, in 2006. During the third quarter of 2005 the Company and one of its insurance providers renegotiated the method used in determining the Company’s auto liability insurance premiums which were previously based on a specified rate per one hundred dollars of revenue. This method had the unintended consequence of penalizing the Company with increased insurance costs solely from passing higher costs along to its customers in the form of rate increases. As a result of these renegotiations, the method of determining the Company’s auto liability insurance premium was amended to use the number of miles traveled instead of revenue generated which allowed the Company to recognize a credit of approximately $600,000 against insurance expense during the third quarter of 2005. Excluding the effect of this credit, insurance and claims expense decreased from 5.8% of revenues, before fuel surcharges, during 2005 to 5.3% of revenues, before fuel surcharges, during 2006. This decrease, as a percentage of revenue, was due to the effect of an increase in Company revenues due to rate increases which dilutes the impact of mileage based expenses. During the third quarter of 2006 the Company’s auto liability insurance policy renewal negotiations resulted in a rate increase of approximately 4.4% and management expects insurance expense to increase to the extent the Company is unable to pass the additional insurance costs to customers in the form of rate increases.

Other expenses decreased from 1.8% of revenues, before fuel surcharges, in 2005 to 1.6% of revenues, before fuel surcharges, in 2006. The decrease relates primarily to a decrease in amounts considered as uncollectible revenue during 2006 as compared to 2005. This decrease was partially offset by an increase in amounts paid for advertising expense during 2006 as compared to 2005.

The truckload services division operating ratio, which measures the ratio of operating expenses, net of fuel surcharges, to operating revenues, before fuel surcharges, decreased to 90.6% for 2006 from 92.3% for 2005.

Results of Operations - Logistics and Brokerage Services

The following table sets forth, for logistics and brokerage services, the percentage relationship of expense items to operating revenues, before fuel surcharges, for the periods indicated. Brokerage service operations occur specifically in certain divisions; however, brokerage operations occur throughout the Company in similar operations having substantially similar economic characteristics. Rent and purchased transportation, which includes costs paid to third party carriers, are shown net of fuel surcharges.

	Years Ended December 31,		
	2007	2006	2005
Operating revenues, before fuel surcharge	100.0%	100.0%	100.0%
Operating expenses:			
Salaries, wages and benefits	6.3	5.0	5.1
Fuel expense	0.0	0.0	0.0
Rent and purchased transportation, net of fuel surcharge	88.9	88.3	88.0
Depreciation and amortization	0.0	0.0	0.2
Operating supplies	0.0	0.0	0.0
Operating taxes and licenses	0.0	0.0	0.0
Insurance and claims	0.1	0.0	0.1
Communications and utilities	0.3	0.3	0.4
Other	2.1	1.4	2.5
Loss on sale or disposal of property	0.0	0.0	0.0
Total operating expenses	97.7	95.0	96.3
Operating income	2.3	5.0	3.7
Non-operating income	0.0	0.0	0.0
Interest expense	(0.4)	(0.4)	(0.6)
Income before income taxes	1.9%	4.6%	3.1%

2007 Compared to 2006

For the year ended December 31, 2007, logistics and brokerage services revenues, before fuel surcharges, decreased 20.9% to $33.8 million as compared to $42.7 million for the year ended December 31, 2006. The decrease was primarily the result of a 22.2% decrease in the number of loads brokered during 2007 as compared to 2006.

Rent and purchased transportation increased from 88.3% of revenues, before fuel surcharges, in 2006 to 88.9% of revenues, before fuel surcharges, in 2007. The increase relates to an increase in amounts charged by third party logistics and brokerage service providers primarily as a result of higher fuel costs.

Other expenses increased from 1.4% of revenues, before fuel surcharges, in 2006 to 2.1% of revenues, before fuel surcharges, in 2007. The increase relates primarily to an increase in amounts considered as uncollectible revenue during 2007 as compared to 2006.

The logistics and brokerage services division operating ratio, which measures the ratio of operating expenses, net of fuel surcharges, to operating revenues, before fuel surcharges, increased to 97.7% for 2007 from 95.0% for 2006.

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2006 Compared to 2005

Logistics and brokerage services revenues, before fuel surcharges, increased 8.9% to $42.7 million for the year ended December 31, 2006 as compared to $39.2 million for the year ended December 31, 2005. The increase was primarily the result of rate increases charged to customers to recover increases in amounts charged by third party logistics and brokerage service providers, and to a lesser extent, an increase in the number of loads brokered.

Rent and purchased transportation increased from 88.0% of revenues, before fuel surcharges, in 2005 to 88.3% of revenues, before fuel surcharges, in 2006. The increase relates to an increase in amounts charged by third party logistics and brokerage service providers primarily as a result of higher fuel costs.

Other expenses decreased from 2.5% of revenues, before fuel surcharges, in 2005 to 1.4% of revenues, before fuel surcharges, in 2006. The decrease relates primarily to a decrease in amounts considered as uncollectible revenue during 2006 as compared to 2005.

The logistics and brokerage services division operating ratio, which measures the ratio of operating expenses, net of fuel surcharges, to operating revenues, before fuel surcharges, decreased to 95.0% for 2006 from 96.3% for 2005.

Results of Operations - Combined Services

2007 Compared to 2006

Income tax expense was approximately $2.0 million in 2007 resulting in an effective rate of 42.6% as compared to income tax expense of approximately $12.1 million in 2006 which resulted in an effective rate of 40.2%. The effective tax rate differs from the statutory rate primarily due to the existence of partially non-deductible meal and incidental expense per-diem payments to company drivers. These per-diem payments may cause a significant difference in the Company’s effective tax rate from period-to-period as the proportion of non-deductible expenses to pre-tax net income increases or decreases.

We have determined, based on significant judgment, that a valuation allowance against our deferred tax assets has not been necessary. Management evaluates the realizability of its deferred tax assets based upon negative and positive evidence available and based on the evidence available at this time, management concludes that it is "more likely than not" that we will be able to realize the benefit of our deferred tax assets in the near future.

The Company adopted the provisions of Financial Accounting Standards Board (“FASB”) Interpretation 48, Accounting for Uncertainty in Income Taxes-an interpretation of FASB Statement No. 109 (“FIN 48”), on January 1, 2007. FIN 48 addressed the determination of how tax benefits claimed or expected to be claimed on a tax return should be recorded in the financial statements. Under FIN 48, the Company may recognize the tax benefit from an uncertain tax position only if it is more likely than not that the position will be sustained on examination by taxing authorities, based on the technical merits of the position. Upon adoption and as of December 31, 2007, there were no unrecognized tax benefits and an adjustment to the Company’s consolidated financial statements for uncertain tax positions was not required as management believes that the Company’s significant tax positions taken in income tax returns filed or to be filed are supported by clear and unambiguous income tax laws.

The Company and its subsidiaries are subject to U.S. and Canadian federal income tax laws as well as the income tax laws of multiple state jurisdictions. The major tax jurisdictions in which we operate generally provide for a deficiency assessment statute of limitation period of three years and as a result, the Company’s tax years 2004 through 2006 remain open to examination in those jurisdictions. During 2007, the Company has not recognized or accrued any interest or penalties related to uncertain income tax positions and does not believe it is reasonably possible that our unrecognized tax benefits will significantly change within the next twelve months.

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Net income for all divisions was $2.7 million, or 0.8% of revenues, before fuel surcharge for 2007 as compared to $18.0 million or 5.1% of revenues, before fuel surcharge for 2006. The decrease in net income combined with the effect of treasury stock repurchases resulted in a decrease in diluted earnings per share to $0.26 for 2007 compared to $1.74 for 2006.

2006 Compared to 2005

Net income for all divisions was $18.0 million, or 5.1% of revenues, before fuel surcharge for 2006 as compared to $13.1 million or 4.0% of revenues, before fuel surcharge for 2005. The increase in net income combined with the effect of treasury stock repurchases resulted in an increase in diluted earnings per share to $1.74 for 2006 compared to $1.20 for 2005.

Quarterly Results of Operations

The following table presents selected consolidated financial information for each of our last eight fiscal quarters through December 31, 2007. The information has been derived from unaudited consolidated financial statements that, in the opinion of management, reflect all adjustments, consisting of normal recurring adjustments, necessary for a fair presentation of the quarterly information.

	Quarter Ended							
	Mar. 31, 2007	June 30, 2007	Sept. 30, 2007	Dec. 31, 2007	Mar. 31, 2006	June 30, 2006	Sept. 30, 2006	Dec. 31, 2006
	(unaudited) (in thousands, except earnings per share data)							
Operating revenues	$ 98,809	$ 106,700	$ 101,171	$ 102,162	$ 100,525	$ 103,365	$ 99,874	$ 96,505
Total operating expenses	96,475	102,528	100,688	103,785	91,473	94,375	94,202	89,154
Operating income (loss)	2,334	4,172	483	(1,623)	9,052	8,990	5,672	7,351
Net income (loss)	1,265	2,192	36	(840)	5,183	5,241	3,268	4,272
Earnings (loss) per common share:								
Basic	$ 0.12	$ 0.21	$ 0.00	$ (0.08)	$ 0.50	$ 0.51	$ 0.32	$ 0.41
Diluted	$ 0.12	$ 0.21	$ 0.00	$ (0.08)	$ 0.50	$ 0.51	$ 0.32	$ 0.41

Liquidity and Capital Resources

The growth of our business has required, and will continue to require, a significant investment in new revenue equipment. Our primary sources of liquidity have been funds provided by operations, proceeds from the sales of revenue equipment, issuances of equity securities, and borrowings under our lines of credit.

During 2007, we generated $45.2 million in cash from operating activities compared to $60.7 million and $23.7 million in 2006 and 2005, respectively. Investing activities used $61.7 million in cash during 2007 compared to $42.7 million and $41.0 million in 2006 and 2005, respectively. The cash used in all three years related primarily to the purchase of revenue equipment (trucks and trailers) used in our operations. Financing activities provided $15.9 million in cash during 2007 compared to financing activities in 2006 and 2005 which used $18.1 million and $1.2 million, respectively. See Consolidated Statements of Cash Flows.

Our primary use of funds is for the purchase of revenue equipment. We typically use our existing lines of credit on an interim basis, in addition to cash flows from operations, to finance capital expenditures and repay long-term debt.

During 2007 and 2006, we utilized cash on hand and our lines of credit to finance revenue equipment purchases for an aggregate of $72.6 million and $50.7 million, respectively.

Occasionally we finance the acquisition of revenue equipment through installment notes with fixed interest rates and terms ranging from 36 to 48 months, however as of December 31, 2007 and 2006, we had no outstanding indebtedness under such installment notes.

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In order to maintain our truck and trailer fleet count it is often necessary to purchase replacement units and place them in service before trade units are removed from service. The timing difference created during this process often requires the Company to pay for new units without any reduction in price for trade units. In this situation, the Company later receives payment for the trade units as they are delivered to the equipment vendor and have passed vendor inspection. During the twelve months ended December 31, 2007 and 2006, the Company received approximately $5.9 million and $9.9 million, respectively, for units delivered for trade.

We maintain two separate $30.0 million revolving lines of credit (Line A and Line B, respectively) with separate financial institutions. Amounts outstanding under Line A bear interest at LIBOR (determined as of the first day of each month) plus 1.25% (6.48% at December 31, 2007), are secured by our accounts receivable and mature on May 31, 2009. At December 31, 2007 outstanding advances on line A were approximately $28.5 million, including $300,000 in letters of credit, with availability to borrow $1.5 million. Amounts outstanding under Line B bear interest at LIBOR (determined on the last day of the previous month) plus 1.15% (6.39% at December 31, 2007), are secured by revenue equipment and mature on June 30, 2008, however the Company has the intent and ability to extend the terms of this line of credit for an additional one year period until June 30, 2009. At December 31, 2007, $17.5 million, including $2.5 million in letters of credit were outstanding under Line B with availability to borrow $12.5 million. In an effort to reduce interest rate risk associated with these floating rate facilities, we entered into interest rate swap agreements in an aggregate notional amount of $20.0 million that terminated in 2006. For additional information regarding the interest rate swap agreements, see Item 7A of this Report.

Marketable equity securities available for sale at December 31, 2007 increased approximately $2.8 million as compared to December 31, 2006. During the year ended December 31, 2007, the Company purchased approximately $5.4 million of equity securities with the remaining increase or decrease attributable to changes in the market value of the investments, net of sales and other-than-temporary write-downs. These securities, combined with equity securities purchased in prior periods, have a combined cost basis of approximately $13.9 million and a combined fair market value of approximately $17.3 million. The Company has developed a strategy to invest in securities from which it expects to receive dividends that qualify for favorable tax treatment, as well as, appreciate in value. The Company anticipates that increases in the market value of the investments combined with dividend payments will exceed interest rates paid on borrowings for the same period. During 2007 the Company had net unrealized pre-tax losses of approximately $1.9 million and received dividends of approximately $655,000. The holding term of these securities depends largely on the general economic environment, the equity markets, borrowing rates and the Company's cash requirements.

Accounts receivable-other at December 31, 2007 increased approximately $4.0 million as compared to December 31, 2006. During 2007, the Company contracted with a third-party qualified intermediary in order to implement a like-kind exchange tax program. Under the program, dispositions of eligible trucks or trailers and acquisitions of replacement trucks or trailers are made in a form whereby any associated tax gains related to the disposal are deferred. To qualify for like-kind exchange treatment, we exchange, through our qualified intermediary, eligible trucks or trailers being disposed with trucks or trailers being acquired. At December 31, 2007 approximately $4.1 million of tractor and trailer sales proceeds were being held by the third-party qualified intermediary. The Company intends to use these $4.1 million in sales proceeds during 2008 to purchase qualified replacement tractors or trailers.

Revenue equipment, which generally consists of trucks, trailers, and revenue equipment accessories such as Qualcomm™ satellite tracking units, increased approximately $5.2 million as compared to December 31, 2006. The increase is primarily related to the net effect of purchasing approximately 610 trucks and 530 trailers during 2007 while only disposing of approximately 590 trucks and 340 trailers during 2007. Also contributing to the increase was an increase in the cost of new truck and trailer units as compared to the units they replaced and to the acquisition of additional Qualcomm™ satellite tracking units. At December 31, 2007, approximately 70 trucks included in revenue equipment had been placed in inactive status as they were prepared for sale or trade. The sale or trade of these trucks in 2008 will reduce the carrying amount of the Company’s revenue equipment and accumulated depreciation at the time of sale or trade.

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Accounts payable at December 31, 2007 decreased approximately $13.2 million as compared to December 31, 2006. The decrease is primarily related to $14.3 million in truck and trailer purchases made during December 2006 for which payment was made in January 2007 as the Company increased its December 2006 truck purchases in an effort to delay purchasing trucks with the 2007 model diesel engines. The 2007 model diesel engines are designed to meet stricter EPA emission standards and were discussed in this report above in “Part I, Item 1, Revenue Equipment”.

Long-term debt at December 31, 2007 increased approximately $23.0 million as compared to December 31, 2006. The increase relates primarily to borrowings against the Company’s two lines of credit in order to finance the purchase of replacement trucks and trailers. During 2007, purchases of revenue equipment, net of sales or trade proceeds received for retired revenue equipment, required the use of cash or borrowings against the lines of credit of approximately $50.4 million. Also, approximately $12.7 million of cash provided by operating activities, which would have been available to purchase revenue equipment, was used to purchase approximately $7.3 million of treasury stock and $5.4 million of marketable investments.

Treasury stock at December 31, 2007 increased approximately $7.3 million as the Company purchased 471,500 shares of its common stock at various times throughout 2007 as part of a stock repurchase plan approved by the Company’s Board of Directors during May 2007. The stock repurchase plan authorizes the purchase of up to 600,000 shares of the Company’s common stock and expires in May 2008.

For 2008, we expect to purchase approximately 550 new trucks and approximately 730 trailers while continuing to sell or trade older equipment, which we expect to result in net capital expenditures of approximately $45.1 million. Management believes we will be able to finance our near term needs for working capital over the next twelve months, as well as acquisitions of revenue equipment during such period, with cash balances, cash flows from operations, and borrowings believed to be available from financing sources. We will continue to have significant capital requirements over the long-term, which may require us to incur debt or seek additional equity capital. The availability of additional capital will depend upon prevailing market conditions, the market price of our common stock and several other factors over which we have limited control, as well as our financial condition and results of operations. Nevertheless, based on our anticipated future cash flows and sources of financing that we expect will be available to us, we do not expect that we will experience any significant liquidity constraints in the foreseeable future.

Contractual Obligations and Commercial Commitments

The following table sets forth the Company's contractual obligations and commercial commitments as of December 31, 2007:

	Payments due by period (in thousands)				
	Total	Less than 1 year	1 to 3 Years	4 to 5 Years	More than 5 Years
Long-term debt	$ 46,237	$ 2,065	$ 44,172	$ -	$ -
Operating leases (1)	1,741	520	762	379	80
Total	$ 47,978	$ 2,585	$ 44,934	$ 379	$ 80

(1) Represents building, facilities, and drop yard operating leases.

Off-Balance Sheet Arrangements

The Company has no off-balance sheet arrangements as defined in Regulation S-K 303 (a)(4)(ii) issued by the Securities and Exchange Commission.

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Insurance

With respect to physical damage for trucks, cargo loss and auto liability, the Company maintains insurance coverage to protect it from certain business risks. These policies are with various carriers and have per occurrence deductibles of $2,500, $10,000 and $2,500 respectively. The Company maintains workers’ compensation coverage in Arkansas, Ohio, Oklahoma, Mississippi, and Florida with a $500,000 self-insured retention and a $500,000 per occurrence excess policy. The Company has elected to opt out of workers' compensation coverage in Texas and is providing coverage through the P.A.M. Texas Injury Plan. The Company has reserved for estimated losses to pay such claims as well as claims incurred but not yet reported. The Company has not experienced any adverse trends involving differences in claims experienced versus claims estimates for workers’ compensation claims. Letters of credit aggregating $400,000 and certificates of deposit totaling $200,000 are held by banks as security for workers’ compensation claims. The Company self insures for employee health claims with a stop loss of $200,000 per covered employee per year and estimates its liability for claims incurred but not reported.

Inflation

Inflation has an impact on most of our operating costs. Recently, the effect of inflation has been minimal.

Competition for drivers has increased in recent years, leading to increased labor costs. While increases in fuel and driver costs affect our operating costs, we do not believe that the effects of such increases are greater for us than for other trucking concerns.

Adoption of Accounting Policies

See “Item 8. Financial Statements and Supplementary Data, Note 1 to the Consolidated Financial Statements - Recent Accounting Pronouncements.”

Critical Accounting Policies

The Company's significant accounting policies are described in Note 1 to the Consolidated Financial Statements. The policies described below represent those that are broadly applicable to the Company's operations and involve additional management judgment due to the sensitivity of the methods, assumptions and estimates necessary in determining the related amounts.

Accounts Receivable. We continuously monitor collections and payments from our customers, third parties and vendors and maintain a provision for estimated credit losses based upon our historical experience and any specific collection issues that we have identified. While such credit losses have historically been within our expectations and the provisions established, we cannot guarantee that we will continue to experience the same credit loss rates that we have in the past.

Property and equipment. Management must use its judgment in the selection of estimated useful lives and salvage values for purposes of depreciating trucks and trailers which in some cases do not have guaranteed residual values. Estimates of salvage value at the expected date of trade-in or sale are based on the expected market values of equipment at the time of disposal which, in many cases include guaranteed residual values by the manufacturers.

Self Insurance. The Company is self-insured for health and workers' compensation benefits up to certain stop-loss limits. Such costs are accrued based on known claims and an estimate of incurred, but not reported (IBNR) claims. IBNR claims are estimated using historical lag information and other data either provided by outside claims administrators or developed internally. This estimation process is subjective, and to the extent that future actual results differ from original estimates, adjustments to recorded accruals may be necessary.

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Revenue Recognition. Revenue is recognized in full upon completion of delivery to the receiver's location. For freight in transit at the end of a reporting period, the Company recognizes revenue prorata based on relative transit miles completed as a portion of the estimated total transit miles. Expenses are recognized as incurred.

Prepaid Tires. Tires purchased with revenue equipment are capitalized as a cost of the related equipment. Replacement tires are included in prepaid expenses and deposits and are amortized over a 24-month period. Costs related to tire recapping are expensed when incurred.

Income Taxes. Significant management judgment is required to determine the provision for income taxes and to determine whether deferred income tax assets will be realized in full or in part. Deferred income tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. When it is more likely that all or some portion of specific deferred income tax assets will not be realized, a valuation allowance must be established for the amount of deferred income tax assets that are determined not to be realizable. A valuation allowance for deferred income tax assets has not been deemed to be necessary. Accordingly, if the facts or financial circumstances were to change, thereby impacting the likelihood of realizing the deferred income tax assets, judgment would need to be applied to determine the amount of valuation allowance required in any given period.

Effective January 1, 2007, the Company adopted the provisions of FIN 48. FIN 48 contains a two-step approach to recognizing and measuring uncertain tax positions accounted for in accordance with SFAS No. 109. The first step is to evaluate the tax position for recognition by determining if the weight of available evidence indicates it is more likely than not that the position will be sustained on audit, including resolution of related appeals or litigation processes, if any. The second step is to measure the tax benefit as the largest amount which is more than 50% likely of being realized upon ultimate settlement. We consider many factors when evaluating and estimating our tax positions and tax benefits, which may require periodic adjustments and which may not accurately anticipate actual outcomes.

Business Combinations and Goodwill. Upon acquisition of an entity, the cost of the acquired entity must be allocated to assets and liabilities acquired. Identification of intangible assets, if any, that meet certain recognition criteria is necessary. This identification and subsequent valuation requires significant judgments. The carrying value of goodwill is tested annually and as of December 31, 2007 the Company determined that there was no impairment. The impairment testing requires an estimate of the value of the Company as a whole, as the Company has determined it only has one reporting unit as defined in Statement of Financial Accounting Standards No. 142, “Goodwill and Other Intangible Assets.”

Item 7A. Quantitative and Qualitative Disclosures about Market Risk.

Our primary market risk exposures include equity price risk, interest rate risk, and commodity price risk (the price paid to obtain diesel fuel for our trucks). The potential adverse impact of these risks and the general strategies we employ to manage such risks are discussed below.

The following sensitivity analyses do not consider the effects that an adverse change may have on the overall economy nor do they consider additional actions we may take to mitigate our exposure to such changes. Actual results of changes in prices or rates may differ materially from the hypothetical results described below.

Equity Price Risk

We hold certain actively traded marketable equity securities which subjects the Company to fluctuations in the fair market value of its investment portfolio based on current market price. The recorded value of marketable equity securities increased to $17.3 million at December 31, 2007 from $14.4 million at December 31, 2006. The increase includes additional purchases, net of sales or write-downs, of approximately $4.8 million during 2007 and a decrease in the fair market value of approximately $1.9 million during 2007. A 10% decrease in the market price of our marketable equity securities would cause a corresponding 10% decrease in the carrying amounts of these securities, or approximately $1.7 million. For additional information with respect to the marketable equity securities, see Note 3 to our consolidated financial statements.

Interest Rate Risk

Our two lines of credit each bear interest at a floating rate equal to LIBOR plus a fixed percentage. Accordingly, changes in LIBOR, which are effected by changes in interest rates, will affect the interest rate on, and therefore our costs under, the lines of credit. In an effort to manage the risks associated with changing interest rates, we entered into interest rate swap agreements effective February 28, 2001 and May 31, 2001, on notional amounts of $15,000,000 and $5,000,000, respectively. The “pay fixed rates” under the $15,000,000 and $5,000,000 swap agreements were 5.08% and 4.83%, respectively. The “receive floating rate” for both swap agreements was “1-month” LIBOR. These interest rate swap agreements terminated on March 2, 2006 and June 2, 2006, respectively. Assuming $40.0 million of variable rate debt was outstanding under Line “A” and not covered by a hedge agreement for a full fiscal year, a hypothetical 100 basis point increase in LIBOR would result in approximately $400,000 of additional interest expense. For additional information with respect to the interest rate swap agreements, see Note 17 to our consolidated financial statements.

Commodity Price Risk

Prices and availability of all petroleum products are subject to political, economic and market factors that are generally outside of our control. Accordingly, the price and availability of diesel fuel, as well as other petroleum products, can be unpredictable. Because our operations are dependent upon diesel fuel, significant increases in diesel fuel costs could materially and adversely affect our results of operations and financial condition. Based upon our 2007 fuel consumption, a 10% increase in the average annual price per gallon of diesel fuel would increase our annual fuel expenses by $11.4 million.

In July 2001, we entered into an agreement to obtain price protection and reduce a portion of our exposure to fuel price fluctuations. Under this agreement, we were obligated to purchase minimum amounts of diesel fuel per month, with a price protection component, for the six-month period ended February 28, 2002. The agreement also provided that if during the twelve-month period commencing January 2005, the price of heating oil on the New York Mercantile Exchange (“NY MX HO”) fell below $.58 per gallon, we would have been obligated to pay the contract holder the difference between $.58 per gallon and the NY MX HO average price, multiplied by 1,000,000 gallons. Accordingly, in any month in which the holder exercised such right, we would have been obligated to pay the holder $10,000 for each cent by which $.58 exceeded the average NY MX HO price for that month. For example, if the NY MX HO average price during March 2005 was approximately $.54, and if the holder were to exercise its payment right, we would have been obligated to pay the holder approximately $40,000. During the twelve-month period commencing January 2005 the average NY MX HO price remained well above the $.58 per gallon threshold and as of December 31, 2005 the agreement expired without any further obligation of either party. For the twelve-month period ended December 31, 2005 an adjustment of $500,000 was made to reflect the decline in fair value of the agreement which had the effect of reducing operating supplies expense and other current liabilities each by $500,000 in the accompanying consolidated financial statements. For the twelve-month period ended December 31, 2004 an adjustment of $250,000 was made to reflect the decline in fair value of the agreement which had the effect of reducing operating supplies expense and other current liabilities each by $250,000 in the accompanying consolidated financial statements, see Note 17 to our consolidated financial statements.

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Item 8. Financial Statements and Supplementary Data.

The following statements are filed with this report:

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

Board of Directors and Shareholders
P.A.M. Transportation Services, Inc. and Subsidiaries

We have audited the accompanying consolidated balance sheets of P.A.M. Transportation Services, Inc. (a Delaware corporation) and subsidiaries (collectively, the Company) as of December 31, 2007 and 2006, and the related consolidated statements of income, stockholders' equity and other comprehensive income, and cash flows for each of the three years in the period ended December 31, 2007. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of P.A.M. Transportation Services, Inc. and subsidiaries as of December 31, 2007 and 2006, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2007 in conformity with accounting principles generally accepted in the United States of America.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), P.A.M. Transportation Services, Inc. and subsidiaries’ internal control over financial reporting as of December 31, 2007, based on criteria established in Internal Control—Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO), and our report dated March 12, 2008 expressed an unqualified opinion thereon.

/s/ GRANT THORNTON LLP

Tulsa, Oklahoma
March 12, 2008

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P.A.M. TRANSPORTATION SERVICES, INC. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS
DECEMBER 31, 2007 AND 2006
(in thousands, except share and per share data)

ASSETS	2007	2006
CURRENT ASSETS:		
Cash and cash equivalents	$ 407	$ 1,040
Accounts receivable—net:		
Trade	58,397	61,469
Other	5,349	1,361
Inventories	905	819
Prepaid expenses and deposits	14,978	14,928
Marketable equity securities	17,269	14,437
Income taxes refundable	2,199	498
Total current assets	99,504	94,552
PROPERTY AND EQUIPMENT:		
Land	2,674	2,674
Structures and improvements	9,795	9,383
Revenue equipment	292,133	286,933
Office furniture and equipment	7,482	6,890
Total property and equipment	312,084	305,880
Accumulated depreciation	(107,841)	(102,566)
Net property and equipment	204,243	203,314
OTHER ASSETS:		
Goodwill	15,413	15,413
Non-compete agreements, net	17	217
Other	727	750
Total other assets	16,157	16,380
TOTAL ASSETS	$ 319,904	$ 314,246

(Continued)

CONSOLIDATED BALANCE SHEETS
DECEMBER 31, 2007 AND 2006
(in thousands, except share and per share data)

LIABILITIES AND SHAREHOLDERS' EQUITY	2007	2006
CURRENT LIABILITIES:		
Accounts payable	$ 25,346	$ 38,510
Accrued expenses and other liabilities	10,323	9,994
Current maturities of long-term debt	2,065	1,915
Deferred income taxes—current	5,117	5,658
Total current liabilities	42,851	56,077
Long-term debt—less current portion	44,172	21,205
Deferred income taxes—less current portion	53,504	51,902
Other	-	34
Total liabilities	140,527	129,218
COMMITMENTS AND CONTINGENCIES (Note 15)		
SHAREHOLDERS' EQUITY		
Preferred stock, $.01 par value, 10,000,000 shares authorized; none issued	-	-
Common stock, $.01 par value, 40,000,000 shares authorized; 11,368,207 and 11,362,207 shares issued; 9,838,107 and 10,303,607 shares outstanding at December 31, 2007 and December 31, 2006, respectively	114	114
Additional paid-in capital	77,557	77,309
Accumulated other comprehensive income	1,921	3,142
Treasury stock, at cost; 1,530,100 and 1,058,600 shares, respectively	(25,200)	(17,869)
Retained earnings	124,985	122,332
Total shareholders’ equity	179,377	185,028
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	$ 319,904	$ 314,246

(Concluded)

See notes to consolidated financial statements.

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P.A.M. TRANSPORTATION SERVICES, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF INCOME
YEARS ENDED DECEMBER 31, 2007, 2006 AND 2005
(in thousands, except per share data)

	2007	2006	2005
OPERATING REVENUES:			
Revenue, before fuel surcharge	$ 351,701	$ 351,373	$ 326,353
Fuel surcharge	57,140	48,896	34,527
Total operating revenues	408,841	400,269	360,880
OPERATING EXPENSES AND COSTS:			
Salaries, wages and benefits	135,606	127,539	122,005
Fuel expense	114,242	97,286	81,017
Rents and purchased transportation	38,718	43,844	39,074
Depreciation and amortization	38,759	33,929	31,376
Operating supplies and expenses	30,845	25,682	23,114
Operating taxes and licenses	17,520	16,421	15,776
Insurance and claims	17,591	16,389	15,992
Communications and utilities	3,113	2,642	2,648
Other	7,130	5,426	6,205
(Gain) loss on sale or disposal of equipment	(48)	47	147
Total operating expenses and costs	403,476	369,205	337,354
OPERATING INCOME	5,365	31,064	23,526
NON-OPERATING INCOME	1,707	448	477
INTEREST EXPENSE	(2,453)	(1,475)	(1,881)
INCOME BEFORE INCOME TAXES	4,619	30,037	22,122
FEDERAL AND STATE INCOME TAXES:			
Current	217	9,768	7,572
Deferred	1,749	2,305	1,411
Total federal and state income taxes	1,966	12,073	8,983
NET INCOME	$ 2,653	$ 17,964	$ 13,139
EARNINGS PER COMMON SHARE:			
Basic	$ 0.26	$ 1.74	$ 1.20
Diluted	$ 0.26	$ 1.74	$ 1.20
AVERAGE COMMON SHARES OUTSTANDING:			
Basic	10,238	10,296	10,966

Diluted	10,239	10,302	10,976

See notes to consolidated financial statements.

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P.A.M. TRANSPORTATION SERVICES, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY AND OTHER COMPREHENSIVE INCOME
YEARS ENDED DECEMBER 31, 2007, 2006 AND 2005
(in thousands)

	Common Stock Shares	/ Amount	Additional Paid-In Capital	Other Comprehensive Income	Accumulated Other Comprehensive Income	Treasury Stock	Retained Earnings	Total
BALANCE— January 1, 2005	11,303	$ 113	$ 76,050		$ 1,151	$ -	$ 91,229	$ 168,543
Components of comprehensive income:								
Net earnings				$ 13,139			13,139	13,139
Other comprehensive gain:								
Unrealized gain on hedge, net of tax of $195				282	282			282
Unrealized gain on marketable securities, net of tax of $189				288	288			288
Total comprehensive income				$ 13,709				
Treasury stock repurchases	(1,059)					(17,869)		(17,869)
Exercise of stock options-shares issued including tax benefits	41		379					379
BALANCE— December 31, 2005	10,285	113	76,429		1,721	(17,869)	104,368	164,762
Components of comprehensive income:								
Net earnings				$ 17,964			17,964	17,964
Other comprehensive gain:								
Unrealized gain on hedge, net of tax of $13				19	19			19

Unrealized gain on marketable securities, net of tax of $923				1,402	1,402			1,402
Total comprehensive income				$ 19,385				
Exercise of stock options-shares issued including tax benefits	18	1	369					370
Share-based compensation			511					511
BALANCE— December 31, 2006	10,303	114	77,309		3,142	(17,869)	122,332	185,028
Components of comprehensive income:								
Net earnings				$ 2,653			2,653	2,653
Other comprehensive gain:								
Realized gain on marketable securities, net of tax of $241				(359)	(359)			(359)
Unrealized loss on marketable securities, net of tax of $(448)				(862)	(862)			(862)
Total comprehensive income				$ 1,432				
Treasury stock repurchases	(471)					(7,331)		(7,331)
Exercise of stock options-shares issued including tax benefits	6		125					125
Share-based compensation			123					123
BALANCE— December 31, 2007	9,838	$ 114	$ 77,557		$ 1,921	$ (25,200)	$ 124,985	$ 179,377

See notes to consolidated financial statements.

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P.A.M. TRANSPORTATION SERVICES, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS
YEARS ENDED DECEMBER 31, 2007, 2006 AND 2005
(in thousands)

	2007	2006	2005
OPERATING ACTIVITIES:			
Net income	$ 2,653	$ 17,964	$ 13,139
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation and amortization	38,759	33,929	31,376
Bad debt expense	573	310	1,428
Stock compensation—net of excess tax benefits	118	441	-
Non-compete agreement amortization—net of payments	-	-	37
Provision for deferred income taxes	1,749	2,305	1,411
Reclassification of unrealized loss on marketable equity securities	95	120	153
Gain on sale of marketable equity securities	(1,071)	(30)	-
(Gain) loss on sale or disposal of equipment	(48)	47	147
Changes in operating assets and liabilities:			
Accounts receivable	2,585	3,685	(19,236)
Prepaid expenses, inventories, and other assets	(113)	440	(40)
Income taxes refundable	(1,696)	(202)	528
Trade accounts payable	1,089	2,219	(5,881)
Accrued expenses	496	(525)	679
Net cash provided by operating activities	45,189	60,703	23,741
INVESTING ACTIVITIES:			
Purchases of property and equipment	(76,166)	(53,514)	(62,013)
Proceeds from sale or disposal of equipment	22,273	11,987	22,850
Changes in restricted cash	(4,073)	-	-
Sales of marketable equity securities	1,622	85	-
Purchases of marketable equity securities	(5,389)	(1,288)	(1,884)
Other	-	-	20
Net cash used in investing activities	(61,733)	(42,730)	(41,027)
FINANCING ACTIVITIES:			
Borrowings under line of credit	508,076	446,221	422,460
Repayments under line of credit	(484,322)	(463,967)	(405,277)
Borrowings of long-term debt	2,067	1,996	1,977
Repayments of long-term debt	(2,704)	(2,682)	(2,913)
Repurchases of common stock	(7,331)	-	(17,869)
Stock compensation excess tax benefits	5	70	-
Exercise of stock options	120	300	378
Net cash provided by (used in) financing activities	15,911	(18,062)	(1,244)
NET DECREASE IN CASH AND CASH EQUIVALENTS	(633)	(89)	(18,530)

CASH AND CASH EQUIVALENTS—Beginning of year		1,040		1,129		19,659
CASH AND CASH EQUIVALENTS—End of year	$	407	$	1,040	$	1,129
SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION—						
Cash paid during the period for:						
Interest	$	2,410	$	1,481	$	1,928
Income taxes	$	1,976	$	10,061	$	7,190
NONCASH INVESTING AND FINANCING ACTIVITIES—						
Purchases of revenue equipment included in accounts payable	$	-	$	14,276	$	-

See notes to consolidated financial statements.

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P.A.M. TRANSPORTATION SERVICES, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
YEARS ENDED DECEMBER 31, 2007, 2006, AND 2005

1. ACCOUNTING POLICIES

Description of Business and Principles of Consolidation–P.A.M. Transportation Services, Inc. (the "Company"), through its subsidiaries, operates as a truckload transportation and logistics company.

The consolidated financial statements include the accounts of the Company and its wholly owned operating subsidiaries: P.A.M. Transport, Inc., P.A.M. Dedicated Services, Inc., Choctaw Express, Inc., Allen Freight Services, Inc., Decker Transport Co., Inc., McNeill Express, Inc., T.T.X., Inc., Transcend Logistics, Inc., and East Coast Transport and Logistics, LLC. The following subsidiaries were inactive during all periods presented: P.A.M. International, Inc., P.A.M. Logistics Services, Inc., Choctaw Brokerage, Inc., P.A.M. Canada, Inc. and S & L Logistics, Inc. All significant intercompany accounts and transactions have been eliminated.

Use of Estimates–The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, disclosure of any contingent assets and liabilities at the financial statement date and reported amounts of revenue and expenses during the reporting period. The Company periodically reviews these estimates and assumptions. The Company's estimates were based on its historical experience and various other assumptions that the Company believes to be reasonable under the circumstances. Actual results could differ from those estimates.

Cash and Cash Equivalents–The Company considers all highly liquid investments with a maturity of three months or less when purchased to be cash equivalents.

Restricted Cash– Restricted cash consists of cash proceeds from the sale of trucks and trailers under our like-kind exchange ("LKE") tax program. See Note 11, "Federal and State Income Taxes," for a discussion of the Company's LKE tax program. We classify restricted cash as a current asset within "Accounts receivable-other" as the exchange process must be completed within 180 days in order to qualify for income tax deferral treatment. The changes in restricted cash balances are reflected as an investing activity in our Consolidated Statements of Cash Flows as they relate to the sales and purchases of revenue equipment.

Bank Overdrafts–The Company classifies bank overdrafts in current liabilities as an accounts payable and does not offset other positive bank account balances located at the same or other financial institutions. Bank overdrafts generally represent checks written that have not yet cleared the Company's bank accounts. The majority of the Company's bank accounts are zero balance accounts that are funded at the point items clear against the account by drawings against a line of credit, therefore the outstanding checks represent bank overdrafts. Because the recipients of these checks have generally not yet received payment, the Company continues to classify bank overdrafts as accounts payable. Bank overdrafts are classified as changes in accounts payable in the cash flows from operating activities section of the Company's Consolidated Statement of Cash Flows. Bank overdrafts as of December 31, 2007 and 2006 were approximately $11,088,000 and $8,230,000, respectively.

Accounts Receivable Other–The components of accounts receivable other consist primarily of amounts held by a third-party qualified intermediary that the Company uses to effectuate deferral of income taxes on gains from sales of trucks and trailers under the Company's LKE tax program. Also included are amounts representing company driver advances, owner operator advances and equipment manufacturer warranties. Advances receivable from company drivers as of December 31, 2007 and 2006, were approximately $598,000 and $503,000, respectively.

Accounts Receivable Allowance–An allowance is provided for accounts receivable based on historical collection experience. Additionally, management considers any accounts individually known to exhibit characteristics indicating a collection problem.

Marketable Equity Securities–Marketable equity securities are classified by the Company as either available for sale or trading. Securities classified as available for sale are carried at market value with unrealized gains and losses recognized in accumulated other comprehensive income in the statements of stockholders' equity. Securities classified as trading are carried at market value with unrealized gains and losses recognized in the statements of income. Realized gains and losses are computed utilizing the specific identification method.

Impairment of Long-Lived Assets–The Company reviews its long-lived assets for impairment whenever events or changes in circumstances indicate that the carrying amount of a long-lived asset may not be recoverable. An impairment loss would be recognized if the carrying amount of the long-lived asset is not recoverable, and it exceeds its fair value. For long-lived assets classified as held and used, if the carrying value of the long-lived asset exceeds the sum of the future net cash flows, it is not recoverable. The Company does not separately identify assets by subsidiary, as trucks and trailers are routinely transferred from one division to another. As a result, none of the Company's long-lived assets have identifiable cash flows from use that are largely independent of the cash flows of other assets and liabilities. Thus, the asset group used to assess impairment would include all assets and liabilities of the Company.

Property and Equipment–Property and equipment is recorded at cost, less accumulated depreciation. For financial reporting purposes, the cost of such property is depreciated principally by the straight-line method. For tax reporting purposes, accelerated depreciation or applicable cost recovery methods are used. Depreciation is recognized over the estimated asset life, considering the estimated salvage value of the asset. Such salvage values are based on estimates using expected market values for used equipment and the estimated time of disposal which, in many cases include guaranteed residual values by the manufacturers. Gains and losses are reflected in the year of disposal. The following is a table reflecting estimated ranges of asset useful lives by major class of depreciable assets:

Asset Class	Estimated Asset Life
Service vehicles	3-5 years
Office furniture and equipment	3-7 years
Revenue equipment	3-10 years
Structure and improvements	5-30 years

Prepaid Tires–Tires purchased with revenue equipment are capitalized as a cost of the related equipment. Replacement tires are included in prepaid expenses and deposits and are amortized over a 24-month period. Amounts paid for the recapping of tires are expensed when incurred.

Advertising Expense–Advertising costs are expensed as incurred and totaled approximately $605,000, $550,000 and $350,000 for the years ended December 31, 2007, 2006, and 2005, respectively.

Repairs and Maintenance–Repairs and maintenance costs are expensed as incurred.

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Goodwill–The Company follows the provisions of Statement of Financial Accounting Standards No. 142, Goodwill and Other Intangible Assets, ("SFAS No. 142"), which requires the Company to assess acquired goodwill for impairment at least annually in the absence of an indicator of possible impairment, and immediately upon an indicator of possible impairment. The Company has selected December 31 for its annual impairment testing and determined as of December 31, 2007 there was no impairment.

Self Insurance Liability—A liability is recognized for known health, workers' compensation, cargo damage, property damage and auto liability damage. An estimate of the incurred but not reported claims for each type of liability is made based on historical claims made, estimated frequency of occurrence, and considering changing factors that contribute to the overall cost of insurance.

Income Taxes–The Company applies the provisions of Statement of Financial Accounting Standards No. 109, Accounting for Income Taxes ("SFAS No. 109"). Under this method, deferred tax liabilities and assets are determined based on the difference between the financial reporting basis and the tax reporting basis of assets and liabilities using enacted tax rates. In June 2006, the Financial Accounting Standards Board ("FASB") issued Interpretation 48, Accounting for Uncertainty in Income Taxes-an interpretation of FASB Statement No. 109 ("FIN 48"), which became effective for the Company on January 1, 2007. FIN 48 addressed the determination of how tax benefits claimed or expected to be claimed on a tax return should be recorded in the financial statements. Under FIN 48, the Company may recognize the tax benefit from an uncertain tax position only if it is more likely than not that the position will be sustained on examination by taxing authorities, based on the technical merits of the position. The application of income tax law to multi-jurisdictional operations such as those performed by the Company, are inherently complex. Laws and regulations in this area are voluminous and often ambiguous. As such, we may be required to make subjective assumptions and judgments regarding our income tax exposures. Interpretations of and guidance surrounding income tax laws and regulations may change over time which could cause changes in our assumptions and judgments that could materially affect amounts recognized in the consolidated financial statements.

Revenue Recognition–Revenue is recognized in full upon completion of delivery to the receiver's location. For freight in transit at the end of a reporting period, the Company recognizes revenue pro rata based on relative transit miles completed as a portion of the estimated total transit miles. Expenses are recognized as incurred.

Share-Based Compensation–The Company adopted Statement of Financial Accounting Standards No. 123(R), Share-Based Payments, effective January 1, 2006, utilizing the "modified prospective" method as described in the standard. Under the "modified prospective" method, compensation cost is recognized for all share-based payments granted after the effective date and for all unvested awards granted prior to the effective date. Prior to adoption, the Company accounted for share-based payments under the recognition and measurement principles of Accounting Principles Board Opinion No. 25, Accounting for Stock Issued to Employees, and related interpretations. The Company uses historical volatility when estimating the expected volatility of its share price. For additional information with respect to share-based compensation, see Note 12 to our consolidated financial statements.

Earnings Per Share–The Company computes and presents earnings per share ("EPS") in accordance with Statement of Financial Accounting Standards No. 128, Earnings per Share ("SFAS No. 128"). The difference between the Company's weighted-average shares outstanding and diluted shares outstanding is due to the dilutive effect of stock options for all periods presented. See Note 13 for computation of diluted EPS.

Business Segment and Concentrations of Credit Risk–The Company operates in one business segment, motor carrier operations. The Company provides truckload transportation services as well as brokerage and logistics services to customers throughout the United States and portions of Canada and Mexico. Truckload transportation services revenues, excluding fuel surcharges, represented 90.4%, 87.8%, and 88.0% of total revenues, excluding fuel surcharges, for the twelve months ended December 31, 2007, 2006, and 2005, respectively. Remaining revenues, excluding fuel surcharges, for each respective year were generated by brokerage and logistics services. The Company performs ongoing credit evaluations and generally does not require collateral from its customers. The Company maintains reserves for potential credit losses. In view of the concentration of the Company's revenues and accounts receivable among a limited number of customers within the automobile industry, the financial health of this industry is a factor in the Company's overall evaluation of accounts receivable.

Recent Accounting Pronouncements–In December 2007, the FASB issued Statement of Financial Accounting Standards No. 160, Noncontrolling Interests in Consolidated Financial Statements ("SFAS No. 160"). SFAS No. 160 re-characterizes minority interests in consolidated subsidiaries as non-controlling interests and requires the classification of minority interests as a component of equity. Under SFAS No. 160, a change in control will be measured at fair value, with any gain or loss recognized in earnings. The effective date for SFAS No. 160 is for annual periods beginning on or after December 15, 2008. Early adoption and retroactive application of SFAS No. 160 to fiscal years preceding the effective date are not permitted. Management does not expect the adoption of SFAS No. 160 to have a material impact on the Company's consolidated financial statements.

In December 2007, the FASB issued Statement of Financial Accounting Standards No. 141(R), Business Combinations ("SFAS No. 141(R)"). SFAS No. 141(R) expands the definition of transactions and events that qualify as business combinations; requires that the acquired assets and liabilities, including contingencies, be recorded at the fair value determined on the acquisition date and changes thereafter reflected in earnings, not goodwill; changes the recognition timing for restructuring costs; and requires acquisition costs to be expensed as incurred. Adoption of SFAS No. 141(R) is required for combinations occurring in fiscal years beginning after December 15, 2008. Early adoption and retroactive application of SFAS 141(R) to fiscal years preceding the effective date are not permitted. Beginning on January 1, 2009, adoption of SFAS No. 141(R) will impact our accounting for business combinations completed on or after that date.

In February 2007, the FASB issued Statement of Financial Accounting Standards No. 159, The Fair Value Option for Financial Assets and Financial Liabilities—Including an Amendment of FASB Statement No. 115 ("SFAS No. 159"). SFAS No. 159 permits an entity the option to measure many financial instruments and certain other items at fair value on specified election dates. Unrealized gains and losses on items for which the fair value option has been elected will be recognized in earnings at each subsequent reporting date. The fair value option: (a) may be applied instrument by instrument, with few exceptions, such as investments otherwise accounted for by the equity method; (b) is irrevocable (unless a new election date occurs); and (c) is applied only to entire instruments and not to portions of instruments. Most of the provisions in SFAS No. 159 are elective; however, the amendment to FASB Statement No. 115, Accounting for Certain Investments in Debt and Equity Securities, applies to all entities with available-for-sale and trading securities. SFAS No. 159 is effective as of the beginning of an entity's first fiscal year that begins after November 15, 2007. Early adoption is permitted as of the beginning of the previous fiscal year provided that the entity adopts SFAS No. 159 in the first 120 days of that fiscal year and also elects to apply the provisions of SFAS No. 157, Fair Value Measurements. The Company did not early-adopt SFAS No. 159 and management does not expect adoption of this statement to have a significant impact on the Company's consolidated financial statements.

In September 2006, the FASB issued Statement of Financial Accounting Standards No. 157, Fair Value Measurements ("SFAS No. 157"). SFAS No. 157 provides enhanced guidance for using fair value to measure assets and liabilities, establishes a common definition of fair value, provides a framework for measuring fair value under United States Generally Accepted Accounting Principles ("GAAP") and expands disclosure requirements about fair value measurements. SFAS No. 157 is effective for financial statements issued in fiscal years beginning after November 15, 2007, and interim periods within those fiscal years. On February 6, 2008, the FASB deferred the effective date of

SFAS No. 157 for one year for all non-financial assets and non-financial liabilities, except for those items that are recognized or disclosed at fair value in the financial statements on a recurring basis (at least annually). Management is currently evaluating the impact that adoption of SFAS No. 157 might have on the Company's consolidated financial statements.

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In June 2006, the FASB issued Interpretation No. 48, Accounting for Uncertainty in Income Taxes-an interpretation of FASB Statement No. 109 (“FIN 48”). FIN 48 clarifies the accounting for uncertainty in income taxes recognized in an enterprise’s financial statements in accordance with Statement of Financial Accounting Standards No. 109, Accounting for Income Taxes. FIN 48 prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. In addition, FIN 48 provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure, and transition and is effective for fiscal years beginning after December 15, 2006. Adoption of this statement did not have a material effect on the Company's consolidated financial statements.

2. TRADE ACCOUNTS RECEIVABLE

The Company's receivables result primarily from the sale of transportation and logistics services. The Company performs ongoing credit evaluations of its customers and generally does not require collateral for accounts receivable. Accounts receivable which consist of both billed and unbilled receivables are recorded at their invoiced amount and are presented net of an allowance for doubtful accounts. Accounts outstanding longer than contractual payment terms are considered past due and are reviewed individually for collectibility. Accounts receivable balances consist of the following components as of December 31, 2007 and 2006:

	2007	2006
	(in thousands)	
Billed	$ 53,439	$ 55,132
Unbilled	6,849	7,794
Allowance for doubtful accounts	(1,891)	(1,457)
Total accounts receivable—net	$ 58,397	$ 61,469

An analysis of changes in the allowance for doubtful accounts for the years ended December 31, 2007, 2006, and 2005 follows:

	2007	2006	2005
		(in thousands)	
Balance—beginning of year	$ 1,457	$ 2,030	$ 768
Provision for bad debts	607	354	1,490
Charge-offs	(361)	(960)	(228)
Recoveries	188	33	-
Balance—end of year	$ 1,891	$ 1,457	$ 2,030

3. MARKETABLE EQUITY SECURITIES

The Company accounts for its marketable securities in accordance with Statement of Financial Accounting Standards No. 115, Accounting for Certain Investments in Debt and Equity Securities (“SFAS No. 115”). SFAS No. 115 requires companies to classify their investments as either trading, available-for-sale or held-to-maturity. The Company’s investments in marketable securities are classified as either trading or available-for-sale and consist of equity securities. Management determines the appropriate classification of these securities at the time of purchase and re-evaluates such designation as of each balance sheet date. During 2007, the Company received proceeds of approximately $1,622,000 for the sale of marketable equity securities with a combined cost of approximately $550,000, resulting in a realized gain of approximately $1,071,000. During 2007, two securities were transferred from available-for-sale to trading. These securities were transferred because, historically, they have significantly underperformed in relation to their benchmarks. The resulting gain recognized was not material. During 2006, there were no reclassifications of marketable securities. Marketable equity securities classified as available-for-sale are carried at fair value, with the unrealized gains and losses, net of tax, included as a component of accumulated other comprehensive income in shareholders' equity. The cost of securities sold is based on the specific identification method. Interest and dividends on marketable securities are included in non-operating income. Realized gains and losses, and declines in value judged to be other-than-temporary on available-for-sale securities, if any, are included in the determination of net income as gains (losses) on the sale of securities.

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As of December 31, 2007, equity securities classified as available-for-sale and equity securities classified as trading had a cost basis of approximately $13,272,000 and $661,000, respectively and fair market values of approximately $16,608,000 and $661,000, respectively. For the year ended December 31, 2007, the Company had net unrealized losses in market value on securities classified as available-for-sale of approximately $1,221,000, net of deferred income taxes. These securities had gross unrealized gains of approximately $4,916,000 and gross unrealized losses of approximately $1,572,000. As of December 31, 2007, the total unrealized gain, net of deferred income taxes, in accumulated other comprehensive income was approximately $1,921,000.

As of December 31, 2006, the Company's equity securities were all classified as available-for-sale and had a combined cost basis of approximately $9,189,000 and a combined fair market value of approximately $14,437,000. For the year ended December 31, 2006, the Company had net unrealized gains in market value of approximately $1,402,000, net of deferred income taxes. These securities had gross unrealized gains of approximately $5,260,000 and gross unrealized losses of approximately $12,000. As of December 31, 2006, the total unrealized gain, net of deferred income taxes, in accumulated other comprehensive income was approximately $3,142,000.

The following table shows the Company's investments' approximate gross unrealized losses and fair value at December 31, 2007 and 2006. These investments consist of equity securities. As of December 31, 2007 and 2006 there were no investments that had been in a continuous unrealized loss position for twelve months or longer.

	2007		2006	
	(in thousands)			
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Equity securities – Available for sale	$ 5,308	$ 1,541	$ 417	$ 12
Equity securities – Trading	409	31	-	-
Totals	$ 5,717	$ 1,572	$ 417	$ 12

4. INTANGIBLE ASSETS

The Company applies the provisions of Statement of Financial Accounting Standards No. 142, Goodwill and Other Intangible Assets (“SFAS No. 142”), which requires the Company to assess acquired goodwill for impairment at least annually in the absence of an indicator of possible impairment, and immediately upon an indicator of possible impairment. The annual assessment of impairment was completed on December 31, 2007 and the Company determined there was no impairment as of that date. Goodwill at December 31 is summarized as follows:

	2007	2006 (in thousands)	2005
Goodwill, beginning of year	$ 15,413	$ 15,413	$ 15,413
Goodwill acquired	-	-	-
Goodwill impairment	-	-	-
Goodwill—end of year	$ 15,413	$ 15,413	$ 15,413

Non-compete agreements are amortized on a straight-line basis over the contractual term of the related agreement. Amortization expense associated with non-compete agreements was approximately $200,000, $200,000 and $237,000, for the years ending December 31, 2007, 2006 and 2005. The Company's non-compete agreements at December 31 are summarized as follows:

	2007 (in thousands)	2006
Non-compete agreements, original cost	$ 1,000	$ 1,000
Accumulated amortization	(983)	(783)
Non-compete agreements—net	$ 17	$ 217

Over the remaining life of the non-compete agreement currently held by the Company, approximately $17,000 of amortization expense will be recognized during 2008.

5. ACCRUED EXPENSES AND OTHER LIABILITIES

Accrued expenses and other liabilities at December 31 are summarized as follows:

	2007 (in thousands)	2006
Payroll	$ 1,818	$ 1,779
Accrued vacation	1,966	1,827
Taxes—other than income	2,598	2,591
Interest	123	80
Driver escrows	1,023	939
Self-insurance claims reserves	2,795	2,778
Total accrued expenses and other liabilities	$ 10,323	$ 9,994

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6. CLAIMS LIABILITIES

With respect to physical damage for trucks, cargo loss and auto liability, the Company maintains insurance coverage to protect it from certain business risks. These policies are with various carriers and have per occurrence deductibles of $2,500, $10,000 and $2,500 respectively. Since 2002, the Company has elected to self insure itself for physical damage to trailers. The Company maintains workers’ compensation coverage in Arkansas, Ohio, Oklahoma, Mississippi, and Florida with a $500,000 self-insured retention and a $500,000 per occurrence excess policy. The Company has elected to opt out of workers' compensation coverage in Texas and is providing coverage through the P.A.M. Texas Injury Plan. The Company has reserved for estimated losses to pay such claims as well as claims incurred but not yet reported. The Company has not experienced any adverse trends involving differences in claims experienced versus claims estimates for workers’ compensation claims. Letters of credit aggregating $400,000 and certificates of deposit totaling $200,000 are held by banks as security for workers’ compensation claims. The Company self insures for employee health claims with a stop loss of $200,000 per covered employee per year and estimates its liability for claims incurred but not reported.

7. LONG-TERM DEBT

Long-term debt at December 31, consists of the following:

	2007	2006
	(in thousands)	
Line of credit with a bank—due May 31, 2009, and collateralized by accounts receivable (1)	$ 28,192	$ 14,437
Line of credit with a bank—due June 30, 2008, and collateralized by revenue equipment (2)	15,000	5,000
Note payable (3)	1,767	2,510
Other (4)	1,124	1,173
Other (5)	154	-
Total long-term debt	$ 46,237	$ 23,120
Less current maturities	(2,065)	(1,915)
Long-term debt—net of current maturities	$ 44,172	$ 21,205

(1) Line of credit agreement with a bank provides for maximum borrowings of $30.0 million and contains certain restrictive covenants that must be maintained by the Company on a consolidated basis. Borrowings on the line of credit are at an interest rate of LIBOR as of the first day of the month plus 1.25% (6.48% at December 31, 2007). Monthly payments of interest are required under this agreement. Also, under the terms of the agreement the Company must have (a) a debt to equity ratio of no more than 2:1, and (b) maintain a tangible net worth of at least $125 million. The Company was in compliance with all provisions of the agreement at December 31, 2007.

(2) Line of credit agreement with a bank provides for maximum borrowings of $30.0 million and contains certain restrictive covenants that must be maintained by the Company on a consolidated basis. Borrowings on the line of credit are at an interest rate of LIBOR as of the last day of the previous month plus 1.15% (6.39% at December 31, 2007). Monthly payments of interest are required under this agreement. Also, under the terms of the agreement the Company must have (a) positive net income, (b) a funded debt to EBITDA ratio of less than 3:1, (c) a leverage ratio of less than 3:1, and (d) maintain a tangible net worth of at least $42 million increased by (1) 50% of cumulative quarterly net income and (2) proceeds of any public stock offering. The Company was in compliance with all provisions of the agreement at December 31, 2007. The Company has the intent and ability to extend the terms of this agreement for an additional one year period until June 30, 2009 and accordingly has

classified the debt as long-term.

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(3) 6.0% note to the former owner of an acquired entity with an original face amount of $4,974,612, payable in monthly installments of $72,672 through March 2010.

(4) 5.75% note to insurance premium finance company at December 31, 2007 with an original face amount of $1,912,934, payable in monthly installments of $163,636 through August 2008.

(5) 5.23% note to insurance premium finance company at December 31, 2007 with an original face amount of $154,023, payable in monthly installments of $19,547 through August 2008.

The Company has provided letters of credit to third parties totaling approximately $2,389,000 at December 31, 2007. The letters are held by these third parties to assist such parties in collection of any amounts due by the Company should the Company default in its commitments to the parties.

Scheduled annual maturities on long-term debt outstanding at December 31, 2007, are:

		(in thousands)
2008	$	2,065
2009		44,028
2010		144
2011		-
2012		-
Total	$	46,237

8. CAPITAL STOCK

The Company's authorized capital stock consists of 40,000,000 shares of common stock, par value $.01 per share, and 10,000,000 shares of preferred stock, par value $.01 per share. At December 31, 2007, there were 11,368,207 shares of our common stock issued and 9,838,107 shares outstanding. No shares of our preferred stock were issued or outstanding at December 31, 2007.

Common Stock

The holders of our common stock, subject to such rights as may be granted to any preferred stockholders, elect all directors and are entitled to one vote per share. All shares of common stock participate equally in dividends when and as declared by the Board of Directors and in net assets on liquidation. The shares of common stock have no preference, conversion, exchange, preemptive or cumulative voting rights.

Preferred Stock

Preferred stock may be issued from time to time by our Board of Directors, without stockholder approval, in such series and with such preferences, conversion or other rights, voting powers, restrictions, limitations as to dividends, qualifications or other provisions, as may be fixed by the Board of Directors in the resolution authorizing their issuance. The issuance of preferred stock by the Board of Directors could adversely affect the rights of holders of shares of common stock; for example, the issuance of preferred stock could result in a class of securities outstanding that would have certain preferences with respect to dividends and in liquidation over the common stock, and that could result in a dilution of the voting rights, net income per share and net book value of the common stock. As of December 31, 2007, we have no agreements or understandings for the issuance of any shares of preferred stock.

Treasury Stock

In April 2005 our Board of Directors authorized the repurchase of up to 600,000 shares of our common stock during the six month period ending October 11, 2005. These 600,000 shares were all repurchased by September 30, 2005. On September 6, 2005 our Board of Directors authorized an extension of the stock repurchase program until September 2006 and the repurchase of up to an additional 900,000 shares of our common stock. The Company repurchased 458,600 of these additional shares prior to December 31, 2005 and made no additional purchases during 2006.

In May 2007, our Board of Directors authorized the repurchase of up to 600,000 shares of our common stock during the twelve month period following the announcement. Subsequent to the date of the announcement and through the remainder of 2007, the Company repurchased 471,500 shares of its common stock.

The Company accounts for Treasury stock using the cost method and as of December 31, 2007, 1,530,100 shares were held in the treasury at an aggregate cost of approximately $25,200,000.

9. COMPREHENSIVE INCOME

Comprehensive income was comprised of net income plus or minus market value adjustments related to fuel hedges, interest rate swap agreements and marketable securities. The components of comprehensive income were as follows:

	2007	2006	2005
		(in thousands)	
Net income	$ 2,653	$ 17,964	$ 13,139
Other comprehensive income (loss):			
Reclassification adjustment for realized gains on marketable securities, included in net income, net of income taxes	(359)	-	-
Reclassification adjustment for losses on derivative instruments included in net income accounted for as hedges, net of income taxes	-	18	227
Reclassification adjustment for unrealized losses on marketable securities, included in net income, net of income taxes	55	53	91
Change in fair value of interest rate swap agreements, net of income taxes	-	1	55
Change in fair value of marketable securities, net of income taxes	(917)	1,349	197
Total comprehensive income	$ 1,432	$ 19,385	$ 13,709

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10. SIGNIFICANT CUSTOMERS AND INDUSTRY CONCENTRATION

In 2007, 2006, and 2005, one customer, who is in the automobile manufacturing industry, accounted for 38%, 41% and 39% of revenues, respectively. The Company also provides transportation services to other manufacturers who are suppliers for automobile manufacturers including suppliers for the Company's largest customer. As a result, concentration of the Company's business within the automobile industry is significant. Of the Company's revenues for 2007, 2006, and 2005, 49%, 52%, and 52%, respectively, were derived from transportation services provided to the automobile manufacturing industry. Accounts receivable from the largest customer totaled approximately $25,830,000 and $30,040,000 at December 31, 2007 and 2006, respectively.

11. FEDERAL AND STATE INCOME TAXES

Under SFAS No. 109, deferred income taxes reflect the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and for income tax reporting purposes.

Significant components of the Company's deferred tax liabilities and assets at December 31 are as follows:

	2007		2006	
	(in thousands)			
	Current	Long-Term	Current	Long-Term
Deferred tax liabilities:				
Property and equipment	$ -	$ 52,062	$ -	$ 49,731
Unrealized gains on securities	1,423	-	2,113	-
Prepaid expenses and other	5,650	3,428	5,665	2,920
Total deferred tax liabilities	7,073	55,490	7,778	52,651
Deferred tax assets:				
Allowance for doubtful accounts	718	-	553	-
Alternative minimum tax credit	-	481	-	-
Compensated absences	630	-	564	-
Self-insurance allowances	492	-	664	-
Share-based compensation	-	289	-	242
Bonus compensation	-	-	235	-
Net operating loss carryover	-	722	-	-
Non-competition agreement	-	494	-	507
Other	116	-	104	-
Total deferred tax assets	1,956	1,986	2,120	749
Net deferred tax liability	$ 5,117	$ 53,504	$ 5,658	$ 51,902

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The reconciliation between the effective income tax rate and the statutory Federal income tax rate for the years ended December 31, 2007, 2006 and 2005 is presented in the following table:

	2007		2006 (in thousands)		2005	
	Amount	Percent	Amount	Percent	Amount	Percent
Income tax at the statutory federal rate	$ 1,571	34.0	$ 10,513	35.0	$ 7,743	35.0
Nondeductible expense	381	8.3	378	1.3	450	2.0
State income taxes—net of federal benefit	14	0.3	1,182	3.9	790	3.6
Total income taxes	$ 1,966	42.6	$ 12,073	40.2	$ 8,983	40.6

The provision for income taxes consisted of the following:

	2007	2006 (in thousands)	2005
Current:			
Federal	$ 305	$ 8,397	$ 6,422
State	(88)	1,371	1,150
	217	9,768	7,572
Deferred:			
Federal	1,295	1,768	876
State	454	537	535
	1,749	2,305	1,411
Total income tax expense	$ 1,966	$ 12,073	$ 8,983

The Company has alternative minimum tax credits of approximately $480,000 at December 31, 2007, which have no expiration date under the current federal income tax laws. The Company also has a net operating loss carryover for federal income purposes of approximately $1.9 million which will expire after the year 2027.

The Company adopted the provisions of FASB Interpretation 48, “Accounting for Uncertainty in Income Taxes-an Interpretation of FASB Statement No. 109” (“FIN 48”), on January 1, 2007. Prior to adoption, the Company’s policy was to establish reserves that reflected the probable outcome of known tax contingencies. The effects of final resolution, if any, were recognized as changes to the effective income tax rate in the period of resolution. FIN 48 requires application of a more likely than not threshold to the recognition and derecognition of uncertain tax positions. FIN 48 permits the Company to recognize the amount of tax benefit that has a greater than 50% likelihood of being ultimately realized upon settlement. It further requires that a change in judgment related to the expected ultimate resolution of uncertain tax positions be recognized in earnings in the quarter of such change.

Upon adoption of FIN 48 on January 1, 2007, the Company recognized no adjustment in the liability for unrecognized income tax benefits and no corresponding change in retained earnings. The Company does not have any material accrued interest or penalties associated with any unrecognized tax benefits. The Company's policy is to account for interest and penalties related to uncertain tax positions, if any, in income tax expense. There was no change in total gross unrecognized tax benefit liabilities for the year ended December 31, 2007.

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The Company and its subsidiaries are subject to U.S. and Canadian federal income tax laws as well as the income tax laws of multiple state jurisdictions. The major tax jurisdictions in which the Company operates generally provide for a deficiency assessment statute of limitation period of three years and as a result, the Company's tax years 2004 through 2006 remain open to examination in those jurisdictions.

During 2007, the Company contracted with a third-party qualified intermediary in order to implement a like-kind exchange tax program. Under the program, dispositions of eligible trucks or trailers and acquisitions of replacement trucks or trailers are made in a form whereby any associated tax gains related to the disposal are deferred. To qualify for like-kind exchange treatment, we exchange, through our qualified intermediary, eligible trucks or trailers being disposed with trucks or trailers being acquired that allows us to generally carryover the tax basis of the trucks or trailers sold. The program is expected to result in a significant deferral of federal and state income taxes. Under the program, the proceeds from the sale of eligible trucks or trailers carry a Company-imposed restriction for the acquisition of replacement trucks or trailers. These proceeds may be disqualified under the program at any time and at the Company's sole discretion, however income tax deferral would not be available on any sale for which the Company disqualifies the related proceeds. At December 31, 2007, the Company had $4.1 million of restricted cash held by the third-party qualified intermediary. There were no cash restrictions for any periods prior to the program implementation occurring during 2007.

12. SHARE-BASED COMPENSATION

The Company maintains a stock option plan under which incentive stock options and nonqualified stock options may be granted. On March 2, 2006, the Company's Board of Director's adopted, and shareholders later approved, the 2006 Stock Option Plan (the "2006 Plan"). The 2006 Plan replaces the expired 1995 Stock Option Plan which had 263,500 options remaining which were never issued. Under the 2006 Plan 750,000 shares are reserved for the issuance of stock options to directors, officers, key employees and others. The option exercise price under the 2006 Plan is the fair market value of the stock on the date the option is granted. The fair market value is determined by the average of the highest and lowest sales prices for a share of the Company's common stock, on its primary exchange, on the same date that the option is granted. During 2007, options for 16,000 shares were issued under the 2006 Plan at an option exercise price of $22.92 per share and at December 31, 2007, 718,000 shares were available for granting future options.

Outstanding incentive stock options at December 31, 2007, must be exercised within six years from the date of grant and vest in increments of 20% each year. Outstanding nonqualified stock options at December 31, 2007, must be exercised within five to ten years from the date of grant.

In August 2002, the Company granted performance-based variable stock options for 300,000 shares to certain key executives. The exercise price for these awards was fixed at the grant date and was equal to the fair market value of the stock on that date. On the date of grant, options for 60,000 shares vested immediately and vesting of the options for the remaining 240,000 shares was scheduled to occur on a straight-line basis each year from March 15, 2003 through March 15, 2008 upon meeting performance criteria. In order to meet the performance criteria, net income for each fiscal year must be at least equal to 1.05 times net income for the preceding fiscal year, unless net income for the preceding fiscal year was zero or negative, in which case net income for the fiscal year must be at least 90% of net income for the most recent year with positive income. The number of shares for which options vest each fiscal year will not be known until the date the performance criteria is measured. As of December 31, 2007, options for 180,000 shares have vested under this 300,000 share option grant (including those options which immediately vested upon grant) while options for 120,000 shares have been forfeited as the performance criteria were not met for the fiscal years 2003, 2004 and 2007.

Transactions in stock options under these plans are summarized as follows:

	Shares Under Option	Weighted-Average Exercise Price
Outstanding—January 1, 2005:	313,500	$ 20.70
Granted	14,000	18.27
Exercised	(41,000)	9.21
Outstanding—December 31, 2005:	286,500	$ 22.22
Granted	16,000	26.73
Exercised	(18,000)	16.67
Outstanding—December 31, 2006:	284,500	$ 22.83
Granted	16,000	22.92
Exercised	(6,000)	19.95
Canceled	(46,000)	23.34
Outstanding—December 31, 2007:	248,500	$ 22.81
Options exercisable—December 31, 2007:	248,500	$ 22.81

Effective January 1, 2006, the Company adopted FASB Statement No. 123(R), Share-Based Payment, ("SFAS No. 123(R)") utilizing the "modified prospective" method as described in SFAS No. 123(R). In the "modified prospective" method, compensation cost is recognized for all share-based payments granted after the effective date and for all unvested awards granted prior to the effective date. In accordance with SFAS No. 123(R), prior period amounts were not restated. As of December 31, 2007 all option awards are classified as equity awards.

Prior to January 1, 2006, the stock-based compensation plans were accounted for based on the intrinsic value method under Accounting Principles Board Opinion No. 25, Accounting for Stock Issued to Employees, ("APB Opinion No. 25") and related interpretations. Pro-forma information regarding the impact of total stock-based compensation on net income and income per share for prior periods is required by SFAS No. 123(R). Such pro-forma information, determined as if the Company had accounted for its employee stock options under the fair value method during the year ending December 31, 2005 is illustrated in the following table:

	2005 (in thousands, except per share data)
Net income—as reported	$ 13,139
Deduct total stock-based employee compensation expense determined under fair value based method for all awards—net of related tax effects	(296)
Pro forma net income	$ 12,843
Earnings per share:	

Basic—as reported	$	1.20
Basic—pro forma	$	1.17
Diluted—as reported	$	1.20
Diluted—pro forma	$	1.17

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The fair value of the Company's employee stock options was estimated at the date of grant using a Black-Scholes-Merton ("BSM") option-pricing model using the following assumptions:

	2007	2006	2005
Dividend yield	0%	0%	0%
Volatility range	37.34%—38.54%	33.34%—38.54%	33.86%—38.54%
Risk-free rate range	4.38%—4.48%	4.38%—5.02%	4.08%—4.38%
Expected life	2.5 years—5 years	2.5 years—5 years	5 years
Fair value of options (per share)	$6.32—$9.45	$6.93—$9.45	$6.73—$9.45

The Company has never paid any cash dividends on its common stock and we do not anticipate paying any cash dividends in the foreseeable future. The estimated volatility is based on the historical volatility of our stock. The risk free rate for the periods within the expected life of the option is based on the U.S. Treasury yield curve in effect at the time of grant. The expected life of the options are calculated using temporary guidance provided by the Securities and Exchange Commission which allows companies to elect a "simplified method" where the expected life is the average of the vesting period and the original contractual term.

Information related to the Company's option activity as of December 31, 2007, and changes during the year then ended is presented below:

	Shares Under Option	Weighted-Average Exercise Price (per share)	Weighted-Average Remaining Contractual Term (in years)	Aggregate Intrinsic Value*
Outstanding at January 1, 2007	284,500	$ 22.83		
Granted	16,000	22.92		
Exercised	(6,000)	19.95		
Canceled/forfeited/expired	(46,000)	23.34		
Outstanding at December 31, 2007	248,500	$ 22.81	4.0	$ -
Fully vested and exercisable at December 31, 2007	248,500	$ 22.81	4.0	$ -

* The intrinsic value of a stock option is the amount by which the market value of the underlying stock exceeds the exercise price of the option. The per share market value of our common stock, as determined by the closing price on December 31, 2007, was $15.54.

The weighted-average grant-date fair value of options granted during the years 2007, 2006, and 2005 was $6.32, $6.93, and $6.73 per share, respectively. The total intrinsic value of options exercised during the years ended December 31, 2007, 2006, and 2005, was approximately $11,000, $175,000, and $323,000, respectively.

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A summary of the status of the Company’s nonvested options as of December 31, 2007 and changes during the year ended December 31, 2007, is presented below:

	Number of Options	Weighted-Average Grant Date Fair Value
Nonvested at January 1, 2007	82,500	$ 9.43
Granted	16,000	6.32
Vested	(58,500)	8.57
Canceled/forfeited/expired	(40,000)	9.45
Nonvested at December 31, 2007	-	$ -

The total fair value of options vested during 2007, 2006, and 2005 was approximately $501,000, $511,000, and $494,000, respectively. As of December 31, 2007, the Company had stock-based compensation plans with total unvested stock-based compensation expense of approximately $22,000 which is being amortized on a straight-line basis over the remaining vesting period of one year. As a result, the Company expects to recognize approximately $22,000 in additional compensation expense related to unvested option awards during 2008. Total pre-tax stock-based compensation expense, recognized in Salaries, wages and benefits was approximately $123,000 during 2007 and includes approximately $101,000 recognized as a result of the annual grant of 2,000 shares to each non-employee director during the first quarter of 2007. The Company recognized a total income tax benefit of approximately $43,000 related to stock-based compensation expense during 2007. The recognition of stock-based compensation expense decreased diluted and basic earnings per common share by approximately $0.01 during 2007. Total pre-tax stock-based compensation expense, recognized in Salaries, wages and benefits during 2006 was approximately $511,000 and includes approximately $111,000 recognized as a result of the annual grant of 2,000 shares to each non-employee director during the second quarter of 2006. The Company recognized a total income tax benefit of approximately $197,000 related to stock-based compensation expense during 2006. The recognition of stock-based compensation expense decreased diluted and basic earnings per common share by approximately $0.03 during 2006. No stock-based compensation expense or related tax benefits were recognized in 2005.

The number, weighted average exercise price and weighted average remaining contractual life of options outstanding as of December 31, 2007 and the number and weighted average exercise price of options exercisable as of December 31, 2007 is as follows:

Exercise Price	Shares Under Outstanding Options	Weighted-Average Remaining Contractual Term (in years)	Shares Under Exercisable Options
$16.99	8,000	1.2	8,000
$18.27	10,000	2.2	10,000
$19.88	12,500	0.7	12,500
$22.68	10,000	0.2	10,000
$22.92	14,000	4.2	14,000
$23.22	180,000	4.7	180,000
$26.73	14,000	3.5	14,000
	248,500	4.0	248,500

Cash received from option exercises totaled approximately $120,000, $300,000, and $378,000 during the years ended December 31, 2007, 2006, and 2005, respectively. The Company issues new shares upon option exercise.

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13. EARNINGS PER SHARE

The Company applies SFAS No. 128 for computing and presenting earnings per share. Basic earnings per common share were computed by dividing net income by the weighted average number of shares outstanding during the period. Diluted earnings per common share were calculated as follows:

	For the Year Ended December 31, 2007	2006	2005
	(in thousands, except per share data)		
Net income	$ 2,653	$ 17,964	$ 13,139
Basic weighted average common shares outstanding	10,238	10,296	10,966
Dilutive effect of common stock equivalents	1	6	10
Diluted weighted average common shares outstanding	10,239	10,302	10,976
Basic earnings per share	$ 0.26	$ 1.74	$ 1.20
Diluted earnings per share	$ 0.26	$ 1.74	$ 1.20

Options to purchase 234,456, 229,337, and 280,160 shares of common stock were outstanding as of December 31, 2007, 2006, and 2005, respectively, but were not included in the computation of diluted earnings per share because to do so would have an anti-dilutive effect.

14. BENEFIT PLAN

The Company sponsors a benefit plan for the benefit of all eligible employees. The plan qualifies under Section 401(k) of the Internal Revenue Code thereby allowing eligible employees to make tax-deductible contributions to the plan. The plan provides for employer matching contributions of 50% of each participant's voluntary contribution up to 3% of the participant's compensation and vests at the rate of 20% each year until fully vested after five years. Total employer matching contributions to the plan totaled approximately $340,000, $330,000 and $300,000 in 2007, 2006 and 2005, respectively.

15. COMMITMENTS AND CONTINGENCIES

The Company is not a party to any pending legal proceedings which management believes to be material to the financial position or results of operations of the Company. The Company maintains liability insurance against risks arising out of the normal course of its business.

The Company leases certain premises under noncancelable operating lease agreements. Future minimum annual lease payments under these leases are as follows:

2008	$ 519,817
2009	394,818
2010	367,000
2011	187,000
2012 and thereafter	272,000
Total	$ 1,740,635

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Total rental expense, net of amounts reimbursed for the years ended December 31, 2007, 2006 and 2005 was approximately $3,035,000, $2,369,000, and $1,760,000, respectively.

16. FAIR VALUE OF FINANCIAL INSTRUMENTS

Statement of Financial Accounting Standards No. 107, Disclosure About Fair Value of Financial Instruments, ("SFAS No. 107") requires disclosure of fair value information about financial instruments, whether or not recognized in the balance sheet, for which it is practicable to estimate that value. The estimated fair value amounts have been determined by the Company using available market information and appropriate valuation methodologies. However, considerable judgment is necessarily required to interpret market data to develop the estimates of fair value. Accordingly, the estimates presented herein are not necessarily indicative of the amounts the Company could realize in a current market exchange. The use of different market assumptions and/or estimation methodologies may have a material effect on the estimated fair value amounts.

The following methods and assumptions were used by the Company in estimating fair value disclosures for financial instruments:

For cash and cash equivalents, accounts receivable, and trade accounts payable, the carrying amount is a reasonable estimate of fair value as the assets are readily redeemable or short-term in nature and the liabilities are short-term in nature. Marketable equity securities are carried at their fair value.

For long-term debt other than the lines of credit, the fair values are estimated using discounted cash flow analyses, based on the Company's current incremental borrowing rates for similar types of borrowing arrangements. The carrying value of this other long-term debt at December 31, 2007 and 2006, respectively, is $3,046,000 and $3,683,000. The fair value of this other long-term debt is estimated to be $3,032,000 and $3,661,000 at December 31, 2007 and 2006, respectively.

The carrying amount for the lines of credit approximates fair value because the lines of credit interest rates are adjusted frequently.

17. DERIVATIVES AND HEDGING ACTIVITIES

Effective February 28, 2001, the Company entered into an interest rate swap agreement on a notional amount of $15,000,000. The pay fixed rate under the swap was 5.08%, while the receive floating rate was "1-month" LIBOR. This interest rate swap agreement terminated on March 2, 2006. Effective May 31, 2001, the Company entered into an interest rate swap agreement on a notional amount of $5,000,000. The pay fixed rate under the swap was 4.83%, while the receive floating rate was "1-month" LIBOR. This interest rate swap agreement terminated on June 2, 2006.

The Company had designated both of these interest rate swaps as cash flow hedges of its exposure to variability in future cash flows resulting from interest payments indexed to "1-month" LIBOR. During the term of the interest rate swap agreements changes in cash flows from the interest rate swaps offset changes in interest rate payments on the first $20,000,000 of the Company's revolving credit facility. The hedge locked the interest rate at 5.08% or 4.83% plus the pricing spread for the notional amounts of $15,000,000 and $5,000,000, respectively.

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These interest rate swap agreements met the specific hedge accounting criteria. The measurement of hedge effectiveness was based upon a comparison of the floating-rate leg of the swap and the hedged floating-rate cash flows on the underlying liability. The effective portion of the cumulative gain or loss was reported as a component of accumulated other comprehensive income in shareholders' equity and was reclassified into current earnings during 2006, the termination year for all swap agreements. The December 31, 2005 balance of the net after tax deferred hedging loss in accumulated other comprehensive income ("AOCI") related to these swap agreements was approximately $19,000 which was the amount reclassified into current earnings during 2006. The change in AOCI related to these swap agreements during the current year was approximately $19,000. Ineffectiveness related to these hedges was not significant.

In July 2001, the Company entered into an agreement to obtain price protection and reduce a portion of our exposure to fuel price fluctuations. Under this agreement, we were obligated to purchase minimum amounts of diesel fuel per month, with a price protection component, for the six month period ended February 28, 2002. The agreement also provided that if during the twelve-month period commencing January 2005, the average NY MX HO was below $.58 per gallon, we would have been obligated to pay the contract holder the difference between $.58 and the average NY MX HO price for such month, multiplied by 1,000,000 gallons. During the twelve-month period commencing January 2005, the average NY MX HO remained well above the $.58 per gallon threshold and as of December 31, 2005 the agreement expired without any further obligation of either party. For the twelve-month period ended December 31, 2005 an adjustment of $500,000 was made to reflect the decline in fair value of the agreement which had the effect of reducing operating supplies expense and other current liabilities each by $500,000 in the accompanying consolidated financial statements.

18. RELATED PARTY TRANSACTIONS

In the normal course of business, the Company provides and receives transportation, repair and other services for and from companies affiliated with a major stockholder, and recognized $1,861,773, $46,576, and $111,510 in operating revenue and $1,909,585, $1,558,371, and $1,616,534 in operating expenses in 2007, 2006, and 2005, respectively. In addition the Company purchased physical damage insurance through an unaffiliated insurance broker which was written by an insurance company affiliated with a major stockholder. Annual premiums were $1,927,964, $1,816,759 and $1,667,928 for 2007, 2006 and 2005, respectively.

Amounts owed to the Company by these affiliates were $1,183,266 and $1,315,844 at December 31, 2007 and 2006 respectively. Of the accounts receivable at December 31, 2007, $11,970 represents revenue resulting from maintenance performed in the Company's maintenance facilities and maintenance charges paid by the Company to third parties on behalf of their affiliate and charged back at the amount paid, $522,413 represents freight transportation and $648,883 represents a prepayment of physical damage insurance premiums. Amounts payable to affiliates at December 31, 2007 and 2006 were $198,416 and $223,420 respectively.

19. QUARTERLY RESULTS OF OPERATIONS (UNAUDITED)

The tables below present quarterly financial information for 2007 and 2006:

	2007 Three Months Ended			
	March 31	June 30	September 30	December 31
	(in thousands, except per share data)			
Operating revenues	$ 98,809	$ 106,700	$ 101,171	$ 102,162
Operating expenses	96,475	102,528	100,688	103,785
Operating income	2,334	4,172	483	(1,623)
Non-operating income	241	167	199	1,099
Interest expense	487	676	620	670
Income taxes	823	1,471	26	(354)
Net income	$ 1,265	$ 2,192	$ 36	$ (840)
Net income per common share:				
Basic	$ 0.12	$ 0.21	$ 0.00	$ (0.08)
Diluted	$ 0.12	$ 0.21	$ 0.00	$ (0.08)
Average common shares outstanding:				
Basic	10,305	10,306	10,265	10,077
Diluted	10,308	10,307	10,266	10,077

	2006 Three Months Ended			
	March 31	June 30	September 30	December 31
	(in thousands, except per share data)			
Operating revenues	$ 100,525	$ 103,365	$ 99,874	$ 96,505
Operating expenses	91,473	94,375	94,202	89,154
Operating income	9,052	8,990	5,672	7,351
Non-operating income	57	116	140	135
Interest expense	465	353	300	357
Income taxes	3,461	3,512	2,244	2,857
Net income	$ 5,183	$ 5,241	$ 3,268	$ 4,272
Net income per common share:				
Basic	$ 0.50	$ 0.51	$ 0.32	$ 0.41
Diluted	$ 0.50	$ 0.51	$ 0.32	$ 0.41
Average common shares outstanding:				

Basic	10,288	10,293	10,301	10,303
Diluted	10,288	10,301	10,309	10,308

Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure.

None.

Item 9A. Controls and Procedures.

Conclusion Regarding the Effectiveness of Disclosure Controls and Procedures

Under the supervision and with the participation of our management, including our principal executive officer and principal financial officer, we conducted an evaluation of our disclosure controls and procedures, as such term is defined under Rule 13a-15(e) promulgated under the Exchange Act, as amended. Based on this evaluation, our principal executive officer and our principal financial officer concluded that our disclosure controls and procedures are effective as of the end of the period covered by this Annual Report.

Management's Report on Internal Control Over Financial Reporting

Our management is responsible for establishing and maintaining adequate internal control over financial reporting, as such term is defined in Exchange Act Rules 13a-15(f). Under the supervision and with the participation of our management, including our principal executive officer and principal financial officer, we conducted an evaluation of the effectiveness of the Company's internal control over financial reporting based on the framework in Internal Control - Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission. Based on our evaluation under the framework in Internal Control - Integrated Framework, our management concluded that our internal control over financial reporting is effective as of December 31, 2007.

Our internal control over financial reporting as of December 31, 2007 has been audited by Grant Thornton LLP, an independent registered public accounting firm, who has issued an attestation report on the Company's internal control over financial reporting, as stated in their report which is included below.

Changes in Internal Control Over Financial Reporting

There were no changes in the Company's internal controls over financial reporting that occurred during the quarter ended December 31, 2007, that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

Board of Directors and Shareholders
P.A.M. Transportation Services, Inc. and Subsidiaries

We have audited P.A.M. Transportation Services, Inc. (a Delaware Corporation) and subsidiaries’ (collectively, the Company) internal control over financial reporting as of December 31, 2007, based on criteria established in Internal Control—Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). The Company’s management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Management’s Report on Internal Control Over Financial Reporting. Our responsibility is to express an opinion on the Company’s internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, testing and evaluating the design and operating effectiveness of internal control based on the assessed risk, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2007, based on criteria established in Internal Control—Integrated Framework issued by COSO.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets of P.A.M. Transportation Services, Inc. and subsidiaries as of December 31, 2007 and 2006, and the related consolidated statements of income, stockholders' equity and other comprehensive income, and cash flows for each of the three years in the period ended December 31, 2007, and our report dated March 12, 2008 expressed an unqualified opinion on those consolidated financial statements.

/s/ GRANT THORNTON LLP

Tulsa, Oklahoma
March 12, 2008

Item 9B. Other Information.

None.

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PART III

Portions of the information required by Part III of Form 10-K are, pursuant to General Instruction G (3) of Form 10-K, incorporated by reference from our definitive proxy statement to be filed pursuant to Regulation 14A for our Annual Meeting of Stockholders to be held on May 29, 2008. We will, within 120 days of the end of our fiscal year, file with the Securities and Exchange Commission a definitive proxy statement pursuant to Regulation 14A.

Item 10. Directors, Executive Officers and Corporate Governance.

Information concerning our executive officers is set forth in Item 1 of this Form 10-K under the caption “Executive Officers of the Registrant.”

The information presented under the captions “Election of Directors,” “Section 16(a) Beneficial Ownership Compliance,” “Corporate Governance - Code of Ethics” and “Corporate Governance–Audit Committee,” in the proxy statement is incorporated here by reference.

We have a separately designated standing audit committee established in accordance with Section 3(a)(58)(A) of the Securities Exchange Act of 1934. The members of the Audit Committee consist of Frank L. Conner, Christopher L. Ellis, and Charles F. Wilkins.

Item 11. Executive Compensation.

The information presented under the captions “Executive Compensation,” “Corporate Governance–Compensation Committee Interlocks and Insider Participation,” and “Compensation Committee Report” in the proxy statement is incorporated here by reference.

Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters.

The information presented under the caption “Security Ownership of Certain Beneficial Owners and Management” in the proxy statement is incorporated here by reference.

Equity Compensation Plan Information

The following table summarizes, as of December 31, 2007, information about compensation plans under which equity securities of the Company are authorized for issuance:

Plan Category	Number of securities to be issued upon exercise of outstanding options, warrants and rights	Weighted-average exercise price of outstanding options, warrants and rights	Number of securities remaining available for future issuance under equity compensation plans
Equity Compensation Plans approved by Security Holders	248,500	$ 22.81	718,000
Equity Compensation Plans not approved by Security Holders	-0-	-0-	-0-
Total	248,500	$ 22.81	718,000

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Item 13. Certain Relationships and Related Transactions, and Director Independence.

The information presented under the captions (i) "Transactions with Related Persons," including the information referenced there that is set forth under the caption "Corporate Governance – Compensation Committee Interlocks and Insider Participation" and (ii) "Corporate Governance – Director Independence" in the proxy statement is incorporated here by reference.

Item 14. Principal Accountant Fees and Services.

The information presented under the caption "Independent Public Accountants – Principal Accountant Fees and Services" in the proxy statement is incorporated here by reference.

PART IV

Item 15. Exhibits, Financial Statement Schedules.

(a) Financial Statements and Schedules.

(1) Financial Statements: See Part II, Item 8 hereof.

Report of Independent Registered Public Accounting Firm - Grant Thornton LLP
Consolidated Balance Sheets - December 31, 2007 and 2006
Consolidated Statements of Income - Years ended December 31, 2007, 2006 and 2005
Consolidated Statements of Shareholders' Equity and Other Comprehensive Income - Years ended December 31, 2007, 2006 and 2005
Consolidated Statements of Cash Flows - Years ended December 31, 2007, 2006 and 2005
Notes to Consolidated Financial Statements

(2) Financial Statement Schedules.

All schedules for which provision is made in the applicable accounting regulations of the SEC areomitted as the requiredinformation is inapplicable, or because the information is presented in the consolidated financial statements or related notes.

(3) Exhibits.

The following exhibits are filed with or incorporated by reference into this Report. The exhibits which are denominated by an asterisk (*) were previously filed as a part of, and are hereby incorporated by reference from either (i) the Form S-1 Registration Statement under the Securities Act of 1933, as filed with the Securities and Exchange Commission on July 30, 1986, Registration No. 33-7618, as amended on August 8, 1986, September 3, 1986 and September 10, 1986 ("1986 S-1"); (ii) the Quarterly Report on Form 10-Q for the quarter ended June 30, 1994 ("6/30/94 10-Q"); (iii) the Quarterly Report on Form 10-Q for the quarter ended June 30, 1995 ("6/30/95 10-Q"); (iv) the Quarterly Report on Form 10-Q for the quarter ended September 30, 1996 ("9/30/96 10-Q"); (v) the Form S-8 Registration Statement filed on June 11, 1999 ("6/11/99 S-8"); (vi) the Annual Report on Form 10-K for the year ended December 31, 2001 ("2001 10-K"); (vii) the Quarterly Report on Form 10-Q for the quarter ended March 31, 2002 ("3/31/02 10-Q"); (viii) the Quarterly Report on Form 10-Q for the quarter ended September 30, 2004 ("9/30/2004 10-Q"); (ix) Form 8-K filed on March 7, 2005 ("3/07/2005 8-K"); (x) Form 8-K filed on May 31, 2006 ("5/31/2006 8-K"); (xi) Form 8-K filed on July 28, 2006 ("7/28/2006 8-K"); (xii) the Form 8-K filed on December 11, 2007 ("12/11/2007 8-K"); or (xiii) the Quarterly Report on Form 10-Q for the quarter ended June 30, 2006 ("6/30/06 10-Q").

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Exhibit #	Description of Exhibit
*3.1	Amended and Restated Certificate of Incorporation of the Registrant (Exh. 3.1, 3/31/02 10-Q)
*3.2	Amended and Restated By-Laws of the Registrant (Exh. 3.2, 12/11/07 8-K)
*4.1	Specimen Stock Certificate (Exh. 4.1, 1986 S-1)
*4.2	Loan Agreement dated July 26, 1994 among First Tennessee Bank National Association, Registrant and P.A.M. Transport, Inc. together with Promissory Note (Exh. 4.1, 6/30/94 10-Q)
*4.2.1	Security Agreement dated July 26, 1994 between First Tennessee Bank National Association and P.A.M. Transport, Inc. (Exh. 4.2, 6/30/94 10-Q)
*4.3	First Amendment to Loan Agreement dated June 27, 1995 by and among P.A.M. Transport, Inc., First Tennessee Bank National Association and P.A.M. Transportation Services, Inc., together with Promissory Note in the principal amount of $2,500,000 (Exh. 4.1.1, 6/30/95 10-Q)
*4.3.1	First Amendment to Security Agreement dated June 28, 1995 by and between P.A.M. Transport, Inc. and First Tennessee Bank National Association (Exh. 4.2.2, 6/30/95 10-Q)
*4.3.2	Security Agreement dated June 27, 1995 by and between Choctaw Express, Inc. and First Tennessee Bank National Association (Exh. 4.1.3, 6/30/95 10-Q)
*4.3.3	Guaranty Agreement of P.A.M. Transportation Services, Inc. dated June 27, 1995 in favor of First Tennessee Bank National Association respecting $10,000,000 line of credit (Exh. 4.1.4, 6/30/95 10-Q)
*4.4	Second Amendment to Loan Agreement dated July 3, 1996 by P.A.M. Transport, Inc., First Tennessee Bank National Association and P.A.M. Transportation Services, Inc., together with Promissory Note in the principal amount of $5,000,000 (Exh. 4.1.1, 9/30/96 10-Q)
*4.4.1	Second Amendment to Security Agreement dated July 3, 1996 by and between P.A.M. Transport, Inc. and First Tennessee National Bank Association (Exh. 4.1.2, 9/30/96 10-Q)
*4.4.2	First Amendment to Security Agreement dated July 3, 1996 by and between Choctaw Express, Inc. and First Tennessee Bank National Association (Exh. 4.1.3, 9/30/96 10-Q)
*4.4.3	Security Agreement dated July 3, 1996 by and between Allen Freight Services, Inc. and First Tennessee Bank National Association (Exh. 4.1.4, 9/30/96 10-Q)

*4.5.1		Loan Agreement dated as of November 22, 2000 by and between P.A.M. Transport, Inc. and SunTrust Bank (Exh. 4.5.1, 2001 10-K)
*4.5.2		Revolving Credit Note dated November 22, 2000 (Exh. 4.5.2, 2001 10-K)
*4.5.3		Security Agreement by and between P.A.M. Transport, Inc. and SunTrust Bank (Exh. 4.5.3, 2001 10-K)
*4.5.4		First Amendment to Loan Agreement, Revolving Credit Note and Security Deposit (Exh. 4.5.4, 2001 10-K)
4.6		Fourth Amendment to Loan Agreement dated July 26, 1994 among First Tennessee Bank National Association, Registrant and P.A.M. Transport, Inc. together with Promissory Note
*10.1	(1)	Employment Agreement between the Registrant and Robert W. Weaver, dated July 10, 2006 (Exh. 10.1, 7/28/2006 8-K)
*10.2	(1)	Employment Agreement between the Registrant and W. Clif Lawson, dated June 1, 2006 (Exh. 10.2, 7/28/2006 8-K)
*10.3	(1)	Employment Agreement between the Registrant and Larry J. Goddard, dated June 1, 2006 (Exh. 10.3, 7/28/2006 8-K)
*10.4	(1)	1995 Stock Option Plan, as Amended and Restated (Exh. 4.1, 6/11/99 S-8)
*10.4.1	(1)	Amendment to 1995 Stock Option Plan (Exh. 10.1, 3/07/2005 8-K)

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*10.4.2	(1)	2006 Stock Option Plan (Exh. 10.1, 5/31/2006 8-K)
*10.5		Interest rate swap agreement, dated March 1, 2001 (Exh. 10.5, 2001 10-K)
*10.6		Interest rate swap agreement dated June 1, 2001 (Exh. 10.6, 2001 10-K)
*10.7	(1)	Employee Non-Qualified Stock Option Agreement (Exh. 10.1, 9/30/2004 10-Q)
*10.8	(1)	Director Non-Qualified Stock Option Agreement (Exh. 10.2, 9/30/2004 10-Q)
*10.8.1	(1)	Form of Non-Qualified Stock option Agreement for Non-Employee Director stock options that are granted under the 2006 Stock Option Plan (Exh. 10.2, 5/31/2006 8-K)
*10.9	(1)	Executive Incentive Plan (Exh. 10.2, 6/30/2006 10-Q)
10.10	(1)	Consulting Agreement between the Registrant and Manuel J. Moroun, dated December 6, 2007
21.1		Subsidiaries of the Registrant
23.1		Consent of Grant Thornton LLP
31.1		Rule 13a-14(a) Certification of Principal Executive Officer
31.2		Rule 13a-14(a) Certification of Principal Financial Officer
32.1		Section 1350 Certification of Chief Executive Officer
32.2		Section 1350 Certification of Chief Financial Officer

(1) Management contract or compensatory plan or arrangement.

SIGNATURES

Pursuant to the requirements of Section 13 of the Securities Exchange Act of 1934, the registrant has caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

P.A.M. TRANSPORTATION SERVICES, INC.

Dated: March 13, 2008 By:/s/ Robert W. Weaver

(1) Includes unpaid interest through the contractual maturity on both fixed and variable rate obligations. The interest included on variable rate obligations is based on interest rates in effect at December 31, 2016.
(2) Including interest accrued and upaid through December 31, 2016.
(3) Due to the uncertainty of future interest rates on borrowings under Pinnacle Financial's junior subordinated debentures issued in connection with trust preferred securities sold by affiliated trusts future interest payments on such obligations are not included in the above table. At December 31, 2016, Pinnacle Financial had junior subordinated debentures of approximately $82.5 million outstanding. During the year ended December 31, 2016, the interest rate on the junior subordinated debentures issued in connection with trust preferred securities issued in 2003, 2005, 2006 and 2007, respectively, ranged from 3.33% to 3.79%, 2.00% to 2.40%, 2.26% to 2.65%, 3.36% to 3.81% , respectively. During the year ended December 31, 2016, Pinnacle Financial incurred interest expense of $365,000, $435,000, $488,000 and $1.1 million, respectively, on its junior subordinated debentures issued in 2003, 2005, 2006 and 2007, respectively. See Note 11 "Investments in Affiliated Companies and Subordinated Debt" to Pinnacle Financial's consolidated financial statements for further information.
(4) Represents interest and principal payments at maturity on Pinnacle Financial's $140.0 million in aggregate principal amount of subordinated notes (including $20.0 million of subordinated notes assumed in connection with Pinnacle Financial's acquisition of Avenue) and Pinnacle Bank's $130.0 million in aggregate principal amount of subordinated notes. $120.0 million of Pinnacle Financial's subordinated notes bear interest at a fixed rate of 5.25% per annum through November 2021, while the $20.0 million of subordinated notes assumed in connection with the Avenue transaction, bear interest at a fixed rate of 6.75% per annun until June 2020. Pinnacle Bank's subordinated notes bear interest at a fixed rate of 4.875% per annum through July 2020. The amounts representing interest payments on the subordinated notes issued by both Pinnacle Financial and Pinnacle Bank for periods after the interest rates are no longer fixed were calculated using the current rates that would be applicable if the floating rate called for by the notes was currently in effect. See Note 11 "Investments in Affiliated Companies and Subordinated Debt" to Pinnacle's consolidated financial statements for further information.

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. Our operating lease commitments are primarily related to our branch and headquarters facilities. The terms of these leases expire at various points ranging from 2017 through 2039. At December 31, 2016, our total minimum operating lease commitment was $76.4 million.

Off-Balance Sheet Arrangements. At December 31, 2016, we had outstanding standby letters of credit of $131.4 million and unfunded loan commitments outstanding of $3.374 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 securities available-for-sale, or on a short-term basis to borrow and purchase Federal funds from other financial institutions. The following table presents additional information about our unfunded commitments as of December 31, 2016, which by their terms, have contractual maturity dates subsequent to December 31, 2016 (in thousands):

	At December 31, 2016				
	Next 12 months	13-36 months	37-60 months	More than 60 months	Totals
Unfunded commitments:					
Lines of credit	$1,062,312	$1,080,003	$539,416	$692,539	$3,374,270
Letters of credit	117,061	12,151	250	1,956	131,418
Totals	$1,179,373	$1,092,154	$539,666	$694,495	$3,505,688

We follow the same credit policies and underwriting practices when making these commitments as we do 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. However, should the commitments be drawn upon and should our customers default on their resulting obligation to us, our maximum exposure to credit loss, without consideration of collateral, is represented by the contractual amount of those instruments. At December 31, 2016, we had accrued $1.1 million for the inherent risks associated with off balance sheet commitments.

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Impact of Inflation

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

Recently Issued Accounting Pronouncements

In February 2016, the FASB issued Accounting Standards Update 2016-02 Leases guidance requiring the recognition in the statement of financial position of lease assets and lease liabilities by lessees for those leases classified as operating leases under previous GAAP. The guidance requires that a lessee should recognize lease assets and lease liabilities as compared to previous GAAP that did not require lease assets and lease liabilities to be recognized for most leases. The guidance becomes effective for us on January 1, 2019. Pinnacle Financial is currently evaluating the impact on its consolidated financial statements.

In March 2016, the FASB issued updated guidance to Accounting Standards Update 2016-09 Stock Compensation Improvements to Employee Share-Based Payment Activity intended to simplify and improve several aspects of the accounting for share-based payment transactions, including the income tax consequences, classification of such awards as either equity or liabilities and classification on the statement of cash flows. This ASU is expected to impact Pinnacle Financial's consolidated financial statements by requiring that all income tax effects related to settlements of share-based payment awards be reported as increases (or decreases) to income tax expense. Previously, income tax benefits at settlement of an award were reported as an increase (or decrease) to additional paid-in capital. The ASU also requires that all income tax related cash flows resulting from share-based payments be reported as operating activities in the statement of cash flows whereas cash flows were previously reported as a reduction to operating cash flows and an increase to financing cash flows. The guidance became effective for us on January 1, 2017.

In June 2016, the FASB issued ASU 2016-13, Financial Instruments - Credit Losses: Measurement of Credit Losses on Financial Instruments (the ASU), which introduces the current expected credit losses methodology. Among other things, the ASU requires the measurement of all expected credit losses for financial assets, including loans and available-for-sale debt securities, held at the reporting date based on historical experience, current conditions, and reasonable and supportable forecasts that affect the collectability of the reported amount. The new model will require institutions to calculate all probable and estimable losses that are expected to be incurred through the loan's entire life. ASU 2016-13 also requires the allowance for credit losses for purchased financial assets with credit deterioration since origination to be determined in a manner similar to that of other financial assets measured at amortized cost; however, the initial allowance will be added to the purchase price rather than recorded as credit loss expense. The disclosure of credit quality indicators related to the amortized cost of financing receivables will be further disaggregated by year of origination (or vintage). Institutions are to apply the changes through a cumulative-effect adjustment to their retained earnings as of the beginning of the first reporting period in which the standard is effective. The amendments are effective for fiscal years beginning after December 15, 2020. Early application will be permitted for fiscal years beginning after December 15, 2018. Pinnacle Financial is currently assessing the impact of the new guidance on its consolidated financial statements.

In August 2016, the FASB issued Accounting Standards Update 2016-15 Statement of Cash Flows (Topic 230) intended to reduce the diversity in practice around how certain transactions are classified within the statement of cash flows. The guidance is effective for public companies for annual periods beginning after December 15, 2017, including interim periods within those fiscal years. Early adoption is permitted with retrospective application. Pinnacle Financial is currently evaluating the impact of the new guidance on its consolidated financial statements.

In May 2014, the FASB issued Accounting Standards Update 2014-09 Revenue from Contracts with Customers (Topic 606) developed as a joint project with the International Accounting Standards Board to remove inconsistencies in revenue requirements and provide a more robust framework for addressing revenue issues. The ASU's core principle is that an entity should recognize revenue when it transfers promised goods or services to customers in an amount that reflects the consideration to which an entity expects to be entitled in exchange for those goods or services. In August 2015, the FASB issued Accounting Standards Update 2015-14, which deferred the effective date by one year (i.e., interim and annual reporting periods beginning after December 15, 2017). Early adoption is permitted, but not before the original effective date (i.e., interim and annual reporting periods beginning after December 15, 2016). The ASU may be adopted using either a modified retrospective method or a full retrospective method. Pinnacle Financial intends to adopt the ASU during the first quarter of 2018, as required, using a modified retrospective approach. Pinnacle Financial's preliminary analysis suggests that the adoption of this accounting guidance is not expected to have a material impact on the Company's consolidated financial statements as the majority of its revenue stream is generated from financial instruments which are not within the scope of this ASU. However, Pinnacle Financial is still evaluating the impact for other fee-based income. The FASB continues to release new accounting guidance related to the adoption of this ASU and the results of Pinnacle Financial's materiality analysis may change based on conclusions reached as to the application of this new guidance.

Other than those pronouncements discussed above and those which have been recently adopted, there were no other recently issued accounting pronouncements that are expected to materially impact Pinnacle Financial.

ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

The response to this Item is included in Item 7. "Management's Discussion and Analysis of Financial Condition and Results of Operations", on pages 40 through 71 and is incorporated herein by reference.

ITEM 8. FINANCIAL STATEMENTS

Pinnacle Financial Partners, Inc. and Subsidiaries

Consolidated Financial Statements

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MANAGEMENT REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING

The management of Pinnacle Financial Partners, Inc. (the "Company") is responsible for establishing and maintaining adequate internal control over financial reporting. The Company's internal control system was designed to provide reasonable assurance to the Company's management and board of directors regarding the preparation and fair presentation of published financial statements. All internal control systems, no matter how well designed, have inherent limitations. Therefore, even those systems determined to be effective can provide only reasonable assurance with respect to financial statement preparation and presentation.

The Company's management assessed the effectiveness of the Company's internal control over financial reporting as of December 31, 2016. In making this assessment, it used the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) in Internal Control-Integrated Framework (2013).

Based on our assessment we believe that, as of December 31, 2016, the Company's internal control over financial reporting is effective based on those criteria.

The Company's independent registered public accounting firm has issued an audit report on the Company's internal control over financial reporting. This report appears on page 77 of this Annual Report on Form 10-K.

Report of Independent Registered Public Accounting Firm

The Board of Directors and Stockholders
Pinnacle Financial Partners, Inc.
Nashville, Tennessee

We have audited the accompanying consolidated balance sheet of Pinnacle Financial Partners, Inc. and subsidiaries (the Company) as of December 31, 2016, and the related consolidated statements of income, comprehensive income, stockholders' equity, and cash flows for the year ended December 31, 2016. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Pinnacle Financial Partners, Inc. and subsidiaries as of December 31, 2016, and the results of their operations and their cash flows for the year ended December 31, 2016, in conformity with accounting principles generally accepted in the United States of America.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the Company's internal control over financial reporting as of December 31, 2016, based on criteria established in the 2013 Internal Control - Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated February 27, 2017 expressed an unqualified opinion thereon.

/s/ Crowe Horwath LLP

Franklin, Tennessee
February 27, 2017

Report of Independent Registered Public Accounting Firm

The Board of Directors and Stockholders
Pinnacle Financial Partners, Inc.:

We have audited the accompanying consolidated balance sheet of Pinnacle Financial Partners, Inc. and subsidiaries (the Company) as of December 31, 2015, and the related consolidated statements of income, comprehensive income, stockholders' equity, and cash flows for each of the years in the two year period ended December 31, 2015. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Pinnacle Financial Partners, Inc. and subsidiaries as of December 31, 2015, and the results of their operations and their cash flows for each of the years in the two year period ended December 31, 2015, in conformity with U.S. generally accepted accounting principles.

/s/ KPMG LLP
Nashville, Tennessee
February 29, 2016

Report of Independent Registered Public Accounting Firm

The Board of Directors and Stockholders
Pinnacle Financial Partners, Inc.:
We have audited Pinnacle Financial Partners, Inc.'s (the Company's) internal control over financial reporting as of December 31, 2016, based on criteria established in the 2013 Internal Control – Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO)". The Company's management is responsible for maintaining effective internal control over financial reporting, and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Management Report on Internal Control Over Financial Reporting. Our responsibility is to express an opinion on the Company's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2016, based on criteria established in the 2013 Internal Control – Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission.
We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheet of Pinnacle Financial Partners, Inc. and subsidiaries as of December 31, 2016 and the related consolidated statements of income, comprehensive income, stockholders' equity, and cash flows for the year ended December 31, 2016, and our report dated February 27, 2017 expressed and unqualified opinion on those consolidated financial statements.

/s/ Crowe Horwath LLP

Franklin, Tennessee
February 27, 2017
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PINNACLE FINANCIAL PARTNERS, INC. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS

	December 31,	
ASSETS	2016	2015
Cash and noninterest-bearing due from banks	$84,732,291	$75,078,807
Interest-bearing due from banks	97,529,713	219,202,464
Federal funds sold and other	1,383,416	26,670,062
Cash and cash equivalents	183,645,420	320,951,333
Securities available-for-sale, at fair value	1,298,546,056	935,064,745
Securities held-to-maturity (fair value of $25,233,254 and $31,585,303 at December 31, 2016 and December 31, 2015, respectively)	25,251,316	31,376,840
Mortgage loans held-for-sale	47,710,120	47,930,253
Commercial loans held-for-sale	22,587,971	-
Loans	8,449,924,736	6,543,235,381
Less allowance for loan losses	(58,980,475)	(65,432,354)
Loans, net	8,390,944,261	6,477,803,027
Premises and equipment, net	88,904,145	77,923,607
Equity method investment	205,359,844	88,880,014
Accrued interest receivable	28,234,826	21,574,096
Goodwill	551,593,796	432,232,255
Core deposits and other intangible assets	15,104,038	10,540,497
Other real estate owned	6,089,804	5,083,218
Other assets	330,651,002	265,183,799
Total assets	$11,194,622,599	$8,714,543,684
Deposits:		
Non-interest-bearing	$2,399,191,152	$1,889,865,113
Interest-bearing	1,808,331,784	1,389,548,175
Savings and money market accounts	3,714,930,351	3,001,950,725
Time	836,853,761	690,049,795
Total deposits	8,759,307,048	6,971,413,808
Securities sold under agreements to repurchase	85,706,558	79,084,298
Federal Home Loan Bank advances	406,304,187	300,305,226
Subordinated debt and other borrowings	350,768,050	141,605,504
Accrued interest payable	5,573,377	2,593,209
Other liabilities	90,267,267	63,930,339
Total liabilities	9,697,926,487	7,558,932,384
Stockholders' equity:		
Preferred stock, no par value; 10,000,000 shares authorized; no shares issued and outstanding	-	-
Common stock, par value $1.00; 90,000,000 shares authorized; 46,359,377 and 40,906,064 issued and outstanding at December 31, 2016 and 2015	46,359,377	40,906,064
Common stock warrants	-	-

Additional paid-in capital	1,083,490,728	839,617,050
Retained earnings	381,072,505	278,573,408
Accumulated other comprehensive loss, net of taxes	(14,226,498)	(3,485,222)
Total stockholders' equity	1,496,696,112	1,155,611,300
Total liabilities and stockholders' equity	$11,194,622,599	$8,714,543,684

See accompanying notes to consolidated financial statements.

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

	For the years ended December 31,		
	2016	2015	2014
Interest income:			
Loans, including fees	$335,734,531	$232,847,334	$184,648,800
Securities:			
Taxable	19,179,012	15,060,392	14,227,172
Tax-exempt	6,014,037	5,783,443	6,167,264
Federal funds sold and other	2,681,348	1,478,711	1,126,726
Total interest income	363,608,928	255,169,880	206,169,962
Interest expense:			
Deposits	23,917,318	13,209,425	9,953,930
Securities sold under agreements to repurchase	185,305	138,347	140,623
Federal Home Loan Bank advances and other borrowings	14,512,024	5,189,193	3,090,860
Total interest expense	38,614,647	18,536,965	13,185,413
Net interest income	324,994,281	236,632,915	192,984,549
Provision for loan losses	18,328,058	9,188,497	3,634,660
Net interest income after provision for loan losses	306,666,223	227,444,418	189,349,889
Noninterest income:			
Service charges on deposit accounts	14,500,679	12,745,742	11,707,274
Investment services	10,757,348	9,971,313	9,382,670
Insurance sales commissions	5,309,494	4,824,007	4,612,583
Gains on mortgage loans sold, net	15,754,473	7,668,960	5,630,371
Investment gains on sales and impairments, net	395,186	552,063	29,221
Trust fees	6,328,021	5,461,257	4,601,036
Income from equity method investment	31,402,923	20,591,484	-
Other noninterest income	36,554,938	24,715,442	16,639,323
Total noninterest income	121,003,062	86,530,268	52,602,478
Noninterest expense:			
Salaries and employee benefits	140,818,772	105,928,914	88,319,567
Equipment and occupancy	35,071,654	27,241,477	24,087,335
Other real estate expense (benefit), net	395,561	(305,956)	664,289
Marketing and other business development	6,536,484	4,863,307	4,127,949
Postage and supplies	3,929,323	3,228,300	2,391,838
Amortization of intangibles	4,281,459	1,973,953	947,678
Merger related expenses	11,746,584	4,797,018	-
Other noninterest expense	33,505,586	23,149,743	15,761,027
Total noninterest expense	236,285,423	170,876,756	136,299,683
Income before income taxes	191,383,862	143,097,930	105,652,684
Income tax expense	64,159,167	47,588,528	35,181,517
Net income	$127,224,695	$95,509,402	$70,471,167
Per share information:			
Basic net income per common share	$2.96	$2.58	$2.03
Diluted net income per common share	$2.91	$2.52	$2.01

Weighted average common shares outstanding:			
Basic	43,037,083	37,015,468	34,723,335
Diluted	43,731,992	37,973,788	35,126,890

See accompanying notes to consolidated financial statements.

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

	Year Ended December 31,		
	2016	2015	2014
Net income:	$127,224,695	$95,509,402	$70,471,167
Other comprehensive income (loss), net of tax:			
Changes in fair value on available-for-sale securities, net of tax	(9,700,933)	(5,582,965)	11,900,309
Changes in fair value of cash flow hedges, net of tax	(800,188)	(1,725,136)	(3,699,569)
Net gain on sale of investment securities reclassified from other comprehensive income into net income, net of tax	(240,155)	(335,489)	(17,758)
Total other comprehensive income (loss), net of tax	(10,741,276)	(7,643,590)	8,182,982
Total comprehensive income	$116,483,419	$87,865,812	$78,654,149

See accompanying notes to consolidated financial statements.
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PINNACLE FINANCIAL PARTNERS, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY

For the each of the years in the three-year period ended December 31, 2016

	Common Stock					
	Shares	Amount	Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total Stockholders' Equity
December 31, 2013	35,221,941	$35,221,941	$ 550,212,135	$ 142,298,199	$ (4,024,614)	$723,707,661
Exercise of employee common stock options, stock appreciation rights and related tax benefits	302,403	302,403	8,444,894	-	-	8,747,297
Issuance of restricted common shares, net of forfeitures	277,187	277,187	(277,187)	-	-	-
Restricted shares withheld for taxes	(69,048)	(69,048)	(2,256,560)	-	-	(2,325,608)
Compensation expense for restricted shares	-	-	5,308,167	-	-	5,308,167
Common dividends paid	-	-	-	(11,398,285)	-	(11,398,285)
Net income	-	-	-	70,471,167	-	70,471,167
Other comprehensive income	-	-	-	-	8,182,982	8,182,982
December 31, 2014	35,732,483	$35,732,483	$ 561,431,449	$ 201,371,081	$ 4,158,368	$802,693,381
Exercise of employee common stock options, stock appreciation rights and related tax benefits	304,313	304,313	7,187,629	-	-	7,491,942
Issuance of restricted common shares, net of forfeitures	257,218	257,218	(257,218)	-	-	-
Common stock issued in conjunction with CapitalMark acquisition, net of issuance costs	3,306,184	3,306,184	202,648,875	-	-	205,955,059
Common stock issued in conjunction with Magna acquisition, net of issuance costs	1,371,717	1,371,717	62,166,214	-	-	63,537,931
	(65,851)	(65,851)	(901,502)	-	-	(967,353)

Restricted shares withheld for taxes						
Compensation expense for restricted shares	-	-	7,341,603	-	-	7,341,603
Common dividends paid	-	-	-	(18,307,075)	-	(18,307,075)
Net income	-	-	-	95,509,402	-	95,509,402
Other comprehensive loss	-	-	-	-	(7,643,590)	(7,643,590)
December 31, 2015	40,906,064	$40,906,064	$ 839,617,050	$ 278,573,408	$ (3,485,222)	$1,155,611,300
Exercise of employee common stock options, stock appreciation rights and related tax benefits	699,810	699,810	16,736,365	-	-	17,436,175
Issuance of restricted common shares, net of forfeitures	200,098	200,098	(200,098)	-	-	-
Common stock issued in conjunction with BHG, net of issuance costs	860,470	860,470	38,833,566	-	-	39,694,036
Common stock issued in conjunction with Avenue, net of acquisition costs	3,760,326	3,760,326	178,708,278	-	-	182,468,604
Restricted shares withheld for taxes	(67,391)	(67,391)	(1,175,282)	-	-	(1,242,673)
Compensation expense for restricted shares	-	-	10,970,849	-	-	10,970,849
Common dividends paid	-	-	-	(24,725,598)	-	(24,725,598)
Net income	-	-	-	127,224,695	-	127,224,695
Other comprehensive loss	-	-	-	-	(10,741,276)	(10,741,276)
December 31, 2016	46,359,377	$46,359,377	$ 1,083,490,728	$ 381,072,505	$ (14,226,498)	$1,496,696,112

See accompanying notes to consolidated financial statements.

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

	For the years ended December 31,		
	2016	2015	2014
Operating activities:			
Net income	$127,224,695	$95,509,402	$70,471,167
Adjustments to reconcile net income to net cash provided by operating activities:			
Net amortization/accretion of premium/discount on securities	8,630,048	5,231,583	4,526,497
Depreciation and amortization	16,995,490	10,268,576	9,282,197
Provision for loan losses	18,328,058	9,188,497	3,634,660
Investment gains on sales and impairments, net	(395,186)	(552,063)	(29,221)
Gain on mortgage loans sold, net	(15,754,473)	(7,668,960)	(5,630,371)
Stock-based compensation expense	10,970,849	7,341,603	5,308,167
Deferred tax expense	14,390,035	5,819,463	394,452
Losses (gains) on disposition of other real estate and other investments	140,992	(433,911)	(74,807)
Gains from equity method investment	(31,402,923)	(20,591,484)	-
Excess tax benefit from stock compensation	(4,604,007)	(4,116,120)	(1,698,521)
Gains on other loans sold, net	(885,320)	-	-
Other loans held for sale:			
Loans originated	(112,669,589)	-	-
Loans sold	90,966,938	-	-
Mortgage loans held for sale:			
Loans originated	(784,213,817)	(524,679,767)	(331,135,205)
Loans sold	803,498,453	519,134,000	335,577,000
Decrease (increase) in other assets	(17,411,223)	(2,359,490)	4,014,267
(Decrease) increase in other liabilities	2,829,656	(7,487,499)	417,873
Net cash provided by operating activities	126,638,676	84,603,830	95,058,155
Investing activities:			
Activities in securities available-for-sale:			
Purchases	(583,330,035)	(342,192,699)	(149,051,923)
Sales	72,829,440	189,029,458	2,360,478
Maturities, prepayments and calls	280,805,769	146,441,236	123,949,792
Activities in securities held-to-maturity:			
Purchases	(560,000)	(1,550,995)	(923,652)
Sales	-	-	-
Maturities, prepayments and calls	6,200,000	8,185,000	1,229,874
Increase in loans, net	(966,207,993)	(668,297,036)	(455,357,214)
Purchases of premises and equipment and software	(17,058,292)	(10,870,851)	(5,878,562)
Proceeds from sales of software, premises, and equipment	2,187,381	782,482	-
Proceeds from sale of mortgage servicing rights	6,747,626	-	-
Acquisitions, net of cash acquired	17,608,471	5,876,592	-
Increase in equity method investment	(74,100,000)	(75,440,530)	-
Dividends received from equity method investment	28,982,009	7,152,000	-
Increase in other investments	(27,508,882)	(1,712,685)	(4,208,447)
Net cash used in investing activities	(1,253,404,506)	(742,598,028)	(487,879,654)

Financing activities:			
Net increase in deposits	822,306,826	783,352,902	249,132,187
Net increase (decrease) in repurchase agreements	6,622,260	(32,784,245)	23,529,404
Advances from Federal Home Loan Bank:			
Issuances	1,934,000,000	1,135,000,000	790,000,000
Payments	(1,934,093,153)	(1,092,781,984)	(685,093,244)
Proceeds from subordinated debt and other borrowings, net of issuance costs	243,226,783	59,129,504	-
Repayment of other borrowings	(74,000,302)	(50,290,006)	(2,500,000)
Principal payments of capital lease obligation	(70,401)	-	-
Exercise of common stock options and stock appreciation rights, net of shares surrendered for taxes	11,589,495	3,602,805	6,421,689
Excess tax benefit from stock compensation	4,604,007	4,116,120	1,698,521
Common dividends paid	(24,725,598)	(18,307,075)	(11,398,285)
Net cash provided by financing activities	989,459,917	791,038,021	371,790,272
Net increase (decrease) in cash and cash equivalents	(137,305,913)	133,043,823	(21,031,227)
Cash and cash equivalents, beginning of year	320,951,333	187,907,510	208,938,737
Cash and cash equivalents, end of year	$183,645,420	$320,951,333	$187,907,510

See accompanying notes to consolidated financial statements.

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

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). Pinnacle Bank is a commercial bank headquartered in Nashville, Tennessee. Pinnacle Financial completed its acquisitions of CapitalMark Bank & Trust (CapitalMark), Magna Bank (Magna) and Avenue Financial Holdings, Inc. (Avenue) on July 31, 2015, September 1, 2015 and July 1, 2016, respectively. Pinnacle Financial and Pinnacle Bank also collectively hold a 49% interest in Bankers Healthcare Group, LLC (BHG), of which 30% was obtained in 2015 and an additional 19% in 2016. BHG is a full-service commercial loan provider to healthcare and other professionals. Pinnacle Bank provides a full range of banking services, including investment, mortgage, and insurance services, and comprehensive wealth management services, in its primary market areas of the Nashville-Davidson-Murfreesboro-Franklin, TN, Knoxville, TN, Chattanooga, TN-GA and Memphis, TN-MS-AR Metropolitan Statistical Areas. Additionally, as noted in the Subsequent Events disclosure below, on January 22, 2017, Pinnacle Financial and a wholly owned subsidiary of Pinnacle Financial entered into an Agreement and Plan of Merger with BNC Bancorp, a North Carolina corporation.

Basis of Presentation — 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. generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities as of the balance sheet dates and the reported amounts of revenues and expenses during the reporting periods. 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, determination of any impairment of intangible assets and the valuation of deferred tax assets.

Impairment — Long-lived assets, including purchased intangible assets subject to amortization, such as core deposit intangible assets, are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset to estimated undiscounted future cash flows expected to be generated by the asset. If the carrying amount of an asset exceeds its estimated future cash flows, an impairment charge is recognized by the amount by which the carrying amount of the asset exceeds the fair value of the asset. Assets to be disposed of would be separately presented in the balance sheet and reported at the lower of the carrying amount or fair value less costs to sell, and are no longer depreciated. Pinnacle Financial had $15.1 million and $10.5 million of long-lived amortizing intangibles at December 31, 2016 and 2015, respectively.

Goodwill is evaluated for impairment at least annually and more frequently if events and circumstances indicate that the asset might be impaired. The Accounting Standards Codification (ASC) 350, Goodwill and Other, regarding testing goodwill for impairment provides an entity the option to first perform a qualitative assessment to determine whether it is more likely than not that the fair value of a reporting unit is less than its carrying amount. If an entity does a qualitative assessment and determines that this is the case, or if a qualitative assessment is not performed, it is required to perform additional goodwill impairment testing to identify potential goodwill impairment and measure the amount of goodwill impairment loss to be recognized for that reporting unit (if any). Based on a qualitative assessment, if an entity determines that the fair value of a reporting unit is more than its carrying amount, the two-step goodwill impairment test is not required. Pinnacle Financial performed its annual assessment as of September 30, 2016. The results of the qualitative assessment indicated that the fair value of Pinnacle Financial's sole reporting unit was more than its carrying value, and accordingly, the two-step goodwill impairment test was not performed.

Should Pinnacle Financial's common stock price decline or other impairment indicators become known, additional impairment testing of goodwill may be required. Should it be determined in a future period that the goodwill has become impaired, then a charge to earnings will be recorded in the period such determination is made. The following table presents activity for goodwill and other intangible assets:

	Goodwill	Core deposit and other intangible assets	Total
Balance at December 31, 2015	$432,232	$ 10,540	$ 442,772
Acquisitions	122,672	8,845	131,517
Amortization	-	(4,281)	(4,281)
Change in purchase price allocation of previous acquisitions	(3,125)	-	(3,125)
Other changes[1]	(185)	-	(185)
Balance at December 31, 2016	$551,594	$ 15,104	$ 566,698

(1) Represents options exercised related to acquisitions which occurred prior to the adoption of ASC 718-20 Compensation.

The following table presents the gross carrying amount and accumulated amortization for the core deposit and other intangible assets, which are subject to amortization:

	December 31, 2016	December 31, 2015
Gross carrying amount	$42,365	$33,520
Accumulated amortization	(27,261)	(22,980)
Net book value	15,104	10,540

Cash Equivalents and Cash Flows — Cash on hand, cash items in process of collection, amounts due from banks, Federal funds sold, short-term discount notes and securities purchased under agreements to resell, with original maturities within ninety days, are included in cash and cash equivalents. The following supplemental cash flow information addresses certain cash payments and noncash transactions for each of the years in the three-year period ended December 31, 2016 as follows:

	For the years ended December 31, 2016	2015	2014
Cash Payments:			
Interest	$37,002,870	$17,435,292	$13,414,134
Income taxes paid	49,503,637	45,715,968	31,350,000
Noncash Transactions:			
Loans charged-off to the allowance for loan losses	31,112,118	21,148,034	7,702,661
Loans foreclosed upon with repossessions transferred to other real estate	4,453,060	341,342	4,649,852
Loans foreclosed upon with repossessions transferred to other repossessed assets	1,842,318	8,259,368	2,262,573
Common stock issued in connection with acquisitions	222,162,640	269,492,990	-

Securities — Securities are classified based on management's intention on the date of purchase. All debt securities classified as available-for-sale are recorded at fair value with any unrealized gains and losses reported in accumulated other comprehensive income (loss), net of the deferred income tax effects. Securities that Pinnacle Financial has both the positive intent and ability to hold to maturity are classified as held-to-maturity and are carried at historical cost and adjusted for amortization of premiums and accretion of discounts.

Interest and dividends on securities, including amortization of premiums and accretion of discounts calculated under the effective interest method, are included in interest income. For certain securities, amortization of premiums and accretion of discounts is computed based on the anticipated life of the security which may be shorter than the stated life of the security. Realized gains and losses from the sale of securities are determined using the specific identification method, and are recorded on the trade date of the sale.

Other-than-temporary Impairment — A decline in the fair value of any available-for-sale or held-to-maturity security below cost that is deemed to be other-than-temporary results in a reduction in the carrying amount of the security. To determine whether impairment is other-than-temporary, management considers whether the entity expects to recover the entire amortized cost basis of the security by reviewing the present value of the future cash flows associated with the security. The shortfall of the present value of the cash flows expected to be collected in relation to the amortized cost basis is referred to as a credit loss and is deemed to be other-than-temporary impairment. If a credit loss is identified, the credit loss is recognized as a charge to earnings and a new cost basis for the security is established. If management concludes that a decline in fair value of a security is temporary and, a full recovery of principal and interest is expected and it is not more-likely-than-not that it will be required to sell the security before recovery of its amortized cost basis, then the security is not other-than-temporarily impaired and the shortfall is recorded as a component of equity.

Periodically, available-for-sale securities may be sold or the composition of the portfolio realigned to improve yields, quality or marketability, or to implement changes in investment or asset/liability strategy, including maintaining collateral requirements and raising funds for liquidity purposes. Additionally, if an available-for-sale security loses its investment grade, tax-exempt status, the underlying credit support is terminated or collection otherwise becomes uncertain based on factors known to management, Pinnacle Financial will consider selling the security, but will review each security on a case-by-case basis as these factors become known. Resultantly, other-than-temporary charges may be incurred as management's intention related to a particular security changes.

The carrying values of Pinnacle Financial's investment securities could decline in the future if the financial condition of the securities' issuer 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.

Loans held-for-sale — Loans originated and intended for sale are carried at the lower of cost or estimated fair value as determined on a loan-by-loan basis. Net unrealized losses, if any, are recognized through a valuation allowance by charges to income. Realized gains and losses are recognized when legal title to the loans has been transferred to the purchaser and sales proceeds have been received and are reflected in the accompanying consolidated statement of income in gains on mortgage loans sold, net of related costs such as compensation expenses, for mortgage loans, and as a component of other noninterest income for commercial loans held-for-sale.

Loans — Pinnacle Financial has five loan segments for financial reporting purposes: commercial and industrial, commercial real estate mortgage, construction and land development, consumer and other and consumer real estate mortgage. The appropriate classification is determined based on the underlying collateral utilized to secure each loan. These classifications are consistent with those utilized in the Quarterly Report of Condition and Income filed by Pinnacle Bank with the Federal Deposit Insurance Corporation (FDIC).

Loans are reported at their outstanding principal balances, net of the allowance for loan losses and any deferred fees or costs on originated loans. Interest income on loans is accrued based on the principal balance outstanding. Loan origination fees, net of certain loan origination costs, are deferred and recognized as an adjustment to the related loan yield using a method which approximates the interest method. At December 31, 2016 and 2015, net deferred loan fees of $7.6 million and $4.2 million respectively, were included in loans on the accompanying consolidated balance sheets.

As part of our routine credit monitoring process, commercial loans receive risk ratings by the assigned financial advisor and are subject to validation by our 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 outlined by Pinnacle Bank's primary federal regulator. At December 31, 2016, approximately 79% of Pinnacle Financial's loan portfolio was assigned a specifically assigned risk rating in the allowance for loan loss assessment. Certain consumer loans and commercial relationships that possess certain qualifying characteristics, including individually smaller balances, are generally not assigned an individual risk rating but are evaluated collectively for credit risk as a homogenous pool of loans and individually as either accrual or nonaccrual based on the performance of the loan.

Loans are placed on nonaccrual status when there is a significant deterioration in the financial condition of the borrower, which generally is the case but is not limited to when the principal or interest is more than 90 days past due, unless the loan is both well-secured and in the process of collection. All interest accrued but not collected for loans that are placed on nonaccrual status is reversed against current interest income. Interest income is subsequently recognized only if certain cash payments are received while the loan is classified as nonaccrual, but interest income recognition is reviewed on a case-by-case basis to determine if the payment should be applied to interest or principal pursuant to regulatory guidelines. A nonaccrual loan is returned to accruing status once the loan has been brought current as to principal and interest and collection is reasonably assured or the loan has been well-secured through other techniques.

All loans that are placed on nonaccrual status are further analyzed to determine if they should be classified as impaired loans. A loan is considered to be impaired when it is probable Pinnacle Financial will be unable to collect all principal and interest payments due in accordance with the contractual terms of the loan. This determination is made using a variety of techniques, which include a review of the borrower's financial condition, debt-service coverage ratios, global cash flow analysis, guarantor support, other loan file information, meetings with borrowers, inspection or reappraisal of collateral and/or consultation with legal counsel as well as results of reviews of other similar industry credits (e.g. builder loans, development loans, church loans, etc.).

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

Purchased Loans — Purchased loans, including loans acquired through a merger, are initially recorded at fair value on the date of purchase. Purchased loans that contain evidence of post-origination credit deterioration as of the purchase date are carried at the net present value of expected future cash flows. All other purchased loans are recorded at their initial fair value, and adjusted for subsequent advances, pay downs, amortization or accretion of any fair value premium or discount on purchase, charge-offs and any other adjustment to carrying value. Pursuant to U.S. generally accepted accounting principles (GAAP), management has up to 12 months following the date of the acquisition to finalize the fair values of acquired assets and assumed liabilities as of the acquisition date. Once management has finalized the fair values of acquired assets and assumed liabilities within this 12-month period, management considers such values to be the day 1 fair values (Day 1 Fair Values).

At the time of acquisition, management evaluates all purchased loans using a variety of factors such as current classification or risk rating, past due status and history as a component of the fair value determination. For those purchased loans without evidence of credit deterioration, management evaluates each reviewed loan using an internal grading system with a grade assigned to each loan at the date of acquisition. To the extent that any purchased loan is not specifically reviewed, such loan is assumed to have characteristics similar to the characteristics of the specifically reviewed acquired portfolio of purchased loans. The grade for each purchased loan without evidence of credit deterioration is reviewed subsequent to the date of acquisition any time a loan is renewed or extended or at any time information becomes available to Pinnacle Financial that provides material insight regarding the loan's performance, the borrower's capacity to repay or the underlying collateral.

In determining the Day 1 Fair Values of purchased loans without evidence of post-origination credit deterioration at the date of acquisition, management includes (i) no carry over of any previously recorded ALL and (ii) an adjustment of the unpaid principal balance to reflect an appropriate market rate of interest and expected loss, given the risk profile and grade assigned to each loan. This adjustment is accreted into earnings as a yield adjustment, using the effective yield method, over the remaining life of each loan.

Purchased loans that contain evidence of credit deterioration on the date of purchase are individually evaluated by management to determine the estimated fair value of each loan. This evaluation includes no carryover of any previously recorded ALL. In determining the estimated fair value of purchased loans with evidence of credit deterioration, management considers a number of factors including, among other things, the remaining life of the acquired loans, estimated prepayments, estimated loss ratios, estimated value of the underlying collateral, estimated holding periods, and net present value of cash flows expected to be received.

In determining the Day 1 Fair Values of purchased loans with evidence of credit deterioration, management calculates a non-accretable difference (the credit risk component of the purchased loans) and an accretable difference (the yield component of the purchased loans). The non-accretable difference is the difference between the contractually required payments and the cash flows expected to be collected in accordance with management's determination of the Day 1 Fair Values. Subsequent increases in expected cash flows will result in an adjustment to accretable yield, which will have a positive impact on interest income. Subsequent decreases in expected cash flows will generally result in increased provision for loan losses. Subsequent increases in expected cash flows following any previous decrease will result in a reversal of the provision for loan losses to the extent of prior charges and then an adjustment to accretable yield. The accretable difference on purchased loans with evidence of credit deterioration is the difference between the expected cash flows and the net present value of expected cash flows. Such difference is accreted into earnings using the effective yield method over the term of the loans. For purchased loans with evidence of credit deterioration for which the expected cash flows cannot be forecasted, these loans are deemed to be collateral dependent, are recorded at their fair value and are placed on nonaccrual.

Allowance for Loan Losses (allowance) — Pinnacle Financial's 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 portfolio, loan loss experience, asset quality trends, known and inherent risks in the portfolio, adverse situations that may affect the borrowers' ability to repay the loan (including the timing of future payment), the estimated value of any underlying collateral, composition of the loan portfolio, economic conditions, industry and peer bank loan quality indications and other pertinent factors, including regulatory recommendations. The level of allowance maintained by management is believed adequate to absorb probable losses inherent in the loan portfolio at the balance sheet date. The allowance is increased by provisions charged to expense and decreased by charge-offs, net of recoveries of amounts previously charged-off. Allocation of the allowance may be made for specific loans, but the entire allowance is available for any loan that, in management's judgment, is deemed uncollectible.

Pinnacle Financial's allowance for loan losses is composed of the result of two independent analyses pursuant to the provisions of ASC 450-20, Loss Contingencies and ASC 310-10-35, Receivables. The ASC 450-20 analysis is intended to quantify the inherent risks in its performing loan portfolio. The ASC 310-10-35 analysis includes a loan-by-loan analysis of impaired loans, both those reported as nonaccrual and troubled-debt restructurings.

In assessing the adequacy of the allowance, Pinnacle Financial also considers the results of Pinnacle Financial's ongoing independent loan review process. Pinnacle Financial undertakes this process both to ascertain those loans in the portfolio with elevated credit risk and to assist in its overall evaluation of the risk characteristics of the entire loan portfolio. Its loan review process includes the judgment of management, independent internal loan reviewers, and reviews that may have been conducted by third-party reviewers including regulatory examiners. Pinnacle Financial incorporates relevant loan review results in the allowance.

The ASC 450-20 component of the allowance for loan losses begins with a migration analysis based on Pinnacle Financial's internal system of risk rating, if applicable, and historical loss data in its portfolio, by loan type. The migration analysis accumulates losses realized over a rolling four-quarter cycle and is utilized to determine an annualized loss rate for each category for each quarter-end in our look-back period. The look-back period in our migration analysis includes 24 quarters as Pinnacle Financial believes this period is representative of an economic cycle. An average of the loss rates calculated within each category is calculated for each quarter-end in the look-back period. Average loss rates by category are then applied to the end of period loan portfolio. The estimated losses by category are then adjusted by a loss emergence period for each type of loan in our portfolio. A loss emergence period represents the length of time from the initial event which triggered the loss to the recognition of the loss and is validated annually. The loss emergence period was determined for the losses in each category of loans and then applied to the loss rates resulting from the migration analysis. Combined, this provides a quantitative estimate of the results in credit losses inherent in Pinnacle Financial's end of period loan portfolio based on its actual loss experience.

The estimated loan loss allocation for all loan segments is then adjusted for management's estimate of probable losses for a number of qualitative factors that have not been considered in the loan migration analysis. The qualitative categories and the measurements used to quantify the risks within each of these categories are subjectively selected by management, but measured by objective measurements period over period. The data for each measurement may be obtained from internal or external sources. The current period measurements are evaluated and assigned a factor commensurate with the current level of risk relative to past measurements over time. The resulting factor is applied to the non impaired loan portfolio. This amount represents estimated probable inherent credit losses which exist, but have not yet been identified either in its risk rating or impairment process, as of the balance sheet date, and is based upon quarterly trend assessments in portfolio concentrations, policy exceptions, economic conditions, lending staff performance, independent loan review results, collateral considerations, credit quality, competition and regulatory requirements, enterprise wide risk assessments, and peer group credit quality. The qualitative allowance allocation, as determined by the processes noted above, is increased or decreased for each loan segment based on the assessment of these various qualitative factors.

The allowance for loan losses for purchased loans is calculated similar to that utilized for legacy Pinnacle Bank loans. Pinnacle Financial's accounting policy is to compare the computed allowance for loan losses for purchased loans to the remaining fair value adjustment. If the computed allowance at the loan level is greater than the remaining fair value adjustment, the excess is added to the allowance for loan losses by a charge to the provision for loan losses.

The ASC 450-20 portion of the allowance includes a small unallocated component. Pinnacle Financial believes that the unallocated amount is warranted for inherent factors that cannot be practically assigned to individual loan categories, such as the imprecision in the overall loss allocation measurement process, the subjectivity risk of potentially not considering all relevant environmental categories and related measurements and imprecision in its credit risk ratings process. The appropriateness of the unallocated component of the allowance is assessed each quarter end based upon changes in the overall business environment not otherwise captured.

The impaired loan allowance is determined pursuant to ASC 310-10-35. Loans are impaired when, based on current information and events, it is probable that we will be unable to collect all amounts due according to the contractual terms of the loan agreement. Collection of all amounts due according to the contractual terms means collecting all interest and principal payments of a loan as scheduled in the loan agreement. This evaluation is inherently subjective as it requires material estimates including the amounts and timing of future cash flows expected to be received on impaired loans that may be susceptible to significant change. Loan losses are charged off when management believes that the full collectability of the loan is unlikely. A loan may be partially charged-off after a "confirming event" has occurred which serves to validate that full repayment pursuant to the terms of the loan is unlikely.

An impairment allowance is recognized if the fair value of the loan is less than the recorded investment in the loan (recorded investment in the loan is the principal balance plus any accrued interest, net of deferred loan fees or costs and unamortized premium or discount). The impairment is recognized through the provision for loan losses and is a component of the allowance for loan losses. Loans that are impaired are recorded at the present value of expected future cash flows discounted at the loan's effective interest rate, or if the loan is collateral dependent, at the fair value of the collateral, less estimated disposal costs. If the loan is collateral dependent, the principal balance of the loan is charged-off in an amount equal to the impairment measurement. The fair value of collateral dependent loans is derived primarily from collateral appraisals performed by independent third-party appraisers. Management believes it follows appropriate accounting and regulatory guidance in determining impairment and accrual status of impaired loans. This analysis is completed for all individual loans greater than $250,000. The resulting allowance percentage by segment adjusted for specific trends identified, if applicable, is then applied to the remaining population of impaired loans.

Pursuant to the guidance set forth in ASU No. 2011-02, A Creditor's Determination of Whether a Restructuring is a Troubled Debt Restructuring, the above impairment methodology is also applied to those loans identified as troubled debt restructurings.

Sufficiency of the computed allowance is then tested by comparison to historical trends and industry and peer information. Pinnacle Financial then evaluates the result of the procedures performed, including the results of our testing, and concludes on the appropriateness of the balance of the allowance in its entirety. The audit committee of the board of directors reviews and approves the methodology and resultant allowance prior to the filing of quarterly and annual financial information.

While its policies and procedures used to estimate the allowance for loan losses, as well as the resultant provision for loan losses charged to income, are considered adequate by management and are reviewed from time to time by regulators, they are necessarily approximate and imprecise. There are factors beyond its control, such as conditions in the local, national, and international economy, a local real estate market or particular industry conditions which may negatively impact materially asset quality and the adequacy of the allowance for loan losses and thus the resulting provision for loan losses.

Transfers of Financial Assets — Transfers of financial assets are accounted for as sales when control over the assets has been surrendered or in the case of a loan participation, a portion of the asset has been surrendered and meets the definition of a "participating interest". Control over transferred assets is deemed to be surrendered when (1) the assets have been isolated from Pinnacle Financial, (2) the transferee obtains the right (free of conditions that constrain it from taking advantage of that right) to pledge or exchange the transferred assets, and (3) Pinnacle Financial does not maintain effective control over the transferred assets through an agreement to repurchase them before maturity.

Premises and Equipment and Leaseholds — Premises and equipment are carried at cost less accumulated depreciation and amortization computed principally by the straight-line method over the estimated useful lives of the assets or the expected lease terms for leasehold improvements, whichever is shorter. Useful lives for all premises and equipment range between three and thirty years.

Pinnacle Bank is the lessee with respect to several office locations. All such leases are being accounted for as operating leases within the accompanying consolidated financial statements, with the exception of the one capital lease agreement discussed below. Several of these leases include rent escalation clauses. Pinnacle Bank expenses the costs associated with these escalating payments over the life of the expected lease term using the straight-line method. At December 31, 2016, the deferred liability associated with these escalating rentals was approximately $3.0 million and is included in other liabilities in the accompanying consolidated balance sheets.

Pinnacle Bank has one lease being accounted for as a capital lease within the accompanying consolidated financial statements. Amortization of property under the capital lease is expensed over the life of the expected lease term using the straight-line method and is included in depreciation expense.

Other Real Estate Owned — Other real estate owned (OREO) represents real estate foreclosed upon or acquired by deed in lieu of foreclosure by Pinnacle Bank through loan defaults by customers. Substantially all of these amounts relate to lots, homes and residential development projects that are either completed or are in various stages of construction for which Pinnacle Financial believes it has adequately supported the value recorded. Upon its acquisition by Pinnacle Bank, the property is recorded at fair value, based on appraised value, less selling costs estimated as of the date acquired. The difference from the loan balance is recognized as a charge-off through the allowance for loan losses. Additional OREO losses for subsequent downward valuation adjustments and expenses to maintain OREO are determined on a specific property basis and are included as a component of noninterest expense. Net gains or losses realized at the time of disposal are reflected in noninterest income or noninterest expense, as applicable.

Included in the accompanying consolidated balance sheet at December 31, 2016 is $6.5 million of OREO with related property-specific valuation allowances of $381,000. At December 31, 2015, OREO totaled $6.6 million with related property-specific valuation allowances of $1.5 million. During the years ended December 31, 2016, 2015 and 2014, Pinnacle Financial had expense of $396,000, a benefit of $306,000 and expense of $664,000, respectively, of net foreclosed real estate expense. Of the net foreclosed real estate expenses, $141,000 were realized losses on the disposition and holding losses on valuations of OREO properties during the year ended December 31, 2016 compared to realized gains and holding losses on valuations of OREO properties of $434,000 and $552,000, respectively, during the years ended December 31, 2015 and 2014.

Other Assets — Included in other assets as of December 31, 2016 and 2015, is approximately $5.7 million and $6.6 million, respectively, of computer software related assets, net of amortization. This software supports Pinnacle

Financial's primary data systems and relates to amounts paid to vendors for installation and development of such systems. These amounts are amortized on a straight-line basis over periods of three to seven years. For the years ended December 31, 2016, 2015, and 2014, Pinnacle Financial's amortization expense was approximately \$2.3 million, \$1.3 million, and \$1.1 million, respectively. Software maintenance fees are capitalized in other assets and amortized over the term of the maintenance agreement.

Pinnacle Financial is required to maintain certain minimum levels of equity investments with certain regulatory and other entities in which Pinnacle Bank has outstanding borrowings, including the Federal Home Loan Bank of Cincinnati. At December 31, 2016 and 2015, the cost of these investments was $31.4 million and $26.5 million, respectively. Pinnacle Financial determined that cost approximates the fair value of these investments. Additionally, Pinnacle Financial has recorded certain investments in other entities primarily non-public private equity funds, at fair value, of $8.3 million and $7.6 million at December 31, 2016 and 2015, respectively. During 2016 and 2015, Pinnacle Financial recorded net losses of $233,000 and $39,000, respectively, due to changes in the fair value of these investments. As more fully described in footnote 11, Pinnacle Financial has an investment in four Trusts valued at $2,476,000 as of December 31, 2016 and 2015. The Trusts were established to issue preferred securities, the dividends for which are paid with interest payments Pinnacle Financial makes on subordinated debentures it issued to the Trusts.

Pinnacle Bank is the owner and beneficiary of various life insurance policies on certain key executives and certain current and former directors, including policies that were acquired in its mergers. Collectively, these policies are reflected in other assets in the accompanying consolidated balance sheets at their respective cash surrender values. At December 31, 2016 and 2015, the aggregate cash surrender value of these policies was approximately $150.6 million and $121.9 million, respectively. Noninterest income related to these policies was $3.5 million, $2.5 million, and $2.4 million, during the years ended December 31, 2016, 2015 and 2014, respectively.

Also, as part of our compliance with the Community Reinvestment Act, we had investments in low income housing entities totaling $43.1 million and $17.1 million, net, as of December 31, 2016 and 2015, respectively. Included in our CRA investments are investments of $18.9 million and $3.2 million at December 31, 2016 and 2015, respectively, net of amortization, that qualify for federal low income housing tax credits. The investments are accounted for under the proportional amortization method. Under the proportional amortization method, the initial cost of the investment is amortized in proportion to the tax credits and other tax benefits received. The amortization and benefits are recognized as a component of income tax expense in the consolidated statements of income. The investments are recorded using the cost method.

Derivative Instruments — In accordance with ASC Topic 815 Derivatives and Hedging, all derivative instruments are recorded on the accompanying consolidated balance sheet at their respective fair values. The accounting for changes in fair value (i.e., gains or losses) of a derivative instrument depends on whether it has been designated and qualifies as part of a hedging relationship. If the derivative instrument is not designated as a hedge, changes in the fair value of the derivative instrument are recognized in earnings in the period of change.

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 large U.S. financial institutions in order to minimize the risk to Pinnacle Financial. These swaps are derivatives, but are not designated as hedging instruments.

Pinnacle Financial also has forward cash flow hedge relationships in the form of interest rate swap agreements to manage our future interest rate exposure. These derivative contracts have been designated as a hedge and, as such, changes in the fair value of the derivative instrument are recorded in other comprehensive income. Pinnacle Financial prepares written hedge documentation for all derivatives which are designated as hedges. The written hedge documentation includes identification of, among other items, the risk management objective, hedging instrument, hedged item and methodologies for assessing and measuring hedge effectiveness and ineffectiveness, along with support for management's assertion that the hedge will be highly effective.

For designated hedging relationships, Pinnacle Financial performs retrospective and prospective effectiveness testing using quantitative methods and does not assume perfect effectiveness through the matching of critical terms. Assessments of hedge effectiveness and measurements of hedge ineffectiveness are performed at least quarterly. The effective portion of the changes in the fair value of a derivative that is highly effective and that has been designated and qualifies as a cash flow hedge are initially recorded in accumulated other comprehensive income (AOCI) and will be reclassified to earnings in the same period that the hedged item impacts earnings; any ineffective portion is recorded in current period earnings.

Hedge accounting ceases on transactions that are no longer deemed effective, or for which the derivative has been terminated or de-designated.

Securities Sold Under Agreements to Repurchase — Pinnacle Financial routinely sells securities to certain treasury management customers and then repurchases these securities the next day. Securities sold under agreements to repurchase are reflected as a secured borrowing in the accompanying consolidated balance sheets at the amount of cash received in connection with each transaction.

Income Taxes — 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. This section also provides guidance on the derecognition, measurement and classification of income tax uncertainties, along with any related interest and penalties, and includes guidance concerning accounting for income tax uncertainties in interim periods.

Deferred tax assets and liabilities are the expected future tax amounts for the temporary differences between carrying amounts and tax bases of assets and liabilities, computed using enacted tax rates. The net deferred tax asset is reflected as a component of other assets on the consolidated balance sheet. A valuation allowance is required for deferred tax assets if, based on available evidence, it is more likely than not that all or some portion of the asset may not be realized due to the inability to generate sufficient taxable income in the period and/or of the character necessary to utilize the benefit of the deferred tax asset.

Income tax expense or benefit for the year is allocated among continuing operations and other comprehensive income (loss), as applicable. The amount allocated to continuing operations is the income tax effect of the pretax income or loss from continuing operations that occurred during the year, plus or minus income tax effects of (i) changes in certain circumstances that cause a change in judgment about the realization of deferred tax assets in future years, (ii) changes in income tax laws or rates, and (iii) changes in income tax status, subject to certain exceptions. The amount allocated to other comprehensive income (loss) is related solely to changes in the valuation allowance on items that are normally accounted for in other comprehensive income (loss) such as unrealized gains or losses on available-for-sale securities.

In accordance with ASC 740-10 Accounting for Uncertainty in Income Taxes, uncertain tax positions are recognized if it is more likely than not, based on technical merits, that the tax position will be realized or sustained upon examination. The term more likely than not means a likelihood of more than 50 percent; the terms examined and upon examination also include resolution of the related appeals or litigation processes, if any. A tax position that meets the more likely than not recognition threshold is initially and subsequently measured as the largest amount of tax benefit that has a greater than 50 percent likelihood of being realized upon settlement with a taxing authority that has full knowledge of all relevant information. The determination of whether or not a tax position has met the more likely than not recognition threshold considers the facts, circumstances and information available at the reporting date.

Pinnacle Financial and its subsidiaries file consolidated U.S. Federal and state of Tennessee income tax returns. Each entity provides for income taxes based on its contribution to income or loss of the consolidated group. Pinnacle Financial has a Real Estate Investment Trust subsidiary that files a separate federal tax return, but its income is included in the consolidated group's return as required by the federal tax laws. Pinnacle Financial remains open to audit under the statute of limitations by the IRS and the states in which we do business for the years ended December 31, 2013 through 2016.

Pinnacle Financial's policy is to recognize interest and/or penalties related to income tax matters in income tax expense. No amounts were accrued for interest and/or penalties at December 31, 2016. The amount accrued for interest and/or penalties related to State uncertain tax positions at December 31, 2015 and 2014 were $96,000 and $140,000, respectively. Pinnacle Financial's policy is to recognize interest and/or penalties related to income tax matters in income tax expense.

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.

As of December 31, 2016, there were 550,490 stock options outstanding to purchase common shares. For the years ended December 31, 2016, 2015 and 2014, respectively, approximately 694,909, 958,320 and 403,555 of dilutive stock options, dilutive restricted shares, restricted share units and stock appreciation rights were included in the diluted earnings per share calculation under the treasury stock method. For the years ended December 31, 2016, 2015 and 2014, there were no stock options, restricted shares, restricted share units and stock appreciation rights excluded from the calculation because they were deemed to be antidilutive.

The following is a summary of the basic and diluted earnings per share calculation for each of the years in the three-year period ended December 31, 2016:

	December 31, 2016	December 31, 2015	December 31, 2014
Basic earnings per share calculation:			
Numerator - Net income	$127,224,695	$95,509,402	$70,471,167
Denominator – Weighted average common shares outstanding	43,037,083	37,015,468	34,723,335
Basic net income per common share	$2.96	$2.58	$2.03
Diluted earnings per share calculation:			
Numerator - Net income	$127,224,695	$95,509,402	$70,471,167
Denominator – Weighted average common shares outstanding	43,037,083	37,015,468	34,723,335
Dilutive shares contingently issuable	694,909	958,320	403,555
Weighted average diluted common shares outstanding	43,731,992	37,973,788	35,126,890
Diluted net income per common share	$2.91	$2.52	$2.01

Stock-Based Compensation — Stock-based compensation expense is recognized based on the fair value of the portion of stock-based payment awards that are ultimately expected to vest, reduced for estimated forfeitures. ASC 718-20 Compensation – Stock Compensation Awards Classified as Equity requires forfeitures to be estimated at the time of grant and revised, if necessary, in subsequent periods if actual forfeitures differ from those estimates. Service based awards with multiple vesting periods are expensed over the entire requisite period as if the award were a single award. For awards with performance vesting criteria, anticipated performance is projected to determine the number of awards expected to vest, and the corresponding aggregate expense is adjusted to reflect the elapsed portion of the applicable performance period.

Comprehensive Income (Loss) — Comprehensive income (loss) consists of the total of all components of comprehensive income (loss) including net income (loss). Other comprehensive income (loss) refers to revenues, expenses, gains and losses that under U.S. generally accepted accounting principles are included in comprehensive income (loss) but excluded from net income (loss). Currently, Pinnacle Financial's other comprehensive income (loss) consists of unrealized gains and losses on securities available-for-sale, net of deferred tax expense (benefit) and unrealized gains (losses) on derivative hedging relationships.

Fair Value Measurement — ASC Topic 820, Fair Value Measurements and Disclosures, which defines fair value, establishes a framework for measuring fair value in U.S. generally accepted accounting principles and established required disclosures about fair value measurements. ASC 820 applies only to fair-value measurements that are already required or permitted by other accounting standards and increases the consistency of those measurements. The definition of fair value focuses on the exit price, i.e., the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date, not the entry price, (i.e., the price that would be paid to acquire the asset or received to assume the liability at the measurement date). The statement emphasizes that fair value is a market-based measurement; not an entity-specific measurement. Therefore, the fair value measurement should be determined based on the assumptions that market participants would use in pricing the asset or liability.

Pinnacle Financial has an established process for determining fair values. Fair value is based upon quoted market prices, where available. If listed prices or quotes are not available, fair value is based upon internally developed models or processes that use primarily market-based or independently-sourced market data, including interest rate yield curves, option volatilities and third party information such as prices of similar assets or liabilities. Valuation adjustments may be made to ensure that financial instruments are recorded at fair value. Furthermore, while Pinnacle

Financial believes its valuation methods are appropriate and consistent with other market participants, the use of different methodologies or assumptions to determine the fair value of certain financial instruments could result in a different estimate of fair value at the reporting date.

Mortgage Servicing Rights — In conjunction with the acquisition of Magna, Pinnacle Bank acquired a residential mortgage servicing portfolio which was recorded at fair value upon acquisition. The residential mortgage servicing portfolio was recorded at $6.4 million as of December 31, 2015, net of related amortization. During the first quarter of 2016, Pinnacle Bank sold the mortgage servicing rights associated with the $830 million Fannie Mae portfolio for $6.6 million, net of associated costs to sell. The purchase agreement related to the sale of these rights includes certain clawback provisions which require Pinnacle Bank to reimburse the acquirer in the event certain conditions are met. Approximately $241,000 was recorded as income during the year ended December 31, 2016 related to the sale.

Recently Adopted Accounting Pronouncements — In April 2015, the Financial Accounting Standards Board (FASB) issued ASU 2015-03 Simplifying the Presentation of Debt Issuance Costs requiring that debt issuance costs related to a debt liability be presented in the balance sheet as a direct reduction from the carrying amount of the related debt liability. The guidance became effective on January 1, 2016. As a result of the adoption of this standard, Pinnacle Financial reclassified approximately $870,000 of deferred financing costs from Other Assets to Subordinated Debt and Other Borrowings in the consolidated balance sheet as of December 31, 2015.

Newly Issued not yet Effective Accounting Standards — In February 2016, the FASB issued Accounting Standards Update 2016-02 Leases guidance requiring the recognition in the statement of financial position of lease assets and lease liabilities by lessees for those leases classified as operating leases under previous GAAP. The guidance requires that a lessee should recognize lease assets and lease liabilities as compared to previous GAAP that did not require lease assets and lease liabilities to be recognized for most leases. The guidance becomes effective for us on January 1, 2019. Pinnacle Financial is currently evaluating the impact on its consolidated financial statements.

In March 2016, the FASB issued updated guidance to Accounting Standards Update 2016-09 Stock Compensation Improvements to Employee Share-Based Payment Activity intended to simplify and improve several aspects of the accounting for share-based payment transactions, including the income tax consequences, classification of such awards as either equity or liabilities and classification on the statement of cash flows. This ASU is expected to impact Pinnacle Financial's consolidated financial statements by requiring that all income tax effects related to settlements of share-based payment awards be reported as increases (or decreases) to income tax expense. Previously, income tax benefits at settlement of an award were reported as an increase (or decrease) to additional paid-in capital. The ASU also requires that all income tax related cash flows resulting from share-based payments be reported as operating activities in the statement of cash flows whereas cash flows were previously reported as a reduction to operating cash flows and an increase to financing cash flows. The guidance became effective for us on January 1, 2017.

In June 2016, the FASB issued Accounting Standards Update 2016-13, Financial Instruments - Credit Losses: Measurement of Credit Losses on Financial Instruments (the ASU), which introduces the current expected credit losses methodology. Among other things, the ASU requires the measurement of all expected credit losses for financial assets, including loans and available-for-sale debt securities, held at the reporting date based on historical experience, current conditions, and reasonable and supportable forecasts that affect the collectability of the reported amount. The new model will require institutions to calculate all probable and estimable losses that are expected to be incurred through the loan's entire life. ASU 2016-13 also requires the allowance for credit losses for purchased financial assets with credit deterioration since origination to be determined in a manner similar to that of other financial assets measured at amortized cost; however, the initial allowance will be added to the purchase price rather than recorded as credit loss expense. The disclosure of credit quality indicators related to the amortized cost of financing receivables will be further disaggregated by year of origination (or vintage). Institutions are to apply the changes through a cumulative-effect adjustment to their retained earnings as of the beginning of the first reporting period in which the standard is effective. The amendments are effective for fiscal years beginning after December 15, 2020. Early application will be permitted for fiscal years beginning after December 15, 2018. Pinnacle Financial is currently assessing the impact of the new guidance on its consolidated financial statements.

In August 2016, the FASB issued Accounting Standards Update 2016-15 Statement of Cash Flows (Topic 230) intended to reduce the diversity in practice around how certain transactions are classified within the statement of cash flows. The guidance is effective for public companies for annual periods beginning after December 15, 2017, including interim periods within those fiscal years. Early adoption is permitted with retrospective application. Pinnacle Financial is currently evaluating the impact of the new guidance on its consolidated financial statements.

In May 2014, the FASB issued Accounting Standards Update 2014-09 Revenue from Contracts with Customers (Topic 606) developed as a joint project with the International Accounting Standards Board to remove inconsistencies in revenue requirements and provide a more robust framework for addressing revenue issues. The ASU's core principle is that an entity should recognize revenue when it transfers promised goods or services to customers in an amount that reflects the consideration to which an entity expects to be entitled in exchange for those goods or services. In August 2015, the FASB issued Accounting Standards Update 2015-14, which deferred the effective date by one year (i.e., interim and annual reporting periods beginning after December 15, 2017). Early adoption is permitted, but not before the original effective date (i.e., interim and annual reporting periods beginning after December 15, 2016). The ASU may be adopted using either a modified retrospective method or a full retrospective method. Pinnacle Financial intends to adopt the ASU during the first quarter of 2018, as required, using a modified retrospective approach. Pinnacle Financial's preliminary analysis suggests that the adoption of this accounting guidance is not expected to have a material impact on the Company's consolidated financial statements as the majority of its revenue stream is generated from financial instruments which are not within the scope of this ASU. However, Pinnacle Financial is still evaluating the impact for other fee-based income. The FASB continues to release new accounting guidance related to the adoption of this ASU and the results of Pinnacle Financial's materiality analysis may change based on conclusions reached as to the application of this new guidance.

Other than those pronouncements discussed above and those which have been recently adopted, there were no other recently issued accounting pronouncements that are expected to materially impact Pinnacle Financial.

Subsequent Events — ASC Topic 855, Subsequent Events, establishes general standards of accounting for and disclosure of events that occur after the balance sheet date but before financial statements are issued. Pinnacle Financial evaluated all events or transactions that occurred after December 31, 2016 through the date of the issued financial statements.

<u>BNC Bancorp, a North Carolina corporation (BNC)</u>

On January 22, 2017, Pinnacle Financial entered into an Agreement and Plan of Merger (the Merger Agreement), among BNC, and Blue Merger Sub, Inc., a North Carolina corporation and a direct, wholly owned subsidiary of Pinnacle Financial (Merger Sub), pursuant to which, on the terms and subject to the conditions set forth therein, Merger Sub will merge with and into BNC (the Merger), with BNC surviving the Merger (the Surviving Company). As soon as reasonably practicable following the Merger and as a part of a single integrated transaction, Pinnacle Financial will cause the Surviving Company to be merged with and into Pinnacle Financial (the Second Step Merger), with Pinnacle Financial as the surviving entity, on the terms and subject to the conditions set forth in the Merger Agreement. Immediately following the Second Step Merger, Bank of North Carolina, a North Carolina state bank and a wholly owned subsidiary of BNC, will merge with and into Pinnacle Bank, a Tennessee state bank and a wholly owned subsidiary of Pinnacle Financial. The Merger Agreement was unanimously approved and adopted by the board of directors of Pinnacle Financial and the board of directors of BNC.

Under the terms and subject to the conditions of the Merger Agreement, at the effective time of the Merger (the Effective Time), outstanding shares of common stock, no par value, of BNC (BNC Common Stock) will be converted into the right to receive 0.5235 shares (the Exchange Ratio) of Pinnacle's common stock, $1.00 per value per share (Pinnacle Financial Common Stock). As of January 13, 2017, BNC had 52,181,073 shares of BNC Common Stock outstanding, 901,726 shares of BNC Common Stock in respect of outstanding restricted stock awards and restricted stock unit awards, in the aggregate, and 66,443 outstanding stock options. The Merger Agreement also includes provisions that address the treatment of the outstanding equity awards of BNC in the Merger. Pursuant to the terms of the Merger Agreement, any outstanding options to purchase shares of BNC Common Stock that are not vested will be accelerated prior to, but conditioned on the occurrence of, the closing of the Merger and all options that are not exercised prior to the closing shall be cancelled and the holders of any such options shall receive an amount in cash equal to the product of (x) the excess, if any, of the average closing prices of Pinnacle Financial's Common Stock for the ten (10) trading days ending on the trading day immediately preceding the closing date of the Merger (adjusted for the Exchange Ratio) over the exercise price of each such option and (y) the number of shares of BNC Common Stock subject to each such option.

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The completion of the Merger is subject to customary conditions, including (1) receipt of the approval of the issuance of the shares of Pinnacle Financial's Common Stock issuable in the Merger from Pinnacle Financial's shareholders and the approval of the Merger Agreement and the transactions contemplated therein, including the Merger, from BNC's shareholders, (2) authorization for listing on the Nasdaq Global Select Market of the shares of Pinnacle Financial Common Stock to be issued in the Merger, (3) the receipt of required regulatory approvals, including the approval of the Federal Reserve Board, the Federal Deposit Insurance Corporation, the Tennessee Department of Financial Institutions and the North Carolina Office of the Commissioner of Banks, (4) effectiveness of the registration statement on Form S-4 for the Pinnacle Financial's Common Stock to be issued in the Merger, and (5) the absence of any order, injunction or other legal restraint preventing the completion of the Merger or making the Merger illegal. Each party's obligations to complete the Merger is also subject to certain additional customary conditions, including (1) subject to certain exceptions, the accuracy of the representations and warranties of Pinnacle Financial and Merger Sub, in the case of BNC, and BNC, in the case of Pinnacle Financial, (2) performance in all material respects by Pinnacle Financial and Merger Sub, in the case of BNC, and BNC, in the case of Pinnacle Financial, of its obligations under the Merger Agreement, and (3) receipt by such party of an opinion from its counsel to the effect that the Merger will qualify as a "reorganization" within the meaning of Section 368(a) of the Internal Revenue Code of 1986, as amended.

The Merger Agreement provides certain termination rights for both BNC and Pinnacle Financial and further provides that a termination fee of $66.0 million will be payable by either BNC or Pinnacle Financial, as applicable, upon termination of the Merger Agreement under certain circumstances, including if the other party or its board of directors withdraws or modifies or qualifies in a manner adverse to the other party its recommendation that its shareholders vote in favor of the Merger Agreement and the transactions contemplated thereby, including the Merger, in the case of BNC's shareholders, and in favor of the issuance of the Pinnacle Financial Common Stock issuable in the Merger, in the case of Pinnacle Financial's shareholders.

The Merger Agreement provides that effective at or immediately following the Effective Time, Pinnacle Financial, Pinnacle Bank and their respective boards of directors will take all requisite action to cause the total number of members of their respective boards of directors as of the Effective Time to be eighteen (18) and elect Richard D. Callicutt II, BNC's President and Chief Executive Officer and three additional members of the board of directors of BNC to the boards of directors of Pinnacle Financial and Pinnacle Bank.

In connection with the execution of the Merger Agreement, Pinnacle Financial has also entered into an employment agreement with Richard D. Callicutt II and a change of control and severance agreement with David Spencer, BNC's Executive Vice President and Chief Financial Officer, that will become effective as of the Effective Time of the Merger and replace those individuals' existing employment agreements with BNC and Bank of North Carolina. In addition, upon consummation of the Merger, Pinnacle Financial will assume BNC's obligations under its outstanding $60.0 million subordinated notes issued in September 2014 that mature in October 2024. These notes bear interest at a rate of 5.5% per annum until September 30, 2019 and may not be repaid prior to that date. Beginning on October 1, 2019, if not redeemed on that date, these notes will bear interest at a floating rate equal to the three-month LIBOR determined on the determination date of the applicable interest period plus 359 basis points.

The $50.5 million in aggregate principal amount of subordinated debentures issued by trust affiliates of BNC in connection with the issuance of trust preferred securities will also be assumed in connection with the Merger. Upon consummation of the Merger, Pinnacle Financial expects that its total assets will exceed $15.0 billion, which as a result of exceeding that level as a result of the Merger, would cause the subordinated debentures Pinnacle Financial and BNC have issued in connection with prior trust preferred securities offerings to cease to qualify as Tier 1 capital under applicable banking regulations. Though these securities would no longer qualify as Tier 1 capital from and after the closing of the Merger, Pinnacle Financial believes these subordinated debentures would continue to qualify as Tier 2 capital.

2017 Public Offering

In January 2017, we completed a public offering of approximately 3.22 million shares of our common stock in a transaction that resulted in net proceeds to us, after deducting underwriting discounts and commissions and estimated other expenses payable by us, of $191.2 million. We have contributed $185.0 million of these net proceeds to our bank subsidiary.

Note 2. Acquisitions

Acquisition – CapitalMark Bank & Trust. On July 31, 2015, Pinnacle Financial consummated its acquisition of CapitalMark. Pursuant to the terms of the Agreement and Plan of Merger dated as of April 7, 2015 by and among Pinnacle Financial, Pinnacle Bank, and CapitalMark (the CapitalMark Merger Agreement), CapitalMark merged with and into Pinnacle Bank, with Pinnacle Bank continuing as the surviving corporation (the CapitalMark Merger).
By virtue of the CapitalMark Merger, each holder of an issued and outstanding share of common stock of CapitalMark had the right to elect, for each share of CapitalMark Common Stock held by such holder, to receive either (i) 0.50 shares of Pinnacle Financial's Common Stock, (ii) an amount in cash equal to the value of 0.50 shares of Pinnacle Financial's Common Stock, based on the 10-day average closing price for Pinnacle Financial's common stock prior to July 31, 2015 (which such amount equaled $26.78), or (iii) a combination of stock and cash.

Approximately 90% and 10%, respectively, of CapitalMark's outstanding shares of Common Stock as of the effective time of the CapitalMark Merger were converted into shares of Pinnacle Financial Common Stock and cash, respectively. As a result, Pinnacle Financial issued approximately 3.3 million shares of Pinnacle Financial's Common Stock and paid approximately $19.7 million in cash (including payments related to fractional shares) to the CapitalMark shareholders. Fractional shares were converted to cash based on the 10-day average closing price for Pinnacle Financial's Common Stock prior to July 31, 2015. All of CapitalMark's outstanding stock options vested upon consummation of the CapitalMark Merger and were converted into options to purchase shares of Pinnacle Financial's Common Stock at the common stock exchange rates. The fair market value of stock options assumed was $30.4 million.

With this acquisition, Pinnacle Financial expanded its presence in the East Tennessee region by expanding into the Chattanooga MSA. The following summarizes consideration paid and an allocation of purchase price to net assets acquired (dollars in thousands):

	Number of Shares	Amount
Equity consideration		
Common stock issued	3,306,184	$175,525
Fair value of stock options assumed		30,430
Total equity consideration		$205,955
Non-equity consideration - Cash		19,675
Total consideration paid		$225,630
Allocation of total consideration paid:		
Fair value of net assets assumed including estimated identifiable intangible assets		$73,186
Goodwill		152,444
		$225,630

Goodwill originating from the CapitalMark Merger resulted primarily from anticipated synergies arising from the combination of certain operational areas of the businesses as well as the purchase premium inherent in buying a complete and successful banking operation. Goodwill associated with the CapitalMark Merger is not amortizable for book or tax purposes.
Acquisition - Magna Bank. On September 1, 2015, Pinnacle Financial consummated its merger with Magna. Pursuant to the terms of the Agreement and Plan of Merger dated as of April 28, 2015 by and among Pinnacle Financial, Pinnacle Bank and Magna (the Magna Merger Agreement), Magna merged with and into Pinnacle Bank, with Pinnacle Bank continuing as the surviving corporation (the Magna Merger).
By virtue of the Magna Merger, each holder of an issued and outstanding share of common stock of Magna (including shares of Magna's common stock issued automatically upon conversion of Magna's Series D preferred stock

immediately prior to the effective time of the Magna Merger) had the right to elect, for each share of Magna common stock held by such holder (including shares of Magna's common stock issued automatically upon conversion of Magna's Series D preferred stock immediately prior to the effective time of the Magna Merger), to receive either (i) 0.3369 shares of Pinnacle Financial's Common Stock, (ii) an amount in cash equal to $14.32, or (iii) a combination of stock and cash.

In total, Magna common shareholders (including holders of shares of Magna's common stock issued automatically upon conversion of Magna's Series D preferred stock immediately prior to the effective time of the Merger) had approximately 75% of their shares of Magna common stock as of the effective time of the Merger (including shares of Magna's common stock issued automatically upon conversion of Magna's Series D preferred stock immediately prior to the effective time of the Merger) converted into shares of Pinnacle Financial Common Stock and approximately 25% of their shares converted into cash. As a result, Pinnacle Financial issued approximately 1.4 million shares of Pinnacle Financial Common Stock and paid approximately $19.5 million in cash (including payments related to fractional shares) to the Magna shareholders. Additionally, at the time of the Magna Merger there were 139,417 unexercised stock options that were exchanged for cash equal to $14.32 less the respective exercise price. This consideration totaled approximately $847,000, including all applicable payroll taxes.

With this acquisition, Pinnacle Financial expanded its presence in the Memphis MSA. The following summarizes consideration paid and a allocation of purchase price to net assets acquired (dollars in thousands)

	Number of Shares	Amount
Equity consideration		
Common stock issued	1,371,717	$63,538
Total equity consideration		$63,538
Non-Equity Consideration:		
Cash paid to common stockholders		$19,453
Cash paid to exchange outstanding stock options		847
Total consideration paid		$83,838
Allocation of total consideration paid:		
Fair value of net assets assumed including estimated identifiable intangible assets		$49,050
Goodwill		34,788
		$83,838

Goodwill originating from the Magna Merger resulted primarily from anticipated synergies arising from the combination of certain operational areas of the businesses as well as the purchase premium inherent in buying a complete and successful banking operation. Goodwill associated with the Magna Merger is not amortizable for book or tax purposes.

Acquisition - Avenue Financial Holdings, Inc. On July 1, 2016, Pinnacle Financial consummated its previously announced acquisition of Avenue. Pursuant to the terms of the Agreement and Plan of Merger dated as of July 1, 2016 by and among Pinnacle Financial, Pinnacle Bank and Avenue (the Avenue Merger Agreement), Avenue merged with and into Pinnacle Financial, with Pinnacle Financial continuing as the surviving corporation (the Avenue Merger). At the same time as the Avenue Merger, Avenue's bank subsidiary Avenue Bank merged with and into Pinnacle Bank, with Pinnacle Bank continuing as the surviving corporation.

The following summarizes the consideration paid and presents a preliminary allocation of purchase price to net assets acquired (dollars in thousands):

	Number of Shares	Amount
Equity consideration:		
Common stock issued	3,760,326	$182,469
Total equity consideration		$182,469
Non-equity consideration:		
Cash paid to common stockholders		$20,910
Cash paid to exchange outstanding stock options		987
Total consideration paid		$204,366

Allocation of total consideration paid:	
Fair value of net assets assumed including estimated identifiable intangible assets	$81,695
Goodwill	122,671
	$204,366

Pinnacle Financial accounted for the aforementioned completed mergers under the acquisition method in accordance with ASC Topic 805. Accordingly, the purchase price is allocated to the fair value of the assets acquired and liabilities assumed as of the date of merger. Purchase price allocations related to the acquisitions of CapitalMark and Magna have been completed.

The following purchase price allocations on the Avenue Merger are preliminary and will be finalized upon the receipt of final valuations on certain assets and liabilities. Upon receipt of final fair value estimates, which must be within one year of the Avenue Merger date, Pinnacle Financial will make any final adjustments to the purchase price allocation and prospectively adjust any goodwill recorded. Information regarding Pinnacle Financial's loan discount and related deferred tax asset, core deposit intangible asset and related deferred tax liability, as well as income taxes payable and the related deferred tax balances recorded in the Avenue Merger, may be adjusted as Pinnacle Financial refines its estimates. Determining the fair value of assets and liabilities, particularly illiquid assets and liabilities, is a complicated process involving significant judgment regarding estimates and assumptions used to calculate estimated fair value. Fair value adjustments based on updated estimates could materially affect the goodwill recorded on the Avenue Merger. Pinnacle Financial may incur losses on the acquired loans that are materially different from losses Pinnacle Financial originally projected.

The acquired assets and liabilities, as well as the adjustments to record the assets and liabilities at their estimated fair values, are presented in the following tables (in thousands):

CapitalMark

	As of July 31, 2015		
	CapitalMark Historical Cost Basis	Fair Value Adjustments	As Recorded by Pinnacle Financial
Assets			
Cash and cash equivalents	$28,021	$ -	$28,021
Investment securities[1]	150,799	(399)	150,400
Loans, net of allowance for loan losses[2]	880,115	(22,600)	857,515
Mortgage loans held for sale	1,791	-	1,791
Other real estate owned	1,728	-	1,728
Core deposit intangible[3]	-	6,193	6,193
Other assets[6]	43,526	6,046	49,572
Total Assets	$1,105,980	$ (10,760)	$1,095,220
Liabilities			
Interest-bearing deposits[4]	$758,492	$ 891	$759,383
Non-interest bearing deposits	193,798	-	193,798
Borrowings[5]	32,874	228	33,102
Other liabilities	35,751	-	35,751
Total Liabilities	$1,020,915	$ 1,119	$1,022,034
Net Assets Acquired	$85,065	$ (11,879)	$73,186

Explanation of certain fair value adjustments:

(1) The amount represents the adjustment of the book value of CapitalMark's investment securities to their estimated fair value on the date of acquisition.

(2) The amount represents the adjustment of the net book value of CapitalMark's loans to their estimated fair value based on current interest rates and expected cash flows as of the date of acquisition, which includes estimates of

expected credit losses inherent in the portfolio.

(3) The amount represents the fair value of the core deposit intangible asset representing the intangible value of the deposit base acquired.

(4) The amount represents the adjustment necessary because the weighted average interest rate of CapitalMark's deposits exceeded the cost of similar funding at the time of acquisition. The fair value adjustment will be amortized to reduce future interest expense over the life of the portfolio.

(5) The amount represents the adjustment necessary because the weighted average interest rate of CapitalMark's FHLB advances exceeded the cost of similar funding at the time of acquisition. The fair value adjustment will be amortized to reduce future interest expense over the life of the portfolio.

(6) The amount represents the deferred tax asset recognized on the fair value adjustment of CapitalMark's acquired assets and assumed liabilities as well as the fair value adjustment on premises and equipment.

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Magna

	As of September 1, 2015		
	Magna Historical Cost Basis	Fair Value Adjustments	As Recorded by Pinnacle Financial
Assets			
Cash and cash equivalents	$17,832	$ -	$17,832
Investment securities[1]	60,018	(280)	59,738
Loans[2]	453,108	(12,429)	440,679
Mortgage loans held for sale	18,886	-	18,886
Other real estate owned[3]	1,471	139	1,610
Core deposit intangible[4]	-	3,170	3,170
Other assets[5]	31,057	4,922	35,979
Total Assets	$582,372	$ (4,478)	$577,894
Liabilities			
Interest-bearing deposits[6]	$402,535	$ 1,268	$403,803
Non-interest bearing deposits	48,851	-	48,851
Borrowings[7]	46,900	506	47,406
Other liabilities[8]	28,043	741	28,784
Total Liabilities	$526,329	$ 2,515	$528,844
Net Assets Acquired	$56,043	$ (6,993)	$49,050

Explanation of certain fair value adjustments:

(1) The amount represents the adjustment of the book value of Magna's investment securities to their estimated fair value on the date of acquisition.

(2) The amount represents the adjustment of the net book value of Magna's loans to their estimated fair value based on interest rates and expected cash flows as of the date of acquisition, which includes estimates of expected credit losses inherent in the portfolio.

(3) The amount represents the adjustment to the book value of Magna's OREO to fair value on the date of acquisition.

(4) The amount represents the fair value of the core deposit intangible asset representing the intangible value of the deposit base acquired.

(5) The amount represents the deferred tax asset recognized on the fair value adjustment of Magna's acquired assets and assumed liabilities as well as the fair value adjustment for the mortgage servicing right and property and equipment. The value of the deferred tax asset was decreased by $1.9 million as a result of the completion of the 2015 tax return.

(6) The amount represents the adjustment necessary because the weighted average interest rate of Magna's deposits exceeded the cost of similar funding at the time of acquisition. The fair value adjustment will be amortized to reduce future interest expense over the life of the portfolio.

(7) The amount represents the adjustment necessary because the weighted average interest rate of Magna's FHLB advances exceeded the cost of similar funding at the time of acquisition. The fair value adjustment will be amortized to reduce future interest expense over the life of the portfolio.

(8) The amount represents the adjustment to accrue two potential loss contingencies related to Magna's business operations that existed as of the acquisition date.

Avenue

	As of July 1, 2016		
	Avenue Historical Cost Basis	Preliminary Fair Value Adjustments	As Recorded by Pinnacle Financial
Assets			
Cash and cash equivalents	$39,485	$ -	$39,485
Investment securities[1]	163,862	(463)	163,399
Loans[2]	980,319	(27,789)	952,530
Mortgage loans held for sale	3,310	-	3,310
Core deposit intangible[3]	-	8,845	8,845
Other assets[4]	47,729	8,774	56,503
Total Assets	$1,234,705	$ (10,633)	$1,224,072
Liabilities			
Interest-bearing deposits[5]	$741,635	$ 1,400	$743,035
Non-interest bearing deposits	223,685	-	223,685
Borrowings[6]	142,639	3,240	145,879
Other liabilities	29,719	59	29,778
Total Liabilities	$1,137,678	$ 4,699	$1,142,377
Net Assets Acquired	$97,027	$ (15,332)	$81,695

Explanation of certain fair value adjustments:

(1) The amount represents the adjustment of the book value of Avenue's investment securities to their estimated fair value on the date of acquisition.

(2) The amount represents the adjustment of the net book value of Avenue's loans to their estimated fair value based on interest rates and expected cash flows as of the date of acquisition, which includes estimates of expected credit losses inherent in the portfolio.

(3) The amount represents the fair value of the core deposit intangible asset representing the intangible value of the deposit base acquired.

(4) The amount represents the deferred tax asset recognized on the fair value adjustment of Avenue's acquired assets and assumed liabilities as well as the fair value adjustment for property and equipment.

(5) The amount represents the adjustment necessary because the weighted average interest rate of Avenue's deposits exceeded the cost of similar funding at the time of acquisition. The fair value adjustment will be amortized to reduce future interest expense over the life of the portfolio.

(6) The amount represents the adjustment necessary because the weighted average interest rate of Avenue's FHLB advances and subordinated debt issuance exceeded the cost of similar funding at the time of acquisition. The fair value adjustment will be amortized to reduce future interest expense over the life of the portfolio.

Note 3. Equity method investment

On February 1, 2015, Pinnacle Bank acquired a 30% interest in Bankers Healthcare Group, LLC (BHG) for $75 million in cash. On March 1, 2016, Pinnacle Bank and Pinnacle Financial increased their investment in BHG by a combined 19%, for a total investment in BHG of 49%. The additional 19% interest was acquired pursuant to a purchase agreement whereby both Pinnacle Financial and Pinnacle Bank acquired 8.55% and an additional 10.45%, respectively, of the outstanding membership interests in BHG in exchange for $74.1 million in cash and 860,470 shares of Pinnacle Financial common stock.

The 860,470 shares of Pinnacle Financial common stock issued at the closing of the investment were issued in a private placement exempt from registration under Section 4(2) of the Securities Act of 1933, as amended (Securities Act), and Rule 506 of Regulation D promulgated under the Securities Act. Subsequent to the placement of the 860,470 shares, Pinnacle Financial filed a registration statement on Form S-3 with the SEC covering the resale of such shares as a secondary offering to be made on a continuous basis pursuant to Rule 415 of the Securities Act.

On March 1, 2016, Pinnacle Financial, Pinnacle Bank and the other members of BHG entered into an Amended and Restated Limited Liability Company Agreement of BHG that provides for, among other things, the following terms:

- the inability of any member of BHG to transfer its ownership interest in BHG without the consent of the other members of BHG for five years, other than transfers to family members, trusts or affiliates of the transferring member, in connection with the acquisition of Pinnacle Financial or Pinnacle Bank or as a result of a change in applicable law that forces Pinnacle Financial and/or Pinnacle Bank to divest their ownership interests in BHG;

- the inability of the board of managers of BHG (of which Pinnacle Financial and Pinnacle Bank have the right to designate two of the five members (the Pinnacle Managers) to approve a sale of BHG without the consent of one of the Pinnacle Managers for four years;
- co-sale rights for Pinnacle Financial and Pinnacle Bank in the event the other members of BHG decide to sell all or a portion of their ownership interests after the above-described five-year limitation; and
- a right of first refusal for BHG and the other members of BHG in the event that Pinnacle Financial and/or Pinnacle Bank decide to sell all or a portion of their ownership interests after the above-described five-year limitation, except in connection with a transfer of their ownership interests to an affiliate or in connection with the acquisition of Pinnacle Financial or Pinnacle Bank.

Pinnacle Financial accounts for this investment pursuant to the equity method for unconsolidated subsidiaries and will recognize its interest in BHG's profits and losses in noninterest income with corresponding adjustments to the BHG investment account. Because BHG has been determined to be a voting interest entity of which Pinnacle Financial and Pinnacle Bank together control less than a majority of the board seats following the closing of the additional investment in March 2016, this investment does not require consolidation and is accounted for pursuant to the equity method of accounting. Additionally, Pinnacle Financial did not recognize any goodwill or other intangible asset associated with these transactions as of the respective purchase dates, however, it will recognize accretion income and amortization expense associated with the fair value adjustments to the net assets acquired including the fair value of certain of BHG's liabilities which are recorded as a component of income from equity method investment, pursuant to the equity method of accounting.

Pinnacle Financial and Pinnacle Bank account for their consolidated interest in BHG's profits and losses in noninterest income with corresponding adjustments to the BHG investment account.

At December 31, 2016, Pinnacle Financial has recorded technology, trade name and customer relationship intangibles, net of related amortization, of $16.8 million compared to $6.1 million as of December 31, 2015. Amortization expense of $3.4 million was included in Pinnacle Financial's results for the year ended December 31, 2016 compared to $1.3 million for the prior year. Accretion income of $2.5 million was included in Pinnacle Financial's results for the year ended December 31, 2016, while no accretion income was recorded in 2015. Additionally, at December 31, 2016, Pinnacle Financial had recorded accretable discounts associated with certain liabilities of BHG of $18.1 million compared to $8.0 million as of December 31, 2015.

During the year ended December 31, 2016, Pinnacle Financial and Pinnacle Bank received dividends from BHG of $29.0 million in the aggregate, respectively, compared to $7.2 million in the year ended December 31, 2015. Earnings from BHG are included in Pinnacle Financial's consolidated tax return. Profits from intercompany transactions are eliminated. As part of ongoing business transacted with BHG, Pinnacle Bank purchased loans totaling $2.2 million during the year ended December 31, 2015. No loans were purchased from BHG for the year ended December 31, 2016.

A summary of BHG's financial position and results of operations as of and for the years ended December 31, 2016 and 2015, respectively, were as follows (unaudited, in thousands):

Banker's Healthcare Group
($ in thousands)

	December 31, 2016	December 31, 2015
Assets	$223,246	$220,578
Liabilities	139,531	137,147

Equity interests	83,715	83,431
Total liabilities and equity	$223,246	$220,578

	For the year ended December 31,	
	2016	2015
Revenues	$136,693	$144,772
Net income, pre-tax	67,135	77,748

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Note 4. Restricted Cash Balances

Regulation D of the Federal Reserve Act requires that banks maintain reserve balances with the Federal Reserve Bank based principally on the type and amount of their deposits. At our option, Pinnacle Financial maintains additional balances to compensate for clearing and other services. For the years ended December 31, 2016 and 2015, the average daily balance maintained at the Federal Reserve was approximately $183.1 million and $134.3 million, respectively.

Note 5. Securities

The amortized cost and fair value of securities available-for-sale and held-to-maturity at December 31, 2016 and 2015 are summarized as follows (in thousands):

December 31, 2016	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Securities available-for-sale:				
U.S Treasury securities	$250	$ -	$ -	$250
U.S. Government agency securities	22,306	-	537	21,769
Mortgage-backed securities	988,008	4,304	15,686	976,626
State and municipal securities	211,581	4,103	2,964	212,720
Asset-backed securities	79,318	111	849	78,580
Corporate notes	8,608	39	46	8,601
	$1,310,071	$ 8,557	$ 20,082	$1,298,546
Securities held-to-maturity:				
State and municipal securities	25,251	87	105	25,233
	$25,251	$ 87	$ 105	$25,233
December 31, 2015				
Securities available-for-sale:				
U.S Treasury securities	$-	$ -	$ -	$-
U.S. Government agency securities	131,499	3	3,309	128,193
Mortgage-backed securities	581,998	5,948	5,030	582,916
State and municipal securities	158,072	7,094	124	165,042
Asset-backed securities	49,598	8	805	48,801
Corporate notes	9,541	589	17	10,113
	$930,708	$ 13,642	$ 9,285	$935,065
Securities held-to-maturity:				
State and municipal securities	31,377	257	48	31,586
	$31,377	$ 257	$ 48	$31,586

At December 31, 2016, approximately $902.9 million of Pinnacle Financial's investment portfolio was pledged to secure public funds and other deposits and securities sold under agreements to repurchase. At December 31, 2016, repurchase agreements comprised of secured borrowings totaled $85.7 million and were secured by $85.7 million of pledged U.S. government agency securities, municipal securities, asset backed securities, and corporate debentures. As the fair value of securities pledged to secure repurchase agreements may decline, Pinnacle Financial regularly evaluates its need to pledge additional securities for the counterparty to remain adequately secured.

The amortized cost and fair value of debt securities as of December 31, 2016 by contractual maturity are shown below. Actual maturities may differ from contractual maturities of mortgage-backed securities since the mortgages underlying the securities may be called or prepaid with or without penalty. Therefore, these securities are not included in the maturity categories in the following summary (in thousands):

	Available-for-sale		Held-to-maturity	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
Due in one year or less	$2,533	$2,556	$594	$594
Due in one year to five years	60,311	61,591	10,186	10,182
Due in five years to ten years	122,753	123,769	10,586	10,567
Due after ten years	57,148	55,424	3,885	3,890
Mortgage-backed securities	988,008	976,626	-	-
Asset-backed securities	79,318	78,580	-	-
	$1,310,071	$1,298,546	$25,251	$25,233

At December 31, 2016 and 2015, included in securities were the following investments with unrealized losses. The information below classifies these investments according to the term of the unrealized loss of less than twelve months or twelve months or longer (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
December 31, 2016						
U.S. Treasury securities	$-	$ -	$-	$ -	$-	$ -
U.S. government agency securities	-	-	20,820	537	20,820	537
Mortgage-backed securities	801,213	15,073	43,148	613	844,361	15,686
State and municipal securities	87,277	3,068	312	1	87,589	3,069
Asset-backed securities	14,510	32	34,097	817	48,607	849
Corporate notes	4,810	46	-	-	4,810	46
Total temporarily-impaired securities	$907,810	$ 18,219	$98,377	$ 1,968	$1,006,187	$ 20,187
December 31, 2015						
U.S. Treasury securities	$-	$ -	$-	$ -	$-	$ -
U.S. government agency securities	61,903	1,702	65,538	1,607	127,441	3,309
Mortgage-backed securities	338,230	2,789	103,003	2,241	441,233	5,030
State and municipal securities	6,509	38	6,135	134	12,644	172
Asset-backed securities	41,466	798	3,539	7	45,005	805
Corporate notes	2,554	17	-	-	2,554	17
Total temporarily-impaired securities	$450,662	$ 5,344	$178,215	$ 3,989	$628,877	$ 9,333

The applicable date for determining when securities are in an unrealized loss position is December 31, 2016 and 2015. As such, it is possible that a security had a market value less than its amortized cost on other days during the twelve-month periods ended December 31, 2016 and 2015, but is not in the "Investments with an Unrealized Loss of less than 12 months" category above.

As shown in the table above, at December 31, 2016 and 2015, Pinnacle Financial had unrealized losses of $20.2 million and $9.3 million on $1.0 billion and $628.9 million, respectively, of available-for-sale and held-to-maturity securities. The unrealized losses associated with these investment securities are primarily driven by changes in interest rates and are not due to the credit quality of the securities. These securities will continue to be monitored as a part of our ongoing impairment analysis, but are expected to perform even if the rating agencies reduce the credit rating of the bond issuers. Management evaluates the financial performance of the issuers on a quarterly basis to determine if it is probable that the issuers can make all contractual principal and interest payments. Because Pinnacle Financial currently does not intend to sell these securities 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 December 31, 2016.

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. Consistent with the investment policy, available-for-sale securities of $72.8 million were sold and net unrealized gains of $395,000 were reclassified from accumulated other comprehensive income into net income.

The carrying values of Pinnacle Financial's investment securities could decline in the future if the financial condition of the securities' 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. Additionally, there is 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.

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Note 6. 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).

Pinnacle Financial uses five loan categories: commercial real estate mortgage, consumer real estate mortgage, construction and land development, commercial and industrial, consumer and other.

- Commercial real-estate mortgage loans. Commercial real-estate mortgage loans are categorized as such based on investor exposures where repayment is largely dependent upon the operation, refinance, or sale of the underlying real estate. Commercial real-estate mortgage also includes owner occupied commercial real estate which shares a similar risk profile to our commercial and industrial products.
- Consumer real-estate mortgage loans. Consumer real-estate mortgage consists primarily of loans secured by 1-4 residential properties including home equity lines of credit.
- Construction and land development loans. Construction and land development loans include loans where the repayment is dependent on the successful operation of the related real estate project. Construction and land development loans include 1-4 family construction projects and commercial construction endeavors such as warehouses, apartments, office and retail space and land acquisition and development.
- Commercial and industrial loans. Commercial and industrial loans include loans to business enterprises issued for commercial, industrial and/or other professional purposes.
- Consumer and other loans. Consumer and other loans include all loans issued to individuals not included in the consumer real-estate mortgage classification. Examples of consumer and other loans are automobile loans, credit cards and loans to finance education, among others.

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. Pass-rated loans include five distinct ratings categories for loans that represent specific attributes. Pinnacle Financial believes that its categories follow those outlined by Pinnacle Bank's primary regulators. At December 31, 2016, approximately 79% 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 a financial advisor and a senior credit officer. At least annually, our credit policy requires 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 such as certain commercial and industrial loans, land loans and/or loan types in certain geographies.

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

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.

The following table outlines the amount of each loan classification categorized into each risk rating category as of December 31, 2016 and 2015 (in thousands):

December 31, 2016	Commercial real estate - mortgage	Consumer real estate - mortgage	Construction and land development	Commercial and industrial	Consumer and other	Total
Accruing loans:						
Pass	$3,137,239	$1,159,003	$ 897,549	$2,782,000	$264,682	$8,240,473
Special Mention	21,449	1,620	2,716	25,641	802	52,228
Substandard (1)	29,674	13,833	5,788	65,215	129	114,639
Total	3,188,362	1,174,456	906,053	2,872,856	265,613	8,407,340
Impaired loans:						
Nonaccruing loans						
Substandard-nonaccrual	4,921	8,073	6,613	7,492	475	27,574
Doubtful-nonaccrual	-	-	-	3	-	3
Total nonaccruing loans(3)	4,921	8,073	6,613	7,495	475	27,577
Troubled debt restructurings(2)						
Pass	213	1,358	7	713	41	2,332
Special Mention	-	236	-	-	-	236
Substandard	-	1,794	-	10,646	-	12,440
Total troubled debt restructurings	213	3,388	7	11,359	41	15,008
Total impaired loans	5,134	11,461	6,620	18,854	516	42,585
Total loans	$3,193,496	$1,185,917	$ 912,673	$2,891,710	$266,129	$8,449,925
December 31, 2015						
Accruing loans:						
Pass	$2,217,639	$1,020,239	$732,662	$2,143,006	$239,874	$6,353,420
Special Mention	18,162	1,894	1,133	26,037	118	47,344
Substandard (1)	33,638	11,346	6,295	53,671	74	105,024
Total	2,269,439	1,033,479	740,090	2,222,714	240,066	6,505,788
Impaired loans:						
Nonaccruing loans						
Substandard-nonaccrual	5,819	9,344	7,607	1,591	4,902	29,263
Doubtful-nonaccrual	2	2	-	92	-	96
Total nonaccruing loans(3)	5,821	9,346	7,607	1,683	4,902	29,359
Troubled debt restructurings(2)						
Pass	223	409	-	553	28	1,213
Special Mention	-	422	-	-	-	422
Substandard	-	2,861	-	3,592	-	6,453
Total troubled debt restructurings	223	3,692	-	4,145	28	8,088
Total impaired loans	6,044	13,038	7,607	5,828	4,930	37,447
Total loans	$2,275,483	$1,046,517	$747,697	$2,228,542	$244,996	$6,543,235

(1) Potential problem loans represent those loans with a well-defined weakness and where information about possible credit problems of borrowers has caused management to have doubts about the borrower's ability to comply with present repayment terms. This definition is believed to be substantially consistent with the standards established by Pinnacle Bank's primary regulators for loans classified as substandard, excluding the impact of substandard nonperforming loans and substandard troubled debt restructurings. Potential problem loans, which are not included in nonperforming assets, amounted to approximately $114.6 million at December 31, 2016, compared to $105.0 million at December 31, 2015.

(2)

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

(3) Included in nonaccrual loans at December 31, 2016 and 2015 are $8.8 million and $12.1 million, respectively, in loans acquired with deteriorated credit quality and accounted for as purchase credit impaired.

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At December 31, 2016 and 2015, all loans classified as nonaccrual were deemed to be impaired. The principal balances of these nonaccrual loans amounted to $27.6 million and $29.4 million at December 31, 2016 and 2015, respectively, and are included in the table above. For the twelve months ended December 31, 2016, the average balance of nonaccrual loans was $35.1 million as compared to $21.6 million for the twelve months ended December 31, 2015. Pinnacle Financial's policy is that the discontinuation of the accrual of interest income will occur when (1) there is a significant deterioration in the financial condition of the borrower and full repayment of principal and interest is not expected or (2) the principal or interest is more than 90 days past due, unless the loan is both well secured and in the process of collection. As such, at the date the above mentioned loans were placed on nonaccrual status, Pinnacle Financial reversed all previously accrued interest income against current year earnings. Had these nonaccruing loans been on accruing status, interest income would have been higher by $2.1 million, $2.3 million and $636,000 for the years ended December 31, 2016, 2015 and 2014, respectively.

As discussed in Note 2, during 2016, the Company acquired loans of $952.5 million from Avenue. Of the $952.5 million of net loans acquired in 2016, $951.1 million were determined to have no evidence of deteriorated credit quality and are accounted for under ASC Topics 310-10 and 310-20. Our acquired loans were recorded at fair value upon acquisition. These loans are subject to additional allowance or provisioning charges in the event there is evidence of credit deterioration. The remaining acquired loans of $1.4 million were determined to have deteriorated credit quality under ASC Topic 310-30. The table below details these two subsections of the acquired loans by loan classification into each risk rating category as of December 31, 2016 (dollars in thousands):

	Commercial real estate - mortgage	Consumer real estate - mortgage	Construction and land development	Commercial and industrial	Consumer and other	Fair Value Adjustment	Net total acquired loans
December 31, 2016							
Gross contractual accruing loans							
Pass	$ 365,797	$119,430	$ 114,849	$ 280,415	11,897	$ (18,893)	$873,495
Special Mention	9,075	-	-	570	-	(142)	9,503
Substandard	-	3,382	1,835	-	-	(132)	5,085
Total	374,872	122,812	116,684	280,985	11,897	(19,167)	888,083
Gross contractual impaired loans[(1)]							
Nonaccrual loans							
Substandard-nonaccrual	-	295	404	388	73	(594)	566
Doubtful-nonaccrual	-	-	-	-	-	-	-
Total nonaccrual loans	-	295	404	388	73	(594)	566
Total gross contractual acquired impaired loans	-	295	404	388	73	(594)	566
Total gross contractual acquired loans	$374,872	$123,107	$117,088	$281,373	$11,970	$(19,761)	$888,649

(1) All of the acquired impaired loans have been deemed to be collateral dependent and as such were placed on nonaccrual. As such, no accretable difference has been recorded on these loans.

The following table provides a rollforward of purchase credit impaired loans from December 31, 2015 through December 31, 2016 (in thousands):

	Gross Contractual Receivable	Accretable Yield	Nonaccretable Yield	Carrying Value
Acquisition Date	$ 19,960	$ -	$ (5,703)	$ 14,257

Settlements	(3,803)	-	1,560	(2,243)
Additional fundings	117	-	-	117
December 31, 2015	16,274	-	(4,143)	12,131
Acquisitions	1,359	-	(812)	547
Settlements	(6,017)	-	1,322	(4,695)
Additional fundings	852	-	-	852
December 31, 2016	$ 12,468	$ -	$ (3,633)	$ 8,835

These loans have been deemed to be collateral dependent and as such, no accretable yield has been recorded for these loans. At the date of acquisition, the Day 1 Fair Value represents the carrying value. The carrying value is adjusted for additional draws, pursuant to contractual arrangements, offset by loan paydowns. Year-to-date settlements include both loans that were charged-off as well as loans that were paid off, typically as a result of refinancings at other institutions.

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The following tables detail the recorded investment, unpaid principal balance and related allowance and average recorded investment of our nonaccrual loans at December 31, 2016, 2015 and 2014 by loan classification and the amount of interest income recognized on a cash basis throughout the year-to-date period then ended, respectively, on these loans that remain on the balance sheets (in thousands):

	December 31, 2016			For the year ended December 31, 2016	
	Recorded investment	Unpaid principal balance	Related allowance[(1)]	Average recorded investment	Cash basis interest income recognized
Collateral dependent nonaccrual loans:					
Commercial real estate – mortgage	$2,308	$2,312	$ -	$2,540	$ -
Consumer real estate – mortgage	2,880	2,915	-	2,907	-
Construction and land development	3,128	3,135	-	3,132	159
Commercial and industrial	6,373	6,407	-	8,841	-
Consumer and other	-	-	-	-	-
Total	$14,689	$14,769	$ -	$17,420	$ 159
Cash flow dependent nonaccrual loans:					
Commercial real estate – mortgage	$2,613	$3,349	$ 59	$2,688	$ -
Consumer real estate – mortgage	5,193	5,775	688	5,966	-
Construction and land development	3,485	4,154	20	3,476	-
Commercial and industrial	1,122	2,714	77	2,884	-
Consumer and other	475	851	227	2,624	-
Total	$12,888	$16,843	$ 1,071	$17,638	$ -
Total Nonaccrual Loans	$27,577	$31,612	$ 1,071	$35,058	$ 159

	December 31, 2015			For the year ended December 31, 2015	
	Recorded investment	Unpaid principal balance	Related allowance[(1)]	Average recorded investment	Cash basis interest income recognized
Collateral dependent nonaccrual loans:					
Commercial real estate – mortgage	$4,411	$5,659	$ -	$2,253	$ -
Consumer real estate – mortgage	5,596	6,242	-	3,067	-
Construction and land development	7,531	7,883	-	4,317	308
Commercial and industrial	1,420	3,151	-	1,527	-
Consumer and other	-	-	-	-	-
Total	$18,958	$22,935	$ -	$11,164	$ 308
Cash flow dependent nonaccrual loans:					
Commercial real estate – mortgage	$1,410	$1,661	$ 20	$1,466	$ -
Consumer real estate – mortgage	3,750	4,098	616	3,815	-
Construction and land development	76	125	12	87	-
Commercial and industrial	263	281	19	168	-
Consumer and other	4,902	5,341	3,002	4,913	-
Total	$10,401	$11,506	$ 3,669	$10,449	$ -

Total Nonaccrual Loans	$29,359	$34,441	$ 3,669	$21,613	$ 308

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	December 31, 2014			For the year ended December 31, 2014	
	Recorded investment	Unpaid principal balance	Related allowance[1]	Average recorded investment	Cash basis interest income recognized
Collateral dependent nonaccrual loans:					
Commercial real estate – mortgage	$2,422	$2,641	$ -	$2,624	$ -
Consumer real estate – mortgage	1,472	1,901	-	1,552	-
Construction and land development	4,810	4,810	-	5,016	256
Commercial and industrial	1,325	1,804	-	1,561	-
Consumer and other	-	-	-	-	-
Total	$10,029	$11,156	$ -	$10,753	$ 256
Cash flow dependent nonaccrual loans:					
Commercial real estate – mortgage	$1,891	$2,107	$ 108	$1,958	$ -
Consumer real estate – mortgage	2,986	3,205	654	3,080	-
Construction and land development	363	406	79	384	-
Commercial and industrial	284	294	62	316	-
Consumer and other	1,152	1,184	252	972	-
Total	$6,676	$7,196	$ 1,155	$6,710	$ -
Total Nonaccrual Loans	$16,705	$18,352	$ 1,155	$17,463	$ 256

(1) Collateral dependent loans are typically charged-off to their net realizable value 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 approximately $159,000, $308,000 and $256,000 in interest income from cash payments received on nonaccrual loans during the years ended December 31, 2016, 2015, and 2014, respectively.

At December 31, 2016 and 2015, there were $15.0 million and $8.1 million, respectively, of troubled debt restructurings that were performing as of their restructure date and which are accruing interest. These troubled debt restructurings are considered impaired loans pursuant to U.S. GAAP. Troubled commercial loans are restructured by specialists within Pinnacle Bank's Special Assets Group, and all restructurings are approved by committees and credit officers separate and apart from the normal loan approval process. These specialists are charged with reducing Pinnacle Financial's overall risk and exposure to loss in the event of a restructuring by obtaining some or all of the following: improved documentation, additional guaranties, increase in curtailments, reduction in collateral release terms, additional collateral or other similar strategies.

The following table outlines the amount of each troubled debt restructuring by loan classification made during the years ended December 31, 2016, 2015 and 2014 (in thousands):

	Number of contracts	Pre Modification Outstanding Recorded Investment	Post Modification Outstanding Recorded Investment, net of related allowance
December 31, 2016			
Commercial real estate – mortgage	-	$ -	$ -
Consumer real estate – mortgage	-	-	-
Construction and land development	-	-	-
Commercial and industrial	6	11,084	11,083
Consumer and other	-	-	-
	6	$ 11,084	$ 11,083
December 31, 2015			
Commercial real estate – mortgage	1	$ 223	$ 185
Consumer real estate – mortgage	-	-	-
Construction and land development	-	-	-
Commercial and industrial	1	434	337
Consumer and other	-	-	-
	2	$ 657	$ 522
December 31, 2014			
Commercial real estate – mortgage	-	$ -	$ -
Consumer real estate – mortgage	1	47	38
Construction and land development	1	436	403
Commercial and industrial	10	3,628	2,646
Consumer and other	-	-	-
	12	$ 4,111	$ 3,087

During the years ended December 31, 2016, 2015 and 2014, Pinnacle Financial had no troubled debt restructurings that subsequently defaulted within twelve months of the restructuring. A default is defined as an occurrence which violates the terms of the receivable's contract.

In addition to the loan metrics above, Pinnacle Financial analyzes its commercial loan portfolio to determine if a concentration of credit risk exists to any industries. Pinnacle Financial utilizes broadly accepted industry classification systems in order to classify borrowers into various industry classifications. Pinnacle Financial has a credit exposure (loans outstanding plus unfunded lines of credit) exceeding 25% of Pinnacle Bank's total risk-based capital to borrowers in the following industries at December 31, 2016 with the comparative exposures for December 31, 2015 (in thousands):

	At December 31, 2016			
	Outstanding Principal Balances	Unfunded Commitments	Total exposure	Total Exposure at December 31, 2015
Lessors of nonresidential buildings	$1,294,366	$ 407,487	$1,701,853	$1,078,211
Lessors of residential buildings	526,259	347,975	874,234	500,266

New housing operative builders	229,035	157,370	386,405	206,538
Hotels and motels	127,296	164,569	291,865	167,317

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The table below presents past due balances at December 31, 2016 and 2015, by loan classification and segment allocated between performing and nonperforming status (in thousands):

December 31, 2016	30-89 days past due and performing	90 days or more past due and performing	Total past due and performing	Nonperforming(1)	Current and performing	Total Loans
Commercial real estate:						
Owner-occupied	$ 3,505	$ -	$ 3,505	$ 4,254	$ 1,347,134	$ 1,354,893
All other	-	-	-	667	1,837,936	1,838,603
Consumer real estate – mortgage	3,838	53	3,891	8,073	1,173,953	1,185,917
Construction and land development	2,210	-	2,210	6,613	903,850	912,673
Commercial and industrial	4,475	-	4,475	7,495	2,879,740	2,891,710
Consumer and other	7,168	1,081	8,249	475	257,405	266,129
	$ 21,196	$ 1,134	$ 22,330	$ 27,577	$ 8,400,018	$ 8,449,925
December 31, 2015						
Commercial real estate:						
Owner-occupied	$ -	$ -	$ -	$ 5,103	$ 1,078,394	$ 1,083,497
All other	-	-	-	718	1,191,268	1,191,986
Consumer real estate – mortgage	6,380	1,396	7,776	9,346	1,029,395	1,046,517
Construction and land development	309	-	309	7,607	739,781	747,697
Commercial and industrial	4,798	-	4,798	1,683	2,222,061	2,228,542
Consumer and other	6,721	373	7,094	4,902	233,000	244,996
	$ 18,208	$ 1,769	$ 19,977	$ 29,359	$ 6,493,899	$ 6,543,235

(1) Approximately $16.7 million and $19.0 million of nonaccrual loans as of December 31, 2016 and 2015, respectively, are currently performing pursuant to their contractual terms.

The following table shows the allowance allocation by loan classification for accruing and nonperforming loans at December 31, 2016 and 2015 (in thousands):

	Accruing Loans		Impaired Loans Nonaccrual Loans		Troubled Debt Restructurings(1)		Total Allowance for Loan Losses	
	December 31, 2016	December 31, 2015	December 31, 2016	December 31, 2015	December 31, 2016	December 31, 2015	December 31, 2016	December 31, 2015
Commercial real estate –mortgage	$ 13,595	$ 15,452	$ 59	$ 20	$ 1	$ 41	$ 13,655	$ 15,513
Consumer real estate – mortgage	5,874	6,109	688	616	2	495	6,564	7,220
Construction and land development	3,604	2,891	20	12	-	-	3,624	2,903
Commercial and industrial	24,648	22,669	77	19	18	955	24,743	23,643
Consumer and other	9,293	12,609	227	3,002	-	5	9,520	15,616
Unallocated	-	-	-	-	-	-	874	537
	$ 57,014	$ 59,730	$ 1,071	$ 3,669	$ 21	$ 1,496	$ 58,980	$ 65,432

(1) Troubled debt restructurings of $15.0 million and $8.1 million as of December 31, 2016 and 2015, respectively, are classified as impaired loans pursuant to U.S. GAAP; however, these loans continue to accrue interest at contractual rates.

The following table details the changes in the allowance for loan losses from December 31, 2014 to December 31, 2015 to December 31, 2016 by loan classification and the allocation of allowance for loan losses (in thousands):

	Commercial real estate - mortgage	Consumer real estate - mortgage	Construction and land development	Commercial and industrial	Consumer and other	Unallocated	Total
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	(875)	(1,621)	(301)	(3,095)	(1,811)	-	(7,703)
Recovery of previously charged-off loans	538	671	277	1,484	487	-	3,457
Provision for loan losses	1,167	(1,981)	(1,487)	5,644	1,262	(970)	3,635
Balance at December 31, 2014	$22,202	$5,424	$5,724	$29,167	$1,570	$3,272	$67,359
Collectively evaluated for impairment	$22,094	$3,963	$5,555	$28,329	$1,261		$61,202
Individually evaluated for impairment	108	1,461	169	838	309		2,885
Loans acquired with deteriorated credit quality	-	-	-	-	-		-
Balance at December 31, 2014	$22,202	$5,424	$5,724	$29,167	$1,570	$3,272	$67,359
Loans:							
Collectively evaluated for impairment	$1,539,778	$712,774	$316,857	$1,779,347	$216,155		$4,564,911
Individually evaluated for impairment	4,313	8,384	5,609	5,382	1,428		25,116
Loans acquired with deteriorated credit quality	-	-	-	-	-		-
Balance at December 31, 2014	$1,544,091	$721,158	$322,466	$1,784,729	$217,583		$4,590,027

Allowance for Loan Losses:							
Balance at December 31, 2014	$22,202	$5,424	$5,724	$29,167	$1,570	$3,272	$67,359
Charged-off loans	(384)	(365)	(190)	(2,207)	(18,002)	-	(21,148)
Recovery of previously charged-off loans	85	874	1,479	1,730	5,865	-	10,033
Provision for loan losses	(6,390)	1,287	(4,110)	(5,047)	26,183	(2,735)	9,188
Balance at December 31, 2015	$15,513	$7,220	$2,903	$23,643	$15,616	$537	$65,432
Collectively evaluated for impairment	$15,452	$6,109	$2,891	$22,669	$12,609		$59,730
Individually evaluated for impairment	61	1,111	12	974	3,007		5,165
	-	-	-	-	-		-

Loans acquired with deteriorated credit quality							
Balance at December 31, 2015	$15,513	$7,220	$2,903	$23,643	$15,616	$537	$65,432
Loans:							
Collectively evaluated for impairment	$2,269,439	$1,033,479	$740,090	$2,222,714	$240,066		$6,505,788
Individually evaluated for impairment	2,420	8,986	3,689	5,288	4,930		25,313
Loans acquired with deteriorated credit quality	3,624	4,052	3,918	540	-		12,134
Balance at December 31, 2015	$2,275,483	$1,046,517	$747,697	$2,228,542	$244,996		$6,543,235

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	Commercial real estate - mortgage	Consumer real estate - mortgage	Construction and land development	Commercial and industrial	Consumer and other	Unallocated	Total
Allowance for Loan Losses:							
Balance at December 31, 2015	$15,513	$7,220	$2,903	$23,643	$15,616	$537	$65,432
Charged-off loans	(276)	(788)	(231)	(5,801)	(24,016)	-	(31,112)
Recovery of previously charged-off loans	208	546	545	2,138	2,895	-	6,332
Provision for loan losses	(1,790)	(414)	407	4,763	15,025	337	18,328
Balance at December 31, 2016	$13,655	$6,564	$3,624	$24,743	$9,520	$874	$58,980
Collectively evaluated for impairment	$13,595	$5,874	$3,604	$24,648	$9,293		$57,014
Individually evaluated for impairment	60	690	20	95	227		1,092
Loans acquired with deteriorated credit quality	-	-	-	-	-		-
Balance at December 31, 2016	$13,655	$6,564	$3,624	$24,743	$9,520	$874	$58,980
Loans:							
Collectively evaluated for impairment	$3,188,362	$1,174,456	$906,053	$2,872,856	$265,613		$8,407,340
Individually evaluated for impairment	2,750	8,941	3,212	18,331	516		33,750
Loans acquired with deteriorated credit quality	2,384	2,520	3,408	523	-		8,835
Balance at December 31, 2016	$3,193,496	$1,185,917	$912,673	$2,891,710	$266,129		$8,449,925

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, historical loss experience, 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 December 31, 2016, Pinnacle Financial had granted loans and other extensions of credit amounting to approximately $22.6 million to current directors, executive officers, and their related entities, of which $14.8 million had been drawn upon. At December 31, 2015, Pinnacle Financial had granted loans and other extensions of credit amounting to approximately $14.5 million to directors, executive officers, and their related entities, of which approximately $11.4 million had been drawn upon. These loans and extensions of credit were made in the ordinary course of business. None of these loans to directors, executive officers, and their related entities were impaired at December 31, 2016 or 2015.

Residential Lending

At December 31, 2016, Pinnacle Financial had approximately $47.7 million of mortgage loans held-for-sale compared to approximately $47.9 million at December 31, 2015. Total loan volumes sold during the year ended December 31, 2016 were approximately $803.5 million compared to approximately $519.1 million for the year ended December 31, 2015. During the year ended December 31, 2016, Pinnacle Financial recognized $15.8 million in gains on the sale of these loans, net of commissions paid, compared to $7.7 million and $5.6 million, respectively, during the years ended December 31, 2015 and 2014.

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 7. Mortgage Servicing Rights

Mortgage servicing rights (MSRs) are recorded at the lower of cost or market in "Other assets" on Pinnacle Financial's consolidated balance sheets and are amortized over the remaining life of the loans and written off when a mortgage loan prepays prior to maturity. The financial data included herein reflects the impact of the mergers that have been consummated beginning on the respective acquisition dates and are subject to future refinements to Pinnacle Financial's purchase accounting adjustments. Mortgage servicing rights had the following carrying values as of December 31, 2015 (in thousands):

	2015 Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount
Mortgage servicing rights	$6,802	$ (390)	$6,412

The following table provides a detail of changes in the mortgage servicing right from September 1, 2015, the closing date of the Magna Merger, to December 31, 2015:

	Residential
Beginning balance acquired in Magna Merger	$ 6,641
Add: Capitalized MSRs	161
Less: Amortization	(390)
Ending balance	$ 6,412

Income and expense associated with these MSRs, which includes servicing fees, late charges, guarantee fees and loan payoff interest, is recorded on a cash basis which approximates income as would be recorded on a U.S. GAAP basis. The following table summarizes the net servicing fee revenues for the year ended December 31, 2015 (in thousands):

	Residential
Gross servicing fees	$ 1,090
Late charges and other ancillary revenue	160
Gross servicing revenue	$ 1,250
Servicing asset amortization	$ 386
Guaranty fees and loan pay-off interest	9
Other servicing expenses	51
Gross servicing expenses	$ 446
Net servicing fee income	$ 804

During the first quarter of 2016, in conjunction with a decision to exit the residential servicing line of business, Pinnacle Bank sold the mortgage servicing rights associated with the $830 million Fannie Mae portion of the residential servicing portfolio for $6.6 million, net of associated costs to sell. Approximately $241,000 was recorded as income during the year ended December 31, 2016 as a result of the sale.

Note 8. Premises and Equipment and Lease Commitments

Premises and equipment at December 31, 2016 and 2015 are summarized as follows (in thousands):

	Range of Useful Lives	2016	2015
Land	Not applicable	$19,467	$19,848
Buildings	15 to 30 years	64,088	60,218

Leasehold improvements	15 to 20 years	28,789	22,485
Furniture and equipment	3 to 15 years	62,982	56,139
		175,326	158,690
Accumulated depreciation and amortization		(86,422)	(80,766)
		$88,904	$77,924

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Depreciation and amortization expense was approximately $9.9 million, $8.5 million, and $5.1 million for the years ended December 31, 2016, 2015 and 2014, respectively.

Pinnacle Financial has entered into various operating leases, primarily for office space and branch facilities. Rent expense related to these leases for 2016, 2015 and 2014 totaled $8.4 million, $5.9 million and $4.9 million, respectively. At December 31, 2016, the approximate future minimum lease payments due under the aforementioned operating leases for their base term are as follows (in thousands):

2017	$7,568
2018	7,538
2019	7,479
2020	7,457
2021	7,349
Thereafter	39,008
	$76,399

During 2016 and as a result of the acquisition of Avenue, Pinnacle Financial has entered into a single capital lease, primarily for office space at an interest rate of 7.22% per year. Rent expense related to this lease for 2016 was approximately $209,000 and is included in total rent expense above. At December 31, 2016, the approximate future minimum lease payments due under the aforementioned capital lease for its base term are as follows (in thousands):

2017	$417
2018	426
2019	470
2020	470
2021	470
Thereafter	3,498
Total minimum lease payments	$5,751
Less: amount representing interest	(1,963)
Present value of net minimum lease payments	$ 3,788

Note 9. Deposits

At December 31, 2016, the scheduled maturities of time deposits are as follows (in thousands):

2017	$617,713
2018	98,689
2019	60,326
2020	31,278
2021	25,041
Thereafter	3,807
	$836,854

Additionally, at December 31, 2016 and 2015, approximately $257.5 million and $279.5 million, respectively, of time deposits had been issued in denominations of $250,000 or greater.

At December 31, 2016 and 2015, Pinnacle Financial had $1.9 million and $1.5 million, respectively, of deposit accounts in overdraft status and thus have been reclassified to loans on the accompanying consolidated balance sheets.

Note 10. Federal Home Loan Bank Advances

Pinnacle Bank is a member of the Federal Home Loan Bank of Cincinnati (FHLB) and as a result, is eligible for advances from the FHLB pursuant to the terms of various borrowing agreements, which assist Pinnacle Bank in the funding of its home mortgage and commercial real estate loan portfolios. Pinnacle Bank has pledged certain qualifying residential mortgage loans and, pursuant to a blanket lien, certain qualifying commercial mortgage loans with an aggregate carrying value of approximately $2.5 billion as collateral under the borrowing agreements with the FHLB.

At December 31, 2016 and 2015, Pinnacle Financial had received advances from the FHLB totaling $406.2 million and $300.3 million, respectively. Additionally, Pinnacle Financial recognized a discount of $167,000 on FHLB advances in conjunction with its acquisition of Avenue in July 2016. At December 31, 2016, the remaining discount was $92,000. At December 31, 2015, there was no discount recognized from previous acquisitions as the discount had been fully amortized. At December 31, 2016, the scheduled maturities of FHLB advances and interest rates are as follows (in thousands):

	Scheduled Maturities	Weighted average interest rates	
2017	$ 392,000	0.79	%
2018	14,003	1.29	%
2019	-	-	
2020	182	2.25	%
2021	-	-	
Thereafter	28	2.75	%
	$ 406,213		
Weighted average interest rate		0.81	%

At December 31, 2016, Pinnacle Bank had accommodations which allow it to borrow from the Federal Reserve Bank of Atlanta's discount window and purchase Federal funds from several of its correspondent banks on an overnight basis at prevailing overnight market rates. These accommodations are subject to various restrictions as to their term and availability, and in most cases, must be repaid within less than a month. At December 31, 2016, there was no balance owed to the Federal Reserve Bank or other correspondents under these agreements. At December 31, 2016, Pinnacle Bank had approximately $3.4 billion in borrowing availability with the FHLB, the Federal Reserve Bank discount window, and other correspondent banks with whom Pinnacle Bank has arranged lines of credit. At December 31, 2016, Pinnacle Bank was not carrying any balances with the Federal Reserve Bank discount window or correspondent banks under these arrangements.

Note 11. Investments in Affiliated Companies and Subordinated Debentures

Beginning on December 29, 2003, Pinnacle Financial established Trusts that were created for the exclusive purpose of issuing 30-year capital trust preferred securities and used the proceeds to acquire junior subordinated debentures (Subordinated Debentures) issued by Pinnacle Financial. The sole assets of the Trusts are the Subordinated Debentures. The $2,476,000 investment in the Trusts is included in other investments in the accompanying consolidated balance sheets and the $82,476,000 obligation is reflected as subordinated debt. The details of the Trusts established are as follows:

Date Established	Maturity	Floating Interest Rate

			Common Securities	Trust Preferred Securities		Interest Rate at December 31, 2016
Trust I	December 29, 2003	December 30, 2033	$ 310,000	$ 10,000,000	Libor + 2.80%	3.76 %
Trust II	September 15, 2005	September 30, 2035	619,000	20,000,000	Libor + 1.40%	2.40 %
Trust III	September 7, 2006	September 30, 2036	619,000	20,000,000	Libor + 1.65%	2.65 %
Trust IV	October 31, 2007	September 30, 2037	928,000	30,000,000	Libor + 2.85%	3.81 %

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

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

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 capital adequacy guidelines, the Trust Preferred Securities are treated as Tier I capital so long as Pinnacle Financial has less than $15 billion in assets.

Note 12. Income Taxes

Income tax expense (benefit) attributable to continuing operations for each of the years ended December 31 is as follows (in thousands):

	2016	2015	2014
Current tax expense :			
Federal	$49,769	$41,721	$34,068
State	-	48	719
Total current tax expense	49,769	41,769	34,787
Deferred tax expense (benefit):			
Federal	12,776	4,963	(1,260)
State	1,614	857	1,655
Total deferred tax expense	14,390	5,820	395
Total income tax expense	$64,159	$47,589	$35,182

Pinnacle Financial's income tax expense (benefit) differs from the amounts computed by applying the Federal income tax statutory rates of 35% to income (loss) before income taxes. A reconciliation of the differences for each of the years in the three-year period ended December 31, 2016 is as follows (in thousands):

	2016	2015	2014
Income tax expense at statutory rate	$66,984	$50,084	$36,978
State excise tax expense, net of federal tax effect	1,049	588	1,827
Tax-exempt securities	(2,510)	(2,543)	(2,675)

Federal tax credits	(282)	-	-
Bank owned life insurance	(1,242)	(892)	(849)
Insurance premiums	(159)	(306)	(401)
Change in uncertain tax positions	-	-	392
Other items	319	658	(90)
Income tax expense	$64,159	$47,589	$35,182

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Pinnacle Financial's effective tax rate for 2016 and 2015 differs from the statutory income tax rates primarily due to a state excise tax expense, investments in bank qualified municipal securities, our real estate investment trust, participation in the Community Investment Tax Credit (CITC) program, and bank owned life insurance, offset in part by the limitation on deductibility of meals and entertainment expense and certain merger-related expenses.

The components of deferred income taxes included in other assets in the accompanying consolidated balance sheets at December 31, 2016 and 2015 are as follows (in thousands):

	2016	2015
Deferred tax assets:		
Loan loss allowance	$22,308	$24,959
Loans	15,534	11,568
Insurance	869	823
Accrued liability for supplemental retirement agreements	5,587	2,476
Restricted stock and stock options	8,643	4,824
Securities	4,275	-
Cash flow hedge	1,520	949
Other real estate owned	149	587
Other deferred tax assets	7,897	2,905
Total deferred tax assets	66,782	49,091
Deferred tax liabilities:		
Depreciation and amortization	5,823	6,273
Core deposit intangible asset	5,621	3,786
Securities	-	2,337
REIT dividends	4,602	1,772
FHLB related liabilities	285	1,385
Mortgage servicing rights	-	2,468
Other deferred tax liabilities	679	473
Total deferred tax liabilities	17,010	18,494
Net deferred tax assets	$49,772	$30,597

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. This section also provides guidance on the derecognition, measurement and classification of income tax uncertainties, along with any related interest and penalties, and includes guidance concerning accounting for income tax uncertainties in interim periods.

A reconciliation of the beginning and ending unrecognized tax benefit related to state uncertain tax positions is as follows (in thousands):

	2016	2015	2014
Balance at January 1,	$134	$391	$-
Increases due to tax positions taken during the current year	1,140	(257)	-
Increases due to tax positions taken during a prior year	-	-	391
Decreases due to the lapse of the statute of limitations during the current year	-	-	-
Decreases due to settlements with the taxing authorities during the current year	-	-	-
Balance at December 31,	$1,274	$134	$391

Pinnacle Financial's policy is to recognize interest and/or penalties related to income tax matters in income tax expense. No interest and penalties were recorded for the year ended December 31, 2016.

Note 13. Commitments and Contingent Liabilities

In the normal course of business, Pinnacle Financial has entered into off-balance sheet financial instruments which include commitments to extend credit (i.e., including unfunded lines of credit) and standby letters of credit. Commitments to extend credit are usually the result of lines of credit granted to existing borrowers under agreements that the total outstanding indebtedness will not exceed a specific amount during the term of the indebtedness. Typical borrowers are commercial concerns that use lines of credit to supplement their treasury management functions, thus their total outstanding indebtedness may fluctuate during any time period based on the seasonality of their business and the resultant timing of their cash flows. Other typical lines of credit are related to home equity loans granted to consumers. Commitments to extend credit generally have fixed expiration dates or other termination clauses and may require payment of a fee. At December 31, 2016, these commitments amounted to $3.374 billion, of which approximately $413.7 million related to home equity lines of credit.

Standby letters of credit are generally issued on behalf of an applicant (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 December 31, 2016, these commitments amounted to $131.4 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 would only be reflected if drawn upon. Since many of the commitments are expected to expire without being drawn upon, the contractual amounts do not necessarily represent future cash requirements. However, should the commitments be drawn upon and should our customers default on their resulting obligation to us, Pinnacle Financial's maximum exposure to credit loss, without consideration of collateral, is represented by the contractual amount of those instruments. At December 31, 2016, Pinnacle Financial had accrued $1.1 million for the inherent risks associated with off balance sheet commitments.

Various legal claims also arise from time to time in the normal course of business. In the opinion of management, the resolution of these routine claims outstanding at December 31, 2016 will not have a material impact on Pinnacle Financial's consolidated financial condition, operating results or cash flows.

On May 9, 2016 a purported class action complaint was filed in the Chancery Court for the State of Tennessee, 20th Judicial District at Nashville, styled Stephen Bushansky, on behalf of himself and all others similarly situated, Plaintiff, versus Avenue Financial Holdings, Inc. Ronald L. Samuels, Kent Cleaver, David G. Anderson, Agenia Clark, James F. Deutsch, Marty Dickens, Patrick G. Emery, Nancy Falls, Joseph C. Galante, David Ingram. Stephen Moore, Ken Robold, Karen Saul and Pinnacle Financial Partners, Inc., Defendants (Case No. 16-489-IV). The complaint alleged that the individual defendants breached their fiduciary duties by, among other things, approving the sale of Avenue for an inadequate price as the result of a flawed sales process, agreeing to the inclusion of unreasonable deal protection devices in the Avenue Merger Agreement, approving the Avenue Merger in order to receive benefits not equally shared by all other shareholders of Avenue, and issuing materially misleading and incomplete disclosures to Avenue's shareholders. The lawsuit also alleged claims against Avenue and Pinnacle

Financial for aiding and abetting the individual defendants' breaches of fiduciary duties. The plaintiff purported to seek class-wide relief, including but not limited to monetary damages and an award of interest, attorney's fees, and expenses. On May 18, 2016, the Bushansky litigation was transferred to the Davidson County, Tennessee Business Court Pilot Project (the "Business Court").

On June 10, 2016, the parties entered into a memorandum of understanding with the plaintiff regarding a settlement of the Bushansky litigation and a release and dismissal of all claims which were or could have been asserted therein. Pursuant to the terms of the settlement, Avenue and Pinnacle Financial agreed to make certain supplemental disclosures to the definitive proxy statement/prospectus. Those supplemental disclosures were issued on June 13, 2016.

On October 18, 2016, the parties finalized a formal Stipulation of Settlement, which the parties submitted to the Business Court for approval along with a proposed Order Granting Preliminary Approval of Settlement, Approving Form of Notice to Class, and Setting Final Settlement Hearing ("Preliminary Approval Order"), a proposed Notice of Pendency and Proposed Settlement of Class Action ("Notice"), and a proposed Final Order and Judgment. Plaintiff also indicated that it would request from the Business Court an award of $300,000 in attorneys' fees and expenses, and defendants agreed not to object to a request in this amount. On October 25, 2016, the Business Court issued a Preliminary Approval Order preliminarily approving the settlement and certifying a class, and providing for mailing of the Notice to class members. On December 16, 2016, following mailing of the Notice to the class in accordance with the Preliminary Approval Order and a hearing on the proposed settlement, the Business Court entered the Final Order and Judgment approving the proposed settlement, awarding plaintiff $300,000 in attorneys' fees and expenses, and dismissing the action with prejudice.

The fact of the settlement and Pinnacle Financial's and Avenue's agreement to make the supplemental disclosures in connection therewith should not be construed as an admission of wrongdoing or liability by any defendant. The defendants have vigorously denied, and continue to vigorously deny, any wrongdoing or liability with respect to the facts and claims asserted, or which could have been asserted, in the Bushansky litigation, including that they have committed any violations of law or breach of fiduciary duty, aided and abetted any violations of law or breaches of fiduciary duty, acted improperly in any way or have any liability or owe any damages of any kind to the plaintiff or the purported class. Pinnacle Financial believes the claims asserted in the Bushansky action are without merit, but entered into the settlement to avoid the costs, risks and uncertainties inherent in litigation.

Note 14. Salary Deferral Plans

Pinnacle Financial has a 401(k) retirement plan (the 401k Plan) covering all employees who elect to participate, subject to certain eligibility requirements. The Plan allows employees to defer up to 50% of their salary subject to regulatory limitations with Pinnacle Financial matching 100% of the first 4% of employee self-directed contributions during 2016, 2015, and 2014. Pinnacle Financial's expense associated with the matching component of the plan for each of the years in the three-year period ended December 31, 2016 was approximately $4.0 million, $2.7 million and $2.4 million, respectively, and is included in the accompanying consolidated statements of operations in salaries and employee benefits expense.

Pinnacle Financial assumed nonqualified noncontributory supplemental retirement agreements (the Cavalry SRAs) for certain directors and executive officers of Cavalry Bancorp, Inc. (Cavalry), which Pinnacle Financial acquired in 2006. During 2007, Pinnacle Financial offered a settlement to all participants in the Cavalry SRAs with eleven participants accepting the settlement. Two individuals remain as participants in the Cavalry SRAs. At December 31, 2016, 2015 and 2014, included in other liabilities is $1.2 million, $1.3 million, and $1.4 million, respectively, which represents the net present value of the future obligation owed the two remaining participants in the Cavalry SRAs using a discount rate of 5% at December 31, 2016, 2015 and 2014.

In conjunction with the acquisition of CapitalMark, Pinnacle assumed a liability of $5.0 million associated with existing supplemental executive retirement plans. These plans provide benefits for former CapitalMark executives and will be paid out over the next 23 years. In conjunction with the acquisition of Avenue, Pinnacle assumed a liability of $8.0 million associated with existing supplemental executive retirement plans. These plans provide benefits for former Avenue executives and will be paid out over the next 26 years.

The balance of all outstanding supplemental executive retirement plans at December 31, 2016 and 2015 is $14.2 million and $6.3 million, respectively, and is included in other liabilities in the accompanying consolidated balance sheets.

Note 15. Stock Options, Stock Appreciation Rights and Restricted Shares

As of December 31, 2016, Pinnacle Financial has one equity incentive plan under which it is able to grant awards, the 2014 Equity Incentive Plan (2014 Plan) and has assumed the stock option plan of CapitalMark (the CapitalMark Option Plan) in connection with the CapitalMark Merger. In addition, awards previously granted remain outstanding under equity plans previously adopted by Pinnacle Financial's Board of Directors or assumed in connection with acquisitions of Mid-America Bancshares, Inc. and Cavalry Bancorp, Inc. No new awards may be granted under these other plans or the CapitalMark Option Plan.

Total shares available for issuance under the 2014 Plan were approximately 995,000 shares as of December 31, 2016, inclusive of shares returned to plan reserves during the year ended December 31, 2016. The 2014 Plan also permits Pinnacle Financial to issue additional awards to the extent that currently outstanding awards are subsequently forfeited, settled in cash or expired unexercised and returned to the 2014 Plan. Upon the acquisition of CapitalMark, Pinnacle Financial assumed approximately 858,000 of stock options under the CapitalMark Plan. No further shares remain available for issuance under the CapitalMark Option Plan. No options were assumed upon the acquisition of Magna or Avenue as all preexisting Magna and Avenue stock options were converted to cash upon acquisition.

Common Stock Options and Stock Appreciation Rights

As of December 31, 2016, of the 550,490 stock options outstanding, approximately 199,000 options were granted with the intention to be incentive stock options qualifying under Section 422 of the Internal Revenue Code for favorable tax treatment to the option holder while approximately 352,000 options would be deemed non-qualified stock options and thus not subject to favorable tax treatment to the option holder. Favorable treatment generally refers to the recipient of the award not having to report ordinary income at the date of exercise. All stock options granted under the Pinnacle Financial equity incentive plans vest in equal increments over five years from the date of grant and are exercisable over a period of ten years from the date of grant. All stock options granted under the CapitalMark Plan were fully-vested at the date of the CapitalMark merger. As of December 31, 2016, there were no stock appreciation rights outstanding.

A summary of stock option and stock appreciation right activity within the equity incentive plans during each of the years in the three-year period ended December 31, 2016 and information regarding expected vesting, contractual terms remaining, intrinsic values and other matters was as follows:

	Number	Weighted-Average Exercise Price	Weighted-Average Contractual Remaining Term (in years)	Aggregate Intrinsic Value [1] (000's)
Outstanding at December 31, 2013	1,002,500	$ 25.77		
Granted	-	-		
Stock options exercised	(301,794)	23.21		
Stock appreciation rights exercised [2]	(1,586)	15.60		
Forfeited	(632)	24.95		
Outstanding at December 31, 2014	698,488	$ 26.89		
Options acquired upon acquisition of CapitalMark	858,148	17.62		
Granted	-	-		
Stock options exercised	(303,754)	24.09		
Stock appreciation rights exercised [2]	(1,276)	15.60		
Forfeited	(5)	23.88		
Outstanding at December 31, 2015	1,251,601	$ 21.23		
Granted	-	-		
Stock options exercised	(698,673)	21.63		
Stock appreciation rights exercised [2]	(2,435)	15.60		
Forfeited	(3)	29.50		
Outstanding at December 31, 2016	550,490	$ 20.75	2.61	$26,728
Outstanding and expected to vest at December 31, 2016	550,490	$ 20.75	2.61	$26,728

(1) The aggregate intrinsic value is calculated as the difference between the exercise price of the underlying awards and the quoted price of Pinnacle Financial Common Stock of $69.30 per common share at December 31, 2016 for the 550,490 options that were in-the-money at December 31, 2016.

(2)

The 1,586 stock appreciation rights exercised during 2014 settled in 609 shares of Pinnacle Financial Common Stock. The 1,276 stock appreciation rights exercised during 2015 settled in 559 shares of Pinnacle Financial Common Stock. The 2,435 stock appreciation rights exercised during 2016 settled in 1,137 shares of Pinnacle Financial Common Stock.

During each of the years in the three-year period ended December 31, 2016, the aggregate intrinsic value of options and stock appreciation rights exercised under Pinnacle Financial's equity incentive plans was $21.7 million, $7.6 million and $4.0 million, respectively, determined as of the date of option exercise.

There have been no options granted by Pinnacle Financial since 2008. All stock option awards granted by Pinnacle Financial were fully vested during 2013. Stock options granted under the CapitalMark Plan were fully vested at the time of acquisition. As such, there was no impact on the results of operations for stock-based compensation related to stock options for the three-year period ended December 31, 2016.

Restricted Shares

Additionally, the 2014 Plan provides for the granting of restricted share awards and other performance or market-based awards. There were no market-based awards or stock appreciation rights outstanding as of December 31, 2016 under the 2014 Plan. During the three-year period ended December 31, 2016, Pinnacle Financial awarded 177,664, 231,504 and 126,117 shares of restricted stock to certain Pinnacle Financial associates and outside directors.

A summary of activity for unvested restricted share awards for the years ended December 31, 2016, 2015, and 2014 follows:

	Number	Grant Date Weighted-Average Cost
Unvested at December 31, 2013	821,695	$ 19.18
Shares awarded	126,117	33.32
Conversion of restricted share units to restricted share awards	186,943	31.68
Restrictions lapsed and shares released to associates/directors	(249,684)	18.19
Shares forfeited	(35,873)	20.70
Unvested at December 31, 2014	849,198	$ 24.26
Shares awarded	231,504	45.71
Conversion of restricted share units to restricted share awards	43,711	34.50
Restrictions lapsed and shares released to associates/directors	(240,102)	23.00
Shares forfeited	(17,997)	30.01
Unvested at December 31, 2015	866,314	$ 31.39
Shares awarded	177,664	48.61
Conversion of restricted share units to restricted share awards	43,694	46.37
Restrictions lapsed and shares released to associates/directors	(245,873)	28.39
Shares forfeited	(21,260)	39.88
Unvested at December 31, 2016	820,539	$ 36.47

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 tables outline restricted stock grants that were made by grant year, grouped by similar vesting criteria, during the three year period ended December 31, 2016. The table below reflects the life-to-date activity for these awards:

Grant Year	Group(1)	Vesting Period in years	Shares awarded	Restrictions Lapsed and shares released to participants	Shares Withheld for taxes by participants	Shares Forfeited by participants(8)	Shares Unvested
Time Based Awards							
2014	Associates(2)	5	113,918	31,110	12,685	11,745	58,378
2015	Associates(2)	5	190,528	25,801	9,369	14,163	141,195
2015	Leadership team(3)	5	16,605	2,530	788	-	13,287
2016	Associates(2)	5	143,273	265	125	3,679	139,204
Performance Based Awards							
2014	Leadership team(4)	5	186,943	63,634	9,375	4,386	109,548
2015	Leadership team(4)	5	43,711	-	-	-	43,711
2015	Leadership team(5)	3	11,302	-	-	-	11,302
2016	Leadership team(4)	3	43,694	-	-	-	43,694
2016	Leadership team(6)	3	15,468	-	-	-	15,468
Outside Director Awards (7)							
2014	Outside directors	1	12,199	10,537	1,662	-	-
2015	Outside directors	1	13,069	11,298	1,771	-	-
2016	Outside directors	1	18,923	889	297	-	17,737

(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 (or have Pinnacle Financial withhold 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 Pinnacle Financial 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) These shares were awarded to individuals joining the leadership team upon acquisition of Magna. The forfeiture restrictions on these restricted share awards lapse in equal installments on the anniversary date of the grant.

(4) Reflects conversion of restricted share units issued in prior years to restricted share awards. 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. Half of the awards inclde a four year vesting period while the remainder include a three year vesting period.

(5)

These shares were awarded to individuals joining the leadership team upon acquisition of CapitalMark. The forfeiture restrictions on these restricted share awards lapse in separate equal installments should Pinnacle Financial achieve certain earnings targets over each year of the vesting period and should the recipient thereafter remain employed by Pinnacle Financial for a subsequent vesting period.

(6) These shares were awarded to individuals joining the leadership team upon acquisition of Avenue. The forfeiture restrictions on these restricted share awards lapse in separate equal installments should Pinnacle Financial achieve certain earnings targets over each year of the vesting period and should the recipient thereafter remain employed by Pinnacle Financial for a subsequent vesting period.

(7) 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 board member meeting attendance goals for the various board and board committee meetings to which each member was scheduled to attend.

(8) These shares represent forfeitures resulting from recipients whose employment or board membership terminated during the year ended December 31, 2016. Any dividends paid on shares for which the forfeiture restrictions do not lapse will be recouped by Pinnacle Financial at the time of termination.

Compensation expense associated with the 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 graded vesting schedule such that each traunche is amortized separately. Compensation expense associated with the time based restricted share awards is recognized over the time period that the restrictions associated with the awards lapse on a straight-line basis based on the total cost of the award.

Restricted Share Units

Pinnacle Financial grants restricted share units to the senior executive officers and other members of the Leadership Team annually. The senior executive officers' restricted share unit awards typically include a range of shares that may be earned from the target level of performance to the maximum level of performance. The Leadership Team awards are granted at the target level of performance. Restricted share units awarded prior to 2015 will convert to a number of restricted share awards based on the achievement of certain performance metrics for each of the fiscal years to which the award relates, with the restrictions on the restricted shares issued in settlement of the restricted share units thereafter lapsing if Pinnacle Bank achieves certain soundness levels in subsequent years. Beginning with grants made in 2015, the awards will be settled in shares of freely tradeable common stock of Pinnacle Financial if the one year performance metrics and subsequent one-year service period requirements are met and subsequent soundness targets for later years are achieved. The performance metrics for each of the performance periods is established concurrently with the award of the restricted share unit grants by the Human Resources and Compensation Committee. The awards may be issued with a post-vest holding period, as shown below. During the post-vest holding period, the shares will not be released to the recipient and cannot be transferred, subject to limited exceptions, but will continue to accrue dividends until the awards are released, which is expected to be commensurate with the filing of Pinnacle Financial's Annual Report on Form 10-K for the prescribed year. 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. The expense is initially accrued using an anticipated performance level for the senior executive officers between the target and maximum performance levels and at the target performance level for the Leadership Team.

The following table details the Restricted Share Unit awards outstanding at December 31, 2016:

	Units Awarded					
Grant year	Named Executive Officers (NEOs)(1)	Leadership Team other than NEOs	Applicable Performance Periods associated with each tranche (fiscal year)	Service period per tranche (in years)	Subsequent holding period per tranche (in years)	Shares settled into RSAs as of period end(2)
2016	73,474-110,223	26,683	2016	2	3	N/A
			2017	2	2	N/A
			2018	2	1	N/A
2015	58,200-101,850	28,378	2015	2	3	N/A
			2016	2	2	N/A
			2017	2	1	N/A
2014(3)	58,404-102,209	29,087	2014	5	N/A	21,856
			2014	4	N/A	21,856
			2015	4	N/A	21,847
			2015	3	N/A	21,847
			2016	3	N/A	
			2016	2	N/A	

1) The named executive officers are awarded a range of awards that may be earned based on attainment of goals at a target level of performance to the maximum level of performance.
2) Restricted stock unit awards granted in 2016 and 2015 if earned will be settled in shares of Pinnacle Financial Common Stock.
3) Restrictions on half of the shares previously converted to RSAs will lapse commensurate with the filing of the Form 10-K for the year ended December 31, 2017 and 2018, respectively, and are reflected as restricted stock awards in the year in which the shares convert.
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A summary of stock compensation expense, net of the impact of income taxes, related to restricted share awards and restricted share units for the three-year period ended December 31, 2016, follows (in thousands except per share data):

	2016	2015	2014
Restricted stock expense	$10,971	$6,033	$4,070
Income tax benefit	4,306	2,368	1,597
Restricted stock expense, net of income tax benefit	$6,665	$3,665	$2,473
Impact on per share results from restricted stock expense:			
Basic	$0.15	$0.10	$0.07
Fully diluted	$0.15	$0.10	$0.07

Note 16. 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 in order to minimize the risk to Pinnacle Financial. These swaps qualify as derivatives, but are not designated as hedging instruments.

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

A summary of Pinnacle Financial's interest rate swaps to facilitate customer transactions as of December 31, 2016 and December 31, 2015 is included in the following table (in thousands):

	December 31, 2016		December 31, 2015	
	Notional Amount	Estimated Fair Value	Notional Amount	Estimated Fair Value
Interest rate swap agreements:				
Pay fixed / receive variable swaps	$666,572	$16,004	$396,112	$16,130
Pay variable / receive fixed swaps	666,572	(16,138)	396,112	(16,329)
Total	$1,333,144	$(134)	$792,224	$(199)

Hedge derivatives

Pinnacle Financial has forward cash flow hedge relationships 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 Notional Amount	Receive Rate	Pay Rate	Term(1)	December 31, 2016 Asset/ (Liabilities)	December 31, 2016 Unrealized Loss in Accumulated Other Comprehensive Income	December 31, 2015 Asset/ (Liabilities)	December 31, 2015 Unrealized Loss in Accumulated Other Comprehensive Income
Interest Rate Swap	$ 33,000	3 month LIBOR	2.265 %	April 2016 - April 2020	(727)	(442)	(784)	(476)
Interest Rate Swap	33,000	3 month LIBOR	2.646 %	April 2016 - April 2022	(1,304)	(792)	(1,478)	(898)
Interest Rate Swap	33,000	3 month LIBOR	2.523 %	Oct. 2016 - Oct. 2020	(1,081)	(657)	(908)	(552)
Interest Rate Swap	33,000	3 month LIBOR	2.992 %	Oct. 2017 - Oct. 2021	(1,200)	(729)	(1,112)	(676)
Interest Rate Swap	34,000	3 month LIBOR	3.118 %	April 2018 - July 2022	(1,222)	(743)	(1,170)	(711)
Interest Rate Swap	34,000	3 month LIBOR	3.158 %	July 2018 - Oct. 2022	(1,198)	(728)	(1,158)	(704)
	$200,000				(6,732)	(4,091)	(6,610)	(4,017)

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

Pinnacle Financial has interest rate swap agreements designated as cash flow hedges intended to protect against the variability of cash flows on selected LIBOR based loans. 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 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.

	Forecasted Notional Amount	Receive Rate	Pay Rate	Term	December 31, 2016 Asset/ (Liabilities)	December 31, 2016 Unrealized Gain (Loss) in Accumulated Other Comprehensive Income	December 31, 2015 Asset/ (Liabilities)	December 31, 2015 Unrealized Gain (Loss) in Accumulated Other Comprehensive Income
Interest Rate Swap	$27,500	2.090 %	1 month LIBOR	July 2014 - July 2021	395	240	663	403
Interest Rate	25,000	2.270 %	1 month LIBOR	July 2014 - July 2022	610	371	968	588

Swap								
Interest Rate Swap	27,500	2.420 %	1 month LIBOR	July 2014 - July 2023	874	531	1,320	802
Interest Rate Swap	30,000	2.500 %	1 month LIBOR	July 2014 - July 2024	900	547	1,333	810
Interest Rate Swap	-	1.048 %	1 month LIBOR	August 2015 - August 2018	-	-	(46)	(28)
Interest Rate Swap	-	1.281 %	1 month LIBOR	August 2015 - August 2019	-	-	(34)	(21)
Interest Rate Swap	15,000	1.470 %	1 month LIBOR	August 2015 - August 2020	(75)	(46)	(14)	(9)
	$ 125,000				2,704	1,643	4,190	2,545

The cash flow hedges were determined to be fully effective during the periods 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 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 17. Employment Contracts

Pinnacle Financial has entered into, and subsequently amended, employment agreements with four of its senior executives: the President and Chief Executive Officer, the Chairman of the Board, the Chief Administrative Officer and the Chief Financial Officer. These agreements, as amended, automatically renew each year on January 1 for an additional year unless any of the parties to the agreements gives notice of intent not to renew the agreement prior to November 30th of the preceding year, in which case the agreement terminates 30 days later. The agreements specify that in certain defined "Terminating Events," Pinnacle Financial will be obligated to pay each of the four senior executives certain amounts, which vary according to the Terminating Event, which is based on their annual salaries and bonuses. These Terminating Events include disability, cause, without cause and other events. During 2012, Pinnacle Financial entered into, and subsequently amended, a change of control agreement with its Senior Credit Officer providing the employee with certain benefits if his employment is terminated under certain scenarios within twelve months of a change in control. This agreement automatically renews each year on January 1 unless a party to the agreement notifies the other parties of intent not to renew the agreement prior to November 30th of the preceding year, in which case the agreement terminates 30 days later. During 2016, in connection with the Avenue Merger, Pinnacle Financial entered into an employment agreement with its Vice Chairman. This agreement is on similar terms as the other employment agreements, except that it provides for a fixed three-year term and does not automatically renew.

Note 18. Related Party Transactions

A local public relations company, of which one of Pinnacle Financial's former directors is a principal, has provided various services for Pinnacle Financial. During the year ended December 31, 2014, Pinnacle Financial incurred approximately $36,000 in expenses relating to services rendered by this public relations company. During 2015, no expenses were incurred relating to services rendered. This director's term ended during the year ended December 31, 2016 and therefore the relationship was no longer considered to be a related party transaction. During the year ended December 31, 2016, $20,000 in expenses were incurred relating to services rendered by this public relations company.

Also see Note 6 - "Loans and Allowance for Loan Losses", concerning loans and other extensions of credit to certain directors, officers, and their related entities and individuals and Note 14 – "Salary Deferral Plans" regarding supplemental retirement agreement obligations to two directors who were formerly directors of Cavalry.

Note 19. 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.

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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 investments – Included in others assets are other investments recorded at fair value primarily 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.

Collateral dependent 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. 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.

The following tables present the financial instruments carried at fair value on a recurring basis as of December 31, 2016 and 2015, by caption on the consolidated balance sheets and by FASB ASC 820 valuation hierarchy (as described above) (in thousands):

December 31, 2016	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)
Investment securities available-for-sale:				
U.S. treasury securities	$ 250	$ -	$ 250	$ -
U.S. government agency securities	21,769	-	21,769	-
Mortgage-backed securities	976,626	-	976,626	-
State and municipal securities	212,720	-	212,720	-
Asset- backed securities	78,580	-	78,580	-
Corporate notes and other	8,601	-	8,601	-
Total investment securities available-for-sale	1,298,546	-	1,298,546	-
Alternative investments	10,478	-	-	10,478
Other assets	13,340	-	13,340	-
Total assets at fair value	$ 1,322,364	$ -	$ 1,311,886	$ 10,478
Other liabilities	$ 15,758	$ -	$ 15,758	$ -
Total liabilities at fair value	$ 15,758	$ -	$ 15,758	$ -
December 31, 2015				
Investment securities available-for-sale:				
U.S. government agency securities	$ 128,193	$ -	$ 128,193	$ -
Mortgage-backed securities	582,916	-	582,916	-
State and municipal securities	165,042	-	165,042	-
Asset- backed securities	48,801	-	48,801	-
Corporate notes and other	10,113	-	10,113	-
Total investment securities available-for-sale	935,065	-	935,065	-
Alternative investments	9,764	-	-	9,764
Other assets	15,147	-	15,147	-
Total assets at fair value	$ 959,976	$ -	$ 950,212	$ 9,764
Other liabilities	$ 16,568	$ -	$ 16,568	$ -
Total liabilities at fair value	$ 16,568	$ -	$ 16,568	$ -

The following table presents assets measured at fair value on a nonrecurring basis as of December 31, 2016 and 2015 (in thousands):

December 31, 2016	Total carrying value in the consolidated balance sheet	Quoted market prices in an active	Models with significant observable market	Models with significant unobservable market parameters	Total losses for the period ended

		market (Level 1)	parameters (Level 2)	(Level 3)	
Other real estate owned	$ 6,090	$ -	$ -	$ 6,090	$ (135)
Nonaccrual loans, net (1)	26,506	-	-	26,506	(7,173)
Total	$ 32,596	$ -	$ -	$ 32,596	$ (7,308)
December 31, 2015					
Other real estate owned	$ 5,083	$ -	$ -	$ 5,083	$ (41)
Nonaccrual loans, net (1)	25,690	-	-	25,690	(2,637)
Total	$ 30,773	$ -	$ -	$ 30,773	$ (2,678)

(1) Amount is net of a valuation allowance of $1.1 million and $3.7 million at December 31, 2016 and 2015, respectively, as required by ASC 310-10, "Receivables."

In the case of the bond portfolio, Pinnacle Financial monitors the valuation technique utilized by various pricing agencies 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 year ended December 31, 2016, there were no transfers between Levels 1, 2 or 3.

The table below includes a rollforward of the balance sheet amounts for the year ended December 31, 2016 for financial instruments classified by Pinnacle Financial within Level 3 of the valuation hierarchy measured at fair value on a recurring basis including changes in fair value due in part to observable factors that are part of the valuation methodology (in thousands):

	For the year ended December 31,			
	2016		2015	
	Other assets	Other liabilities	Other assets	Other liabilities
Fair value, January 1	$9,764	$ -	$8,004	$ -
Total net realized losses included in income	131	-	149	-
Change in unrealized gains/losses included in other comprehensive income for assets and liabilities still held at December 31	-	-	-	-
Purchases	1,639	-	2,254	-
Issuances	-	-	-	-
Settlements	(1,056)	-	(643)	-
Transfers out of Level 3	-	-	-	-
Fair value, December 31	$10,478	$ -	$9,764	$ -
Total realized losses included in income related to financial assets and liabilities still on the consolidated balance sheet at December 31	$131	$ -	$149	$ -

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 December 31, 2016 and 2015, respectively. 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.

Held-to-maturity securities - 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 - The fair value of Pinnacle Financial's loan portfolio includes a credit risk factor in the determination of the fair value of its loans. This credit risk assumption is intended to approximate the fair value that a market participant would realize in a hypothetical orderly transaction. Pinnacle Financial's loan portfolio is initially fair valued using a segmented approach. Pinnacle Financial divides its 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.

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 Federal Home Loan Bank, and floating rate subordinated debt and other borrowings approximate their fair values. Fair values for certificates of deposit, fixed rate advances from the Federal Home Loan Bank 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 December 31, 2016 and 2015. 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.

December 31, 2016	Carrying/ Notional Amount	Estimated Fair Value (1)	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)
Financial assets:					
Securities held-to-maturity	$25,251	$25,233	$ -	$ 25,233	$ -
Loans, net	8,390,944	8,178,982	-	-	8,178,982
Mortgage loans held-for-sale	47,710	47,892	-	47,892	-
Commercial loans held-for-sale	22,588	22,674	-	22,674	-
Financial liabilities:					
Deposits and securities sold under agreements to repurchase	8,845,014	8,579,664	-	-	8,579,664
Federal Home Loan Bank advances	406,304	406,491	-	-	406,491
Subordinated debt and other borrowings	350,768	328,049	-	-	328,049
Off-balance sheet instruments:					
Commitments to extend credit (2)	3,374,269	383	-	-	383
Standby letters of credit (3)	131,418	740	-	-	740
December 31, 2015					
Financial assets:					
Securities held-to-maturity	$31,377	$31,586	$ -	$ 31,586	$ -
Loans, net	6,477,803	6,379,153	-	-	6,379,153
Mortgage loans held for sale	47,930	48,365	-	48,365	-
Financial liabilities:					
Deposits and securities sold under agreements to repurchase	7,050,498	6,562,509	-	-	6,562,509
Federal Home Loan Bank advances	300,305	299,214	-	-	299,214
Subordinated debt and other borrowings	141,606	131,494	-	-	131,494
Off-balance sheet instruments:					
Commitments to extend credit (2)	2,218,784	1,017	-	-	1,017
Standby letters of credit (3)	93,534	354	-	-	354

(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.

(2)

At the end of each period, 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 our loan portfolio. Additionally, Pinnacle Financial evaluates the probability that the outstanding commitment will eventually become a funded loan. As a result, at both December 31, 2016 and 2015, respectively, Pinnacle Financial included in other liabilities $383,000 and $1.0 million representing the inherent risks associated with these off-balance sheet commitments.

(3) At December 31, 2016 and 2015, the fair value of Pinnacle Financial's standby letters of credit was $740,000 and $354,000, respectively. This amount represents the unamortized fee associated with these standby letters of credit, which were priced at market when issued, 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 20. Other Borrowings

On July 30, 2015, Pinnacle Bank issued $60.0 million in aggregate principal amount of Fixed-to-Floating Rate Subordinated Notes due 2025 ("Pinnacle Bank Notes") in a private placement transaction to institutional accredited investors. On March 10, 2016, Pinnacle Bank issued an additional $70.0 million in aggregate principal amount of the Pinnacle Bank Notes. The Pinnacle Bank Notes issued on March 10, 2016 were priced at 99.023% of the principal amount per note, for an effective interest rate of 5.125%. The maturity date of the Pinnacle Bank Notes is July 30, 2025, although Pinnacle Bank may redeem some or all of the Pinnacle Bank Notes beginning on the interest payment date of July 30, 2020 and on any interest payment date thereafter at a redemption price equal to 100% of the principal amount of the Pinnacle Bank Notes to be redeemed plus accrued and unpaid interest to the date of redemption, subject to the prior approval of the FDIC. Pinnacle Bank may redeem the Pinnacle Bank Notes at any time upon the occurrence of certain tax events, capital events or investment company events.

From the date of the issuance through July 29, 2020, the Pinnacle Bank Notes will bear interest at the rate of 4.875% per year and will be payable semi-annually in arrears on January 30 and July 30 of each year, beginning on January 30, 2016. From July 30, 2020, the Pinnacle Bank Notes will bear interest at a rate per annum equal to the three-month LIBOR rate plus 3.128%, payable quarterly in arrears on each January 30, April 30, July 30, and October 30, beginning on July 30, 2020, through the maturity date or the early redemption date of the Pinnacle Bank Notes.

The sale of the Pinnacle Bank Notes on July 30, 2015 yielded net proceeds of $59 million after deducting the placement agents' fees and expenses payable by Pinnacle Bank. Pinnacle Bank used the net proceeds from the July 30, 2015 offering, together with available cash, to pay the cash portion of the merger consideration payable to the shareholders of CapitalMark and Magna in connection with those mergers, to pay the amounts necessary to redeem the preferred shares that each of CapitalMark and Magna had issued to the United States Department of the Treasury in connection with their participation in the Treasury's Small Business Lending Fund and for general corporate purposes. The sale of the Pinnacle Bank Notes on March 10, 2016 yielded net proceeds of approximately $68.4 million after deducting the initial purchasers' discount and expenses payable by Pinnacle Bank. Pinnacle Bank used the net proceeds from the March 1, 2016 offering for general corporate purposes, (including the repayment of short term borrowings of Pinnacle Bank used to pay a portion of the cash portion of the purchase price for the additional equity interests of BHG acquired by Pinnacle Bank on March 1, 2016).

On March 29, 2016, Pinnacle Financial entered into a revolving credit agreement with a bank for borrowings of up to $75 million (the Loan Agreement). Borrowings under the revolving credit facility have been used to fund the cash portion of the purchase price of Avenue and to support capital contributions to Pinnacle Bank. Future borrowings may be used for general corporate purposes including to fund capital contributions to Pinnacle Bank. Pinnacle Financial's borrowings under the Loan Agreement bear interest at a rate equal to 2.25% plus the greater of (i) zero percent (0%) or (ii) the one-month LIBOR rate quoted by the lender. The Loan Agreement also requires Pinnacle Financial to pay a quarterly fee beginning June 30, 2016 equal to 0.35% per annum on the average daily unused amount of available borrowings. At December 31, 2016 there were no borrowings under the Loan Agreement, which terminates on March 28, 2017.

Upon consummation of the Avenue Merger, Pinnacle Financial assumed Avenue's obligations under its outstanding $20.0 million subordinated notes issued on December 29, 2014 (Avenue Subordinated Notes). The Avenue Subordinated Notes mature on December 29, 2024 and bear interest at a rate of 6.75% per annum until January 1, 2020. Beginning on January 1, 2020, the Avenue Subordinated Notes will bear interest at a floating rate equal to the three-month LIBOR determined on the determination date of the applicable interest period plus 4.95%. Interest on the Avenue Subordinated Notes is payable quarterly in arrears on January 1, April 1, July 1 and October 1 of each year, through December 29, 2024 or the earlier date of redemption of all of the Avenue Subordinated Notes. These Avenue Subordinated Notes were recorded at fair value as of the acquisition date, and included a discount of $2.7 million, which will be accreted over the life of these notes.

The Avenue Subordinated Notes will be redeemable by Pinnacle Financial, in whole or in part, on or after January 1, 2020, subject to prior approval of the Federal Reserve, or, in whole but not in part, upon the occurrence of certain specified tax events, capital events or investment company events. The Avenue Subordinated Notes are not subject to redemption at the option of the holders.

On November 16, 2016, Pinnacle Financial completed the issuance, through a private placement, of $120.0 million aggregate principal amount of Fixed–to-Floating Rate Subordinated Notes due November 16, 2026 (the "Pinnacle Financial Notes") to certain institutional accredited investors. The Pinnacle Financial Notes bear a fixed interest rate of 5.25 percent per annum until November 16, 2021 subject to prior approval of the Federal Reserve, payable semi-annually in arrears. From November 16, 2021, the Pinnacle Financial Notes will bear a floating rate of interest equal to 3-Month LIBOR + 3.884 percent per annum until their maturity on November 16, 2026, or such earlier redemption date, payable quarterly in arrears. The Pinnacle Financial Notes will be redeemable by the Company, in whole or in part, on or after November 16, 2021, subject to prior approval by the Federal Reserve, or, in whole but not in part, upon the occurrence of certain specified tax events, capital events or investment company events. The Pinnacle Financial Notes are not subject to redemption at the option of the holders. The sale of the Pinnacle Financial Notes yielded net proceeds of approximately $118.3 million, and the Pinnacle Financial Notes qualify initially as Tier 2 capital for regulatory purposes. The Company used approximately $57.0 million of the net proceeds to retire all of the outstanding debt under the Company's $75.0 million revolving credit facility entered into in March 2016. The Company has contributed $50.0 million of the net proceeds to Pinnacle Bank and has retained the remaining net proceeds for general corporate purposes. The foregoing description does not purport to be a complete description of the Pinnacle Financial Notes.

The subordinated debt is recorded net of associated financing fees, fair value adjustments, in accordance with ASU No. 2015-03, Simplifying the Presentation of Debt Issuance Costs and totals $268.3 million as of December 31, 2016, compared to $59.1 million at December 31, 2015, net of associated debt issuance costs and fair value adjustments upon acquisition.

Note 21. 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 VIE's 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 VIE's primary beneficiary and disclosures surrounding those VIE's which have not been consolidated. The consolidation methodology provided in this footnote as of December 31, 2016 and 2015 has been prepared in accordance with ASC 810.

Non-consolidated Variable Interest Entities

At December 31, 2016, Pinnacle Financial did not have any consolidated variable interest entities to disclose but did have the following non-consolidated variable interest entities: low income housing partnerships, trust preferred issuances, troubled debt restructuring commercial loans, and managed discretionary trusts.

Since 2003, Pinnacle Financial has made equity investments as a limited partner in various partnerships that sponsor affordable housing projects. The purpose of these investments is to achieve a satisfactory return on capital and to support Pinnacle Financial's community reinvestment initiatives. The activities of the limited partnerships include the identification, development, and operation of multi-family housing that is leased to qualifying residential tenants generally within Pinnacle Financial's primary geographic region. These partnerships are considered VIEs because Pinnacle Financial, as the holder of the equity investment at risk, does not have the ability to direct the activities that most significantly affect the success of the entity through voting rights or similar rights. While Pinnacle Financial could absorb losses that are significant to these partnerships as it has a risk of loss for its initial capital contributions and funding commitments to each partnership, it is not considered the primary beneficiary of the partnerships as the general partners whose managerial functions give them the power to direct the activities that most significantly impact the partnerships' economic performance and who are exposed to all losses beyond Pinnacle Financial's initial capital contributions and funding commitments are considered the primary beneficiaries.

Pinnacle Financial has previously issued subordinated debt totaling $82.5 million to PNFP Statutory Trust I, II, III, and IV. These trusts are considered VIEs because Pinnacle Financial's capital contributions to these trusts are not considered "at risk" in evaluating whether the holders of the equity investments at risk in the trusts have the power through voting rights or similar rights to direct the activities that most significantly impact the entities' economic performance. These trusts were not consolidated by Pinnacle Financial because the holders of the securities issued by the trusts absorb a majority of expected losses and residual returns.

For certain troubled commercial loans, Pinnacle Financial restructures the terms of the borrower's debt in an effort to increase the probability of receipt of amounts contractually due. However, Pinnacle Financial does not assume decision-making power or responsibility over the borrower's operations. Following a debt restructuring, the borrowing entity typically meets the definition of a VIE as the initial determination of whether the entity is a VIE must be reconsidered and economic events have proven that the entity's equity is not sufficient to permit it to finance its activities without additional subordinated financial support or a restructuring of the terms of its financing. As Pinnacle Financial does not have the power to direct the activities that most significantly impact such troubled commercial borrowers' operations, it is not considered the primary beneficiary even in situations where, based on the size of the financing provided, Pinnacle Financial is exposed to potentially significant benefits and losses of the borrowing entity. Pinnacle Financial has no contractual requirements to provide financial support to the borrowing entities beyond certain funding commitments established upon restructuring of the terms of the debt to allow for completion of activities which prepare the collateral related to the debt for sale.

Pinnacle Financial serves as manager over certain discretionary trusts, for which it makes investment decisions on behalf of the trusts' beneficiaries in return for a management fee. The trusts meet the definition of a VIE since the holders of the equity investments at risk do not have the power through voting rights or similar rights to direct the activities that most significantly impact the entities' economic performance. However, since the management fees Pinnacle Financial receives are not considered variable interests in the trusts as all of the requirements related to permitted levels of decision maker fees are met, such VIEs are not consolidated by Pinnacle Financial because it cannot be the trusts' primary beneficiary. Pinnacle Financial has no contractual requirements to provide financial support to the trusts.

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The following table summarizes VIE's that are not consolidated by Pinnacle Financial as of December 31, 2016 and 2015 (in thousands):

	December 31, 2016		December 31, 2015		
Type	Maximum Loss Exposure	Liability Recognized	Maximum Loss Exposure	Liability Recognized	Classification
Low Income Housing Partnerships	$24,150	$ -	$13,889	$ -	Other Assets
Trust Preferred Issuances	N/A	82,476	N/A	82,476	Subordinated Debt
Commercial Troubled Debt Restructurings	11,572	-	4,368	-	Loans
Managed Discretionary Trusts	N/A	N/A	N/A	N/A	N/A

Note 22. 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 year ended December 31, 2016, Pinnacle Bank paid $27.7 million in dividends to Pinnacle Financial. As of December 31, 2016, Pinnacle Bank could pay approximately $239.5 million of additional dividends to Pinnacle Financial 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 increased the dividend to $0.12 beginning in the first quarter of 2015 and to $0.14 beginning in the first quarter of 2016. The amount and timing of all future dividend payments, if any, is subject to the discretion of Pinnacle Financial's board of directors 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. Pinnacle Financial's and Pinnacle Bank's capital amounts and classification are also subject to qualitative judgments by the regulators about components, risk weightings, and other factors.

Quantitative measures established by regulation to ensure capital adequacy require Pinnacle Financial and its banking subsidiary to maintain minimum amounts and ratios of common equity Tier 1 capital to risk-weighted assets, Tier I capital to risk-weighted assets, total risk-based capital to risk-weighted assets and of Tier 1 capital to average assets.

The final rules implementing the Basel Committee on Banking Supervision's capital guidelines for U.S. banks (Basel III rules) became effective for Pinnacle Financial on January 1, 2015 with full compliance with all of the requirements being phased in over a multi-year schedule, and fully phased in by January 1, 2019. The minimum capital level requirements applicable to bank holding companies and banks subject to the rules are: (i) a common equity Tier 1 capital ratio of 4.5%; (ii) a Tier 1 risk-based capital ratio of 6%; (iii) a total risk-based capital ratio of 8%; and (iv) a Tier 1 leverage ratio of 4% for all institutions. The Basel III rules, also establish a capital conservation buffer of 2.5% (to be phased in over three years) above the regulatory minimum risk-based capital ratios. The capital conservation buffer is to be phased in beginning in January 2016 at 0.625% and is scheduled to increase each year by a like percentage until fully implemented in January 2019. The net unrealized gain or loss on available-for-sale securities is not included in computing regulatory capital. Management believes, as of December 31, 2016, 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 1 risk-based, common equity Tier 1 and Tier 1 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):

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	Actual Amount	Ratio	Minimum Capital Requirement Amount	Ratio	Minimum To Be Well-Capitalized Amount	Ratio
December 31, 2016						
Total capital to risk weighted assets:						
Pinnacle Financial	$1,211,105	11.9 %	$816,857	8.0 %	$1,021,071	10.0 %
Pinnacle Bank	$1,136,782	11.2 %	$814,254	8.0 %	$1,017,817	10.0 %
Tier 1 capital to risk weighted assets:						
Pinnacle Financial	$882,654	8.6 %	$612,643	6.0 %	$816,857	8.0 %
Pinnacle Bank	$949,193	9.3 %	$610,690	6.0 %	$814,254	8.0 %
Common equity Tier 1 capital:						
Pinnacle Financial	$802,532	7.9 %	$459,482	4.5 %	$663,696	6.5 %
Pinnacle Bank	$949,070	9.3 %	$458,018	4.5 %	$661,581	6.5 %
Tier 1 capital to average assets (*):						
Pinnacle Financial	$882,654	8.6 %	$412,902	4.0 %	N/A	N/A
Pinnacle Bank	$949,193	9.2 %	$412,124	4.0 %	$515,155	5.0 %
At December 31, 2015						
Total capital to risk weighted assets:						
Pinnacle Financial	$883,085	11.2 %	$628,500	8.0 %	$785,624	10.0 %
Pinnacle Bank	$830,863	10.6 %	$626,486	8.0 %	$783,107	10.0 %
Tier 1 capital to risk weighted assets:						
Pinnacle Financial	$756,316	9.6 %	$471,375	6.0 %	$628,500	8.0 %
Pinnacle Bank	$704,095	9.0 %	$469,864	6.0 %	$626,486	8.0 %
Common equity Tier 1 capital:						
Pinnacle Financial	$676,316	8.6 %	$353,531	4.5 %	$510,656	6.5 %
Pinnacle Bank	$704,095	9.0 %	$352,398	4.5 %	$509,020	6.5 %
Tier 1 capital to average assets (*):						
Pinnacle Financial	$756,316	9.4 %	$322,920	4.0 %	N/A	N/A
Pinnacle Bank	$704,095	8.8 %	$321,991	4.0 %	$402,489	5.0 %

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

Note 23. Parent Company Only Financial Information

The following information presents the condensed balance sheets, statements of operations, and cash flows of Pinnacle Financial as of December 31, 2016 and 2015 and for each of the years in the three-year period ended December 31, 2016 (in thousands):

CONDENSED BALANCE SHEETS

	2016	2015
Assets:		
Cash and cash equivalents	$36,984	$21,740
Investments in bank	1,579,728	1,184,779
Investments in consolidated subsidiaries	5,484	9,934
Investment in unconsolidated subsidiaries:		
PNFP Statutory Trust I	310	310

PNFP Statutory Trust II	619	619
PNFP Statutory Trust III	619	619
PNFP Statutory Trust IV	928	928
Other investments	61,374	5,453
Current income tax receivable	6,831	10,132
Other assets	29,182	4,260
	$1,722,059	$1,238,774
Liabilities and stockholders' equity:		
Income taxes payable to subsidiaries	-	12
Subordinated debt and other borrowings	223,337	82,476
Other liabilities	2,026	675
Stockholders' equity	1,496,696	1,155,611
	$1,722,059	$1,238,774

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CONDENSED STATEMENTS OF OPERATIONS

	2016	2015	2014
Revenues:			
Income from bank subsidiaries	$ 27,663	19,038	21,185
Income from nonbank subsidiaries	5,198	210	193
Income from equity method investment	7,663	-	-
Other income (loss)	21	(132)	714
Expenses:			
Interest expense	1,997	220	468
Personnel expense, including stock compensation	10,971	7,342	5,308
Other expense	3,653	2,889	2,789
Loss before income taxes and equity in undistributed income of subsidiaries	23,924	8,665	13,527
Income tax benefit	(3,428)	(4,119)	(3,066)
Loss before equity in undistributed income of subsidiaries	27,352	12,874	16,593
Equity in undistributed income of bank subsidiaries	104,318	81,536	52,414
Equity in undistributed income (loss) of nonbank subsidiaries	(4,445)	1,189	1,464
Net income	$ 127,225	$ 95,509	$ 70,471

CONDENSED STATEMENTS OF CASH FLOWS

	2016	2015	2014
Operating activities:			
Net income	$127,225	$95,509	$70,471
Adjustments to reconcile net income to net cash provided by (used in) operating activities:			
Amortization and accretion	543	-	-
Stock-based compensation expense	10,971	7,342	5,308
Increase in income tax payable, net	(12)	(10,870)	-
Deferred tax expense	1,025	(394)	27
Gains from equity method investments, net	(8,350)	-	-
Excess tax benefit from stock compensation	(4,604)	(4,116)	(1,699)
Loss (gain) on other investments	497	132	(710)
Decrease in other assets	2,636	1,194	1,852
Increase in other liabilities	3,157	3,771	203
Equity in undistributed income of bank subsidiaries	(104,318)	(81,530)	(52,414)

Equity in undistributed income of nonbank subsidiaries	4,445	(1,189)	(1,464)
Net cash provided by (used in) operating activities	33,215	9,849	21,574
Investing activities:			
Investment in consolidated banking subsidiaries	(118,878)	-	-
Investment in unconsolidated banking subsidiaries	-	-	-
Increase in equity method investment	(11,400)	-	-
Dividends received from equity method investment	3,255	-	-
Increase in other investments	(710)	(335)	(397)
Net cash provided by (used in) investing activities	(127,733)	(335)	(397)
Financing activities:			
Net (decrease) increase in subordinated debt and other borrowings	118,294	(13,682)	(2,500)
Exercise of common stock options and stock appreciation rights, net of repurchase of restricted shares	11,589	3,603	6,422
Excess tax benefit from stock compensation	4,604	4,116	1,699
Common dividends paid	(24,725)	(18,307)	(11,398)
Net cash used in financing activities	109,762	(24,270)	(5,777)
Net increase (decrease) in cash	15,244	(14,756)	15,400
Cash and cash equivalents, beginning of year	21,740	36,496	21,096
Cash and cash equivalents, end of year	$36,984	$21,740	$36,496

Pinnacle Bank is subject to restrictions on the payment of dividends to Pinnacle Financial under Tennessee banking laws. Pinnacle Bank paid dividends of $27.7 million, $19.0 million and $21.2 million, respectively to Pinnacle Financial in each of the years ended December 31, 2016, 2015 and 2014.

Note 24. Quarterly Financial Results (unaudited)

A summary of selected consolidated quarterly financial data for each of the years in the three-year period ended December 31, 2016 follows:

(in thousands, except per share data)	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
2016				
Interest income	$80,974	$83,762	$97,380	$101,493
Net interest income	73,902	75,044	86,635	89,413
Provision for loan losses	3,894	5,280	6,108	3,046
Net income before taxes	41,800	46,546	48,693	54,345
Net income	27,964	30,787	32,377	36,097
Basic net income per share	$0.70	$0.75	$0.71	$0.79
Diluted net income per share	$0.68	$0.73	$0.71	$0.78
2015				
Interest income	$54,679	$55,503	$67,192	$77,797
Net interest income	51,269	51,831	62,059	71,475
Provision for loan losses	315	1,186	2,228	5,459
Net income before taxes	32,617	33,917	36,134	40,432
Net income	21,843	22,665	24,149	26,854
Basic net income per share	$0.62	$0.65	$0.64	$0.67
Diluted net income per share	$0.62	$0.64	$0.62	$0.65
2014				
Interest income	$49,291	$50,564	$52,782	$53,533
Net interest income	45,908	47,226	49,537	50,313
Provision for loan losses	488	254	851	2,041
Net income before taxes	24,506	25,668	27,215	28,264
Net income	16,367	17,170	18,197	18,737
Basic net income per share	$0.47	$0.49	$0.52	$0.54
Diluted net income per share	$0.47	$0.49	$0.52	$0.53

ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

Information required by this item will be included under the heading "Independent Registered Public Accounting Firm" in Pinnacle Financial's Proxy Statement for the Annual Meeting of Shareholders to be held April 18, 2017.

ITEM 9A. 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.

Management Report on Internal Control Over Financial Reporting

The report of Pinnacle Financial's management on Pinnacle Financial's internal control over financial reporting is set forth on page 74 of this Annual Report on Form 10-K. The report of Pinnacle Financial's independent registered public accounting firm on Pinnacle Financial's internal control over financial reporting is set forth on page 77 of this Annual Report on Form 10-K.

Changes in Internal Controls

There were no changes in Pinnacle Financial's internal control over financial reporting during Pinnacle Financial's fiscal quarter ended December 31, 2016 that have materially affected, or are reasonably likely to materially affect, Pinnacle Financial's internal control over financial reporting.

ITEM 9B. OTHER INFORMATION

None.

PART III

ITEM 10. DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE

The responses to this Item will be included in Pinnacle Financial's Proxy Statement for the Annual Meeting of Shareholders to be held April 18, 2017 under the headings "Corporate Governance-Code of Conduct," "Proposal #1 Election of Directors-Audit Committee," "Proposal #1 Election of Directors," "Executive Management," and "Section 16A Beneficial Ownership Reporting Compliance" and are incorporated herein by reference.

ITEM 11. EXECUTIVE COMPENSATION

The responses to this Item will be included in Pinnacle Financial's Proxy Statement for the Annual Meeting of Shareholders to be held April 18, 2017 under the heading, "Proposal #1 Election of the Directors-Director Compensation," "Executive Compensation" and "Human Resources and Compensation Committee Interlocks and Insider Participation" and are incorporated herein by reference.

ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS

The responses to this Item regarding security ownership of certain beneficial owners management and will be included in Pinnacle Financial's Proxy Statement for the Annual Meeting of Shareholders to be held April 18, 2017 under the heading, "Security Ownership of Certain Beneficial Owners and Management," and are incorporated herein by reference.

The following table summarizes information concerning Pinnacle Financial's equity compensation plans at December 31, 2016:

Plan Category	Number of Securities to be Issued upon Exercise of Outstanding Options, Warrants and Rights[(1)(2)]	Weighted Average Exercise Price of Outstanding Options, Warrants and Rights[(1)]	Number of Securities Remaining Available for Future Issuance Under Equity Compensation Plans (Excluding Securities Reflected in First Column)
Equity compensation plans approved by shareholders:			
2004 Equity Incentive Plan	160,027	$ 24.94	-
Bank of the South 2001 Stock Option Plan	-	-	-
Mid-America Bancshares, Inc. 2006 Omnibus Equity Incentive Plan	1,862	20.41	-
2014 Equity Incentive Plan	301,208	-	995,356
Equity compensation plans not approved by shareholders	N/A	N/A	N/A
Total	464,979	$ 24.89	995,356

(1) Includes 301,208 performance-based restricted stock units under the 2014 Plan. Performance-based restricted stock units do not have an exercise price because their value is dependent upon continued employment over a period of time or the achievement of certain performance goals, and are to be settled for shares of common stock. Accordingly, they have been disregarded for purposes of computing the weighted-average exercise price.

(2) All of CapitalMark's outstanding stock options vested upon consummation of the CapitalMark merger and were converted into options to purchase shares of Pinnacle Financial's Common Stock. 388,601 shares of Pinnacle Financial's common stock remain subject to outstanding options issued to the CapitalMark optionholders and the weighted average exercise price of those options is $19.00.

ITEM 13. CERTAIN RELATIONSHIPS, RELATED TRANSACTIONS AND DIRECTOR INDEPENDENCE

The responses to this Item will be included in Pinnacle Financial's Proxy Statement for the Annual Meeting of Shareholders to be held April 18, 2017 under the headings, "Certain Relationships and Related Transactions," and "Corporate Governance-Director Independence" and are incorporated herein by reference.

ITEM 14. PRINCIPAL ACCOUNTANT FEES AND SERVICES

The responses to this Item will be included in Pinnacle Financial's Proxy Statement for the Annual Meeting of Shareholders to be held April 18, 2017 under the heading, "Independent Registered Public Accounting Firm" and are incorporated herein by reference.

ITEM 15. EXHIBITS AND FINANCIAL STATEMENT SCHEDULES

(a) Exhibits

Exhibit No.	Description
2.1	Agreement and Plan of Merger by and among Pinnacle Financial Partners, Inc., Pinnacle Bank and CapitalMark Bank & Trust (Schedules and exhibits omitted pursuant to Item 601(b)(2) of Regulation S-K will be furnished supplementally to the Securities andi Exchange Commission upon request (1)
2.2	Agreement and Plan of Merger by and among Pinnacle Financial Partners, Inc., Pinnacle Bank and Magna Bank (Schedules and exhibits omitted pursuant to Item 601(b)(2) of Regulation S-K will be furnished supplementally to the Securities andi Exchange Commission upon request (2)
2.3	Agreement and Plan of Merger by and among Pinnacle Financial Partners, Inc. and Avenue Financial Holdings, Inc., dated January 28, 2016 (Schedules and exhibits omitted pursuant to Item 601(b)(2) of Regulation S-K will be furnished supplementally to the Securities andi Exchange Commission upon request (3)
2.4	Agreement and Plan of Merger, dated as of January 22, 2017, by and among Pinnacle Financial Partners, Inc., BNC Bancorp and Blue Merger Sub, Inc. (schedules and exhibits omitted pursuant to 601(b)(2) of Regulation S-K will be furnished supplementally to the Securities and Exchange Commission upon request) (4)
3.1	Amended and Restated Charter, as amended (Restated for SEC filing purposes only)(5)
3.2	Bylaws (5)
4.1.1	Specimen Common Stock Certificate (6)
4.1.2	See Exhibits 3.1 and 3.2 for provisions of the Charter and Bylaws defining rights of holders of the Common Stock
4.2	Form of 4.875% Fixed-to-Floating Rate Subordinated Note due July 30, 2025(7)
4.3	Form of Certificate for Avenue Financial Holdings, Inc. Fixed/Floating Rate Subordinated Note due December 29, 2024 (8)
4.4	Form of 5.25% Fixed-to-Floating Rate Subordinated Note due November 16, 2026 Certificate (9)
10.1	Amended Employment Agreement by and among Pinnacle Bank, Pinnacle Financial Partners, Inc. and M. Terry Turner (10) *
10.2	Amended Employment Agreement by and among Pinnacle Bank, Pinnacle Financial Partners, Inc. and Robert A. McCabe, Jr. (10) *
10.3	Amended Employment Agreement by and among Pinnacle Bank, Pinnacle Financial Partners, Inc. and Hugh M. Queener (10) *
10.4	Amended Employment Agreement by and among Pinnacle Bank, Pinnacle Financial Partners, Inc. and Harold R. Carpenter (10) *
10.5	Form of Named Executive Officers 2012 Restricted Stock Unit Award Agreement (11)*
10.6	Pinnacle Financial Partners, Inc. Amended and Restated 2004 Equity Incentive Plan (12)
10.7	Change of Control Agreement dated as of September 4, 2012 by and among Pinnacle Financial Partners, Inc., Pinnacle Bank and Joseph Harvey White (13)
10.8	Form of Named Executive Officers 2013 Restricted Stock Unit Award Agreement (14)
10.9	Amendment No. 1 dated November 20, 2012 to Amended Employment Agreement by and among Pinnacle Bank, Pinnacle Financial Partners, Inc. and M. Terry Turner(15)*
10.10	Amendment No. 1 dated November 20, 2012 to Amended Employment Agreement by and among Pinnacle Bank, Pinnacle Financial Partners, Inc. and Robert A. McCabe(15)*
10.11	Amendment No. 1 dated November 20, 2012 to Amended Employment Agreement by and among Pinnacle Bank, Pinnacle Financial Partners, Inc. and Hugh M. Queener(15)*
10.12	Amendment No. 1 dated November 20, 2012 to Amended Employment Agreement by and among Pinnacle Bank, Pinnacle Financial Partners, Inc. and Harold R. Carpenter(15)*
10.13	Amendment No. 1 dated November 20, 2012 to Amended Change of Control Agreement by and among Pinnacle Bank, Pinnacle Financial Partners, Inc. and J. Harvey White(15)*
10.14	Form of Named Executive Officers 2014 Performance Unit Award Agreement (16)

10.15	Amendment No. 2 dated February 4, 2014 to Amended Employment Agreement by and among Pinnacle Bank, Pinnacle Financial Partners, Inc. and M. Terry Turner (17)*
10.16	Amendment No. 2 dated February 4, 2014 to Amended Employment Agreement by and among Pinnacle Bank, Pinnacle Financial Partners, Inc. and Robert A. McCabe (17)*
10.17	Amendment No. 2 dated February 4, 2014 to Amended Employment Agreement by and among Pinnacle Bank, Pinnacle Financial Partners, Inc. and Hugh M. Queener (17)*
10.18	Amendment No. 2 dated February 4, 2014 to Amended Employment Agreement by and among Pinnacle Bank, Pinnacle Financial Partners, Inc. and Harold R. Carpenter (17)*
10.19	Amendment No. 1 to Pinnacle Financial Partners, Inc. 2004 Amended and Restated Equity Incentive Plan (17)*

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10.20	Second Amended and Restated Mid-America Bancshares, Inc. 2006 Omnibus Equity Incentive Plan (17)*
10.21	Form of Directors' 2014 Restricted Stock Agreement (17)*
10.22	Pinnacle Financial Partners, Inc. 2014 Equity Incentive Plan (18)*
10.23	Form of Named Executive Officers 2015 Performance Unit Award Agreement (19)*
10.24	CapitalMark Bank & Trust Stock Option Plan (20)*
10.25	Pinnacle Financial Partners, Inc. 2016 Annual Cash Incentive Plan (21)*
10.26	Loan Agreement dated as of March 29, 2016 by and between Pinnacle Financial Partners, Inc., as Borrower, and US Bank, National Association, as lender (22)
10.27	Employment Agreement, effective July 1, 2016, by and among Pinnacle Financial Partners, Inc., Pinnacle Bank, and Ronald L. Samuels (23)
10.28	Form of Pinnacle Financial Partners, Inc. 2016 Restricted Stock Award Agreement (24)
10.29	Supplemental Executive Retirement Plan Agreement between Avenue Bank and Ronald Samuels, dated October 26, 2007 (25)
10.30	Pinnacle Financial Partners, Inc. 2017 Annual Cash Incentive Plan (26)
21.1	Subsidiaries of Pinnacle Financial Partners, Inc.
23.1	Consent of Crowe Horwath LLP
23.2	Consent of KPMG LLP
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.SCH	XBRL Schema Documents
101.CAL	XBRL Calculation Linkbase Document
101.LAB	XBRL Label Linkbase Document
101.PRE	XBRL Presentation Linkbase Document
101.DEF	XBRL Definition Linkbase Document

(*) Management compensatory plan or arrangement

(1) Registrant hereby incorporates by reference to Registrant's Current Report on Form 8-K filed on April 8, 2015.
(2) Registrant hereby incorporates by reference to Registrant's Current Report on Form 8-K filed on April 29, 2015.
(3) Registrant hereby incorporates by reference to Registrant's Current Report on Form 8-K filed on January 29, 2016.
(4) Registrant hereby incorporates by reference to Registrant's Current Report on Form 8-K filed on January 23, 2017.
(5) Registrant hereby incorporates by reference to Registrant's Current Report on Form 8-K filed on April 27, 2015.
(6) Registrant hereby incorporates by reference to the Registrant's Registration Statement on Form SB-2, as amended (File No. 333-38018).
(7) Registrant hereby incorporates by reference to the Registrant's Current Report on Form 8-K filed on August 5, 2015.
(8) Registrant hereby incorporates by reference to the Registrant's Current Report on Form 8-K filed on July 7, 2016.
(9) Registrant hereby incorporates by reference to the Registrant's Current Report on Form 8-K filed on November 18, 2016.
(10) Registrant hereby incorporates by reference to Registrant's Form 10-K for the fiscal year ended December 31, 2007 as filed with the SEC on March 7, 2008.
(11) Registrant hereby incorporates by reference to Registrant's Current Report on Form 8-K filed on January 20, 2012.
(12) Registrant hereby incorporates by reference to Registrant's Current Report on Form 8-K filed on April 20, 2012.
(13) Registrant hereby incorporates by reference to Registrant's Current Report on Form 8-K filed on September 6, 2012.
(14) Registrant hereby incorporates by reference to Registrant's Current Report on Form 8-K filed on January 17, 2013.
(15) Registrant hereby incorporates by reference to Registrants's Form 10-K for the fiscal year ended December 31, 2012 as filed with the SEC on February 22, 2013.
(16) Registrant hereby incorporates by reference to Registrant's Current Report on Form 8-K filed on January 24, 2014.
(17) Registrant hereby incorporates by reference to Registrant's Form 10-K for the fiscal year ended December 31, 2013 as filed with the SEC of February 25, 2014.
(18) Registrant hereby incorporates by reference to Registrant's Current Report on Form 8-K filed on April 17, 2014.
(19) Registrant hereby incorporates by reference to Registrant's Current Report on Form 8-K filed on January 27, 2015.
(20) Registrant hereby incorporates by reference to Registrant's Post-Effective Amendment No. 1 to the Registration Statement on Form S-8 filed on August 10, 2015.
(21) Registrant hereby incorporates by reference to Registrant's Current Report on Form 8-K filed on January 26, 2016.
(22) Registrant hereby incorporates by reference to Registrant's Current Report on Form 8-K filed on March 31, 2016.
(23) Registrant hereby incorporates by reference to Registrant's Current Report on Form 8-K filed on July 7, 2016.
(24) Registrant hereby incorporates by reference to Registrant's Current Report on Form 8-K filed on July 7, 2016.
(25) Registrant hereby incorporates by reference to Registrant's Current Report on Form 8-K filed on July 7, 2016.
(26) Registrant hereby incorporates by reference to Registrant's Current Report on Form 8-K filed on January 20, 2017.

Pinnacle Financial is a party to certain agreements entered into in connection with the offering by PNFP Statutory Trust I, PNFP Statutory Trust II, PNFP Statutory Trust III, and PNFP Statutory Trust IV of an aggregate of $80,000,000 in trust preferred securities, as more fully described in this Annual Report on Form 10-K. In accordance with Item 601(b)(4)(ii) of Regulation SB, and because the total amount of the trust preferred securities is not in excess of 10% of Pinnacle Financial's total assets, Pinnacle Financial has not filed the various documents and agreements associated with the trust preferred securities herewith. Pinnacle Financial has, however, agreed to furnish copies of the various documents and agreements associated with the trust preferred securities to the Securities and Exchange Commission upon request.

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) 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
By:	/s/ M. Terry Turner
	M. Terry Turner
Date: February 27, 2017	President and Chief Executive Officer

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Pursuant to the requirements of the Securities Exchange Act of 1934, this Report has been signed below by the following persons on behalf of the Registrant and in the capacities and on the dates indicated.

SIGNATURES	TITLE	DATE
/s/ Robert A. McCabe, Jr. Robert A. McCabe, Jr.	Chairman of the Board	February 27, 2017
/s/ M. Terry Turner M. Terry Turner	Director, President and Chief Executive Officer (Principal Executive Officer)	February 27, 2017
/s/ Harold R. Carpenter Harold R. Carpenter	Chief Financial Officer (Principal Financial and Accounting Officer)	February 27, 2017
/s/ Ronald L. Samuels Ronald L. Samuels	Vice Chairman of the Board	February 27, 2017
/s/ H. Gordon Bone H. Gordon Bone	Director	February 27, 2017
/s/ Charles E. Brock Charles E. Brock	Director	February 27, 2017
/s/ Renda J. Burkhart Renda J. Burkhart	Director	February 27, 2017
/s/ Gregory L. Burns Gregory L. Burns	Director	February 27, 2017
/s/ Colleen Conway-Welch Colleen Conway- Welch	Director	February 27, 2017
/s/ Marty G. Dickens Marty G. Dickens	Director	February 27, 2017
/s/ Thomas C. Farnsworth, III Thomas C. Farnsworth, III	Director	February 27, 2017
/s/ Joseph Galante Joseph Galante	Director	February 27, 2017
/s/ Glenda Baskin Glover Glenda Baskin Glover	Director	February 27, 2017
/s/ William F. Hagerty, IV William F. Hagerty, IV	Director	February 27, 2017
/s/ William H. Huddleston, IV William H. Huddleston, IV	Director	February 27, 2017
/s/ David B. Ingram	Director	February 27, 2017

David B. Ingram

/s/ Ed C. Loughry, Jr. Ed C. Loughry, Jr.	Director	February 27, 2017

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/s/ Gary Scott Gary Scott	Director	February 27, 2017
/s/ Reese L. Smith, III Reese L. Smith, III	Director	February 27, 2017

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