CHIMERA INVESTMENT CORP
Form 424B5
January 16, 2019
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Filed Pursuant to Rule 424(b)(5)

Registration No. 333-229255

CALCULATION OF REGISTRATION FEE

Title of each class of securities to be registered	Amount to be registered	Proposed maximum offering price per unit	Proposed maximum aggregate offering price	Amount of registration fee(1)
8.00% Series D Fixed-to-Floating Rate Cumulative Redeemable Preferred Stock, $0.01 par value per share	8,510,000	$25.00	$212,750,000	$25,786

(1) Calculated pursuant to Rule 457(r) under the Securities Act of 1933, as amended (the Securities Act). In accordance with Rules 456(b) and 457(r) under the Securities Act, the registrant deferred payment of the registration fee for Registration Statement No. 333-229255.

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PROSPECTUS SUPPLEMENT

(To Prospectus Dated January 14, 2019)

7,400,000 Shares

8.00% Series D Fixed-to-Floating Rate Cumulative Redeemable Preferred Stock

(Liquidation Preference $25.00 Per Share)

We are offering 7,400,000 shares of our 8.00% Series D Fixed-to-Floating Rate Cumulative Redeemable Preferred Stock, par value $0.01 per share, with a liquidation preference of $25.00 per share, or the Series D Preferred Stock. Holders of Series D Preferred Stock will be entitled to receive cumulative cash dividends (i) from and including the original issue date to, but excluding, March 30, 2024 at a fixed rate equal to 8.00% per annum of the $25.00 per share liquidation preference (equivalent to $2.00 per annum per share) and (ii) from and including March 30, 2024, at a floating rate equal to three-month LIBOR plus a spread of 5.379% per annum. Dividends will be payable quarterly in arrears on the 30th day of March, June, September and December of each year, when and as declared, beginning on June 30, 2019 (long first dividend period). Dividends will accumulate and be cumulative from, and including, the date of original issuance of the Series D Preferred Stock.

The Series D Preferred Stock is not redeemable by us prior to March 30, 2024, except under circumstances where it is necessary to preserve our qualification as a real estate investment trust, or REIT, for U.S. federal income tax purposes and except as described below upon the occurrence of a Change of Control (as defined herein). On or after March 30, 2024, we may, at our option, redeem any or all of the shares of the Series D Preferred Stock at a redemption price of $25.00 per share, plus any accumulated and unpaid dividends thereon (whether or not authorized or declared) to, but excluding, the redemption date. In addition, upon the occurrence of a Change of Control, we may, at our option, redeem any or all of the shares of Series D Preferred Stock within 120 days after the first date on which such Change of Control occurred at a redemption price of $25.00 per share, plus any accumulated and unpaid dividends thereon (whether or not authorized or declared) to, but excluding, the redemption date. The Series D Preferred Stock has no stated maturity, is not subject to any sinking fund or mandatory redemption and will remain outstanding indefinitely unless repurchased or redeemed by us or converted into shares of our common stock, par value $0.01 per share, or our common stock, in connection with a Change of Control by the holders of Series D Preferred Stock.

Upon the occurrence of a Change of Control, each holder of Series D Preferred Stock will have the right (subject to our election to redeem the Series D Preferred Stock in whole or in part, as described above, prior to the Change of Control Conversion Date (as defined herein)) to convert some or all of the shares of the Series D Preferred Stock held by such holder on the Change of Control Conversion Date into a number of shares of our common stock per share of Series D Preferred Stock equal to the lesser of:

the quotient obtained by dividing (i) the sum of the $25.00 liquidation preference per share of the Series D Preferred Stock, plus any accumulated and unpaid dividends thereon (whether or not authorized or declared) to, but excluding, the Change of Control Conversion Date (unless the Change of Control Conversion Date is after a dividend record date (as defined herein) and prior to the corresponding dividend payment date (as defined herein) for the Series D Preferred Stock, in which case no additional amount for such accumulated and unpaid dividends to be paid on such dividend payment date will be included in this sum) by (ii) the Common Stock Price (as defined herein); and

2.72035, or the Share Cap, subject to certain adjustments as explained herein;

in each case, on the terms and subject to the conditions described in this prospectus supplement, including provisions for the receipt, under specified circumstances, of alternative consideration as described in this prospectus supplement.

The Series D Preferred Stock has not been rated. No current market exists for the Series D Preferred Stock. We intend to apply to list the shares of the Series D Preferred Stock on the New York Stock Exchange, or NYSE, under the symbol CIM PRD . If the application is approved, trading of the Series D Preferred Stock on the NYSE is expected to begin within 30 days after the date of initial issuance of the Series D Preferred Stock. Our common stock is traded on the NYSE under the symbol CIM .

There are restrictions on transfer and ownership of the Series D Preferred Stock intended to, among other purposes, preserve our qualification as a REIT. Please see the sections entitled Description of the Series D Preferred Stock Restrictions on Transfer and Ownership, in this prospectus supplement and Restrictions on Ownership and Transfer in the accompanying prospectus. In addition, except under limited circumstances as described in this prospectus supplement, holders of Series D Preferred Stock generally do not have any voting rights.

Investing in the Series D Preferred Stock involves risks that are described under the caption Risk Factors beginning on page S-9 of this prospectus supplement and in our Annual Report on Form 10-K for the fiscal year ended December 31, 2017 and as updated by our subsequent Quarterly Reports on Form 10-Q, which are incorporated by reference in this prospectus supplement.

	Per Share	Total[(1)]
Price to the public	$ 25.00	$ 185,000,000
Underwriting discounts and commissions	$ 0.7875	$ 5,827,500
Proceeds to us (before expenses)	$ 24.2125	$ 179,172,500

(1) Assumes no exercise of the underwriters over-allotment option.

Neither the U.S. Securities and Exchange Commission, or the SEC, nor any state securities commission has approved or disapproved of these securities or determined if this prospectus supplement or the accompanying

prospectus to which it relates is truthful or complete. Any representation to the contrary is a criminal offense.

We have granted the underwriters the option to purchase a maximum of 1,110,000 additional shares of Series D Preferred Stock solely to cover over-allotments, if any, on the same terms and conditions set forth above within 30 days of the date of this prospectus supplement.

Delivery of the shares of the Series D Preferred Stock will be made on or about January 23, 2019, only in book-entry form through The Depository Trust Company.

Joint Book-Running Managers

Morgan Stanley RBC Capital Markets UBS Investment Bank Wells Fargo Securities J.P. Morgan Keefe, Bruyette & Woods

A Stifel Company

The date of this prospectus supplement is January 15, 2019

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You should rely only on the information contained or incorporated by reference in this prospectus supplement, the accompanying prospectus or any applicable free writing prospectus. We have not, and the underwriters have not, authorized anyone to provide you with different information.

We are not, and the underwriters are not, making an offer of the shares of Series D Preferred Stock covered by this prospectus supplement and the accompanying prospectus in any jurisdiction where the offer is not permitted. You should assume that the information appearing in this prospectus supplement, the accompanying prospectus, any applicable free writing prospectus and the documents incorporated by reference

herein or therein is accurate only as of their respective dates or on the date or dates which are specified in these documents. Our business, financial condition, liquidity, results of operations and prospects may have changed since those dates.

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ABOUT THIS PROSPECTUS SUPPLEMENT AND THE PROSPECTUS

This document is in two parts. The first part is this prospectus supplement, which describes the specific terms of this offering and also adds to, changes and updates information contained in the accompanying prospectus and the documents incorporated by reference herein or therein. The second part, the accompanying prospectus, gives more general information, some of which may not apply to this offering.

To the extent the information contained in this prospectus supplement differs or varies from the information contained in the accompanying prospectus or the documents incorporated by reference herein or therein, the information in this prospectus supplement will supersede such information. In addition, any statement in a filing we make with the SEC that adds to, updates or changes information contained in an earlier filing we made with the SEC shall be deemed to modify and supersede such information in the earlier filing.

This prospectus supplement does not contain all of the information that is important to you. You should read the accompanying prospectus as well as the documents incorporated by reference in this prospectus supplement and the accompanying prospectus. See Where You Can Find More Information in this prospectus supplement and in the accompanying prospectus. Unless otherwise indicated or unless the context requires otherwise, references in this prospectus supplement to we, our, us and our company refer to Chimera Investment Corporation, a Maryland corporation, excluding its subsidiaries.

WHERE YOU CAN FIND MORE INFORMATION

We have filed a registration statement on Form S-3 with the SEC in connection with this offering. In addition, we file annual, quarterly, and current reports, proxy statements and other information with SEC. Our SEC filings are also available to you, free of charge, on the SEC s website at www.sec.gov. Finally, we also maintain an internet site where you can find additional information. The address of our internet site is http://www.chimerareit.com. All internet site addresses provided in this prospectus supplement and accompanying prospectus are for informational purposes only and are not intended to be hyperlinks. In addition, the information on our internet site is not a part of, and is not incorporated or deemed to be incorporated by reference in this prospectus supplement or accompanying prospectus. Accordingly, no information in our or any of these other internet site addresses is included herein or incorporated or deemed to be incorporated by reference herein.

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A WARNING ABOUT FORWARD-LOOKING STATEMENTS

Certain statements contained in this prospectus supplement and the accompanying prospectus, and the information incorporated by reference in this prospectus supplement and the accompanying prospectus, and certain statements contained in our future filings with the SEC, in our press releases or in our other public or shareholder communications may not be based on historical facts and are forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, or the Securities Act, and Section 21E of the Exchange Act. Forward-looking statements, which are based on various assumptions (some of which are beyond our control), may be identified by reference to a future period or periods or by the use of forward-looking terminology, such as may, would, will, believe, expect, anticipate, continue, should, intend, estimate, plan, or other similar t those terms or the negative of those terms. Actual results could differ materially from those set forth in forward-looking statements due to a variety of factors, including, but not limited to:

- our business and investment strategy;
- availability of investment opportunities in real estate-related and other securities;
- our expected investments;
- changes in the value of our investments;
- changes in interest rates and mortgage prepayment rates;
- prepayments of the mortgage and other loans underlying our mortgage-backed securities, or RMBS, or other asset-backed securities, or ABS;
- rates of default, delinquencies or decreased recovery rates on our investments;
- general volatility of the securities markets in which we invest;
- our ability to maintain existing financing arrangements and our ability to obtain future financing arrangements;
- our ability to effect our strategy to securitize residential mortgage loans;
- interest rate mismatches between our investments and our borrowings used to finance such purchases;

effects of interest rate caps on our adjustable-rate investments;

the degree to which our hedging strategies may or may not protect us from interest rate volatility;

the impact of and changes to various government programs;

impact of and changes in governmental regulations, tax law and rates, accounting guidance, and similar matters;

market trends in our industry, interest rates, the debt securities markets or the general economy;

estimates relating to our ability to make distributions to our stockholders in the future;

our understanding of our competition;

availability of qualified personnel;

our ability to maintain our classification as a REIT for U.S. federal income tax purposes;

our ability to maintain our exemption from registration under the Investment Company Act of 1940, as amended, or the 1940 Act;

our expectations regarding materiality or significance;

the effectiveness of our disclosure controls and procedures; and

the use of proceeds of this offering.

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The forward-looking statements are based on our beliefs, assumptions and expectations of our future performance, taking into account all information currently available to us. You should not place undue reliance on these forward-looking statements. These beliefs, assumptions and expectations can change as a result of many possible events or factors, not all of which are known to us. Some of these factors are described under the captions Summary Overview and Risk Factors in this prospectus supplement and our most recent Annual Report on Form 10-K and as updated by our subsequent Quarterly Reports on Form 10-Q, which are incorporated by reference in this prospectus supplement and the accompanying prospectus. If a change occurs, our business, financial condition, liquidity and results of operations may vary materially from those expressed in our forward-looking statements. Any forward-looking statement speaks only as of the date on which it is made. New risks and uncertainties arise from time to time, and it is impossible for us to predict those events or how they may affect us. Except as required by law, we are not obligated to, and do not intend to, update or revise any forward-looking statements, whether as a result of new information, future events or otherwise.

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SUMMARY

The following summary highlights information contained elsewhere or incorporated by reference in this prospectus supplement and the accompanying prospectus. It may not contain all of the information that is important to you. Before making a decision to invest in the Series D Preferred Stock, you should read carefully this entire prospectus supplement and the accompanying prospectus, including the risks set forth under the caption Risk Factors in this prospectus supplement and in our Annual Report on Form 10-K for the fiscal year ended December 31, 2017, and as updated by our subsequent Quarterly Reports on Form 10-Q, which are incorporated by reference in this prospectus supplement. This summary is qualified in its entirety by the more detailed information and financial statements, including the notes thereto, appearing elsewhere or incorporated by reference in this prospectus supplement. Except where the context suggests otherwise, the terms Chimera, company, we, us and our refer to Chimera Investment Corporation. The term you refers to a prospective investor.

Overview

Our Company

We are a publicly traded REIT that commenced operations on November 21, 2007. We are primarily engaged in the business of investing directly or indirectly through our subsidiaries, on a leveraged basis, in a diversified portfolio of mortgage assets, including residential mortgage loans, Non-Agency RMBS, Agency commercial mortgage-backed securities, Agency RMBS, and other real estate related securities. Our principal business objective is to deliver shareholder value through the generation of distributable income and through asset performance linked to residential mortgage credit fundamentals.

We focus our investment activities primarily on acquiring residential mortgage loans and on acquiring Non-Agency and Agency residential and commercial mortgage-backed securities, or MBS. At September 30, 2018, based on the amortized cost balance of our interest earning assets, approximately 52% of our investment portfolio was residential mortgage loans, 41% of our investment portfolio was Agency MBS and 7% of our investment portfolio was Non-Agency RMBS, respectively. At December 31, 2017, based on the amortized cost balance of our interest earning assets, approximately 67% of our investment portfolio was residential mortgage loans, 22% of our investment portfolio was Agency MBS and 11% of our investment portfolio was Non-Agency RMBS, respectively.

Our investment strategy is intended to take advantage of opportunities in the current interest rate and credit environment. We expect to adjust our strategy to changing market conditions by shifting our asset allocations across these various asset classes as interest rate and credit cycles change over time. We believe that our strategy will enable us to pay dividends and preserve capital throughout changing market cycles. We expect to take a long-term view of assets and liabilities, and our reported earnings and estimates of the fair value of our investments at the end of a financial reporting period will not significantly impact our objective of providing attractive risk-adjusted returns to our stockholders over the long-term.

We use leverage to increase returns and to finance the acquisition of our assets. We are not required to maintain any specific debt-to-equity ratio as we believe the appropriate leverage for the particular assets we are financing depends on the credit quality and risk of those assets. Subject to maintaining our REIT qualification, we may use a number of sources to finance our investments, including repurchase agreements, warehouse facilities, securitizations and resecuritizations. Subject to maintaining our REIT qualification, we may manage our debt and interest rate risk by utilizing interest rate hedges, such as interest rate swaps, caps, options and futures to reduce the effect of interest rate fluctuations related to our financing sources.

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Under the U.S. credit risk retention rules that became effective on December 24, 2015, for transactions which we sponsor we have committed to consolidate the loans and retain a meaningful investment for at least five years. Our credit investments are generally structurally locked out from pre-payments resulting in a high yielding longer duration credit portfolio.

To assist us in maintaining our qualification as a REIT for U.S. federal income tax purposes, no person may own more than 9.8%, in value or in number of shares, whichever is more restrictive, of the outstanding shares of any class or series of our capital stock, excluding any shares of capital stock not treated as outstanding for U.S. federal income tax purposes, unless our board of directors waives this limitation.

Recent Developments

Fourth Quarter 2018 Cash Dividends

On October 30, 2018, we declared our fourth quarter 2018 common stock cash dividend of $0.50 per common share. This dividend is payable January 31, 2019 to common stockholders of record on December 31, 2018.

On December 31, 2018, we paid our fourth quarter cash dividend of $0.50 per share of Series A Preferred Stock, our fourth quarter cash dividend of $0.50 per share of Series B Preferred Stock and our fourth quarter cash dividend of $0.53819 per share of Series C Preferred Stock, in each case to holders of record on November 30, 2018.

Corporate Information

Our common stock is traded on the NYSE under the symbol CIM. Our principal executive offices are located at 520 Madison Ave, 32nd Floor, New York, New York 10022. Our telephone number is (212) 626-2300.

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THE OFFERING

The following is a brief summary of certain terms of this offering. For a more complete description of the terms of the Series D Preferred Stock, see Description of the Series D Preferred Stock in this prospectus supplement and Description of Equity Securities Preferred Stock in the accompanying prospectus.

In this prospectus supplement, (i) our Junior Stock means our common stock and any class or series of stock we may issue in the future that by its terms ranks junior to the Series D Preferred Stock with respect to the payment of dividends and the distribution of assets in the event of our liquidation, dissolution or winding up, (ii) our Parity Stock means our 8.00% Series A Cumulative Redeemable Preferred Stock, par value $0.01 per share, or the Series A Preferred Stock, our 8.00% Series B Fixed-to-Floating Rate Cumulative Redeemable Preferred Stock, or the Series B Preferred Stock, our 7.75% Series C Fixed-to-Floating Rate Cumulative Redeemable Preferred Stock, par value $0.01 per share, or the Series C Preferred Stock, our Series D Preferred Stock and any class or series of stock issued by us that by its terms ranks on parity with the Series A Preferred Stock, the Series B Preferred Stock, the Series C Preferred Stock and the Series D Preferred Stock with respect to the payment of dividends and the distribution of assets in the event of our liquidation, dissolution or winding up, and (iii) our Senior Stock means any class or series of stock we may issue in the future that by its terms ranks senior to the Series D Preferred Stock with respect to the payment of dividends and the distribution of assets in the event of our liquidation, dissolution or winding up. The term stock does not include any convertible or exchangeable debt securities we may issue in the future.

Issuer	Chimera Investment Corporation
Securities Offered	7,400,000 shares of 8.00% Series D Fixed-to-Floating Rate Cumulative Redeemable Preferred Stock, $0.01 par value per share (plus up to an additional 1,110,000 shares of 8.00% Series D Fixed-to-Floating Rate Cumulative Redeemable Preferred Stock that we will issue and sell in the event the underwriters exercise their over-allotment option).
Dividends	Holders of Series D Preferred Stock will be entitled to receive cumulative cash dividends (i) from and including the original issue date to, but excluding, March 30, 2024 at a fixed rate equal to 8.00% per annum of the $25.00 per share liquidation preference (equivalent to $2.00 per annum per share) and (ii) from and including March 30, 2024, at a floating rate equal to three-month LIBOR plus a spread of 5.379% per annum of the $25.00 per share liquidation preference.
	Dividends will be payable quarterly in arrears on the 30th day of March, June, September and December of each year, when and as declared, provided that if any dividend payment date is not a business day, then the dividend which would otherwise have been payable on that dividend payment date may be paid on the next succeeding business day. Dividends will accumulate and be cumulative from, and including, the date of original issuance, which is expected to be January 23, 2019. The

first dividend is scheduled to be payable on or about June 30, 2019 (long first dividend period) in the amount of $0.87222 per share and will be paid to the persons who are the holders of record of the Series D Preferred Stock at the close of business on the corresponding record date fixed by our board of

	directors in accordance with the articles supplementary classifying and designating the Series D Preferred Stock.
No Maturity	The Series D Preferred Stock has no stated maturity and will not be subject to any sinking fund or mandatory redemption. Shares of the Series D Preferred Stock will remain outstanding indefinitely unless we decide to redeem or otherwise repurchase them or they become convertible and are converted as described below under Conversion Rights. We are not required to set apart for payment the funds to redeem the Series D Preferred Stock.
Optional Redemption	The Series D Preferred Stock is not redeemable by us prior to March 30, 2024, except under circumstances where it is necessary to preserve our qualification as a REIT for U.S. federal income tax purposes and except as described below under Special Optional Redemption upon the occurrence of a Change of Control (as defined herein). On and after March 30, 2024, we may, at our option, redeem the Series D Preferred Stock, in whole or in part, at any time or from time to time, for cash at a redemption price of $25.00 per share, plus any accumulated and unpaid dividends thereon (whether or not authorized or declared) to, but excluding, the redemption date. Please see the section entitled Description of the Series D Preferred Stock Redemption Optional Redemption.
Special Optional Redemption	Upon the occurrence of a Change of Control, we may, at our option, redeem the Series D Preferred Stock, in whole or in part, within 120 days after the first date on which such Change of Control occurred, for cash at a redemption price of $25.00 per share, plus any accumulated and unpaid dividends thereon (whether or not authorized or declared) to, but excluding, the redemption date. If, prior to the Change of Control Conversion Date (as defined herein), we have provided notice of our election to redeem some or all of the shares of Series D Preferred Stock (whether pursuant to our optional redemption right described above or this special optional redemption right), the holders of Series D Preferred Stock will not have the conversion right described below under Conversion Rights with respect to the shares of Series D Preferred Stock called for redemption. Please see the section entitled Description of the Series D Preferred Stock Redemption in this prospectus supplement.
	A Change of Control is deemed to occur when, after the original issuance of the Series D Preferred Stock, the following have occurred and are continuing:

the acquisition by any person, including any syndicate or group deemed to be a person under Section 13(d)(3) of the Exchange Act, of beneficial ownership, directly or indirectly, through a purchase, merger or other acquisition transaction or series of purchases, mergers or other acquisition transactions of our stock entitling that person to exercise more than 50% of the total voting

- power of all our stock entitled to vote generally in the election of our directors (except that such person will be deemed to have beneficial ownership of all securities that such person has the right to acquire, whether such right is currently exercisable or is exercisable only upon the occurrence of a subsequent condition); and

- following the closing of any transaction referred to in the bullet point above, neither we nor the acquiring or surviving entity has a class of common securities (or American Depositary Receipts representing such securities) listed on the NYSE, the NYSE American LLC or the Nasdaq Stock Market, or listed or quoted on an exchange or quotation system that is a successor to the NYSE, the NYSE American LLC or the Nasdaq Stock Market.

Conversion Rights

Upon the occurrence of a Change of Control, each holder of Series D Preferred Stock will have the right (unless we have exercised our right to redeem the Series D Preferred Stock in whole or part, as described above under Optional Redemption or Special Optional Redemption, prior to the Change of Control Conversion Date) to convert some or all of the shares of Series D Preferred Stock held by such holder on the Change of Control Conversion Date into a number of shares of our common stock per share of Series D Preferred Stock to be converted equal to the lesser of:

- the quotient obtained by dividing (i) the sum of the $25.00 liquidation preference per share of Series D Preferred Stock, plus any accumulated and unpaid dividends thereon (whether or not authorized or declared) to, but excluding, the Change of Control Conversion Date (unless the Change of Control Conversion Date is after a dividend record date (as defined herein) and prior to the corresponding dividend payment date (as defined herein) for the Series D Preferred Stock, in which case no additional amount for such accumulated and unpaid dividends to be paid on such dividend payment date will be included in this sum) by (ii) the Common Stock Price (as defined herein); and

- 2.72035, or the Share Cap, subject to adjustments to the Share Cap for any splits, including those effected by distributions, subdivisions or combinations of our common stock;

in each case, on the terms and subject to the conditions described in this prospectus supplement, including provisions for the receipt, under specified circumstances, of alternative consideration as described in this prospectus supplement.

For definitions of Change of Control Conversion Right, Change of Control Conversion Date and Common Stock Price and a description of certain adjustments and provisions for the receipt of alternative consideration that may be applicable to the conversion of Series D Preferred Stock in the event of a Change of Control, and for

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	other important information, please see the section entitled Description of the Series D Preferred Stock Conversion Rights.
Liquidation Preference	If we liquidate, dissolve or wind up, holders of Series D Preferred Stock will have the right to receive $25.00 per share, plus any accumulated and unpaid dividends thereon (whether or not authorized or declared) to, but excluding, the payment date, before any payment is made to the holders of our common stock and the holders of any other Junior Stock we may issue in the future. Please see the section entitled Description of the Series D Preferred Stock Liquidation Preference.
Ranking	The Series D Preferred Stock will rank, with respect to rights to the payment of dividends and the distribution of assets upon our liquidation, dissolution or winding up: senior to all classes or series of our common stock and any other Junior Stock we may issue in the future; on a parity with our Series A Preferred Stock, Series B Preferred Stock, Series C Preferred Stock and any other Parity Stock we may issue in the future; junior to any Senior Stock we may issue in the future; and effectively junior to all of our existing and future indebtedness (including indebtedness convertible into or exchangeable for our common stock or preferred stock) and the indebtedness of our existing and future subsidiaries.
Voting Rights	Holders of Series D Preferred Stock will generally have no voting rights. However, if we do not pay dividends on the Series D Preferred Stock for six or more full quarterly Dividend Periods (as defined herein) (whether or not consecutive), the number of directors constituting the board of directors will automatically be increased by two and the holders of Series D Preferred Stock, voting together as a single class with the holders of the Series A Preferred Stock, Series B Preferred Stock, Series C Preferred Stock and all other classes or series of our preferred stock we may issue in the future ranking on parity with the Series D Preferred Stock and upon which like voting rights have been conferred and are exercisable, will be entitled to vote for the election of two additional directors to serve on our board of directors until we pay all dividends

accumulated on the Series D Preferred Stock for all past Dividend Periods and the then current Dividend Period.

In addition, the affirmative vote of the holders of at least two-thirds of the outstanding shares of Series D Preferred Stock, voting together as a single class with the holders of the Series A Preferred Stock, Series B Preferred Stock, Series C Preferred Stock and all other classes or series of our preferred stock we may issue in the future ranking on

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parity with the Series D Preferred Stock upon which like voting rights have been conferred and are exercisable, is required for us to:

- authorize, create or increase the authorized or issued amount of any class or series of Senior Stock; or

- amend, alter or repeal any provision of our charter (including the articles supplementary designating the Series D Preferred Stock) so as to materially and adversely affect any rights of the Series D Preferred Stock. However, if any such change would materially and adversely affect the rights, preferences, privileges or voting rights of the Series D Preferred Stock disproportionately relative to other classes or series of Parity Stock, then the affirmative vote or consent of the holders of at least two-thirds of the outstanding shares of Series D Preferred Stock (voting as a separate class) will also be required.

Among other things, we may, without a vote of the holders of Series D Preferred Stock, issue additional shares of Series D Preferred Stock and we may authorize and issue additional classes or series of Parity Stock, including the Series A Preferred Stock, Series B Preferred Stock and Series C Preferred Stock.

Information Rights

During any period in which we are not subject to Section 13 or 15(d) of the Exchange Act and any shares of Series D Preferred Stock are outstanding, we will use our best efforts to transmit through our website at http://www.chimerareit.com (or other permissible means under the Exchange Act) copies of the Annual Reports on Form 10-K and Quarterly Reports on Form 10-Q that we would have been required to file with the SEC pursuant to Section 13 or 15(d) of the Exchange Act if we were subject thereto (other than any exhibits that would have been required). We will use our best efforts to provide such reports on our website within 15 days after the respective dates by which we would have been required to file such reports with the SEC if we were subject to Section 13 or 15(d) of the Exchange Act and we were a non-accelerated filer within the meaning of the Exchange Act.

Listing

No current market exists for the Series D Preferred Stock. We intend to apply to list the Series D Preferred Stock on the NYSE under the symbol CIM PRD . If approved for listing, we expect that trading on the NYSE will commence within 30 days after the date of initial issuance of the Series D Preferred Stock. Certain of the underwriters have advised us that they intend to make a market in the Series D Preferred Stock prior to the commencement of any trading on the NYSE, but they are not

obligated to do so and may discontinue market making at any time without notice. We cannot assure you that a market for the Series D Preferred Stock will develop prior to commencement of trading on the NYSE or, if developed, will be maintained or will provide you with adequate liquidity.

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Restrictions on Transfer and Ownership	In order to ensure that we remain qualified as a REIT for U.S. federal income tax purposes, among other purposes, our charter, including the articles supplementary setting forth the terms of the Series D Preferred Stock, provides that generally no person, other than certain excepted holders, may own, or be deemed to own by virtue of the attribution provisions of the Internal Revenue Code of 1986, as amended, or the Code, more than 9.8% in value or in number of shares, whichever is more restrictive, of the outstanding shares of any class or series of our stock, excluding any shares of capital stock not treated as outstanding for U.S. federal income tax purposes. These provisions may restrict the ability of a holder of Series D Preferred Stock to convert such stock into our common stock as described above under Conversion Rights. Our board of directors may, in its sole discretion, exempt a person from the 9.8% ownership limit under certain circumstances. Please see the sections entitled Description of the Series D Preferred Stock Restrictions on Transfer and Ownership in this prospectus supplement and Restrictions on Ownership and Transfer in the accompanying prospectus.
Book Entry and Form	The Depository Trust Company will act as securities depositary for the Series D Preferred Stock, which will only be issued in the form of global securities held in book-entry form.
Use of Proceeds	We expect that the net proceeds from the Series D Preferred Stock offering will be approximately $178.9 million after deducting the underwriting discount and our estimated expenses. We intend to use the net proceeds of this offering to finance the acquisition of mortgage assets including residential mortgage loans, non-Agency RMBS, Agency RMBS, Agency and non-Agency CMBS and other targeted assets, and for other general corporate purposes such as repayment of outstanding indebtedness or to pay down other liabilities, working capital and for liquidity needs. See Use of Proceeds in this prospectus supplement.
U.S. Federal Income Tax Considerations	For a discussion of the material U.S. federal income tax considerations relating to of purchasing, owning and disposing of the Series D Preferred Stock and any common stock received upon conversion of the Series D Preferred Stock, please see the section entitled Material U.S. Federal Income Tax Considerations in the accompanying prospectus.
Risk Factors	Investing in the Series D Preferred Stock involves risks that are described under the caption Risk Factors in this prospectus supplement and in our Annual Report on Form 10-K for the fiscal year ended December 31, 2017 and as updated by our subsequent Quarterly Reports on Form 10-Q, which are incorporated by reference into this prospectus supplement.

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RISK FACTORS

Investing in the Series D Preferred Stock involves risk. Please see the risks described below in addition to the risk factors included in our most recent Annual Report on Form 10-K, in our Quarterly Reports on Form 10-Q and other information that we file from time to time with the SEC. Such risks are not the only risks we face. Additional risks and uncertainties not currently known to us or that we currently deem to be immaterial may also materially adversely affect us and the market value of the Series D Preferred Stock. The risks described could affect our business, financial condition, liquidity, results of operations, prospects, and the market value of the Series D Preferred Stock. In such a case, you may lose all or part of your original investment. You should consider carefully the risks described below and in these reports, as well as other information and data set forth in this prospectus supplement, the accompanying prospectus and the documents incorporated by reference herein and therein before making an investment decision with respect to the Series D Preferred Stock.

Risks Related to the Series D Preferred Stock

The Series D Preferred Stock ranks junior to our existing and future indebtedness and any Senior Stock we may issue in the future, and your interests could be diluted by the issuance of additional shares of preferred stock and by other transactions.

The Series D Preferred Stock ranks junior to all of our existing and future indebtedness and any Senior Stock we may issue in the future and to other non-equity claims on us and our assets available to satisfy claims against us, including claims in bankruptcy, liquidation or similar proceedings. In the event of our bankruptcy, liquidation or dissolution or the winding-up of our affairs, our assets will be available to pay obligations on the Series D Preferred Stock only after all of our indebtedness and other liabilities have been paid. In addition, the Series D Preferred Stock would effectively rank junior to all indebtedness and other liabilities of any existing or future subsidiaries. Such subsidiaries are or would be separate legal entities and have or will have no legal obligation to pay any amounts to us in respect of dividends due on the Series D Preferred Stock. If we are forced to liquidate our assets to pay our creditors, we may not have sufficient assets to pay amounts due on any or all of the Series D Preferred Stock then outstanding. We may in the future incur substantial amounts of debt and other obligations that will rank senior to the Series D Preferred Stock.

Our charter currently authorizes the issuance of up to 100,000,000 shares of preferred stock in one or more classes or series. Prior to this offering, we have issued 5,800,000 shares of Series A Preferred Stock, 13,000,000 shares of Series B Preferred Stock and 10,400,000 shares of Series C Preferred Stock. Subject to limitations prescribed by Maryland law and our charter, our board of directors is authorized to issue, from our authorized but unissued shares of stock, preferred stock in such classes or series as our board of directors may determine and to establish from time to time the number of shares of preferred stock to be included in any such class or series. The issuance of additional shares of Series A Preferred Stock, Series B Preferred Stock, Series C Preferred Stock, Series D Preferred Stock or other Parity Stock would dilute the interests of the holders of Series D Preferred Stock, and the issuance of any Senior Stock or the incurrence of additional indebtedness could affect our ability to pay dividends on, redeem or pay the liquidation preference on the Series D Preferred Stock. Other than the limited conversion rights afforded to holders of Series D Preferred Stock that may become exercisable in connection with certain changes of control as described in this prospectus supplement under the heading Description of the Series D Preferred Stock Conversion Rights, none of the provisions relating to the Series D Preferred Stock contain any terms relating to or limiting our indebtedness or affording the holders of Series D Preferred Stock protection in the event of a highly leveraged or other transaction, including a merger or the sale, lease or conveyance of all or substantially all our assets, so long as the rights of the holders of Series D Preferred Stock are not materially and adversely affected.

The Series D Preferred Stock has not been rated.

We have not sought to obtain a rating for the Series D Preferred Stock, and the Series D Preferred Stock may never be rated. It is possible, however, that one or more rating agencies might independently determine to

assign a rating to the Series D Preferred Stock or that we may elect to obtain a rating of our Series D Preferred Stock in the future. Furthermore, we may elect to issue other securities for which we may seek to obtain a rating. If any ratings are assigned to the Series D Preferred Stock in the future or if we issue other securities with a rating, such ratings, if they are lower than market expectations or are subsequently lowered or withdrawn, could adversely affect the market for or the market value of the Series D Preferred Stock.

Ratings only reflect the views of the issuing rating agency or agencies and such ratings could at any time be revised downward or withdrawn entirely at the discretion of the issuing rating agency. Further, a rating is not a recommendation to purchase, sell or hold any particular security, including the Series D Preferred Stock. In addition, ratings do not reflect market prices or suitability of a security for a particular investor and any future rating of the Series D Preferred Stock may not reflect all risks related to the Company and its business, or the structure or market value of the Series D Preferred Stock.

We may not be able to pay dividends or other distributions on the Series D Preferred Stock.

Under Maryland law, no distributions on stock may be made if, after giving effect to the distribution, (i) the corporation would not be able to pay the indebtedness of the corporation as such indebtedness becomes due in the usual course of business or (ii) except in certain limited circumstances when distributions are made from net earnings, the corporation s total assets would be less than the sum of the corporation s total liabilities plus, unless the charter provides otherwise (which our charter does, with respect to the Series A Preferred Stock, Series B Preferred Stock, the Series C Preferred Stock and the Series D Preferred Stock), the amount that would be needed, if the corporation were to be dissolved at the time of the distribution, to satisfy the preferential rights upon dissolution of stockholders whose preferential rights on dissolution are superior to those receiving the distribution. There can be no guarantee that we will have sufficient cash to pay dividends on the Series D Preferred Stock. Our ability to pay dividends may be impaired if any of the risks described in this prospectus supplement and the accompanying prospectus or incorporated by reference in this prospectus supplement and in the accompanying prospectus were to occur. In addition, payment of our dividends depends upon our earnings, our financial condition, maintenance of our REIT qualification and other factors as our board of directors may deem relevant from time to time. We cannot assure you that our business will generate sufficient cash flow from operations or that future borrowings will be available to us in an amount sufficient to enable us to make distributions on the Series A Preferred Stock, Series B Preferred Stock, the Series C Preferred Stock, the Series D Preferred Stock and on our common stock, to pay our indebtedness or to fund our other liquidity needs.

You may not be able to exercise conversion rights upon a Change of Control. If exercisable, the change of control conversion rights described in this prospectus supplement may not adequately compensate you. These change of control conversion rights may also make it more difficult for a party to acquire us or discourage a party from acquiring us.

Upon the occurrence of a Change of Control, each holder of the Series D Preferred Stock will have the right (unless, prior to the Change of Control Conversion Date, we have provided notice of our election to redeem some or all of the shares of Series D Preferred Stock held by such holder as described under Description of the Series D Preferred Stock Redemption Optional Redemption or Description of the Series D Preferred Stock Redemption Special Optional Redemption, in which case such holder will have the right only with respect to shares of Series D Preferred Stock that are not called for redemption) to convert some or all of such holder s Series D Preferred Stock into shares of our common stock (or under specified circumstances certain alternative consideration). Notwithstanding that we generally may not redeem the Series D Preferred Stock prior to March 30, 2024, we have a special optional redemption right to redeem the Series D Preferred Stock in the event of a Change of Control, and holders of Series D Preferred Stock will not have the right to convert any shares that we have elected to redeem prior to the Change of Control Conversion

Date. Please see the sections entitled Description of the Series D Preferred Stock Redemption Special Optional Redemption and Description of the Series D Preferred Stock Conversion Rights.

If we do not elect to redeem the Series D Preferred Stock prior to the Change of Control Conversion Date, then upon an exercise of the conversion rights provided to the holders of our Series D Preferred Stock, the holders of Series D Preferred Stock will be limited to a maximum number of shares of our common stock (or, if applicable, the Alternative Conversion Consideration (as defined below)) equal to the Share Cap multiplied by the number of shares of Series D Preferred Stock converted. If the Common Stock Price is less than $9.19 per share (which is 50% of the per share closing sale price of our common stock reported on the NYSE on January 14, 2019), subject to adjustment in certain circumstances, the holders of Series D Preferred Stock will receive a maximum of 2.72035 shares of our common stock per share of Series D Preferred Stock, which may result in a holder receiving shares of common stock (or Alternative Conversion Consideration, as applicable) with a value that is less than the liquidation preference of the Series D Preferred Stock.

In addition, the Change of Control conversion feature of the Series D Preferred Stock may have the effect of discouraging a third party from making an acquisition proposal for us or of delaying, deferring or preventing a change of control transaction under circumstances that otherwise could provide the holders of Series D Preferred Stock with the opportunity to realize a premium over the then-current market price of such stock or that stockholders may otherwise believe is in their best interests.

Our charter, including the articles supplementary designating the Series D Preferred Stock, contains restrictions upon transfer and ownership of our stock, which may impair the ability of holders to acquire the Series D Preferred Stock or convert Series D Preferred Stock into our common stock.

Our charter, including the articles supplementary designating the Series D Preferred Stock, contains restrictions on transfer and ownership of our stock intended to, among other purposes, assist us in maintaining our qualification as a REIT for U.S. federal income tax purposes. Our charter provides that generally no person, other than certain excepted holders, may own, or be deemed to own by virtue of the attribution provisions of the Code, more than 9.8% in value or in number of shares, whichever is more restrictive, of the outstanding shares of any class or series of our stock, excluding any shares of capital stock not treated as outstanding for U.S. federal income tax purposes. See Description of the Series D Preferred Stock Restrictions on Transfer and Ownership of Stock in this prospectus supplement and Restrictions on Ownership and Transfer in the accompanying prospectus. You should consider these ownership limitations prior to your purchase of the Series D Preferred Stock. No holder of Series D Preferred Stock will be entitled to convert such stock into our common stock to the extent that receipt of shares of our common stock would cause the holder to exceed any of the limitations on ownership and transfer contained in our charter. In addition, these restrictions could have anti-takeover effects and could reduce the possibility that a third party will attempt to acquire control of us, which could adversely affect the market price of the Series D Preferred Stock.

The historical levels of three-month LIBOR are not an indication of the future levels of three-month LIBOR.

From March 30, 2024, the dividend rate for the Series D Preferred Stock will be determined based on three-month LIBOR. In the past, the level of three-month LIBOR has experienced significant fluctuations. Historical levels, fluctuations and trends of three-month LIBOR are not necessarily indicative of future levels. Any historical upward or downward trend in three-month LIBOR is not an indication that three-month LIBOR is more or less likely to increase or decrease at any time during the floating rate period, and you should not take the historical levels of three-month LIBOR as an indication of its future performance.

Although the actual three-month LIBOR on a dividend payment date or at other times during a Dividend Period (as defined herein) may be higher than the three-month LIBOR on the applicable Dividend Determination Date (as defined herein), you will not benefit from the three-month LIBOR at any time other than on the Dividend Determination Date for such Dividend Period. As a result, changes in the three-month LIBOR may not result in a

comparable change in the market value of the Series D Preferred Stock from March 30, 2024.

Changes in banks inter-bank lending rate reporting practices or the method pursuant to which LIBOR is determined may adversely affect the value of the Series D Preferred Stock.

LIBOR and other indices which are deemed benchmarks are the subject of recent national, international, and other regulatory guidance and proposals for reform. Some of these reforms are already effective while others are still to be implemented. These reforms may cause such benchmarks to perform differently than in the past, or have other consequences which cannot be predicted. In particular, regulators and law enforcement agencies in the U.K. and elsewhere are conducting criminal and civil investigations into whether the banks that contribute information to the British Bankers Association (the BBA) in connection with the daily calculation of LIBOR may have been under-reporting or otherwise manipulating or attempting to manipulate LIBOR. A number of BBA member banks have entered into settlements with their regulators and law enforcement agencies with respect to this alleged manipulation of LIBOR. Actions by the regulators or law enforcement agencies, as well as ICE Benchmark Administration (the current administrator of LIBOR), may result in changes to the manner in which LIBOR is determined or the establishment of alternative reference rates. For example, on July 27, 2017, the U.K. Financial Conduct Authority announced that it intends to stop persuading or compelling banks to submit LIBOR rates after 2021.

At this time, it is not possible to predict the effect of any such changes, any establishment of alternative reference rates or any other reforms to LIBOR that may be implemented in the U.K. or elsewhere. Uncertainty as to the nature of such potential changes, alternative reference rates or other reforms may adversely affect the trading market for securities on which the interest or dividend is determined by reference to LIBOR, such as the Series D Preferred Stock. To the extent the Three-Month LIBOR Rate is discontinued or is no longer quoted, the applicable base rate used to calculate dividend payments on the Series D Preferred Stock during the floating rate period will be determined using the alternative methods described in Description of the Series D Preferred Stock Dividends. Any of these alternative methods may result in dividend payments that are lower than or that do not otherwise correlate over time with the dividend payments that would have been made on the Series D Preferred Stock during the floating rate period if the Three-Month LIBOR Rate was available in its current form. The final alternative method sets the dividend rate for a Dividend Period during the floating rate period at the same rate as the immediately preceding Dividend Period during the floating rate period or, in the case of the first Dividend Period in the floating rate period, the most recent dividend rate that could have been determined had the floating rate period been applicable prior to the first Dividend Period in the floating rate period. More generally, any of the above changes or any other consequential changes to LIBOR or any other benchmark as a result of international, national or other proposals for reform or other initiatives or investigations, or any further uncertainty in relation to the timing and manner of implementation of such changes, could have a material adverse effect on the value of and return on any securities based on or linked to a benchmark, such as the Series D Preferred Stock.

We may issue additional shares of Series A Preferred Stock, Series B Preferred Stock, Series C Preferred Stock, Series D Preferred Stock and additional series of preferred stock that rank on parity with or senior to the Series D Preferred Stock as to dividend rights, rights upon liquidation or voting rights.

The issuance of additional shares of Series A Preferred Stock, Series B Preferred Stock, Series C Preferred Stock, Series D Preferred Stock and additional series of preferred stock on parity with or senior to the Series D Preferred Stock would dilute the interests of the holders of the Series D Preferred Stock, and any issuance of preferred stock senior to the Series D Preferred Stock or of additional indebtedness could affect our ability to pay dividends on, redeem or pay the liquidation preference on the Series D Preferred Stock. In addition, although holders of Series D Preferred Stock are entitled to limited voting rights, as described in Description of the Series DC Preferred Stock Voting Rights, with respect to such matters, subject to certain exceptions, the Series D Preferred Stock will vote as a class with the Series A Preferred Stock, Series B Preferred Stock, Series C Preferred Stock and all other classes or

series of preferred stock that we may issue upon which like voting rights have been conferred and are exercisable. As a result, generally, the voting rights of holders of Series D Preferred Stock may be significantly diluted, and the holders of such other series of preferred stock that we may issue may

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be able to control or significantly influence the outcome of any vote. Future issuances and sales of Parity Stock, or the perception that such issuances and sales could occur, may cause prevailing market prices for the Series D Preferred Stock and our common stock to decline and may adversely affect our ability to raise additional capital in the financial markets at times and prices favorable to us.

As a holder of Series D Preferred Stock, you will have limited voting rights.

Your voting rights as a holder of Series D Preferred Stock will be limited. Our common stock is the only class of our securities that currently carries full voting rights. Holders of Series D Preferred Stock may vote only (i) to elect, voting together as a single class, with holders of our Parity Stock having similar voting rights, including holders of Series A Preferred Stock and Series B Preferred Stock, Series C Preferred Stock two additional directors to our board of directors in the event that six full quarterly dividends (whether or not consecutive) payable on the Series D Preferred Stock are in arrears, (ii) on amendments to our charter, including the articles supplementary designating the Series D Preferred Stock, that materially and adversely affect the rights of the holders of Series D Preferred Stock or (iii) to authorize or create, or increase the authorized or issued amount of, additional classes or series of Senior Stock. Other than the limited circumstances described in this prospectus supplement, holders of Series D Preferred Stock will not have any voting rights. See Description of the Series D Preferred Stock Voting Rights in this prospectus supplement.

The market price of the Series D Preferred Stock could be substantially affected by various factors.

The market price of the Series D Preferred Stock will depend on many factors, which may change from time to time, including:

- prevailing interest rates, increases in which may have an adverse effect on the market price of the Series D Preferred Stock;
- trading prices of common and preferred equity securities issued by REITs and other similar companies;
- the annual yield from distributions on the Series D Preferred Stock as compared to yields on other financial instruments;
- general economic and financial market conditions;
- government action or regulation;
- our financial condition, performance and prospects and those of our competitors;
- changes in financial estimates or recommendations by securities analysts with respect to us, our competitors or our industry;

- our issuance of additional preferred equity securities or the incurrence of debt; and

- actual or anticipated variations in our quarterly operating results and those of our competitors.

As a result of these and other factors, investors who purchase the Series D Preferred Stock in this offering may experience a decrease, which could be substantial and rapid, in the market price of the Series D Preferred Stock, including decreases unrelated to our operating performance or prospects.

The Series D Preferred Stock is a new issue of securities and does not have an established trading market, which may negatively affect its value and your ability to transfer and sell your shares.

The Series D Preferred Stock is a new issue of securities and currently no market exists for the Series D Preferred Stock. We intend to apply to list the Series D Preferred Stock on the NYSE. However, we cannot assure you that the Series D Preferred Stock will be approved for listing on the NYSE. Even if so approved, trading of the Series D Preferred Stock on the NYSE is not expected to begin until sometime during the period

ending 30 days after the date of initial issuance of the Series D Preferred Stock and, in any event, a trading market on the NYSE for the Series D Preferred Stock may never develop or, even if one develops, may not be maintained and may not provide you with adequate liquidity. Certain of the underwriters have advised us that they intend to make a market in the Series D Preferred Stock prior to the commencement of any trading on the NYSE, but they are not obligated to do so and may discontinue market making at any time without notice. The liquidity of any market for the Series D Preferred Stock that may develop will depend on a number of factors, including prevailing interest rates, the dividend rate on our common stock, our financial condition and operating results, the number of holders of Series D Preferred Stock, the market for similar securities and the interest of securities dealers in making a market in the Series D Preferred Stock. As a result, the ability to transfer or sell the Series D Preferred Stock and the amount you receive upon any sale or transfer of the Series D Preferred Stock could be adversely affected.

Future offerings of debt or equity securities may adversely affect the market price of the Series D Preferred Stock.

Future issuances and sales of Parity Stock, or the perception that such issuances and sales could occur, may cause prevailing market prices for the Series D Preferred Stock and our common stock to decline and may adversely affect our ability to raise additional capital in the financial markets at times and prices favorable to us.

If we decide to issue debt or Senior Stock in the future, it is possible that these securities will be governed by an indenture or other instrument containing covenants or other provisions that will restrict our operating flexibility. Additionally, any convertible or exchangeable securities that we issue in the future may have rights, preferences and privileges more favorable than those of the Series D Preferred Stock and may result in dilution to owners of the Series D Preferred Stock. We and, indirectly, our stockholders, will bear the cost of issuing and servicing such securities. Because our decision to issue debt or equity securities in any future offering will depend on market conditions and other factors beyond our control, we cannot predict or estimate the amount, timing or nature of our future offerings. Thus, holders of Series D Preferred Stock bear the risk of our future offerings reducing the market price of the Series D Preferred Stock and diluting the value of their holdings in us.

If our common stock is delisted, your ability to transfer or sell your shares of the Series D Preferred Stock may be limited and the market value of the Series D Preferred Stock will likely be materially adversely affected

Other than in connection with a Change of Control, the Series D Preferred Stock does not contain provisions that are intended to protect you if our common stock is delisted from the NYSE. Since the Series D Preferred Stock has no stated maturity date, you may be forced to hold your shares of the Series D Preferred Stock and receive stated dividends on the Series D Preferred Stock when, as and if authorized by our board of directors and declared and paid by us with no assurance as to ever receiving the liquidation value thereof. In addition, if our common stock is delisted from the NYSE, it is likely that the Series D Preferred Stock will be delisted from the NYSE as well. Accordingly, if our common stock is delisted from the NYSE, your ability to transfer or sell your shares of the Series D Preferred Stock may be limited and the market value of the Series D Preferred Stock will likely be materially adversely affected.

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USE OF PROCEEDS

We estimate that the net proceeds of this offering will be approximately $178.9 million (or approximately $205.7 million if the underwriters exercise their over-allotment option in full), after deduction of underwriting discounts and estimated offering expenses payable by us.

We intend to use the net proceeds of this offering to finance the acquisition of mortgage assets including residential mortgage loans, non-Agency RMBS, Agency RMBS, Agency and non-Agency CMBS and other targeted assets, and for other general corporate purposes such as repayment of outstanding indebtedness or to pay down other liabilities, working capital and for liquidity needs.

Pending these uses, we may invest the net offering proceeds in interest-bearing, short-term investments, including money market accounts that are consistent with our intention to maintain our qualification as a REIT, or we may use them to reduce short-term indebtedness.

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CAPITALIZATION

The following table sets forth our consolidated capitalization as of September 30, 2018 (i) on an actual basis and (ii) on an as adjusted basis after giving effect to the designation of 8,510,000 shares of our authorized but unissued preferred stock as Series D Preferred Stock and the issuance and sale of 7,400,000 shares of Series D Preferred Stock in this offering (assuming no exercise of the underwriters over-allotment option).

You should read the table below in conjunction with the section entitled Management s Discussion and Analysis of Financial Condition and Results of Operations and the accompanying consolidated financial statements and related notes in our annual report on Form 10-K for the year ended December 31, 2017 and in our quarterly report on Form 10-Q for the quarter ended September 30, 2018, which are incorporated by reference into this prospectus supplement and the accompanying prospectus.

	As of September 30, 2018 (unaudited)	
	Actual	As Adjusted
	(Amounts in thousands, except share and per share data)	
Cash and cash equivalents	$ 121,046	$ 299,919
Total liabilities	$ 21,266,745	$ 21,266,745
Stockholders Equity:		
Preferred stock, $0.01 par value per share, 100,000,000 shares authorized, 29,200,000 shares issued and outstanding on an actual basis and 36,600,000 shares issued and outstanding on an as adjusted basis[1]	292	366
Common stock, $0.01 par value per share, 300,000,000 shares authorized, 500,000,000 shares authorized on an as adjusted basis, 187,006,943 shares issued and outstanding on an actual and as adjusted basis[2][3]	1,870	1,870
Additional paid-in capital	4,069,868	4,248,667
Accumulated other comprehensive income	627,936	627,936
Cumulative earnings	3,482,287	3,482,287
Cumulative distributions to stockholders	(4,269,072)	(4,269,072)
Total stockholders equity	$ 3,913,181	$ 4,092,054
Total capitalization	$ 25,179,926	$ 25,358,799

(1) Does not include up to 1,110,000 shares of Series D Preferred Stock that may be issued upon exercise of the underwriters over-allotment option.

(2) Excludes shares of common stock issuable upon vesting of outstanding restricted common stock reserved for future issuance under our equity incentive plan.

(3) We intend to amend our charter to increase the aggregate number of authorized shares of common stock from 300,000,000 to 500,000,000. See Description of Series D Preferred Stock General.

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DESCRIPTION OF THE SERIES D PREFERRED STOCK

This description of certain terms of the Series D Preferred Stock supplements, and, to the extent inconsistent therewith, replaces, the description of the general terms and provisions of our preferred stock set forth in the accompanying prospectus. The description of certain terms of the Series D Preferred Stock in this prospectus supplement does not purport to be complete and is in all respects subject to, and qualified in its entirety by references to the relevant provisions of our charter, including the articles supplementary designating the terms of the Series D Preferred Stock, our bylaws and Maryland law. Copies of our charter and our bylaws are filed as exhibits to the registration statement of which this prospectus supplement and accompanying prospectus form a part.

General

Pursuant to our charter, we are currently authorized to designate and issue up to 100,000,000 shares of preferred stock, $0.01 par value per share, in one or more classes or series and, subject to the limitations prescribed by our charter and Maryland law, with such terms of each class or series of preferred stock, including preferences, conversion or other rights, voting power, restrictions, limitations as to dividends or other distributions, qualifications, and terms and conditions of redemption and the number of shares constituting any class or series, as our board of directors may determine, without any vote or action by our stockholders. As of the date of this prospectus supplement, we have 5,800,000 shares of Series A Preferred Stock issued and outstanding, 13,000,000 shares of Series B Preferred Stock issued and outstanding and 10,400,000 shares of Series C Preferred Stock issued and outstanding.

On January 14, 2019, our board of directors approved an amendment to our charter (the Amendment) to increase the number of shares of our common stock authorized to be issued by us from time to time from 300,000,000 to 500,000,000 shares. We intend to cause the Amendment to become effective upon its filing with State Department of Assessments and Taxation of Maryland on or about the time we close this offering of Series D Preferred Stock.

In connection with this offering, our board of directors and a committee of the board will, as permitted by our charter and Maryland law, classify and designate a new series of preferred stock with the rights set forth herein consisting of shares designated as the 8.00% Series D Fixed-to-Floating Rate Cumulative Redeemable Preferred Stock, par value $0.01 per share, which we refer to herein as the Series D Preferred Stock, by adopting and filing the articles supplementary with the State Department of Assessments and Taxation of Maryland. Subsequent to the completion of this offering, we will have available for issuance 59,980,000 authorized but undesignated and unissued shares of preferred stock. Our board of directors may, without the approval of holders of Series A Preferred Stock, Series B Preferred Stock, Series C Preferred Stock, Series D Preferred Stock or our common stock, designate additional series of authorized preferred stock ranking junior to or on parity with the Series D Preferred Stock or designate additional shares of the Series D Preferred Stock and authorize the issuance of such shares.

We intend to apply to list the shares of the Series D Preferred Stock on the NYSE under the symbol CIM PRD. If the application is approved, we expect trading to commence within 30 days after the initial delivery of the shares of Series D Preferred Stock.

The registrar, transfer agent and dividend and redemption price disbursing agent in respect of the Series D Preferred Stock will be Computershare Inc.

Maturity

The Series D Preferred Stock has no stated maturity and will not be subject to any sinking fund or mandatory redemption. Shares of the Series D Preferred Stock will remain outstanding indefinitely unless we

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decide to redeem or otherwise repurchase them or they become convertible and are converted as described below under Conversion Rights. We are not required to set apart for payment the funds to redeem the Series D Preferred Stock.

Ranking

The Series D Preferred Stock will rank, with respect to rights to the payment of dividends and the distribution of assets upon our liquidation, dissolution or winding up:

- senior to all classes or series of our common stock and any other Junior Stock we may issue;
- on a parity with our Series A Preferred Stock, Series B Preferred Stock, Series C Preferred Stock and any Parity Stock we may issue; junior to any Senior Stock we may issue; and
- effectively junior to all of our existing and future indebtedness (including indebtedness convertible into or exchangeable for our common stock or preferred stock) and the indebtedness of our existing and future subsidiaries.

Dividends

Holders of shares of the Series D Preferred Stock are entitled to receive, when, as and if authorized by our board of directors and declared by us, out of funds legally available for the payment of dividends, cumulative cash dividends. The initial dividend rate for the Series D Preferred Stock from and including the date of original issuance to, but not including, March 30, 2024 (the Fixed Rate Period) will be 8.00% of the $25.00 per share liquidation preference per annum (equivalent to $2.00 per annum per share). On and after March 30, 2024 (the Floating Rate Period), dividends on the Series D Preferred Stock will accumulate at a percentage of the $25.00 liquidation preference equal to an annual floating rate of the Three-Month LIBOR Rate plus a spread of 5.379%. Dividends on the Series D Preferred Stock will accumulate daily and be cumulative from, and including, the date of original issue and will be payable quarterly in arrears on the 30th day of each March, June, September and December (each, as may be modified as provided below, a dividend payment date). If any dividend payment date is not a business day, as defined in the articles supplementary designating the Series D Preferred Stock, then the dividend which would otherwise have been payable on that dividend payment date may be paid on the next succeeding business day with the same force and effect as if paid on such dividend payment date, and no interest, additional dividends or sums in lieu of interest will be payable for the period from and after that dividend payment date to that next succeeding business day. The first dividend on the Series D Preferred Stock is scheduled to be paid on or about June 30, 2019 (long first dividend period), in the amount of $0.87222 per share. Dividends payable on the Series D Preferred Stock for the Fixed Rate Period, including dividends payable for any partial Dividend Period, will be computed on the basis of a 360-day year consisting of twelve 30-day months. Dividends payable on the Series D Preferred Stock for the Floating Rate Period, including dividends payable for any partial Dividend Period, will be computed based on the actual number of days in a Dividend Period and a 360-day year. Dividends will be payable to holders of record as they appear on our stock records at the close of business on the applicable record date, which will be no fewer than ten days and no more than 35 days prior to the applicable dividend payment date, as shall be fixed by the Board of Directors (each, a dividend record date). The dividends payable on any dividend payment date shall include dividends accumulated to, but not including, such dividend payment date.

For each Dividend Period during the Floating Rate Period, LIBOR (the London interbank offered rate) (Three-Month LIBOR Rate) will be determined by us, as of the applicable Dividend Determination Date (as defined below), in accordance with the following provisions:

LIBOR will be the rate (expressed as a percentage per year) for deposits in U.S. dollars having an index maturity of three months, in amounts of at least $1,000,000, as such rate appears on Reuters Page LIBOR01 at approximately 11:00 a.m. (London time) on the relevant Dividend Determination Date; or

if no such rate appears on Reuters Page LIBOR01 or if the Reuters Page LIBOR01 is not available at approximately 11:00 a.m. (London time) on the relevant Dividend Determination Date, then we will select four nationally-recognized banks in the London interbank market and request that the principal London offices of those four selected banks provide us with their offered quotation for deposits in U.S. dollars for a period of three months, commencing on the first day of the applicable Dividend Period, to prime banks in the London interbank market at approximately 11:00 a.m. (London time) on that Dividend Determination Date for the applicable Dividend Period. Offered quotations must be based on a principal amount equal to an amount that, in our discretion, is representative of a single transaction in U.S. dollars in the London interbank market at that time. If at least two quotations are provided, the Three-Month LIBOR Rate for such Dividend Period will be the arithmetic mean (rounded upward if necessary, to the nearest 0.00001 of 1%) of those quotations. If fewer than two quotations are provided, the Three-Month LIBOR Rate for such Dividend Period will be the arithmetic mean (rounded upward if necessary, to the nearest 0.00001 of 1%) of the rates quoted at approximately 11:00 a.m. (New York City time) on that Dividend Determination Date for such Dividend Period by three nationally-recognized banks in New York, New York selected by us, for loans in U.S. dollars to nationally-recognized European banks (as selected by us), for a period of three months commencing on the first day of such Dividend Period. The rates quoted must be based on an amount that, in our discretion, is representative of a single transaction in U.S. dollars in that market at that time. If no quotation is provided as described above, then if a Calculation Agent (as defined below) has not been appointed at such time, we will appoint a Calculation Agent who shall, after consulting such sources as it deems comparable to any of the foregoing quotations or display page, or any such source as it deems reasonable from which to estimate LIBOR or any of the foregoing lending rates, shall determine LIBOR for the second London Business Day immediately preceding the first day of such distribution period in its sole discretion. If the Calculation Agent is unable or unwilling to determine LIBOR as provided in the immediately preceding sentence, then LIBOR will be equal to Three-Month LIBOR for the then current Dividend Period, or, in the case of the first Dividend Period in the Floating Rate Period, the most recent dividend rate that would have been determined based on the last available Reuters Page LIBOR01 had the Floating Rate Period been applicable prior to the first Dividend Period in the Floating Rate Period.

Notwithstanding the foregoing, if we determine on the relevant Dividend Determination Date that the LIBOR base rate has been discontinued, then we will appoint a Calculation Agent and the Calculation Agent will consult with an investment bank of national standing to determine whether there is an industry accepted substitute or successor base rate to Three-Month LIBOR Rate. If, after such consultation, the Calculation Agent determines that there is an industry accepted substitute or successor base rate, the Calculation Agent shall use such substitute or successor base rate. In such case, the Calculation Agent in its sole discretion may (without implying a corresponding obligation to do so) also implement changes to the business day convention, the definition of business day, the Dividend Determination Date and any method for obtaining the substitute or successor base rate if such rate is unavailable on the relevant Business Day, in a manner that is consistent with industry accepted practices for such substitute or successor base rate. Unless the Calculation Agent determines that there is an industry accepted substitute or successor base rate as so provided above, the Calculation Agent will, in consultation with us, follow the steps specified in the second bullet point in the immediately preceding paragraph in order to determine Three-Month LIBOR Rate for the applicable Dividend Period.

 Calculation Agent shall mean a third party independent financial institution of national standing with experience providing such services, which has been selected by us.

 Dividend Determination Date means the London Business Day (as defined below) immediately preceding the first date of the applicable Dividend Period.

Dividend Period means the period from, and including, a dividend payment date to, but excluding, the next succeeding dividend payment date, except for the initial Dividend Period, which will be the period from, and including, the original issue date of the Series D Preferred Stock to, but excluding, June 30, 2019.

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London Business Day means any day on which dealings in deposits in U.S. dollars are transacted in the London interbank market.

Reuters Page LIBOR01 means the display so designated on the Reuters 3000 Xtra (or such other page as may replace the LIBOR01 page on that service, or such other service as may be nominated by the ICE Benchmark Administration Limited, or ICE, or its successor, or such other entity assuming the responsibility of ICE or its successor in the event ICE or its successor no longer does so, as the successor service, for the purpose of displaying London interbank offered rates for U.S. dollar deposits).

No dividends on shares of Series D Preferred Stock may be authorized by our board of directors or paid or set apart for payment by us at any time when the terms and provisions of any agreement of ours, including any agreement relating to our indebtedness, prohibit the authorization, payment or setting apart for payment thereof or provide that the authorization, payment or setting apart for payment thereof would constitute a breach of the agreement or a default under the agreement, or if the authorization, payment or setting apart for payment is restricted or prohibited by law. You should review the information appearing above under Risk Factors We may not be able to pay dividends or other distributions on the Series D Preferred Stock for more information as to, among other things, other circumstances under which we may be unable to pay dividends on the Series D Preferred Stock.

Notwithstanding the foregoing, dividends on the Series D Preferred Stock will accumulate whether or not (i) the terms and provisions of any laws or agreements referred to in the preceding paragraph at any time prohibit the current payment of dividends, (ii) we have earnings, (iii) there are funds legally available for the payment of those dividends and (iv) those dividends are declared. No interest, or sum in lieu of interest, will be payable in respect of any dividend payment or payments on the Series D Preferred Stock which may be in arrears, and holders of Series D Preferred Stock will not be entitled to any dividends in excess of full cumulative dividends described above. Any dividend payment made on the Series D Preferred Stock will first be credited against the earliest accumulated but unpaid dividend due with respect to those shares.

Future dividends on our common stock and preferred stock, including the Series D Preferred Stock offered pursuant to this prospectus supplement, will be at the discretion of our board of directors and will depend on, among other things, our results of operations, cash flow from operations, financial condition and capital requirements, the annual distribution requirements under the REIT provisions of the Code, applicable law, any debt service requirements and any other factors our board of directors deems relevant. Accordingly, we cannot guarantee that we will be able to make cash distributions on the Series D Preferred Stock or what the actual dividends will be for any future period.

Except as noted below, unless full cumulative dividends on the Series D Preferred Stock have been or contemporaneously are declared and paid or declared and a sum sufficient for the payment thereof is set apart for payment for all past Dividend Periods, no dividends (other than in shares of our common stock or other Junior Stock we may issue) may be declared or paid or set apart for payment upon our common stock or other Junior Stock or our Series A Preferred Stock, Series B Preferred Stock and Series C Preferred Stock or other Parity Stock we may issue and no other distribution may be declared or made upon our common stock or other Junior Stock or our Series A Preferred Stock, Series B Preferred Stock and Series C Preferred Stock or other Parity Stock we may issue. In addition, our common stock and other Junior Stock or Parity Stock we may issue may not be redeemed, purchased or otherwise acquired for any consideration (or any moneys be paid to or made available for a sinking fund for the redemption of any such securities) by us (except by conversion into or exchange for shares of, or options, warrants or rights to purchase or subscribe for, our common stock or other Junior Stock we may issue or pursuant to an exchange offer made on the same terms to all holders of Series D Preferred Stock and all Parity Stock). The foregoing will not, however, prevent the redemption, purchase or acquisition by us of shares of any class or series of stock for the purpose of enforcing restrictions on transfer and ownership of our stock contained in our charter, or the redemption, purchase

or acquisition by us of shares of our common stock for purposes of and in compliance with any incentive or benefit plan of ours.

When dividends are not paid in full (or a sum sufficient for such full payment is not so set apart) upon the Series A Preferred Stock, Series B Preferred Stock, Series C Preferred Stock, Series D Preferred Stock and any other Parity Stock we may issue, all dividends declared upon the Series A Preferred Stock, Series B Preferred Stock, Series C Preferred Stock, Series D Preferred Stock and such other Parity Stock must be declared pro rata so that the amount of dividends declared per share of Series A Preferred Stock, Series B Preferred Stock, Series C Preferred Stock, Series D Preferred Stock and such other Parity Stock will in all cases bear to each other the same ratio that accumulated dividends per share on the Series A Preferred Stock, Series B Preferred Stock, Series C Preferred Stock, Series D Preferred Stock and such Parity Stock (which will not include any accrual in respect of unpaid dividends for prior Dividend Periods if such other Parity Stock do not have a cumulative dividend) bear to each other. No interest, or sum of money in lieu of interest, will be payable in respect of any dividend payment or payments on the Series D Preferred Stock which may be in arrears.

Liquidation Preference

In the event of our voluntary or involuntary liquidation, dissolution or winding up, the holders of Series D Preferred Stock will be entitled to be paid out of the assets we have legally available for distribution to our stockholders, subject to the preferential rights of the holders of any Senior Stock, a liquidation preference of $25.00 per share, plus any accumulated and unpaid dividends thereon (whether or not authorized or declared) to, but excluding, the payment date, before any distribution of assets is made to holders of common stock or other Junior Stock we may issue; and the holders of Series D Preferred Stock will not be entitled to any further payment.

In the event that, upon any such voluntary or involuntary liquidation, dissolution or winding up, our available assets are insufficient to pay the amount of the liquidating distributions on all outstanding shares of Series A Preferred Stock, Series B Preferred Stock, Series C Preferred Stock, Series D Preferred Stock and any other Parity Stock we may issue, then the holders of Series A Preferred Stock, Series B Preferred Stock, Series C Preferred Stock, Series D Preferred Stock and such other Parity Stock will share ratably in any such distribution of assets in proportion to the full liquidating distributions to which they would otherwise be respectively entitled. As of the date of this prospectus supplement, we have outstanding 5,800,000 shares of Series A Preferred Stock, 13,000,000 shares of Series B Preferred Stock and 10,400,000 shares of Series C Preferred Stock.

Notice of any such liquidation stating the payment date or dates when, and the place or places where, the amounts distributable in each circumstance shall be payable, will be given no fewer than 30 days and no more than 60 days prior to the payment date, to each holder of record of Series D Preferred Stock at the address of such holder as it appears on our stock records. After payment of the full amount of the liquidating distributions to which they are entitled, the holders of Series D Preferred Stock will have no right or claim to any of our remaining assets. The consolidation, conversion or merger of us with or into any other corporation, trust or entity or of any other entity with or into us, the sale, lease, transfer or conveyance of all or substantially all of our property or business or a statutory share exchange, will not be deemed to constitute a liquidation, dissolution or winding up of us (although such events may give rise to the special optional redemption and contingent conversion rights described below).

In determining whether a distribution (other than upon voluntary or involuntary liquidation), by dividend, redemption or other acquisition of shares of stock or otherwise, is permitted under Maryland law with respect to any share of any class or series of our stock, amounts that would be needed, if we were to be dissolved at the time of the distribution, to satisfy the preferential rights upon dissolution of holders of shares of Series D Preferred Stock will not be added to our total liabilities.

Redemption

The Series D Preferred Stock is not redeemable by us prior to March 30, 2024, except under circumstances where it is necessary to preserve our qualification as a REIT for U.S. federal income tax purposes (please see

Restrictions on Transfer and Ownership below and Restrictions on Ownership and Transfer in the accompanying prospectus) and except as described below under Special Optional Redemption upon the occurrence of a Change of Control (as defined herein).

Optional Redemption. On and after March 30, 2024, we may, at our option, upon not less than 30 nor more than 60 days notice, redeem the Series D Preferred Stock, in whole or in part, at any time or from time to time, for cash at a redemption price of $25.00 per share, plus any accumulated and unpaid dividends thereon (whether or not authorized or declared) to, but excluding, the redemption date, without interest.

Special Optional Redemption. Upon the occurrence of a Change of Control, we may, at our option, upon not less than 30 nor more than 60 days notice, redeem the Series D Preferred Stock, in whole or in part, within 120 days after the first date on which such Change of Control occurred, for cash at a redemption price of $25.00 per share, plus any accumulated and unpaid dividends thereon (whether or not authorized or declared) to, but excluding, the redemption date. If, prior to the Change of Control Conversion Date, we have provided notice of our election to redeem some or all of the shares of Series D Preferred Stock (whether pursuant to our optional redemption right described above under Optional Redemption or this special optional redemption right), the holders of Series D Preferred Stock will not have the Change of Control Conversion Right (as defined below) described below under Conversion Rights with respect to the shares called for redemption.

A Change of Control is deemed to occur when, after the original issuance of the Series D Preferred Stock, the following have occurred and are continuing:

- the acquisition by any person, including any syndicate or group deemed to be a person under Section 13(d)(3) of the Exchange Act, of beneficial ownership, directly or indirectly, through a purchase, merger or other acquisition transaction or series of purchases, mergers or other acquisition transactions of our stock entitling that person to exercise more than 50% of the total voting power of all our stock entitled to vote generally in the election of our directors (except that such person will be deemed to have beneficial ownership of all securities that such person has the right to acquire, whether such right is currently exercisable or is exercisable only upon the occurrence of a subsequent condition); and

- following the closing of any transaction referred to in the bullet point above, neither we nor the acquiring or surviving entity has a class of common securities (or American Depositary Receipts representing such securities) listed on the NYSE, the NYSE American LLC or the Nasdaq Stock Market, or listed or quoted on an exchange or quotation system that is a successor to the NYSE, the NYSE American LLC or the Nasdaq Stock Market.

Redemption Procedures. In the event we elect to redeem Series D Preferred Stock pursuant to our optional redemption right or our special optional redemption right, the notice of redemption will be given to each holder of record of Series D Preferred Stock called for redemption at such holder s address as it appears on our stock records and will state the following:

- the redemption date;

the number of shares of Series D Preferred Stock to be redeemed;

the redemption price;

the place or places where certificates (if any) for the Series D Preferred Stock are to be surrendered for payment of the redemption price;

that dividends on the shares to be redeemed will cease to accumulate on the redemption date;

if applicable, that such redemption is being made in connection with a Change of Control and, in that case, a brief description of the transaction or transactions constituting such Change of Control; and

if such redemption is being made in connection with a Change of Control, that the holders of the shares of Series D Preferred Stock being so called for redemption will not be able to tender such shares of Series D Preferred Stock for conversion in connection with the Change of Control and that each share of Series D Preferred Stock tendered for conversion that is called, prior to the Change of Control Conversion Date, for redemption will be redeemed on the related date of redemption instead of converted on the Change of Control Conversion Date.

If less than all of the Series D Preferred Stock held by any holder is to be redeemed, the notice given to such holder shall also specify the number of shares of Series D Preferred Stock held by such holder to be redeemed. No failure to give such notice or any defect thereto or in the giving thereof will affect the validity of the proceedings for the redemption of any shares of Series D Preferred Stock, except as to the holder to whom notice was defective or not given.

Holders of shares of Series D Preferred Stock to be redeemed must surrender such shares at the place designated in the notice of redemption and will be entitled to the redemption price and any accumulated and unpaid dividends payable upon the redemption following the surrender. If notice of redemption of any shares of Series D Preferred Stock has been given and if we have irrevocably set apart for payment the funds necessary for redemption (including any accumulated and unpaid dividends) in trust for the benefit of the holders of the shares of Series D Preferred Stock so called for redemption, then from and after the redemption date (unless we default in providing for the payment of the redemption price plus accumulated and unpaid dividends, if any), dividends will cease to accumulate on those shares of Series D Preferred Stock, those shares of Series D Preferred Stock will no longer be deemed outstanding and all rights of the holders of those shares will terminate, except the right to receive the redemption price plus accumulated and unpaid dividends, if any, payable upon redemption. If any redemption date is not a business day, then the redemption price and accumulated and unpaid dividends, if any, payable upon redemption may be paid on the next business day and no interest, additional dividends or other sums will accumulate on the amount payable for the period from and after that redemption date to that next business day. If less than all of the outstanding shares of Series D Preferred Stock are to be redeemed, the shares of Series D Preferred Stock to be redeemed will be selected pro rata (as nearly as may be practicable without creating fractional shares) or by lot. If such redemption is to be by lot and if, as a result of such redemption, any holder of Series D Preferred Stock would own, or be deemed by virtue of certain attribution provisions of the Code to own, in excess of 9.8% in value or in number of shares (whichever is more restrictive) of any class or series of our stock (including the Series D Preferred Stock), or violate any other restriction or limitation of our stock set forth in our charter, then, except as otherwise permitted in our charter, we will redeem the requisite number of shares of Series D Preferred Stock of that holder such that the holder will not own or be deemed by virtue of certain attribution provisions of the Code to own, subsequent to the redemption, in excess of 9.8% in value or in number of shares (whichever is more restrictive) of any class or series of our stock or violate any other restriction or limitation of our stock set forth in our charter. See Restrictions on Transfer and Ownership in this prospectus supplement and in accompanying prospectus under the heading Restrictions on Ownership and Transfer.

Immediately prior to any redemption of Series D Preferred Stock, we will pay, in cash, any accumulated and unpaid dividends to, but excluding, the redemption date, unless a redemption date falls after a dividend record date and prior to the corresponding dividend payment date, in which case each holder of Series D Preferred Stock at the close of business on such dividend record date will be entitled to the dividend payable on such shares on the corresponding dividend payment date notwithstanding the redemption of such shares before such dividend payment date. Except as provided above, we will make no payment or allowance for unpaid dividends, whether or not in arrears, on shares of the Series D Preferred Stock to be redeemed.

Unless full cumulative dividends on all shares of Series D Preferred Stock have been or contemporaneously are declared and paid or declared and a sum sufficient for the payment thereof has been or contemporaneously is set apart for payment for all past Dividend Periods, no shares of Series D Preferred Stock may be redeemed unless all

outstanding shares of Series D Preferred Stock are simultaneously redeemed, and we may not purchase

or otherwise acquire directly or indirectly any shares of Series D Preferred Stock (except by conversion into or exchange for shares of, or options, warrants or rights to purchase or subscribe for, our common stock or other Junior Stock we may issue or pursuant to a purchase or exchange offer made on the same terms to all holders of Series D Preferred Stock and all Parity Stock); provided, however, that the foregoing will not prevent the redemption, purchase or acquisition by us of shares of Series D Preferred Stock for the purpose of enforcing restrictions on ownership and transfer of our stock contained in our charter.

Subject to applicable law, we may purchase shares of Series D Preferred Stock in the open market, by tender or by privately negotiated transactions. Any shares of Series D Preferred Stock that we acquire, by redemption or otherwise, shall be reclassified as authorized but unissued shares of preferred stock, without designation as to class or series, and may thereafter be issued as any class or series of preferred stock.

Conversion Rights

Upon the occurrence of a Change of Control, each holder of Series D Preferred Stock will have the right (unless, prior to the Change of Control Conversion Date, we have provided notice of our election to redeem some or all of the shares of Series D Preferred Stock held by such holder as described above under Redemption, in which case such holder will have the right only with respect to shares of Series D Preferred Stock that are not called for redemption) to convert some or all of the shares of the Series D Preferred Stock held by such holder (the Change of Control Conversion Right) on the Change of Control Conversion Date into a number of shares of our common stock per share of Series D Preferred Stock (the Common Stock Conversion Consideration) equal to the lesser of:

the quotient obtained by dividing (i) the sum of the $25.00 liquidation preference per share of Series D Preferred Stock, plus any accumulated and unpaid dividends thereon (whether or not authorized or declared) to, but excluding, the Change of Control Conversion Date (unless the Change of Control Conversion Date is after a dividend record date and prior to the corresponding dividend payment date for the Series D Preferred Stock, in which case no additional amount for such accumulated and unpaid dividends to be paid on such dividend payment date will be included in this sum) by (ii) the Common Stock Price, as defined below (such quotient, the Conversion Rate); and

2.72035, or the Share Cap, subject to certain adjustments as described below.

Notwithstanding anything in the articles supplementary designating the Series D Preferred Stock to the contrary and except as otherwise required by law, the persons who are the holders of record of shares of Series D Preferred Stock at the close of business on a dividend record date will be entitled to receive the dividend payable on the corresponding dividend payment date notwithstanding the conversion of those shares after such dividend record date and on or prior to such dividend payment date and, in such case, the full amount of such dividend will be paid on such dividend payment date to the persons who were the holders of record at the close of business on such dividend record date. Except as provided above, we will make no allowance for unpaid dividends that are not in arrears on the shares of Series D Preferred Stock to be converted.

The Share Cap is subject to pro rata adjustments for any share splits (including those effected pursuant to a distribution of our common stock to existing holders of our common stock), subdivisions or combinations (in each case, a Share Split) with respect to our common stock as follows: the adjusted Share Cap as the result of a Share Split will be the number of shares of our common stock that is equivalent to the product obtained by multiplying (i) the Share Cap in effect immediately prior to such Share Split by (ii) a fraction, the numerator of which is the number of

shares of our common stock outstanding immediately after giving effect to such Share Split and the denominator of which is the number of shares of our common stock outstanding immediately prior to such Share Split.

For the avoidance of doubt, subject to the immediately succeeding sentence, the aggregate number of shares of our common stock (or equivalent Alternative Conversion Consideration, as applicable) issuable or deliverable,

as applicable, in connection with the exercise of the Change of Control Conversion Right will not exceed the product of the Share Cap times the aggregate number of shares of the Series D Preferred Stock issued and outstanding at the Change of Control Conversion Date (or equivalent Alternative Conversion Consideration, as applicable) (the Exchange Cap). The Exchange Cap is subject to pro rata adjustments for any share splits on the same basis as the corresponding adjustment to the Share Cap.

In the case of a Change of Control pursuant to which our common stock is or will be converted into cash, securities or other property or assets (including any combination thereof) (the Alternative Form Consideration), a holder of Series D Preferred Stock will receive upon conversion of such shares of the Series D Preferred Stock the kind and amount of Alternative Form Consideration which such holder would have owned or been entitled to receive upon the Change of Control had such holder held a number of shares of our common stock equal to the Common Stock Conversion Consideration immediately prior to the effective time of the Change of Control (the Alternative Conversion Consideration). The Common Stock Conversion Consideration or the Alternative Conversion Consideration, whichever shall be applicable to a Change of Control, is referred to as the Conversion Consideration.

If the holders of our common stock have the opportunity to elect the form of consideration to be received in the Change of Control, the Conversion Consideration in respect of such Change of Control will be deemed to be the kind and amount of consideration actually received by holders of a majority of the outstanding shares of our common stock that made or voted for such an election (if electing between two types of consideration) or holders of a plurality of the outstanding shares of our common stock that made or voted for such an election (if electing between more than two types of consideration), as the case may be, and will be subject to any limitations to which all holders of our common stock are subject, including, without limitation, pro rata reductions applicable to any portion of the consideration payable in such Change of Control.

We will not issue fractional shares of our common stock upon the conversion of the Series D Preferred Stock in connection with a Change of Control. Instead, we will make a cash payment equal to the value of such fractional shares based upon the Common Stock Price used in determining the Common Stock Conversion Consideration for such Change of Control.

Within 15 days following the occurrence of a Change of Control, provided that we have not then exercised our right to redeem all shares of Series D Preferred Stock pursuant to the redemption provisions described above, we will provide to holders of Series D Preferred Stock a notice of occurrence of the Change of Control that describes the resulting Change of Control Conversion Right, which notice shall be delivered to the holders of record of the shares of Series D Preferred Stock to their addresses as they appear on our stock records. No failure to give such notice or any defect thereto or in the giving thereof will affect the validity of the proceedings for the conversion of any shares of Series D Preferred Stock except as to the holder to whom notice was defective or not given. This notice will state the following:

- the events constituting the Change of Control;
- the date of the Change of Control;
- the last date on which the holders of Series D Preferred Stock may exercise their Change of Control Conversion Right;

the method and period for calculating the Common Stock Price;

the Change of Control Conversion Date;

that if, prior to the Change of Control Conversion Date, we have provided notice of our election to redeem all or any shares of Series D Preferred Stock, holders of Series D Preferred Stock that are subject to such notice of redemption will not be able to convert the shares of Series D Preferred Stock called for redemption and such shares will be redeemed on the related redemption date, even if such shares have already been tendered for conversion pursuant to the Change of Control Conversion Right;

- if applicable, the type and amount of Alternative Conversion Consideration entitled to be received per share of Series D Preferred Stock;

- the name and address of the paying agent, transfer agent and conversion agent for the Series D Preferred Stock;

- the procedures that the holders of Series D Preferred Stock must follow to exercise the Change of Control Conversion Right (including procedures for surrendering shares of Series D Preferred Stock for conversion through the facilities of a Depositary (as defined below)), including the form of conversion notice to be delivered by such holders as described below; and

- the last date on which holders of Series D Preferred Stock may withdraw shares of Series D Preferred Stock surrendered for conversion and the procedures that such holders must follow to effect such a withdrawal.

Under such circumstances, we also will issue a press release containing such notice for publication on the Wall Street Journal, Business Wire, PR Newswire or Bloomberg Business News (or, if these organizations are not in existence at the time of issuance of the press release, such other news or press organization as is reasonably calculated to broadly disseminate the relevant information to the public), and post a notice on our website (if any), in any event prior to the opening of business on the first business day following any date on which we provide the notice described above to the holders of Series D Preferred Stock.

To exercise the Change of Control Conversion Right, the holders of Series D Preferred Stock will be required to deliver, on or before the close of business on the Change of Control Conversion Date, the certificates (if any) representing the shares of Series D Preferred Stock to be converted, duly endorsed for transfer (or, in the case of any shares of Series D Preferred Stock held in book-entry form through a Depositary or shares directly registered with the transfer agent, therefor, to deliver, on or before the close of business on the Change of Control Conversion Date, the shares of Series D Preferred Stock to be converted through the facilities of such Depositary or through such transfer agent, respectively), together with a written conversion notice in the form provided by us, duly completed, to our transfer agent. The conversion notice must state:

- the relevant Change of Control Conversion Date;

- the number of shares of Series D Preferred Stock to be converted; and

- that the shares of the Series D Preferred Stock are to be converted pursuant to the applicable provisions of the articles supplementary designating the Series D Preferred Stock.

The Change of Control Conversion Date is the date the Series D Preferred Stock is to be converted, which will be a business day selected by us that is no fewer than 20 days nor more than 35 days after the date on which we provide the notice described above to the holders of Series D Preferred Stock.

The Common Stock Price is (i) if the consideration to be received in the Change of Control by the holders of our common stock is solely cash, the amount of cash consideration per share of our common stock or (ii) if the

consideration to be received in the Change of Control by holders of our common stock is other than solely cash (x) the average of the closing sale prices per share of our common stock (or, if no closing sale price is reported, the average of the closing bid and ask prices per share or, if more than one in either case, the average of the average closing bid and the average closing ask prices per share) for the ten consecutive trading days immediately preceding, but not including, the date on which such Change of Control occurred as reported on the principal U.S. securities exchange on which our common stock is then traded, or (y) if our common stock is not then listed for trading on a U.S. securities exchange, the average of the last quoted bid prices for our common stock in the over-the-counter market as reported by OTC Markets Group or similar organization for the ten consecutive trading days immediately preceding, but not including, the date on which such Change of Control occurred.

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Holders of Series D Preferred Stock may withdraw any notice of exercise of a Change of Control Conversion Right (in whole or in part) by a written notice of withdrawal delivered to our transfer agent prior to the close of business on the business day prior to the Change of Control Conversion Date. The notice of withdrawal delivered by any holder must state:

- the number of withdrawn shares of Series D Preferred Stock;
- if certificated shares of Series D Preferred Stock have been surrendered for conversion, the certificate numbers of the withdrawn shares of Series D Preferred Stock; and
- the number of shares of Series D Preferred Stock, if any, which remain subject to the holder s conversion notice.

Notwithstanding the foregoing, if any shares of Series D Preferred Stock are held in book-entry form through The Depository Trust Company (DTC) or a similar depositary (each, a Depositary), the conversion notice and/or the notice of withdrawal, as applicable, must comply with applicable procedures, if any, of the applicable Depositary.

Shares of Series D Preferred Stock as to which the Change of Control Conversion Right has been properly exercised and for which the conversion notice has not been properly withdrawn will be converted into the applicable Conversion Consideration in accordance with the Change of Control Conversion Right on the Change of Control Conversion Date, unless prior to the Change of Control Conversion Date we have provided notice of our election to redeem some or all of the shares of Series D Preferred Stock, as described above under Redemption, in which case only the shares of Series D Preferred Stock properly surrendered for conversion and not properly withdrawn that are not called for redemption will be converted as aforesaid. If we elect to redeem shares of Series D Preferred Stock that would otherwise be converted into the applicable Conversion Consideration on a Change of Control Conversion Date, such shares of Series D Preferred Stock will not be so converted and the holders of such shares will be entitled to receive on the applicable redemption date the redemption price described above under Redemption Optional Redemption or Redemption Special Optional Redemption, as applicable.

We will deliver all securities, cash and any other property owing upon conversion no later than the third business day following the Change of Control Conversion Date. Notwithstanding the foregoing, the persons entitled to receive any shares of our common stock or other securities delivered on conversion will be deemed to have become the holders of record thereof as of the Change of Control Conversion Date.

In connection with the exercise of any Change of Control Conversion Right, we will comply with all applicable federal and state securities laws and stock exchange rules in connection with any conversion of shares of the Series D Preferred Stock into shares of our common stock or other property. Notwithstanding any other provision of the Series D Preferred Stock, no holder of Series D Preferred Stock will be entitled to convert such shares of the Series D Preferred Stock into shares of our common stock to the extent that receipt of such shares of common stock would cause such holder (or any other person) to violate the applicable restrictions on transfer and ownership of our stock contained in our charter, unless we provide an exemption from this limitation to such holder. Please see the sections entitled Restrictions on Transfer and Ownership below and Restrictions on Ownership and Transfer in the accompanying prospectus.

The Change of Control conversion feature may make it more difficult for a third party to acquire us or discourage a party from acquiring us. See Risk Factors You may not be able to exercise conversion rights upon a Change of Control. If exercisable, the change of control conversion rights described in this prospectus supplement may not adequately compensate you. These change of control conversion rights may also make it more difficult for a party to acquire us or discourage a party from acquiring us.

Except as provided above in connection with a Change of Control, the Series D Preferred Stock is not convertible into or exchangeable for any other securities or property.

Voting Rights

Holders of Series D Preferred Stock will not have any voting rights, except as set forth below.

Whenever dividends on any shares of Series D Preferred Stock are in arrears for six or more full quarterly Dividend Periods, whether or not consecutive, the number of directors constituting our board of directors will be automatically increased by two (if not already increased by two by reason of the election of directors by the holders of any other class or series of preferred stock we may issue and upon which like voting rights have been conferred and are exercisable, including the Series A Preferred Stock, Series B Preferred Stock and Series C Preferred Stock) and the holders of Series D Preferred Stock, voting as a single class with holders of the Series A Preferred Stock, Series B Preferred Stock, Series C Preferred Stock and all other classes or series of Parity Stock upon which like voting rights have been conferred and are exercisable, will be entitled to vote for the election of those two additional directors at a special meeting called by us at the request of the holders of record of at least 25% of the outstanding shares of Series A Preferred Stock, Series B Preferred Stock, Series C Preferred Stock, Series D Preferred Stock and all other classes or series of preferred stock we may issue and upon which like voting rights have been conferred and are exercisable to be held no later than 90 days after our receipt of such request (unless the request is received less than 90 days before the date fixed for the next annual or special meeting of our stockholders, in which case, such vote will be held at the earlier of the next annual or special meeting of the stockholders to the extent permitted by applicable law), and at each subsequent annual meeting until all dividends accumulated on the Series D Preferred Stock for all past Dividend Periods and the then current Dividend Period will have been fully paid. In that case, the right of holders of Series D Preferred Stock to elect any directors will cease and, unless there are other classes or series of our preferred stock upon which like voting rights have been conferred and are exercisable, the term of office of any directors elected by holders of Series D Preferred Stock will immediately terminate and the number of directors constituting the board of directors will be reduced accordingly. For the avoidance of doubt, in no event will the total number of directors elected by holders of Series D Preferred Stock (voting together as a single class with the Series A Preferred Stock, Series B Preferred Stock and Series C Preferred Stock and all other classes or series of preferred stock we may issue and upon which like voting rights have been conferred and are exercisable) pursuant to these voting rights exceed two. The directors elected by the holders of the Series D Preferred Stock and the holders of the Series A Preferred Stock, Series B Preferred Stock, Series C Preferred Stock and all other classes or series of preferred stock upon which like voting rights have been conferred and are exercisable will be elected by a plurality of the votes cast by the holders of the outstanding shares of Series D Preferred Stock when they have the voting rights described in this paragraph, the Series A Preferred Stock, Series B Preferred Stock, Series C Preferred Stock and any other classes or series of preferred stock we may issue and upon which like voting rights have been conferred and are exercisable (voting together as a single class) to serve until our next annual meeting of stockholders and until their successors are duly elected and qualified or until such directors right to hold the office terminates as described above, whichever occurs earlier.

On each matter on which holders of Series D Preferred Stock are entitled to vote, each share of Series D Preferred Stock will be entitled to one vote, except that when shares of any other class or series of preferred stock we may issue, including the Series A Preferred Stock, the Series B Preferred Stock and the Series C Preferred Stock, have the right to vote with the Series D Preferred Stock as a single class on any matter, the Series D Preferred Stock, the Series A Preferred Stock, the Series B Preferred Stock, the Series C Preferred Stock and each such other class or series of stock will have one vote for each $25.00 of liquidation preference (excluding accumulated dividends). If, at any time when the voting rights conferred upon the Series D Preferred Stock are exercisable, any vacancy in the office of a director elected by the holders of the Series A Preferred Stock, Series B Preferred Stock, Series C Preferred Stock and any other classes or series of preferred stock upon which like voting rights have been conferred and are exercisable will occur, then such vacancy may be filled only by the remaining such director or by vote of the holders of the outstanding Series A Preferred Stock, Series B Preferred Stock, Series C Preferred Stock, Series D Preferred Stock

and any other classes or series of preferred stock upon which like voting rights have been conferred and are exercisable.

Any director elected by holders of shares of Series A Preferred Stock, Series B Preferred Stock, Series C Preferred Stock, Series D Preferred Stock and any class or series of preferred stock we may issue upon which like voting rights have been conferred and are exercisable may be removed at any time, with or without cause, by the vote of, and may not be removed otherwise than by the vote of, the holders of record of a majority of the outstanding shares of Series A Preferred Stock, Series B Preferred Stock, Series C Preferred Stock, Series D Preferred Stock and any class or series of preferred stock we may issue when they have the voting rights described above (voting as a single class with all other classes or series of preferred stock we may issue upon which like voting rights have been conferred and are exercisable).

So long as any shares of Series D Preferred Stock remain outstanding, we will not, without the affirmative vote or consent of the holders of at least two-thirds of the shares of Series D Preferred Stock outstanding at the time, voting together as a single class with the Series A Preferred Stock, Series B Preferred Stock, Series C Preferred Stock and all other classes or series of Parity Stock we may issue and upon which like voting rights have been conferred and are exercisable, (i) authorize, create, or increase the authorized or issued amount of, any class or series of Senior Stock or reclassify any of our authorized stock into such shares, or create or authorize or issue any obligation or security convertible into or evidencing the right to purchase any such shares or (ii) amend, alter or repeal the provisions of our charter, whether by merger, conversion, consolidation or otherwise, so as to materially and adversely affect any right, preference, privilege or voting power of the Series D Preferred Stock (each, an Event); provided, however, with respect to the occurrence of any Event set forth in clause (ii) above, so long as the Series D Preferred Stock remains outstanding with the terms thereof materially unchanged or the holders of Series D Preferred Stock receive shares of stock or other equity interests with rights, preferences, privileges and voting powers substantially the same as those of the Series D Preferred Stock, taking into account that upon the occurrence of an Event we may not be the successor entity, the occurrence of any such Event will not be deemed to materially and adversely affect the rights, preferences, privileges or voting power of holders of Series D Preferred Stock; and, provided further, that any increase in the amount of the authorized or issued Series D Preferred Stock or the creation or issuance, or any increase in the amounts authorized of any Parity Stock or Junior Stock will not be deemed to materially and adversely affect the rights, preferences, privileges or voting powers of holders of Series D Preferred Stock. Notwithstanding the foregoing, if any amendment, alteration or repeal of any provision of our charter would materially and adversely affect the rights, preferences, privileges or voting rights of the Series D Preferred Stock disproportionately relative to other classes or series of Parity Stock, then the affirmative vote or consent of the holders of at least two-thirds of the outstanding shares of Series D Preferred Stock (voting as a separate class) shall also be required.

The foregoing voting provisions will not apply if, at or prior to the time when the act with respect to which such vote would otherwise be required shall be effected, all outstanding shares of Series D Preferred Stock have been redeemed or called for redemption upon proper notice and sufficient funds have been irrevocably set apart to effect such redemption.

Except as expressly stated in the articles supplementary designating the Series D Preferred Stock, the Series D Preferred Stock will not have any relative, participating, optional or other special voting rights or powers and the consent of the holders thereof will not be required for the taking of any corporate action. The holders of Series D Preferred Stock will have exclusive voting rights on any amendment to our charter that would alter the contract rights, as expressly set forth in the charter, of only the Series D Preferred Stock.

Information Rights

During any period in which we are not subject to Section 13 or 15(d) of the Exchange Act and any shares of Series D Preferred Stock are outstanding, we will use our best efforts to (i) transmit through our website at http://www.chimerareit.com (or other permissible means under the Exchange Act) copies of the Annual Reports on

Form 10-K and Quarterly Reports on Form 10-Q that we would have been required to file with the SEC pursuant to Section 13 or 15(d) of the Exchange Act if we were subject thereto (other than any exhibits that would have been required). We will use our best efforts to provide such reports on our website within 15 days after the

respective dates by which we would have been required to file such reports with the SEC if we were subject to Section 13 or 15(d) of the Exchange Act and we were a non-accelerated filer within the meaning of the Exchange Act.

Restrictions on Transfer and Ownership

In order to ensure that we remain qualified as a REIT for U.S. federal income tax purposes, among other purposes, our charter, including the articles supplementary setting forth the terms of the Series D Preferred Stock, provides that generally no person, other than certain excepted holders, may own, or be deemed to own by virtue of the attribution provisions of the Code, more than 9.8% in value or in number of shares, whichever is more restrictive, of the outstanding shares of any class or series of our stock. These provisions may restrict the ability of a holder of Series D Preferred Stock to convert such stock into our common stock as described above under Conversion Rights. Our board of directors may, in its sole discretion, exempt a person from the 9.8% ownership limit under certain circumstances as described under Restrictions on Ownership and Transfer in the accompanying prospectus.

Preemptive Rights

No holders of Series D Preferred Stock will, as holders of Series D Preferred Stock, have any preemptive rights to purchase or subscribe for our common stock or any of our other securities.

Book-Entry Procedures

DTC will act as securities depositary for the Series D Preferred Stock, which will only be issued in the form of global securities held in book-entry form. We will not issue certificates to you for the shares of Series D Preferred Stock that you purchase, unless DTC s services are discontinued as described below.

Title to book-entry interests in the Series D Preferred Stock will pass by book-entry registration of the transfer within the records of DTC in accordance with its procedures. Book-entry interests in the securities may be transferred within DTC in accordance with procedures established for these purposes by DTC. Each person owning a beneficial interest in shares of the Series D Preferred Stock must rely on the procedures of DTC and the participant through which such person owns its interest to exercise its rights as a holder of the Series D Preferred Stock.

DTC has advised us that it is a limited-purpose trust company organized under the New York Banking Law, a member of the Federal Reserve System, a clearing corporation within the meaning of the New York Uniform Commercial Code and a clearing agency registered under the provisions of Section 17A of the Exchange Act. DTC holds securities that its participants (Direct Participants) deposit with DTC. DTC also facilitates the settlement among Direct Participants of securities transactions, such as transfers and pledges, in deposited securities through electronic computerized book-entry changes in Direct Participants accounts, thereby eliminating the need for physical movement of securities certificates. Direct Participants include securities brokers and dealers, banks, trust companies, clearing corporations, and certain other organizations. Access to the DTC system is also available to others such as securities brokers and dealers, including the underwriters, banks and trust companies that clear through or maintain a custodial relationship with a Direct Participant, either directly or indirectly (Indirect Participants). The rules applicable to DTC and its Direct and Indirect Participants are on file with the SEC.

When you purchase shares of Series D Preferred Stock within the DTC system, the purchase must be by or through a Direct Participant. The Direct Participant will receive a credit for the Series D Preferred Stock on DTC s records. You will be considered to be the beneficial owner of the Series D Preferred Stock. Your beneficial ownership interest will be recorded on the Direct and Indirect Participants records, but DTC will have no knowledge of your individual ownership. DTC s records reflect only the identity of the Direct Participants to whose accounts shares of Series D

Preferred Stock are credited.

You will not receive written confirmation from DTC of your purchase. The Direct or Indirect Participants through whom you purchased the Series D Preferred Stock should send you written confirmations providing details of your transactions, as well as periodic statements of your holdings. The Direct and Indirect Participants are responsible for keeping an accurate account of the holdings of their customers like you.

Transfers of ownership interests held through Direct and Indirect Participants will be accomplished by entries on the books of Direct and Indirect Participants acting on behalf of the beneficial owners.

Conveyance of notices and other communications by DTC to Direct Participants, by Direct Participants to Indirect Participants, and by Direct Participants and Indirect Participants to beneficial owners will be governed by arrangements among them, subject to any statutory or regulatory requirements as may be in effect from time to time.

We understand that, under DTC s existing practices, in the event that we request any action of the holders, or an owner of a beneficial interest in a global security, such as you, desires to take any action which a holder is entitled to take under our charter (including the articles supplementary designating the Series D Preferred Stock), DTC would authorize the Direct Participants holding the relevant shares to take such action, and those Direct Participants and any Indirect Participants would authorize beneficial owners owning through those Direct and Indirect Participants to take such action or would otherwise act upon the instructions of beneficial owners owning through them.

Any redemption notices with respect to the Series D Preferred Stock will be sent to Cede & Co. If less than all of the outstanding shares of Series D Preferred Stock are being redeemed, DTC will reduce each Direct Participant s holdings of shares of Series D Preferred Stock in accordance with its procedures.

In those instances where a vote is required, neither DTC nor Cede & Co. itself will consent or vote with respect to the shares of Series D Preferred Stock. Under its usual procedures, DTC would mail an omnibus proxy to us as soon as possible after the record date. The omnibus proxy assigns Cede & Co. s consenting or voting rights to those Direct Participants whose accounts the shares of Series D Preferred Stock are credited to on the record date, which are identified in a listing attached to the omnibus proxy.

Dividends on the Series D Preferred Stock will be made directly to DTC s nominee (or its successor, if applicable). DTC s practice is to credit participants accounts on the relevant payment date in accordance with their respective holdings shown on DTC s records unless DTC has reason to believe that it will not receive payment on that payment date.

Payments by Direct and Indirect Participants to beneficial owners will be governed by standing instructions and customary practices, as is the case with securities held for the accounts of customers in bearer form or registered in street name. These payments will be the responsibility of the participant and not of DTC, us or any agent of ours.

DTC may discontinue providing its services as securities depositary with respect to the Series D Preferred Stock at any time by giving reasonable notice to us. Additionally, we may decide to discontinue the book-entry only system of transfers with respect to the Series D Preferred Stock. In that event, we will print and deliver certificates in fully registered form for the Series D Preferred Stock. If DTC notifies us that it is unwilling to continue as securities depositary, or it is unable to continue or ceases to be a clearing agency registered under the Exchange Act and a successor depositary is not appointed by us within 90 days after receiving such notice or becoming aware that DTC is no longer so registered, we will issue the Series D Preferred Stock in definitive form, at our expense, upon registration of transfer of, or in exchange for, such global security.

According to DTC, the foregoing information with respect to DTC has been provided to the financial community for informational purposes only and is not intended to serve as a representation, warranty or contract modification of any kind.

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Global Clearance and Settlement Procedures

Initial settlement for the Series D Preferred Stock will be made in immediately available funds. Secondary market trading among DTC s Participants will occur in the ordinary way in accordance with DTC s rules and will be settled in immediately available funds using DTC s Same-Day Funds Settlement System.

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UNDERWRITING

Morgan Stanley & Co. LLC, RBC Capital Markets, LLC, UBS Securities LLC, Wells Fargo Securities, LLC, J.P. Morgan Securities LLC and Keefe, Bruyette & Woods, Inc. are acting as joint book-running managers of the offering and as representatives of the underwriters named below. Subject to the terms and conditions stated in the underwriting agreement dated the date of this prospectus supplement, each underwriter named below has severally agreed to purchase, and we have agreed to sell to that underwriter, the number of shares of Series D Preferred Stock set forth opposite that underwriter s name.

Underwriters	**Number of Shares**
Morgan Stanley & Co. LLC	1,406,000
RBC Capital Markets, LLC	1,406,000
UBS Securities LLC	1,406,000
Wells Fargo Securities, LLC	1,406,000
J.P. Morgan Securities LLC	1,036,000
Keefe, Bruyette & Woods, Inc.	740,000
Total	7,400,000

The underwriting agreement provides that the obligations of the underwriters to purchase the shares included in this offering are subject to approval of legal matters by counsel and to other conditions. The underwriters are obligated to purchase all the shares (other than those covered by the over-allotment option described below) if they purchase any of the shares.

The underwriters initially propose to offer the shares of Series D Preferred Stock directly to the public at the public offering price set forth on the cover page of this prospectus supplement and to certain dealers at a price that represents a concession not in excess of $0.50 per share below the public offering price. Any underwriters may allow, and such dealers may re-allow, a concession not in excess of $0.45 per share to other underwriters or to certain dealers. If the shares are not sold at the initial price to the public, the underwriters may change the offering price and the other selling terms. The offering of the shares by the underwriters is subject to receipt and acceptance and subject to the underwriters right to reject any order in whole or in part.

We have granted to the underwriters an option, exercisable for 30 days from the date of this prospectus supplement, to purchase up to 1,110,000 additional shares at the public offering price less the underwriting discount. The underwriters may exercise the option solely for the purpose of covering over-allotments, if any, in connection with this offering. To the extent the option is exercised, each underwriter must purchase a number of additional shares approximately proportionate to that underwriter s initial purchase commitment. Any shares issued or sold under the option will be issued and sold on the same terms and conditions as the other shares that are the subject of this offering.

We have agreed that, for a period of 30 days from the date of this prospectus supplement, we will not, without the prior written consent of Morgan Stanley & Co. LLC, dispose of or hedge any shares of Series D Preferred Stock or other preferred stock or any securities convertible into or exchangeable for shares of Series D Preferred Stock or other preferred stock.

The Series D Preferred Stock has not been rated. No current market exists for the Series D Preferred Stock. We intend to apply to list the Series D Preferred Stock on the NYSE under the symbol CIM PRD . If the application is approved,

trading of the Series D Preferred Stock on the NYSE is expected to begin within 30 days after the date of initial issuance of the Series D Preferred Stock. Certain of the underwriters have advised us that they intend to make a market in the Series D Preferred Stock prior to the commencement of any trading on the NYSE, but they are not obligated to do so and may discontinue market making at any time without notice. We cannot assure you that a market for the Series D Preferred Stock will develop prior to the commencement of trading on the NYSE or, if developed, will be maintained or will provide you with adequate liquidity.

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The following table shows the underwriting discounts and commissions that we are to pay to the underwriters in connection with this offering. These amounts are shown assuming both no exercise and full exercise of the underwriters over-allotment option.

	Per Share	Total Without Over-Allotment	With Over-Allotment
Underwriting discount paid by us	$ 0.7875	$ 5,827,500	$ 6,701,625
Proceeds, before expenses, to us	$ 24.2125	$ 179,172,500	$ 206,048,375

We estimate that our total expenses incurred in connection with this offering, excluding the underwriting discounts, will be approximately $300,000.

In connection with the offering, the underwriters may purchase and sell shares in the open market. Purchases and sales in the open market may include short sales, purchases to cover short positions, which may include purchases pursuant to the over-allotment option, and stabilizing purchases.

Short sales involve secondary market sales by the underwriters of a greater number of shares than they are required to purchase in the offering.

Covered short sales are sales of shares in an amount up to the number of shares represented by the underwriters over-allotment option.

Naked short sales are sales of shares in an amount in excess of the number of shares represented by the underwriters over-allotment option.

Covering transactions involve purchases of shares either pursuant to the over-allotment option or in the open market after the distribution has been completed in order to cover short positions.

To close a naked short position, the underwriters must purchase shares in the open market after the distribution has been completed. A naked short position is more likely to be created if the underwriters are concerned that there may be downward pressure on the price of the shares in the open market after pricing that could adversely affect investors who purchase in the offering.

To close a covered short position, the underwriters must purchase shares in the open market after the distribution has been completed or must exercise the over-allotment option. In determining the source of shares to close the covered short position, the underwriters will consider, among other things, the price of shares available for purchase in the open market as compared to the price at which they may purchase shares through the over-allotment option.

Stabilizing transactions involve bids to purchase shares so long as the stabilizing bids do not exceed a specified maximum.

Purchases to cover short positions and stabilizing purchases, as well as other purchases by the underwriters for their own accounts, may have the effect of preventing or retarding a decline in the market price of the shares. They may also cause the price of the shares to be higher than the price that would otherwise exist in the open market in the absence of these transactions. The underwriters may conduct these transactions on the NYSE, in the over-the-counter market or otherwise. If the underwriters commence any of these transactions, they may discontinue them at any time.

Certain underwriters or their affiliates have performed, and in the future may perform, commercial banking, investment banking and advisory services for us in the ordinary course of their business for which they have received, and in the future are expected to receive, customary fees. Some of the underwriters or their affiliates have engaged in, and may in the future engage in, investment banking and other commercial dealings in the ordinary course of business with our affiliates. They have received, or may in the future receive, customary fees and commissions for these transactions.

We have agreed to indemnify the underwriters against certain liabilities, including liabilities under the Securities Act, or to contribute to payments the underwriters may be required to make because of any of those liabilities.

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We expect that delivery of the shares of our Series D Preferred Stock will be made to investors on or about the fifth business day following the date of the final prospectus supplement (this settlement cycle being referred to as T+5). Under Rule 15c6-1 of the Exchange Act, trades in the secondary market are required to settle in two business days, unless the parties to any such trade expressly agree otherwise. Accordingly, if you wish to trade shares of our Series D Preferred Stock before their delivery, you will be required, because the shares initially will settle in T+5, to specify an alternate settlement cycle at the time of any such trade to prevent a failed settlement. If you wish to trade shares of our Series D Preferred Stock before their delivery, you should consult your advisors.

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LEGAL MATTERS

Certain legal matters in connection with this offering will be passed upon for us by Hunton Andrews Kurth LLP and, with respect to certain matters of Maryland law, Venable LLP. Certain legal matters will be passed upon for the underwriters by Ropes & Gray LLP.

EXPERTS

The consolidated financial statements of Chimera Investment Corporation appearing in Chimera Investment Corporation s Annual Report (Form 10-K) for the year ended December 31, 2017, and the effectiveness of Chimera Investment Corporation s internal control over financial reporting as of December 31, 2017, have been audited by Ernst & Young LLP, independent registered public accounting firm, as set forth in their reports thereon included therein, and incorporated herein by reference. Such financial statements are, and audited financial statements to be included in subsequently filed documents will be, incorporated herein in reliance upon the reports of Ernst & Young LLP pertaining to such financial statements and the effectiveness of our internal control over financial reporting as of the respective dates (to the extent covered by consents filed with the Securities and Exchange Commission) given on the authority of such firm as experts in accounting and auditing.

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INCORPORATION OF CERTAIN DOCUMENTS BY REFERENCE

We are incorporating by reference certain information that we file with the SEC, which means that we are disclosing important information to you by referring you to another document filed separately with the SEC. The information incorporated by reference is an important part of this prospectus supplement and the accompanying prospectus, and the information that we subsequently file with the SEC will automatically update and supersede information in this prospectus supplement and the accompanying prospectus and in our other filings with the SEC. We have filed the documents listed below with the SEC (File No. 001-33796) under the Securities Exchange Act of 1934, as amended, or the Exchange Act, and these documents are incorporated herein by reference. We are not, however, incorporating by reference any documents or portions thereof, whether specifically listed below or filed in the future, that are not deemed filed with the SEC, including without limitation any information furnished pursuant to Items 2.02 or 7.01 of Form 8-K.

Our Annual Report on Form 10-K for the fiscal year ended December 31, 2017, filed on February 20, 2018;

Our Quarterly Reports on Form 10-Q for the quarter ended March 31, 2018, filed on May 3, 2018, for the quarter ended June 30, 2018, filed on August 2, 2018 and for the quarter ended September 30, 2018, filed on November 1, 2018;

The information specifically incorporated by reference into our Annual Report on Form 10-K for the year ended December 31, 2017 from our Definitive Proxy Statement on Schedule 14A filed on April 19, 2018;

Our Current Reports on Form 8-K, filed on March 6, 2018, June 4, 2018, September 19, 2018 and December 21, 2018;

The description of our common stock, par value $0.01 per share, included in our Registration Statement on Form 8-A, filed on November 5, 2007;

The description of our Series A Preferred Stock, included in our Registration Statement on Form 8-A, filed on October 12, 2016;

The description of our Series B Preferred Stock, included in our Registration Statement on Form 8-A, filed on February 24, 2017; and

The description of our Series C Preferred Stock, included in our Registration Statement on Form 8-A, filed on September 18, 2018.

All documents we file with the SEC pursuant to Sections 13(a), 13(c), 14 or 15(d) of the Exchange Act after the date of this prospectus supplement and before the termination of the offering of the securities to which this prospectus supplement relates (other than information in such documents that is not deemed to be filed) shall be deemed to be

incorporated by reference into this prospectus supplement and the accompanying prospectus and to be part hereof from the date of filing of those documents.

Any statement contained in a document that is incorporated by reference in this prospectus supplement and the accompanying prospectus is automatically updated and superseded to the extent that a statement contained in this prospectus supplement and the accompanying prospectus or in any other document that we file with the SEC, and which is also incorporated by reference in this prospectus supplement and the accompanying prospectus, modifies or replaces that statement.

We will provide to each person, including any beneficial owner, to whom a copy of this prospectus supplement and the accompanying prospectus is delivered, a copy of any or all of the information that has been incorporated by reference in this prospectus supplement and the accompanying prospectus but not delivered with this prospectus supplement and the accompanying prospectus (other than the exhibits to such documents unless those exhibits are specifically incorporated by reference into those documents); we will provide this information at no cost to the requester upon written or oral request to Investor Relations, Chimera Investment Corporation, 520 Madison Ave., 32nd Floor, New York, New York 10022, telephone number (888) 895-6557.

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PROSPECTUS

Common Stock, Preferred Stock, Warrants and Debt Securities

By this prospectus, we may offer, from time to time:

- shares of our common stock;
- shares of our preferred stock;
- warrants to purchase shares of our common stock, shares of our preferred stock or debt securities; and
- debt securities, which may consist of debentures, notes, or other types of debt.

The securities covered by this registration statement may be sold or otherwise distributed separately, together or as units with other securities covered by this registration statement. We will provide specific terms of each issuance of these securities in supplements to this prospectus. You should read this prospectus and any supplement carefully before you decide to invest.

This prospectus may not be used to consummate sales of these securities unless it is accompanied by a prospectus supplement.

The New York Stock Exchange lists our common stock, par value $0.01 per share, under the symbol CIM , our 8.00% Series A Cumulative Redeemable Preferred Stock, par value $0.01 per share, under the symbol CIM PrA , our 8.00% Series B Fixed-to-Floating Rate Cumulative Redeemable Preferred Stock, par value $0.01 per share, under the symbol CIM PrB and our 7.75% Series C Fixed-to-Floating Rate Cumulative Redeemable Preferred Stock, par value $0.01 per share, under the symbol CIM PrC .

To assist us in qualifying as a real estate investment trust, or REIT, for U.S. federal income tax purposes, our Charter provides that no person may own more than 9.8%, in value or in number of shares, whichever is more restrictive, of the outstanding shares of any class or series of our capital stock, excluding any shares of capital stock not treated as outstanding for federal income tax purposes, unless our board of directors waives this limitation.

Investing in these securities involves risks. You should carefully consider the information referred to under the heading Risk Factors beginning on page 3 of this prospectus.

We may sell these securities to or through underwriters, dealers or agents, or we may sell the securities directly to investors on our own behalf.

Neither the Securities and Exchange Commission nor any state securities commission has approved or disapproved of these securities or determined if this prospectus is truthful or complete. Any representation to the contrary is a criminal offense.

The date of this prospectus is January 14, 2019.

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ABOUT THIS PROSPECTUS

This prospectus is part of a registration statement that we filed with the Securities and Exchange Commission (or the SEC or Commission) using a shelf registration process. Under this shelf registration process, we may offer and sell the securities described in this prospectus in one or more offerings. This prospectus provides you with a general description of the securities we may offer. Each time we offer to sell securities, we will provide a supplement to this prospectus that will contain specific information about the terms of that offering. The prospectus supplement may also add, update or change information contained in this prospectus. It is important for you to consider the information contained in this prospectus and any prospectus supplement together with additional information described under the heading Where You Can Find More Information.

You should rely only on the information contained in or incorporated by reference into or set forth in this prospectus or the applicable prospectus supplement. We have not authorized any other person to provide you with additional or different information. If anyone provides you with different or inconsistent information, you should not rely on it. We are not making an offer to sell these securities in any jurisdiction where the offer or sale is not permitted. You should not assume that the information in this prospectus, the applicable prospectus supplement or any other offering material is accurate as of any date other than the dates on the front of those documents. Our business, financial condition, results of operations and prospects may have changed since such dates.

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A WARNING ABOUT FORWARD-LOOKING STATEMENTS

Certain statements contained in this prospectus, any prospectus supplement and any other offering material, and the information incorporated by reference into this prospectus, any prospectus supplement and/or any other offering material, and certain statements contained in our future filings with the SEC, in our press releases or in our other public or stockholder communications may not be based on historical facts and are forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended (or the Securities Act), and Section 21E of the Securities Exchange Act of 1934, as amended (or the Exchange Act). Forward-looking statements, which are based on various assumptions (some of which are beyond our control), may be identified by reference to a future period or periods or by the use of forward-looking terminology, such as may, will, believe, expect, anticipate, continue, intend, estimate, plan, or similar terms, variations on those terms or the negative of those terms. Actual results could differ materially from those set forth in forward-looking statements due to a variety of factors, including, but not limited to:

- our business and investment strategy;
- availability of investment opportunities in real estate-related and other securities;
- our expected investments;
- changes in the value of our investments;
- changes in interest rates and mortgage prepayment rates;
- prepayments of the mortgage and other loans underlying our residential mortgage-backed securities, or RMBS, or other asset-backed securities, or ABS;
- rates of default, delinquencies or decreased recovery rates on our investments;
- general volatility of the securities markets in which we invest;
- our ability to maintain existing financing arrangements and our ability to obtain future financing arrangements;
- our ability to effect our strategy to securitize residential mortgage loans;

interest rate mismatches between our investments and our borrowings used to finance such purchases;

effects of interest rate caps on our adjustable-rate investments;

the degree to which our hedging strategies may or may not protect us from interest rate volatility;

the impact of and changes to various government programs;

impact of and changes in governmental regulations, tax law and rates, accounting guidance, and similar matters;

market trends in our industry, interest rates, the debt securities markets or the general economy;

estimates relating to our ability to make distributions to our stockholders in the future;

our understanding of our competition;

availability of qualified personnel;

our ability to maintain our classification as a REIT for U.S. federal income tax purposes;

our ability to maintain our exemption from registration under the Investment Company Act of 1940, as amended, or 1940 Act;

our expectations regarding materiality or significance; and

the effectiveness of our disclosure controls and procedures.

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The forward-looking statements are based on our beliefs, assumptions and expectations of our future performance, taking into account all information currently available to us. You should not place undue reliance on these forward-looking statements. These beliefs, assumptions and expectations can change as a result of many possible events or factors, not all of which are known to us. Some of these factors are described under the caption About Chimera Investment Corporation in this prospectus and under the caption Risk Factors in our most recent Annual Report on Form 10-K and our subsequent Quarterly Reports on Form 10-Q, which are incorporated by reference into the prospectus. If a change occurs, our business, financial condition, liquidity and results of operations may vary materially from those expressed in our forward-looking statements. Any forward-looking statement speaks only as of the date on which it is made. New risks and uncertainties arise from time to time, and it is impossible for us to predict those events or how they may affect us. Except as required by law, we are not obligated to, and do not intend to, update or revise any forward-looking statements, whether as a result of new information, future events or otherwise.

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ABOUT CHIMERA INVESTMENT CORPORATION

General

We are a publicly traded REIT that commenced operations on November 21, 2007. We are primarily engaged in the business of investing directly or indirectly through our subsidiaries, on a leveraged basis, in a diversified portfolio of mortgage assets, including residential mortgage loans, Non-Agency RMBS, Agency commercial mortgage-backed securities, Agency RMBS, and other real estate related securities. Our principal business objective is to deliver shareholder value through the generation of distributable income and through asset performance linked to residential mortgage credit fundamentals.

We focus our investment activities primarily on acquiring residential mortgage loans and on acquiring Non-Agency and Agency residential and commercial mortgage-backed securities, or MBS. At September 30, 2018, based on the amortized cost balance of our interest earning assets, approximately 52% of our investment portfolio was residential mortgage loans, 41% of our investment portfolio was Agency MBS and 7% of our investment portfolio was Non-Agency RMBS, respectively. At December 31, 2017, based on the amortized cost balance of our interest earning assets, approximately 67% of our investment portfolio was residential mortgage loans, 22% of our investment portfolio was Agency MBS and 11% of our investment portfolio was Non-Agency RMBS, respectively.

Our investment strategy is intended to take advantage of opportunities in the current interest rate and credit environment. We expect to adjust our strategy to changing market conditions by shifting our asset allocations across these various asset classes as interest rate and credit cycles change over time. We believe that our strategy will enable us to pay dividends and preserve capital throughout changing market cycles. We expect to take a long-term view of assets and liabilities, and our reported earnings and estimates of the fair value of our investments at the end of a financial reporting period will not significantly impact our objective of providing attractive risk-adjusted returns to our stockholders over the long-term.

We use leverage to increase returns and to finance the acquisition of our assets. We are not required to maintain any specific debt-to-equity ratio as we believe the appropriate leverage for the particular assets we are financing depends on the credit quality and risk of those assets. Subject to maintaining our REIT qualification, we may use a number of sources to finance our investments, including repurchase agreements, warehouse facilities, securitizations and resecuritizations. Subject to maintaining our REIT qualification, we may manage our debt and interest rate risk by utilizing interest rate hedges, such as interest rate swaps, caps, options and futures to reduce the effect of interest rate fluctuations related to our financing sources.

Under the U.S. credit risk retention rules that became effective on December 24, 2015, for transactions which we sponsor we have committed to consolidate the loans and retain a meaningful investment for at least five years. Our credit investments are generally structurally locked out from pre-payments resulting in a high yielding longer duration credit portfolio.

To assist us in qualifying as a REIT for U.S. federal income tax purposes, no person may own more than 9.8%, in value or in number of shares, whichever is more restrictive, of the outstanding shares of any class or series of our capital stock, excluding any shares of capital stock not treated as outstanding for federal income tax purposes, unless our board of directors waives this limitation.

Stock Listing

The New York Stock Exchange lists our common stock under the symbol CIM , our 8.00% Series A Cumulative Redeemable Preferred Stock, par value $0.01 per share (Series A Preferred Stock), under the symbol CIM PrA , our 8.00% Series B Fixed-to-Floating Rate Cumulative Redeemable Preferred Stock, par value $0.01 per share (Series B Preferred Stock), under the symbol CIM PrB and our 7.75% Series C Fixed-to-Floating Rate Cumulative Redeemable Preferred Stock, par value $0.01 per share (Series C Preferred Stock), under the symbol CIM PrC .

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Principal Executive Offices and Telephone Number

Our principal executive offices are located at 520 Madison Ave, 32nd Floor, New York, New York 10022. Our telephone number is (212) 626-2300.

Internet Address

Our internet address is www.chimerareit.com. The contents of our internet website are not a part of, and are not incorporated by reference into, this prospectus or any accompanying prospectus supplement.

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RISK FACTORS

Investing in our securities involves risks. You should carefully consider the risks described under Risk Factors in our most recent Annual Report on Form 10-K and any subsequent Quarterly Reports on Form 10-Q (which descriptions are incorporated by reference herein), as well as the other information contained or incorporated by reference into this prospectus or in any prospectus supplement hereto before making a decision to invest in our securities. See Where You Can Find More Information below.

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USE OF PROCEEDS

Unless otherwise indicated in an accompanying prospectus supplement, we intend to use the net proceeds from the sale of the securities offered by this prospectus and the related accompanying prospectus supplement to finance the acquisition of mortgage assets including residential mortgage loans, non-Agency RMBS, Agency RMBS, Agency and non-Agency CMBS and other targeted assets, and for other general corporate purposes such as repayment of outstanding indebtedness or to pay down other liabilities, working capital, and for liquidity needs. Pending any such uses, we may invest the net proceeds from the sale of any securities in interest-bearing short-term investments, including money market accounts that are consistent with our intention to maintain our qualification as a REIT, or we may use them to reduce short-term indebtedness.

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DESCRIPTION OF EQUITY SECURITIES

General

Our charter provides that we may issue 400,000,000 shares of stock, consisting of 300,000,000 shares of common stock, par value of $0.01 per share, and 100,000,000 shares of preferred stock, par value of $0.01 per share. Of the preferred stock, 6,210,000 shares have been further classified as Series A Preferred Stock, 13,800,000 shares have been further classified as Series B Preferred Stock and 11,500,000 shares have been further classified as Series C Preferred Stock. As of December 31, 2018, 187,052,398 shares of common stock, 5,800,000 shares of Series A Preferred Stock, 13,000,000 shares of Series B Preferred Stock and 10,400,000 shares of Series C Preferred Stock were issued and outstanding. Our board of directors, with the approval of a majority of the entire board and without any action on the part of our stockholders, may amend our charter from time to time to increase or decrease the aggregate number of shares of stock or the number of shares of stock of any class or series that we have authority to issue. Under Maryland law, our stockholders generally are not personally liable for our debts and obligations solely as a result of their status as stockholders.

Common Stock

All shares of our common stock have equal rights as to earnings, assets, dividends and voting and, when they are issued, will be duly authorized, validly issued, fully paid and non-assessable. Distributions may be paid to the holders of our common stock if, as and when authorized by our board of directors and declared by us out of assets legally available therefor. Shares of our common stock have no preemptive, appraisal, preferential exchange, conversion or redemption rights and are freely transferable, except where their transfer is restricted by federal and state securities laws, by contract or by the restrictions in our charter. In the event of our liquidation, dissolution or winding up, each share of our common stock would be entitled to share ratably in all of our assets that are legally available for distribution after payment of or adequate provision for all of our known debts and other liabilities and subject to any preferential rights of holders of our preferred stock, if any preferred stock is outstanding at such time. Subject to our charter restrictions on the transfer and ownership of our stock and except as may otherwise be specified in the terms of any class or series of common stock, each share of our common stock entitles the holder to one vote on all matters submitted to a vote of stockholders, including the election of directors. Except as provided with respect to any other class or series of stock, the holders of our common stock will possess exclusive voting power. There is no cumulative voting in the election of directors, which means that holders of a majority of the outstanding shares of common stock can elect all of our directors, and holders of less than a majority of such shares will be unable to elect any director.

Preferred Stock

The following description sets forth general terms and provisions of the preferred stock to which any prospectus supplement may relate. The statements below describing the preferred stock are in all respects subject to and qualified in their entirety by reference to our charter, as amended, by-laws, as amended, and any articles supplementary to our charter, as amended, designating terms of a series of preferred stock. The preferred stock, when issued, will be validly issued, fully paid, and non-assessable. Because our board of directors has the power to establish the preferences, powers and rights of each series of preferred stock, our board of directors may afford the holders of any series of preferred stock preferences, powers and rights, voting or otherwise, senior to the rights of common stockholders.

The rights, preferences, privileges and restrictions of each series of preferred stock will be fixed by the articles supplementary relating to the series. A prospectus supplement, relating to each series, will specify the terms of the preferred stock, as follows:

the title and stated value of the preferred stock;

the voting rights of the preferred stock, if applicable;

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- the preemptive rights of the preferred stock, if applicable;
- the restrictions on alienability of the preferred stock, if applicable;
- the number of shares offered, the liquidation preference per share and the offering price of the shares;
- liability to further calls or assessment of the preferred stock, if applicable;
- the dividend rate(s), period(s) and payment date(s) or method(s) of calculation applicable to the preferred stock (including fixed and floating rates, as applicable);
- the date from which dividends on the preferred stock will accumulate, if applicable;
- the procedures for any auction and remarketing for the preferred stock;
- the provision for a sinking fund, if any, for the preferred stock;
- the provision for and any restriction on redemption, if applicable, of the preferred stock;
- the provision for and any restriction on repurchase, if applicable, of the preferred stock;
- any listing of the preferred stock on any securities exchange;
- the terms and provisions, if any, upon which the preferred stock will be convertible into common stock, including the conversion price (or manner of calculation) and conversion period;
- the terms under which the rights of the preferred stock may be modified, if applicable;
- any other specific terms, preferences, rights, limitations or restrictions of the preferred stock;
- a discussion of material U.S. federal income tax considerations applicable to the preferred stock;

the relative ranking and preferences of the preferred stock as to dividend rights and rights upon the liquidation, dissolution or winding-up of our affairs;

any limitation on issuance of any series of preferred stock ranking senior to or on a parity with the series of preferred stock as to dividend rights and rights upon the liquidation, dissolution or winding-up of our affairs; and

any limitations on direct or beneficial ownership and restrictions on transfer of the preferred stock, in each case as may be appropriate to preserve our qualification as a REIT.

Power to Reclassify Shares of Our Stock

Our charter authorizes our board of directors to classify and reclassify any unissued shares of stock into other classes or series of stock, including preferred stock. Before issuance of shares of each class or series, our board of directors is required by Maryland law and by our charter to set, subject to our charter restrictions on the transfer and ownership of our stock, the terms, preferences, conversion or other rights, voting powers, restrictions, limitations as to dividends or other distributions, qualifications and terms or conditions of redemption for each class or series. Thus, our board of directors could authorize the issuance of shares of common stock or preferred stock with terms and conditions which could have the effect of delaying, deferring or preventing a transaction or a change in control that might involve a premium price for holders of our common stock or otherwise be in their best interests. As of December 31, 2018, we had 5,800,000 shares Series A Preferred Stock, 13,000,000 shares of Series B Preferred Stock and 10,400,000 shares of Series C Preferred Stock issued and outstanding.

Power to Issue Additional Shares of Common Stock and Preferred Stock

We believe that the power of our board of directors to amend the charter without stockholder approval to increase the total number of authorized shares of our stock or any class or series of our stock, to issue additional

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authorized but unissued shares of our common stock or preferred stock and to classify or reclassify unissued shares of our common stock or preferred stock and thereafter to cause us to issue such classified or reclassified shares of stock will provide us with increased flexibility in structuring possible future financings and acquisitions and in meeting other needs that might arise. The additional classes or series, as well as our common stock, will be available for issuance without further action by our stockholders, unless stockholder action is required by applicable law or the rules of any stock exchange or automated quotation system on which our securities may be listed or traded. Although our board of directors has no intention at the present time of doing so, it could authorize us to issue a class or series that could, depending upon the terms of such class or series, delay, defer or prevent a transaction or a change in control of us that might involve a premium price for holders of our common stock or otherwise be in their best interests.

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DESCRIPTION OF WARRANTS

We may issue warrants to purchase debt or equity securities. We may issue warrants independently or together with any offered securities. The warrants may be attached to or separate from those offered securities. We will issue the warrants under warrant agreements to be entered into between us and a bank or trust company, as warrant agent, all as described in the applicable prospectus supplement. The warrant agent will act solely as our agent in connection with the warrants and will not assume any obligation or relationship of agency or trust for or with any holders or beneficial owners of warrants.

The prospectus supplement relating to any warrants that we may offer will contain the specific terms of the warrants. These terms may include the following:

- the title of the warrants;
- the designation, amount and terms of the securities for which the warrants are exercisable;
- the designation and terms of the other securities, if any, with which the warrants are to be issued and the number of warrants issued with each other security;
- the price or prices at which the warrants will be issued;
- the aggregate number of warrants;
- any provisions for adjustment of the number or amount of securities receivable upon exercise of the warrants or the exercise price of the warrants;
- the price or prices at which the securities purchasable upon exercise of the warrants may be purchased;
- if applicable, the date on and after which the warrants and the securities purchasable upon exercise of the warrants will be separately transferable;
- if applicable, a discussion of the material U.S. federal income tax considerations applicable to the exercise of the warrants;
- any other terms of the warrants, including terms, procedures and limitations relating to the exchange and exercise of the warrants;

the date on which the right to exercise the warrants will commence, and the date on which the right will expire;

the maximum or minimum number of warrants that may be exercised at any time; and

information with respect to book-entry procedures, if any.

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DESCRIPTION OF DEBT SECURITIES

The following description of debt securities describes general terms and provisions of a series of debt securities to which any prospectus supplement may relate. When we offer to sell a series of debt securities, we will describe the specific terms of the series in the applicable prospectus supplement. If any particular terms of the debt securities of that series or the indenture described in a prospectus supplement differ from any of the terms described in this prospectus, then the terms described in the applicable prospectus supplement will supersede the terms described in this prospectus.

We may issue our debt securities either separately, or together with, or upon the conversion or exercise of or in exchange for, other securities described in this prospectus. The debt securities will be our unsubordinated and, unless otherwise expressly stated in the applicable prospectus supplement, unsecured obligations and may be issued in one or more series. If so indicated in the applicable prospectus supplement, we may issue debt securities that are secured by specified collateral.

The debt securities will be issued under one or more indentures, each to be entered into by us and a trustee, which trustee shall be named in the applicable prospectus supplement. Unless otherwise expressly stated in the applicable prospectus supplement, we may issue both secured and unsecured debt securities under the same indenture. Unless otherwise expressly stated or the context otherwise requires, references in this section to the indenture and the trustee refer to the applicable indenture pursuant to which any particular series of debt securities is issued and to the trustee under that indenture. The terms of any series of debt securities will be those specified in or pursuant to the applicable indenture and in the certificates evidencing that series of debt securities and those made part of the indenture by the Trust Indenture Act of 1939, as amended, or the Trust Indenture Act of 1939.

The following summary of selected provisions of the indenture is not complete, and the summary of selected terms of a particular series of debt securities in the applicable prospectus supplement also will not be complete. You should review the form of applicable indenture, the form of any applicable supplemental indenture and the form of certificate evidencing the applicable debt securities, which forms have been or will be filed as exhibits to the registration statement of which this prospectus is a part or as exhibits to documents which have been or will be incorporated by reference into this prospectus. To obtain a copy of the form of indenture, the form of any such supplemental indenture or the form of certificate for any debt securities, see Where You Can Find More Information in this prospectus. The following summary and the summary in the applicable prospectus supplement are qualified in their entirety by reference to all of the provisions of the applicable indenture, any supplemental indenture and the certificates evidencing the applicable debt securities, which provisions, including defined terms, are incorporated by reference into this prospectus.

Capitalized terms used in this section and not defined have the meanings assigned to those terms in the indenture. Unless otherwise expressly stated or the context otherwise requires, references in this section to Chimera, we, our company, us and our and other similar references mean Chimera Investment Corporation, excluding its subsidiaries.

General

The debt securities may be issued from time to time in one or more series. We can issue an unlimited amount of debt securities under the indenture. The indenture provides that debt securities of any series may be issued up to the aggregate principal amount that may be authorized from time to time by us. Please read the applicable prospectus supplement relating to the series of debt securities being offered for specific terms, including, where applicable:

the title of the series of debt securities;

any limit on the aggregate principal amount of debt securities of the series;

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the price or prices at which debt securities of the series will be issued;

the person to whom any interest on a debt security of the series shall be payable, if other than the person in whose name that debt security is registered on the applicable record date;

the date or dates on which we will pay the principal of and premium, if any, on debt securities of the series, or the method or methods, if any, used to determine those dates;

the rate or rates, which may be fixed or variable, at which debt securities of the series will bear interest, if any, or the method or methods, if any, used to determine those rates;

the basis used to calculate interest, if any, on the debt securities of the series if other than a 360-day year of twelve 30-day months;

the date or dates, if any, from which interest on the debt securities of the series will begin to accrue, or the method or methods, if any, used to determine those dates;

the dates on which the interest, if any, on the debt securities of the series will be payable and the record dates for the payment of interest;

the place or places where amounts due on the debt securities of the series will be payable and where the debt securities of the series may be surrendered for registration of transfer and exchange, if other than the corporate trust office of the applicable trustee;

the terms and conditions, if any, upon which we may, at our option, redeem debt securities of the series;

the terms and conditions, if any, upon which we will repurchase or repay debt securities of the series at the option of the holders of debt securities of the series;

the terms of any sinking fund or analogous provision;

if other than U.S. dollars, the currency in which the purchase price for the debt securities of the series will be payable, the currency in which payments on the debt securities of the series will be payable, and the ability, if any, of us or the holders of debt securities of the series to have payments made in any other currency or currencies;

with respect to debt securities of the series, any addition of any covenant or Event of Default, or the modification or deletion of, any covenant or Event of Default;

whether the debt securities of the series are to be issuable, in whole or in part, in bearer form (bearer debt securities);

whether any debt securities of the series will be issued in temporary or permanent global form (global debt securities) and, if so, the identity of the depositary for the global debt securities if other than The Depository Trust Company (DTC);

if and under what circumstances we will pay additional amounts (Additional Amounts) on the debt securities of the series in respect of specified taxes, assessments or other governmental charges and, if so, whether we will have the option to redeem the debt securities of the series rather than pay the Additional Amounts;

the manner in which, or the person to whom, any interest on any bearer debt security of the series will be payable, if other than upon presentation and surrender of the coupons relating to the bearer debt security;

the extent to which, or the manner in which, any interest payable on a temporary global debt security will be paid, if other than in the manner provided in the indenture;

the portion of the principal amount of the debt securities of the series which will be payable upon acceleration if other than the full principal amount;

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- the authorized denominations in which the debt securities of the series will be issued, if other than denominations of $1,000 and any integral multiples of $1,000, in the case of debt securities in registered form (registered debt securities) or $5,000, in the case of bearer debt securities;

- the terms, if any, upon which debt securities of the series may be convertible into or exchangeable for other securities or property;

- if the amount of payments on the debt securities of the series may be determined with reference to an index, formula or other method or methods and the method used to determine those amounts;

- if the debt securities of the series will be secured by any collateral and, if so, a general description of the collateral and of some of the terms of any related security, pledge or other agreements;

- any listing of the debt securities on any securities exchange; and

- any other terms of the debt securities of the series (whether or not such other terms are consistent or inconsistent with any other terms of the indenture).

As used in this prospectus and any prospectus supplement relating to the offering of debt securities of any series, references to the principal of and premium, if any, and interest, if any, on the debt securities of the series include the payment of Additional Amounts, if any, required by the debt securities of the series to be paid in that context.

We may issue debt securities at a discount from, or at a premium to, their stated principal amount. A prospectus supplement may describe U.S. federal income tax considerations and other special considerations applicable to a debt security issued with original issue discount or at a premium.

If the principal of, premium, if any, or interest, if any, with regard to any series of debt securities is payable in a foreign currency, then in the prospectus supplement relating to those debt securities, we will describe any restrictions on currency conversions, tax considerations or other material restrictions with respect to that issue of debt securities.

The terms of the debt securities of any series may differ from the terms of the debt securities of any other series, and the terms of particular debt securities within any series may differ from each other. Unless otherwise expressly provided in the prospectus supplement relating to any series of debt securities, we may, without the consent of the holders of the debt securities of any series, reopen an existing series of debt securities and issue additional debt securities of that series.

Unless otherwise described in a prospectus supplement relating to any series of debt securities and except to the limited extent set forth below under Merger, Consolidation and Transfer of Assets, the indenture does not contain any provisions that would limit our ability or the ability of any of our subsidiaries to incur indebtedness or other liabilities or that would afford holders of debt securities protection in the event of a business combination, takeover, recapitalization or highly leveraged or similar transaction involving us. Accordingly, we and our subsidiaries may in the future enter into transactions that could increase the amount of our consolidated indebtedness and other liabilities or otherwise adversely affect our capital structure or credit rating without the consent of the holders of the debt securities of any series.

Registration, Transfer and Payment

Unless otherwise indicated in the applicable prospectus supplement, each series of debt securities will be issued in registered form only, without coupons. The indenture, however, provides that we may also issue a series of debt securities in bearer form only, or in both registered and bearer form.

Unless otherwise indicated in the applicable prospectus supplement, registered debt securities will be issued in denominations of $1,000 or any integral multiples of $1,000, and bearer debt securities will be issued in denominations of $5,000.

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Unless otherwise indicated in the applicable prospectus supplement, the debt securities will be payable and may be surrendered for registration of transfer or exchange and, if applicable, for conversion into or exchange for other securities or property, at an office or agency maintained by us in the United States. However, we, at our option, may make payments of interest on any registered debt security by check mailed to the address of the person entitled to receive that payment or by wire transfer to an account maintained by the payee with a bank located in the United States. Unless otherwise indicated in the applicable prospectus supplement, no service charge shall be made for any registration of transfer or exchange, redemption or repayment of debt securities, or for any conversion or exchange of debt securities for other securities or property, but we may require payment of a sum sufficient to cover any tax or other governmental charge that may be imposed in connection with such transaction.

Unless otherwise indicated in the applicable prospectus supplement, payment of principal, premium, if any, and interest, if any, on bearer debt securities will be made, subject to any applicable laws and regulations, at an office or agency outside the United States. Unless otherwise indicated in the applicable prospectus supplement, payment of interest due on bearer debt securities on any interest payment date will be made only against surrender of the coupon relating to that interest payment date. Unless otherwise indicated in the applicable prospectus supplement, no payment of principal, premium, if any, or interest, if any, with respect to any bearer debt security will be made at any office or agency in the United States or by check mailed to any address in the United States or by wire transfer to an account maintained with a bank located in the United States. However, if any bearer debt securities are payable in U.S. dollars, payments on those bearer securities may be made at the corporate trust office of the relevant trustee or at any office or agency designated by us in the United States if, but only if, payment of the full amount due on the bearer debt securities for principal, premium, if any, or interest, if any, at all offices outside of the United States maintained for that purpose by us is illegal or effectively precluded by exchange controls or similar restrictions.

Unless otherwise indicated in the applicable prospectus supplement, we will not be required to:

- issue, register the transfer of or exchange debt securities of any series during a period beginning at the opening of business 15 days before any selection of debt securities of that series of like tenor and terms to be redeemed and ending at the close of business on the day of that selection;

- register the transfer of or exchange any registered debt security, or portion of any registered debt security, selected for redemption, except the unredeemed portion of any registered debt security being redeemed in part;

- exchange any bearer debt security selected for redemption, except to exchange a bearer debt security for a registered debt security of that series of like tenor and terms that is simultaneously surrendered for redemption; or

- issue, register the transfer of or exchange a debt security that has been surrendered for repayment at the option of the holder, except the portion, if any, of the debt security not to be repaid.

Book-Entry Debt Securities

The securities depositary will be The Depository Trust Company, New York, NY, known as DTC, unless otherwise identified in the prospectus supplement relating to the securities. If DTC is the depositary for an issuance of securities,

the issuance will be issued as fully-registered securities registered in the name of Cede & Co. (DTC s partnership nominee) or such other name as may be requested by an authorized representative of DTC. One fully registered security certificate will be issued for each issue of securities, each in the aggregate principal amount of such issue, and will be deposited with DTC. If, however, the aggregate amount of any issue exceeds $500 million, one certificate will be issued with respect to each $500 million of issue and an additional certificate will be issued with respect to any remaining amount of such issue.

DTC has advised us that it is a limited-purpose trust company organized under the New York Banking Law, a banking organization within the meaning of the New York Banking Law, a member of the Federal Reserve

System, a clearing corporation within the meaning of the New York Uniform Commercial Code, and a clearing agency registered under Section 17A of the Securities Exchange Act of 1934. DTC holds and provides asset servicing for issues of U.S. and non-U.S. equity issues, corporate and municipal debt issues, and money market instruments that its direct participants deposit with DTC. Direct participants include both U.S. and non-U.S. securities brokers and dealers, banks, trust companies, clearing corporations, and certain other organizations. Access to the DTC system is also available to others such as both U.S. and non-U.S. securities brokers and dealers, banks, trust companies, and clearing corporations that clear through or maintain a custodial relationship with a direct participant, either directly or indirectly (indirect participants).

Purchases of the securities under the DTC system must be made by or through direct participants, which will receive a credit for the securities on DTC s records. The ownership interest of each actual purchaser of each security, the beneficial owner, is in turn to be recorded on the direct and indirect participants records. Beneficial owners will not receive written confirmation from DTC of their purchase. A beneficial owner, however, is expected to receive written confirmations providing details of the transaction, as well as periodic statements of its holdings, from the direct or indirect participant through which the beneficial owner entered into the transaction. Transfers of ownership interests in the securities are to be accomplished by entries made on the books of direct and indirect participants acting on behalf of beneficial owners. Beneficial owners will not receive certificates representing their ownership interests in the securities, except if the use of the book-entry system for the securities is discontinued. The deposit of global securities with DTC and their registration in the name of Cede & Co. or such other nominee, as the case may be, do not effect any change in beneficial ownership. DTC has no knowledge of the actual beneficial owners of the global securities; DTC s records reflect only the identity of the direct participants to whose accounts global securities are credited, which may or may not be the beneficial owners. The direct participants and indirect participants will remain responsible for keeping account of their holdings on behalf of their customers.

Conveyance of notices and other communications by DTC to direct participants, by direct participants to indirect participants and by direct participants and indirect participants to beneficial owners will be governed by arrangements among them, subject to any statutory or regulatory requirements as may be in effect from time to time.

To the extent any issuance of securities is redeemable, we will send redemption notices to DTC. If less than all of the securities within an issue are being redeemed, DTC s practice is to determine by lot the amount of the interest of each direct participant in such issue to be redeemed. The applicable prospectus supplement for an issuance of securities will indicate whether such issue is redeemable.

None of DTC, Cede & Co., or any other DTC nominee will consent or vote with respect to the securities unless authorized by a direct participant in accordance with DTC s MMI procedures. Under its usual procedures, DTC mails an omnibus proxy to us as soon as possible after the record date. The omnibus proxy assigns Cede & Co. s consenting or voting rights to those direct participants to whose accounts the securities are credited on the record date (identified in a listing attached to the omnibus proxy).

A beneficial owner must give any required notice of its election to have its securities repurchased, through the participant through which it holds its beneficial interest in the security, to the applicable trustee or tender agent. The beneficial owner shall effect delivery of its securities by causing the direct participant to transfer its interest in the securities on DTC s records. The requirement for physical delivery of securities in connection with an optional tender or a mandatory purchase will be deemed satisfied when the ownership rights in the securities are transferred by the direct participant on DTC s records and followed by a book-entry credit of tendered securities to the applicable trustee or agent s DTC account.

Redemption proceeds, distributions, and dividend payments on the global securities will be made to Cede & Co., or such other nominee as may be requested by an authorized representative of DTC. DTC s practice is to credit direct participants accounts, upon DTC s receipt of funds and corresponding detail information from the

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issuer or agent, on the payable date in accordance with their respective holdings shown on DTC s records. Payments by participants to beneficial owners will be governed by standing instructions and customary practices, as in the case of securities held for the accounts of customers in bearer form or registered in street name. These payments will be the responsibility of such participant and not DTC, Chimera or any agent thereof, subject to any statutory or regulatory requirements as may be in effect from time to time. Payment of redemption proceeds, distributions, and dividend payments to Cede & Co. (or such other nominee as may be requested by an authorized representative of DTC) will be the responsibility of Chimera or its respective agent. Disbursement of such payments to direct participants will be the responsibility of DTC, and disbursement of such payments to beneficial owners will be the responsibility of direct participants and indirect participants. None of Chimera, any trustee or agent, or the registrar for the securities will have any responsibility or liability for any aspect of the records relating to or payments made on account of beneficial ownership interests of the global security or global securities for any series of securities or for maintaining, supervising or reviewing any records relating to such beneficial interests.

DTC may discontinue providing its services as depositary with respect to any securities at any time by giving reasonable notice to the issuer or its agent. Under such circumstances, in the event that a successor depositary is not obtained, security certificates will be printed and delivered to DTC. In addition, an issuer may decide to discontinue use of the system of book-entry-only transfers through DTC (or a successor securities depositary). In that event, security certificates are required to be printed and delivered.

If so stated in the relevant prospectus supplement, beneficial owners may elect to hold interests in the securities through either Clearstream Banking S.A., known as Clearstream, Luxembourg, or through Euroclear Bank S.A./N.V., as operator of the Euroclear System, or Euroclear (in Europe), either directly if they are participants of such systems or indirectly through organizations that are participants in such systems. Clearstream, Luxembourg and Euroclear will hold interests on behalf of their participants through customers securities accounts in Clearstream, Luxembourg s and Euroclear s names on the books of their U.S. depositaries, which in turn will hold such interests in customers securities accounts in the U.S. depositaries names on the books of DTC.

Euroclear and Clearstream, Luxembourg each hold securities for their customers and facilitate the clearance and settlement of securities transactions by electronic book-entry transfer between their respective account holders (each such account holder, a participant and collectively, the participants). Euroclear and Clearstream, Luxembourg provide various services including safekeeping, administration, clearance and settlement of internationally traded securities and securities lending and borrowing. Euroclear and Clearstream, Luxembourg also deal with domestic securities markets in several countries through established depositary and custodial relationships. Euroclear and Clearstream, Luxembourg have established an electronic bridge between their two systems across which their respective participants may settle trades with each other. Euroclear is incorporated under the laws of Belgium and Clearstream, Luxembourg is incorporated under the laws of Luxembourg.

Euroclear and Clearstream, Luxembourg customers are world-wide financial institutions, including underwriters, securities brokers and dealers, banks, trust companies, and clearing corporations. Indirect access to Euroclear and Clearstream, Luxembourg is available to other institutions that clear through or maintain a custodial relationship with a participant of either system. The address of Euroclear is Euroclear Bank S.A./N.V., 1 Boulevard du Roi Albert II, B-1210 Brussels, and the address of Clearstream, Luxembourg is Clearstream Banking, 42 Avenue JF Kennedy, L-1855, Luxembourg.

If DTC is the depositary for a global security, Euroclear and Clearstream, Luxembourg may hold interests in the global security as participants in DTC.

The laws of some jurisdictions may require that purchasers of securities take physical delivery of those securities in definitive form. Accordingly, the ability to transfer interests in the securities represented by a global

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security to those persons may be limited. In addition, because DTC can act only on behalf of its participants, who in turn act on behalf of persons who hold interests through participants, the ability of a person having an interest in securities represented by a global security to pledge or transfer such interest to persons or entities that do not participate in DTC s system, or otherwise to take actions in respect of such interest, may be affected by the lack of a physical definitive security in respect of such interest.

Neither we nor the principal paying agent will have any responsibility or liability for any aspect of the records relating to, or payments made on account of, securities by DTC, Clearstream, Luxembourg, or Euroclear, or for maintaining, supervising or reviewing any records of those organizations relating to the securities.

Redemption and Repurchase

The debt securities of any series may be redeemable at our option or may be subject to mandatory redemption by us as required by a sinking fund or otherwise. In addition, the debt securities of any series may be subject to repurchase or repayment by us at the option of the holders. The applicable prospectus supplement will describe the terms, the times and the prices regarding any optional or mandatory redemption by us or any repurchase or repayment at the option of the holders of any series of debt securities, if any.

Conversion and Exchange

The terms, if any, on which debt securities of any series are convertible into or exchangeable for our common shares or any other securities or property will be set forth in the applicable prospectus supplement. Such terms may include provisions for conversion or exchange, either mandatory, at the option of the holders or at our option. Unless otherwise expressly stated in the applicable prospectus supplement or the context otherwise requires, references in this prospectus and any prospectus supplement to the conversion or exchange of debt securities of any series for other securities or property shall be deemed not to refer to or include any exchange of any debt securities of a series for other debt securities of the same series.

Secured Debt Securities

The debt securities of any series may be secured by collateral. The applicable prospectus supplement will describe any such collateral and the terms of such secured debt securities.

Merger, Consolidation and Transfer of Assets

The indenture provides that we will not, in any transaction or series of related transactions, consolidate with, or sell, lease or convey all or substantially all of our property and assets to, or merge with or into, any person unless:

either (1) we shall be the continuing person (in the case of a merger) or (2) the successor person (if other than us) formed by or resulting from the consolidation or merger or which shall have received the transfer of assets shall be an entity organized and existing under the laws of the United States, any state thereof or the District of Columbia and shall expressly assume the due and punctual payment of the principal of, premium, if any, and interest, if any, on all the debt securities outstanding under the indenture and the due and punctual performance and observance of all covenants and conditions in such outstanding debt securities and the indenture to be performed or satisfied by us (including, without limitation, the obligation to convert or exchange any debt securities that are convertible into or exchangeable for other securities or property in

accordance with the provisions of such debt securities and the indenture) by a supplemental indenture reasonably satisfactory in form to the trustee;

immediately after giving effect to the transaction described above, no Event of Default under the indenture, and no event which, after notice or lapse of time or both, would become an Event of Default under the indenture, shall have occurred and be continuing; and

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the trustee shall have received the officers certificate and opinion of counsel called for by the indenture.
In the case of any such consolidation, sale, lease, conveyance or merger in which we are not the continuing entity and upon execution and delivery by the successor person of the supplemental indenture described above, such successor person shall succeed to, and be substituted for, us and may exercise every right and power of ours under the indenture with the same effect as if such successor person had been named as us therein, and we shall be automatically released and discharged from all obligations and covenants under the indenture and the debt securities issued under that indenture.

Events of Default

Unless otherwise specified in the applicable prospectus supplement, an Event of Default with respect to the debt securities of any series is defined in the indenture as being:

1. default in payment of any interest, if any, on, or any Additional Amounts, if any, payable in respect of any interest, if any, on, any of the debt securities of that series when due, and continuance of such default for a period of 30 days;

2. default in payment of any principal of or premium, if any, on, or any Additional Amounts, if any, payable in respect of any principal of or premium, if any, on, any of the debt securities of that series when due (whether at maturity, upon redemption, upon repayment or repurchase at the option of the holder or otherwise and whether payable in cash or in our common shares or other securities or property);

3. default in the deposit of any sinking fund payment or payment under any analogous provision when due with respect to any of the debt securities of that series;

4. default in the delivery when due of any securities, cash or other property (including, without limitation, any of our common shares) when required to be delivered upon conversion of any convertible debt security of that series or upon the exchange of any debt security of that series which is exchangeable for our common shares or other securities or property (other than an exchange of debt securities of that series for other debt securities of the same series);

5. default in the performance, or breach, of any other covenant or warranty applicable to us in the indenture or in any debt security of that series other than a covenant or warranty included in the indenture solely for the benefit of a series of debt securities other than that series, and continuance of that default or breach (without that default or breach having been cured or waived in accordance with the indenture) for a period of 60 days after notice to us by the trustee or the holders of not less than 25% in aggregate principal amount of the debt securities of that series then outstanding;

6. default after the expiration of any applicable grace period in the payment of principal when due, or resulting in acceleration of, other indebtedness (other than Non-recourse Debt, as defined below) of us or any Significant Subsidiary of ours for borrowed money where the aggregate principal amount with respect to

which the default or acceleration has occurred exceeds $100 million and such indebtedness has not been discharged, or such default in payment or acceleration has not been cured or rescinded, prior to written notice of acceleration of the debt securities of that series;

7. failure by us or any of our Subsidiaries to pay final judgments or decrees entered by a court or courts of competent jurisdiction aggregating in excess of $100 million, which judgments are not paid, discharged or stayed for a period of 30 calendar days after such judgments become final and non-appealable;

8. specified events of bankruptcy, insolvency or reorganization with respect to us or any Significant Subsidiary of ours; or

9. any other Event of Default established for the debt securities of that series.

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No Event of Default with respect to any particular series of debt securities necessarily constitutes an Event of Default with respect to any other series of debt securities. The indenture provides that, within 90 days after the occurrence of any default with respect to the debt securities of any series, the trustee will mail to all holders of the debt securities of that series notice of that default if known to the trustee, unless that default has been cured or waived. However, the indenture provides that the trustee may withhold notice of a default with respect to the debt securities of that series, except a default in payment of principal, premium, if any, interest, if any, Additional Amounts, if any, or sinking fund payments, if any, if the trustee considers it in the best interests of the holders to do so. As used in this paragraph, the term default means any event which is, or after notice or lapse of time or both would become, an Event of Default with respect to the debt securities of any series.

The indenture provides that if an Event of Default (other than an Event of Default specified in clause (8) of the second preceding paragraph with respect to us) occurs and is continuing with respect to any series of debt securities, either the trustee or the holders of at least 25% in principal amount of the debt securities of that series then outstanding may declare the principal of, or if debt securities of that series are original issue discount securities, such lesser amount as may be specified in the terms of that series of debt securities, and accrued and unpaid interest, if any, on all the debt securities of that series to be due and payable immediately. The indenture also provides that if an Event of Default specified in clause (8) of the second preceding paragraph with respect to us occurs with respect to any series of debt securities, then the principal of, or if debt securities of that series are original issue discount securities, such lesser amount as may be specified in the terms of that series of debt securities, and accrued and unpaid interest, if any, on all the debt securities of that series will automatically become and be immediately due and payable without any declaration or other action on the part of the trustee or any holder of the debt securities of that series. However, upon specified conditions, the holders of a majority in principal amount of the debt securities of a series then outstanding may rescind and annul an acceleration of the debt securities of that series and its consequences. For purposes of clarity, references to an Event of Default specified in clause (8) of the second preceding paragraph with respect to us shall not include any Event of Default specified in clause (8) of the second preceding paragraph with respect to any Significant Subsidiary of ours.

Subject to the provisions of the Trust Indenture Act of 1939 requiring the trustee, during the continuance of an Event of Default under the indenture, to act with the requisite standard of care, the trustee is under no obligation to exercise any of its rights or powers under the indenture at the request or direction of any of the holders of debt securities of any series unless those holders have offered the trustee indemnity reasonably satisfactory to the trustee against the costs, fees and expenses and liabilities that might be incurred in compliance with such request or direction. Subject to the foregoing, holders of a majority in principal amount of the outstanding debt securities of any series issued under the indenture have the right to direct the time, method and place of conducting any proceeding for any remedy available to the trustee under the indenture with respect to that series. The indenture requires the annual filing by us with the trustee of a certificate that states whether or not we are in default under the terms of the indenture.

No holder of any debt securities of any series shall have any right to institute any proceeding, judicial or otherwise, with respect to the indenture, or for the appointment of a receiver or trustee, or for any other remedy under the indenture, unless

- such holder has previously given written notice to the trustee of a continuing Event of Default with respect to the debt securities of such series;

the holders of not less than 25% in aggregate principal amount of the outstanding debt securities of such series shall have made written request to the trustee to institute proceedings in respect of such Event of Default in its own name as trustee under the indenture;

such holder or holders have offered to the trustee indemnity reasonably satisfactory to the trustee against the costs, fees and expenses and liabilities which might be incurred in compliance with such request;

the trustee for 60 days after its receipt of such notice, request and offer of indemnity has failed to institute any such proceeding; and

no direction inconsistent with such written request has been given to the trustee during such 60-day period by the holders of a majority in principal amount of the outstanding debt securities of such series.

Notwithstanding any other provision of the indenture, the holder of a debt security will have the right, which is absolute and unconditional, to receive payment of the principal of and premium, if any, and interest, if any, on that debt security on the respective due dates for those payments and, in the case of any debt security that is convertible into or exchangeable for other securities or property, to convert or exchange, as the case may be, that debt security in accordance with its terms, and to institute suit for the enforcement of those payments and any right to effect such conversion or exchange, and this right shall not be impaired without the consent of the holder.

Modification, Waivers and Meetings

The indenture permits us and the trustee, with the consent of the holders of a majority in principal amount of the outstanding debt securities of each series issued under the indenture and affected by a modification or amendment, to modify or amend any of the provisions of the indenture or of the debt securities of the applicable series or the rights of the holders of the debt securities of that series under the indenture. However, the consent of the holder of each debt security affected will be required for any modification or amendment that, among other things:

changes the stated maturity of the principal of, or premium, if any, or any installment of interest, if any, on or any Additional Amounts, if any, with respect to any debt securities issued under the indenture;

reduces the principal of or any premium on any debt securities, reduces the rate of interest on any debt securities or reduces the price payable upon the redemption of any debt securities, whether such redemption is mandatory or at our option, or upon the repurchase of any debt securities at the option of the holder, or reduces any Additional Amounts with respect to any debt securities, or change our obligation to pay Additional Amounts;

reduces the amount of principal of any original issue discount securities that would be due and payable upon an acceleration of the maturity thereof;

adversely affects any right of repayment or repurchase of any debt securities at the option of any holder;

changes any place where, or the currency in which, debt securities are payable;

impairs the holder s right to institute suit to enforce the payment of any debt securities on or after their stated maturity or, in the case of any debt securities that are convertible into or exchangeable for other securities or property, to institute suit to enforce the right to convert or exchange such debt securities in accordance with its terms;

makes any change that adversely affects the right, if any, to convert or exchange any debt securities for other securities or property;

reduces the percentage of debt securities of any series issued under the indenture whose holders must consent to any modification or amendment or any waiver of compliance with specific provisions of such indenture or specified defaults under the indenture and their consequences; or

reduces the requirements for a quorum or voting at a meeting of holders of the applicable debt securities.

The indenture also contains provisions permitting us and the trustee, without the consent of the holders of any debt securities issued under the indenture, to modify or amend the indenture, among other things:

to evidence the succession of another person to us and the assumption by that successor of our covenants contained in the indenture and in the debt securities;

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to add to our covenants for the benefit of the holders of all or any series of debt securities issued under the indenture or to surrender any right or power conferred upon us with respect to all or any series of debt securities issued under the indenture;

to add to or change any provisions of the indenture to facilitate the issuance of bearer securities;

to establish the form or terms of debt securities of any series and any related coupons, including, without limitation, conversion and exchange provisions applicable to debt securities which are convertible into or exchangeable for other securities or property, and to establish any provisions with respect to any security or other collateral for such debt securities, and to make any deletions from or additions or changes to the indenture in connection with any of the matters referred to in this bullet point so long as those deletions, additions and changes are not applicable to any other series of debt securities then outstanding;

to evidence and provide for the acceptance of the appointment of a successor trustee in respect of the debt securities of one or more series;

to cure any ambiguity or correct or supplement any provision in such indenture which may be defective or inconsistent with other provisions in the indenture, or to make any other provisions with respect to matters or questions arising under the indenture, which shall not adversely affect the interests of the holders of the debt securities of any series then outstanding in any material respect;

to add any additional Events of Default with respect to all or any series of debt securities;

to supplement any of the provisions of the indenture to permit or facilitate defeasance, covenant defeasance and/or satisfaction and discharge of any series of debt securities, provided that such action shall not adversely affect the interests of any holder of a debt security of such series or any other debt security in any material respect;

to secure or, if applicable, to provide additional security for all or any debt securities issued under the indenture and to provide for any and all matters relating thereto, and to provide for the release of any collateral as security for all or any debt securities in accordance with the terms of the indenture;

to add to or change or eliminate any provision of the indenture as is necessary or desirable in accordance with any amendment to the Trust Indenture Act;

to make any change to the indenture, or any supplemental indenture, or any debt securities to conform the terms thereof to any provision of the description of a series of any debt securities in any prospectus (including this prospectus), prospectus supplement, offering memorandum or similar offering document used in connection with the initial offering or sale of any debt securities to the extent that such provision in such

description was intended to be a substantially verbatim recitation of a provision of the indenture or debt securities;

in the case of any series of debt securities which are convertible into or exchangeable for our common shares or other securities or property, to provide for the conversion or exchange rights of those debt securities in the event of any reclassification or change of our common shares or any of our other securities into which such debt securities are convertible or for which such debt securities are exchangeable or any similar transaction if expressly required by the terms of that series of debt securities; or

to amend or supplement any provision contained in the indenture or in any debt securities, provided that such amendment or supplement does not apply to any outstanding debt securities issued prior to the date of such supplemental indenture and entitled to the benefits of such provisions.

The holders of a majority in aggregate principal amount of the outstanding debt securities of any series may waive our compliance with the provisions described above under Merger, Consolidation and Transfer of Assets and certain other provisions of the indenture and, if specified in the prospectus supplement relating to

such series of debt securities, any additional covenants applicable to the debt securities of such series. The holders of a majority in aggregate principal amount of the outstanding debt securities of any series may, on behalf of all holders of debt securities of that series, waive any past default under the indenture with respect to debt securities of that series and its consequences, except a default in the payment of the principal of, or premium, if any, or interest, if any, on debt securities of that series or, in the case of any debt securities that are convertible into or exchangeable for other securities or property, a default in any such conversion or exchange, or a default in respect of a covenant or provision that cannot be modified or amended without the consent of the holder of each outstanding debt security of the affected series.

The indenture contains provisions for convening meetings of the holders of a series of debt securities if (and only if) debt securities of such series are issued or issuable, in whole or in part, in the form of bearer debt securities. A meeting may be called at any time by the trustee, and also upon our request or the request of holders of at least 33 1/3% in principal amount of the outstanding debt securities of a series. Notice of a meeting must be given in accordance with the provisions of the indenture. Except for any consent which must be given by the holder of each outstanding debt security affected in the manner described above, any resolution presented at a meeting or adjourned meeting duly reconvened at which a quorum, as described below, is present may be adopted by the affirmative vote of the holders of a majority in principal amount of the outstanding debt securities of that series. However, any resolution with respect to any request, demand, authorization, direction, notice, consent, waiver or other action which the indenture provides may be made, given or taken by the holders of a specified percentage, which is less or more than a majority, in principal amount of the outstanding debt securities of a series may be adopted at a meeting or adjourned meeting duly reconvened at which a quorum is present by the affirmative vote of the holders of that specified percentage in principal amount of the outstanding debt securities of that series. Any resolution passed or decision taken at any meeting of holders of debt securities of any series duly held in accordance with the indenture will be binding on all holders of debt securities of that series and the related coupons, if any. The quorum at any meeting called to adopt a resolution, and at any reconvened meeting, will be persons entitled to vote a majority in principal amount of the outstanding debt securities of a series, or, if any action is to be taken at a meeting with respect to any request, demand, authorization, direction, notice, consent, waiver or other action which the indenture provides may be given by holders of a greater percentage in principal amount of outstanding debt securities of a series, the persons entitled to vote at such greater percentage in principal amount of the outstanding debt securities of such series.

Discharge, Defeasance and Covenant Defeasance

Unless otherwise provided in the applicable prospectus supplement, upon our direction, the indenture shall cease to be of further effect with respect to any series of debt securities issued under the indenture specified by us, subject to the survival of specified provisions of the indenture (including the obligation to pay Additional Amounts to the extent described below and the obligation, if applicable, to exchange or convert debt securities of that series into other securities or property in accordance with their terms) when:

either

(1) all outstanding debt securities of that series and, in the case of bearer securities, all related coupons, have been delivered to the trustee for cancellation, subject to exceptions, or

(2)

all debt securities of that series and, if applicable, any related coupons have become due and payable or will become due and payable at their stated maturity within one year or are to be called for redemption within one year and we have deposited with the trustee, in trust, funds in U.S. dollars or in the foreign currency in which the debt securities of that series are payable in an amount sufficient to pay the entire indebtedness on the debt securities of that series in respect of principal, premium, if any, and interest, if any (and, to the extent that (x) the debt securities of that series provide for the payment of Additional Amounts upon the occurrence of specified events of taxation, assessment or governmental charge with respect to payments on the debt securities and (y) the amount of any Additional Amounts which are or will be payable is at the time of deposit reasonably determinable by us, in the exercise of our sole and

absolute discretion, those Additional Amounts) to the date of such deposit, if the debt securities of that series have become due and payable, or to the maturity or redemption date of the debt securities of that series, as the case may be;

we have paid all other sums payable under the indenture with respect to the debt securities of that series; and

the trustee has received an officers certificate and an opinion of counsel called for by the indenture.

Unless otherwise provided in the applicable prospectus supplement, we may elect with respect to any series of debt securities either:

to defease and be discharged from all of our obligations with respect to that series of debt securities (defeasance), except for:

(1) the obligation to pay Additional Amounts, if any, upon the occurrence of specified events of taxation, assessment or governmental charge with respect to payments on that series of debt securities to the extent (and only to the extent) that those Additional Amounts exceed the amount deposited in respect of those Additional Amounts as provided below,

(2) the obligation, if applicable, to exchange or convert debt securities of that series into other securities or property in accordance with their terms, and

(3) certain other limited obligations.

to be released from our obligations with respect to the debt securities of such series under such covenants as may be specified in the applicable prospectus supplement, and any omission to comply with those obligations shall not constitute a default or an Event of Default with respect to that series of debt securities (covenant defeasance), in either case upon the irrevocable deposit with the trustee, or other qualifying trustee, in trust for that purpose, of an amount in U.S. dollars or in the foreign currency in which those debt securities are payable at stated maturity or, if applicable, upon redemption, and/or Government Obligations which through the payment of principal and interest in accordance with their terms will provide money, in an amount sufficient to pay the principal of and any premium and any interest on (and, to the extent that (x) the debt securities of that series provide for the payment of Additional Amounts and (y) the amount of the Additional Amounts which are or will be payable is at the time of deposit reasonably determinable by us, in the exercise of our sole and absolute discretion, the Additional Amounts with respect to) that series of debt securities, and any mandatory sinking fund or analogous payments on that series of debt securities, on the due dates for those payments.

The defeasance or covenant defeasance described above shall only be effective if, among other things:

it shall not result in a breach or violation of, or constitute a default under, the indenture;

in the case of defeasance, we shall have delivered to the trustee an opinion of independent counsel reasonably acceptable to the trustee confirming that (A) we have received from or there has been published by the Internal Revenue Service, or IRS, a ruling or (B) since the date of the indenture there has been a change in applicable U.S. federal income tax law, in either case to the effect that, and based on this ruling or change the opinion of counsel shall confirm that, the holders and beneficial owners of the debt securities of the applicable series will not recognize income, gain or loss for U.S. federal income tax purposes as a result of the defeasance and will be subject to U.S. federal income tax on the same amounts, in the same manner and at the same times as would have been the case if the defeasance had not occurred;

in the case of defeasance, we shall provide money in an amount sufficient in the written opinion of a nationally recognized firm of independent public accountants to pay the principal of, premium, if any, and each installment of interest on the debt securities;

in the case of covenant defeasance, we shall have delivered to the trustee an opinion of independent counsel reasonably acceptable to the trustee to the effect that the holders and beneficial owners of the debt securities of the applicable series will not recognize income, gain or loss for U.S. federal income tax purposes as a result of the covenant defeasance and will be subject to U.S. federal income tax on the same amounts, in the same manner and at the same times as would have been the case if the covenant defeasance had not occurred;

if the cash and Government Obligations deposited are sufficient to pay the outstanding debt securities of that series provided those debt securities are redeemed on a particular redemption date, we shall have given the trustee irrevocable instructions to redeem those debt securities on that date; and

no Event of Default or event which with notice or lapse of time or both would become an Event of Default with respect to debt securities of that series shall have occurred and be continuing on the date of the deposit into trust; and, solely in the case of defeasance, no Event of Default arising from specified events of bankruptcy, insolvency or reorganization with respect to us or event which with notice or lapse of time or both would become such an Event of Default with respect to us shall have occurred and be continuing during the period through and including the 91st day after the date of the deposit into trust.

The applicable prospectus supplement may further describe the provisions, if any, permitting or restricting satisfaction and discharge, defeasance or covenant defeasance with respect to the debt securities of a particular series.

Definitions

As used in the indenture, the following terms have the meanings specified below:

The term Corporation includes corporations, partnerships, associations, limited liability companies and other companies and business trusts. The term corporation means a corporation and does not include partnerships, associations, limited liability companies or other companies or business trusts.

Non-recourse Debt means any indebtedness the terms of which provide that the claim for repayment of such indebtedness by the holder thereof is limited solely to a claim against the property or assets (including, without limitation, securities or interests in securities) that secure such indebtedness; provided, however, that any obligations or liabilities of the debtor or obligor or any other person solely for indemnities, covenants or breaches of warranties, representations or covenants or similar matters in respect of any indebtedness will not prevent such indebtedness from constituting Non-recourse Debt.

Person or person means any individual, Corporation, joint venture, joint-stock company, trust, unincorporated organization or government or any agency or political subdivision thereof.

Significant Subsidiary means, as of any date of determination, a Subsidiary of ours that would constitute a significant subsidiary as such term is defined under Rule 1-02(w) of Regulation S-X of the Securities and Exchange Commission as in effect on the date of the indenture.

Subsidiary means, with respect to any Person, (i) any corporation, association or other business entity of which more than 50% of the total voting power of shares of capital stock or other equity interests entitled (without regard to the occurrence of any contingency) to vote in the election of directors, managers or trustees thereof is at the time owned or controlled, directly or indirectly, by such Person or one or more of the other Subsidiaries of such Person (or a

combination thereof) and (ii) any partnership (a) the sole general partner or managing general partner of which is such Person or a Subsidiary of such Person or (b) the only general partners of which are such Person or one or more Subsidiaries of such Person (or any combination thereof).

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Governing Law

The indenture and the debt securities will be governed by, and construed in accordance with, the laws of the State of New York, without regard to conflicts of laws principles thereof.

Regarding the Trustees

The Trust Indenture Act of 1939 limits the rights of a trustee, if the trustee becomes a creditor of us, to obtain payment of claims or to realize on property received by it in respect of those claims, as security or otherwise. Any trustee is permitted to engage in other transactions with us and our subsidiaries from time to time. However, if a trustee acquires any conflicting interest it must eliminate the conflict upon the occurrence of an Event of Default under the applicable indenture or resign as trustee.

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RESTRICTIONS ON OWNERSHIP AND TRANSFER

To qualify as a REIT under the Internal Revenue Code of 1986, as amended, or the Code, for each taxable year beginning after December 31, 2007, our shares of capital stock must be beneficially owned by 100 or more persons during at least 335 days of a taxable year of 12 months or during a proportionate part of a shorter taxable year. Also, beginning after December 31, 2007, no more than 50% of the value of our outstanding shares of capital stock may be owned, directly or constructively, by five or fewer individuals (as defined in the Code to include certain entities) during the second half of any calendar year.

Our charter, subject to certain exceptions, contains restrictions on the number of shares of our capital stock that a person may own. Our charter provides that (subject to certain exceptions described below) no person may own, or be deemed to own by the attribution provisions of the Code, more than 9.8% in value or in number of shares, whichever is more restrictive, of any class or series of our capital stock, excluding any shares of capital stock not treated as outstanding for U.S. federal income tax purposes.

Our charter also prohibits any person from (i) beneficially or constructively owning shares of our capital stock that would result in our being closely held under Section 856(h) of the Code or otherwise cause us to fail to qualify as a REIT and (ii) transferring shares of our capital stock if such transfer would result in our capital stock being owned by fewer than 100 persons. Any person who acquires or attempts or intends to acquire beneficial or constructive ownership of shares of our capital stock that will or may violate any of the foregoing restrictions on transferability and ownership, or who is the intended transferee of shares of our stock that are transferred to the trust (as described below), will be required to give notice immediately to us and provide us with such other information as we may request to determine the effect of such transfer on our status as a REIT. The foregoing restrictions on transferability and ownership will not apply if our board of directors determines that it is no longer in our best interests to attempt to qualify, or to continue to qualify, as a REIT.

Our board of directors, in its sole discretion, may exempt a person from the foregoing restrictions. The person seeking an exemption must provide to our board of directors such representations, covenants and undertakings as our board of directors may deem appropriate to conclude that granting the exemption will not cause us to lose our status as a REIT. Our board of directors may also require a ruling from the IRS or an opinion of counsel to determine or ensure our status as a REIT.

Any attempted transfer of our securities that, if effective, would result in a violation of the foregoing restrictions will cause the number of securities causing the violation (rounded to the nearest whole share) to be automatically transferred to a trust for the exclusive benefit of one or more charitable beneficiaries, and the proposed transferee will not acquire any rights in such securities. The automatic transfer will be deemed to be effective as of the close of business on the business day (as defined in our charter) before the date of the transfer. If, for any reason, the transfer to the trust is ineffective, our charter provides that the purported transfer in violation of the restrictions will be void *ab initio*. Shares of our stock held in the trust will be issued and outstanding shares. The proposed transferee will not benefit economically from ownership of any securities held in the trust, will have no rights to dividends and no rights to vote or other rights attributable to the shares of stock held in the trust. The trustee of the trust will have all voting rights and rights to dividends or other distributions with respect to shares held in the trust. These rights will be exercised for the exclusive benefit of the charitable beneficiary. Any dividend or other distribution paid before our discovery that shares of stock have been transferred to the trust will be paid by the recipient to the trustee upon demand. Any dividend or other distribution authorized but unpaid will be paid when due to the trustee. Any dividend or distribution paid to the trustee will be held in trust for the charitable beneficiary. Subject to Maryland law, the trustee will have the authority (i) to rescind as void any vote cast by the proposed transferee before our discovery that the shares have been transferred to the trust and (ii) to recast the vote in accordance with the desires of the trustee

acting for the benefit of the charitable beneficiary. However, if we have already taken irreversible corporate action, then the trustee will not have the authority to rescind and recast the vote.

Within 20 days of receiving notice from us that the securities have been transferred to the trust, the trustee will sell the securities to a person designated by the trustee, whose ownership of the securities will not violate the above ownership limitations. Upon such sale, the interest of the charitable beneficiary in the securities sold will terminate and the trustee will distribute the net proceeds of the sale to the proposed transferee and to the charitable beneficiary as follows. The proposed transferee will receive the lesser of (i) the price paid by the proposed transferee for the securities or, if the proposed transferee did not give value for the securities in connection with the event causing the securities to be held in the trust (e.g., a gift, devise or other similar transaction), the market price (as defined in our charter) of the securities on the day of the event causing the securities to be held in the trust and (ii) the price received by the trustee from the sale or other disposition of the securities. The trustee may reduce the amount payable to the proposed transferee by the amount of dividends and distributions paid to the proposed transferee and owed by the proposed transferee to the trustee. Any net sale proceeds in excess of the amount payable to the proposed transferee will be paid immediately to the charitable beneficiary. If, before our discovery that the securities have been transferred to the trust, the securities are sold by the proposed transferee, then (i) the securities shall be deemed to have been sold on behalf of the trust and (ii) to the extent that the proposed transferee received an amount for the securities that exceeds the amount the proposed transferee was entitled to receive, the excess shall be paid to the trustee upon demand.

In addition, the securities held in the trust will be deemed to have been offered for sale to us, or our designee, at a price per share equal to the lesser of (i) the price per share in the transaction that resulted in the transfer to the trust (or, in the case of a devise or gift, the market price at the time of the devise or gift) and (ii) the market price on the date we, or our designee, accept the offer. We may reduce the amount payable to the proposed transferee, however, by the amount of any dividends or distributions paid to the proposed transferee on the securities and owed by the proposed transferee to the trustee. We will have the right to accept the offer until the trustee has sold the securities. Upon a sale to us, the interest of the charitable beneficiary in the securities sold will terminate and the trustee will distribute the net proceeds of the sale to the proposed transferee.

All certificates representing the securities will bear a legend referring to the restrictions described above or will state that we will furnish a full statement about certain transfer restrictions to a stockholder upon request and without charge.

Every owner of more than 5% (or such lower percentage as required by the Code or the regulations promulgated thereunder) in value of all classes or series of our stock, including shares of common stock, within 30 days after the end of each taxable year, will be required to give written notice to us stating the name and address of such owner, the number of shares of each class and series of shares of our stock that the owner beneficially owns and a description of the manner in which the shares are held. Each owner shall provide to us such additional information as we may request to determine the effect, if any, of the beneficial ownership on our status as a REIT and to ensure compliance with the ownership limitations. In addition, each such owner shall upon demand be required to provide to us such information as we may request, in good faith, to determine our status as a REIT and to comply with the requirements of any taxing authority or governmental authority or to determine such compliance.

These ownership limitations could delay, defer or prevent a transaction or a change in control that might involve a premium price for the common stock or might otherwise be in your best interests.

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CERTAIN PROVISIONS OF MARYLAND LAW AND OF OUR CHARTER AND BYLAWS

We have summarized certain terms and provisions of the Maryland General Corporation Law and our charter and bylaws. This summary is not complete and is qualified by the provisions of our charter and bylaws, and the Maryland General Corporation Law. See Where You Can Find More Information. For restrictions on ownership and transfer of our capital stock contained in our charter, see Restrictions on Ownership and Transfer.

Classification of Board of Directors, Vacancies and Removal of Directors

Our charter and bylaws provide for a classified board of directors consisting of up to 15 directors. Our charter provides that our directors shall be divided into three classes. The number of directors in each class and the expiration of each class term are as follows:

Class I	3 Directors	Expires 2020
Class II	3 Directors	Expires 2021
Class III	2 Directors	Expires 2019

At each annual meeting of our stockholders, successors of the class of directors whose term expires at that meeting will be elected for a term expiring at the annual meeting of stockholders held in the third year following the year of their election and until their successors are duly elected and qualify, and the directors in the other two classes will continue in office. A classified board of directors may delay, defer or prevent a change in control or other transaction that might involve a premium over the then prevailing market price for our common stock or other attributes that our stockholders may consider desirable. In addition, a classified board of directors could prevent stockholders who do not agree with the policies of our board of directors from replacing a majority of the board of directors for two years, except in the event of removal for cause.

Any vacancy on our board of directors may be filled only by a majority of the remaining directors, except as may be provided by the board of directors in setting the terms of any class or series of stock. Any individual so elected director will hold office for the remainder of the full term of the directorship in which the vacancy occurred. Our charter provides that a director may be removed at any time, but only for cause (as defined in our charter) upon the affirmative vote of at least two-thirds of the votes entitled to be cast in the election of directors. These provisions preclude stockholders from removing incumbent directors, except for cause and upon a substantial affirmative vote, and filling the vacancies created by such removal with their own nominees.

Indemnification

Our bylaws obligate us to indemnify our directors and officers and to pay or reimburse expenses for them before the final disposition of a proceeding to the maximum extent permitted by Maryland law. The Maryland General Corporation Law (the MGCL) permits a corporation to indemnify its present and former directors and officers against judgments, penalties, fines, settlements and reasonable expenses actually incurred by them in connection with any proceeding to which they may be made a party by reason of their service in those or other capacities, unless it is established that (1) the act or omission of the director or officer was material to the matter giving rise to the proceeding and (a) was committed in bad faith, or (b) was the result of active and deliberate dishonesty, or (2) the director or officer actually received an improper personal benefit in money, property or services, or (3) in the case of any criminal proceeding, the director or officer had reasonable cause to believe that the act or omission was unlawful.

Limitation of Liability

The MGCL permits the charter of a Maryland corporation to include a provision limiting the liability of its directors and officers to the corporation and its stockholders for money damages, except to the extent that (1) it is

proved that the person actually received an improper benefit or profit in money, property or services, or (2) a judgment or other final adjudication adverse to the person is entered in a proceeding based on a finding that the person s action, or failure to act, was the result of active and deliberate dishonesty and was material to the cause of action adjudicated in the proceeding. Our charter provides for elimination of the liability of our directors and officers to us or our stockholders for money damages to the maximum extent permitted by Maryland law from time to time.

Maryland Business Combination Act

The MGCL prohibits business combinations between a corporation and an interested stockholder or an affiliate of an interested stockholder for five years after the most recent date on which the interested stockholder becomes an interested stockholder. These business combinations include a merger, consolidation, statutory share exchange, or, in circumstances specified in the statute, certain transfers of assets, certain stock issuances and transfers, liquidation plans and reclassifications involving interested stockholders and their affiliatespparent from the consolidated financial statements. The following discussion and analysis should be read along with our consolidated financial statements and the related notes included elsewhere herein.

Overview

General. Pinnacle Financial's rapid organic growth from its inception through the fourth quarter of 2006 together with its merger with Cavalry Bancorp, Inc. ("Cavalry"), a one-bank holding company located in Murfreesboro, Tennessee, on March 15, 2006 has had a material impact on Pinnacle Financial's financial condition and results of operations. This rapid growth resulted in net income for the year ended December 31, 2006 of $1.18 per diluted share as compared to $0.85 and $0.61 per diluted share for 2005 and 2004, respectively. At December 31, 2006, loans totaled $1.498 billion, as compared to $648 million at December 31, 2005, while total deposits increased to $1.622 billion at December 31, 2006 from $810 million at December 31, 2005.

Acquisition. On March 15, 2006, we consummated our merger with Cavalry. Pursuant to the merger agreement, we acquired all Cavalry common stock via a tax-free exchange whereby Cavalry shareholders received a fixed exchange ratio of 0.95 shares of our common stock for each share of Cavalry common stock, or approximately 6.9 million Pinnacle Financial shares. The financial information herein includes the activities of the former Cavalry (the "Rutherford County market") since March 15, 2006.

In accordance with Statement of Financial Accounting Standards ("SFAS") No. 141, "Accounting for Business Combinations" ("SFAS No. 141"), SFAS No. 142, "Goodwill and Intangible Assets" ("SFAS No. 142") and SFAS No. 147, "Acquisition of Certain Financial Institutions" ("SFAS No. 147"), we recorded at fair value the following assets and liabilities of Cavalry as of March 15, 2006 (dollars in thousands):

Cash and cash equivalents	$ 37,420
Investment securities - available-for-sale	39,476
Loans, net of an allowance for loan losses of $5,102	545,598
Goodwill	114,288
Core deposit intangible	13,168
Other assets	42,937
Total assets acquired	792,887
Deposits	583,992
Federal Home Loan Bank advances	17,767

Other liabilities		18,851
Total liabilities assumed		620,610
Total consideration paid for Cavalry	$	172,277

We are in the process of finalizing the allocation of the purchase price to the acquired net assets noted above. Accordingly, the above allocations should be considered preliminary as of December 31, 2006.

As noted above, total consideration for Cavalry approximates $172.3 million of which $171.1 million was in the form of our common shares and options to acquire our common shares and $1.2 million in investment banking fees, attorney's fees and other costs related to the purchase of Cavalry. We issued 6,856,298 shares of our common stock to the former Cavalry shareholders. In accordance with EITF 99-12, "Determination of the Measurement Date for the Market Price of Acquirer Securities Issued in a Purchase Business Combination," the shares were valued at $24.53 per common share which represents the average closing price of our common stock from the two days prior to the merger announcement on September 30, 2005 through the two days after the merger announcement. Aggregate consideration for the common stock issued was approximately $168.2 million. Additionally, we also have assumed the Cavalry Bancorp, Inc. 1999 Stock Incentive Plan (the "Cavalry Plan") pursuant to which we were obligated to issue 195,551 shares of our common stock upon exercise of stock options awarded to certain former Cavalry employees who held outstanding options as of March 15, 2006. All of these options were fully vested prior to the merger announcement date and expire at various dates between 2011 and 2012. The exercise prices for these stock options range between $10.26 per share and $13.68 per share. In accordance with SFAS No. 141, we considered the fair value of these options in determining the acquisition cost of Cavalry. The fair value of these vested options approximated $2.9 million which has been included as a component of the aggregate purchase price.

In accordance with SFAS Nos. 141 and 142, we recognized $13.2 million as a core deposit intangible. This identified intangible is being amortized over seven years using an accelerated method which anticipates the life of the underlying deposits to which the intangible is attributable. For the year ended December 31, 2006, approximately $1.8 million was recognized in the statement of income. Amortization expense associated with the core deposit intangible will approximate $1.8 million to $2.1 million per year for the next five years with lesser amounts for the remaining two years.

We also recorded other adjustments to the carrying value of Cavalry's assets and liabilities in order to reflect the fair value of those net assets in accordance with generally accepted accounting principles, including a $4.8 million discount associated with the loan portfolio, a $2.9 million premium for Cavalry's certificates of deposit and a $4.6 million premium for Cavalry's land and buildings. We have also recorded the corresponding deferred tax asset or liability associated with these adjustments. The discounts and premiums related to financial assets and liabilities will be amortized into our statements of income in future periods using a method that approximates the level yield method over the anticipated lives of the underlying financial assets or liabilities. For the year ended December 31, 2006, the accretion of the fair value discounts related to the acquired loans and certificates of deposit increased net interest income by approximately $3.7 million. Based on the estimated useful lives of the acquired loans and deposits, we expect to recognize increases in net interest income related to accretion of these purchase accounting adjustments of $4.0 million in subsequent years.

We also incurred approximately $1,636,000 in merger related expenses during the year ended December 31, 2006 directly related to the Cavalry merger. These charges were for our integration of Cavalry and accelerated depreciation and amortization related to software and other technology assets whose useful lives were shortened as a result of the Cavalry acquisition.

Results of Operations. Our net interest income increased to $61.0 million for 2006 compared to $29.0 million for 2005 and $20.3 million in 2004. The net interest margin (the ratio of net interest income to average earning assets) for 2006 was 3.90% for 2006 compared to 3.60% for the same period in 2005 and 3.62% in 2004.

Our provision for loan losses was $3.7 million for 2006 compared to $2.2 million in 2005 and $2.9 million in 2004. The provision for loan losses increased primarily due to increases in loan volumes and charge-offs in 2006 compared to 2005, while the decrease in expense between 2005 and 2004 was due to increases in loan volumes offset by a significant decrease in charge-offs in 2005.

Noninterest income for 2006 compared to 2005 increased by $10.4 million, or 193%. This increase is largely attributable to the fee businesses associated with the Cavalry acquisition, particularly with regard to service charges on deposit accounts, insurance sales commissions and trust fees. Noninterest income for 2005 compared to 2004 increased by $416,000, or 8.4%, which was due in large part to increases in investment sales commissions, insurance commissions, trust fees and other fees.

Our continued growth in 2006 resulted in increased noninterest expense compared to 2005 due to the addition of the Rutherford County market, increases in salaries and employee benefits, equipment and occupancy expenses and other operating expenses. The number of full-time equivalent employees increased from 156.5 at December 31, 2005 to 404.0 at December 31, 2006. As a result, we experienced increases in compensation and employee benefit expense. Additionally, we adopted SFAS No. 123(R) in 2006 which addresses the accounting for employee equity based incentives which also increased our compensation and employee benefit expense in 2006 when compared to no expense in 2006. We expect to add additional employees throughout 2007 which will cause our compensation and employee benefit expense to increase in 2007. Additionally, our branch expansion efforts during the last few years and the addition of the nine Cavalry branches also increased noninterest expense. The increased operational expenses for the recently opened branches and the additional planned branch in the Donelson area of Davidson County expected to open in early 2007 will continue to result in increased noninterest expense in future periods. Our efficiency ratio (the ratio of noninterest expense to the sum of net interest income and noninterest income) was 60.6% in 2006 compared to 61.1% in 2005 and 58.6% in 2004. These calculations include the impact of approximately $1,636,000 in merger related charges in 2006.

The effective income tax expense rate for 2006 was approximately 32.1% compared to an effective income tax expense rate for 2005 of approximately 28.4% and 29.0% for 2004. The increase in the effective tax rate between the periods was due to the additional earnings being taxed at a higher rate as the various tax savings initiatives (e.g., municipal bond income) had a lesser impact in 2006 when compared to the previous periods. Additionally, the impact of our incentive stock options and their treatment pursuant to the adoption of SFAS No. 123(R) also contributed to the increase in our effective rate in 2006.

Net income for 2006 was $17.9 million compared to $8.1 million in 2005, an increase of 123%. Net income for 2005 was 51% higher than net income for 2004 of $5.3 million. Fully-diluted net income per common share was $1.18 for 2006 compared to $0.85 for 2005 and $0.61 for 2004.

Excluding the after-tax (rate of 39.23%) impact of merger related charges, net income for 2006 was $18.9 million compared to $8.1 million for 2005, an increase of 135%. As a result, adjusted diluted net income per common share was $1.25 for 2006 compared to $0.85 for 2005, an increase of 47%. For a reconciliation of these non-GAAP financial measures to their most directly comparable GAAP financial measure, see "Reconciliation of Non-GAAP financial measures" on page 25.

Financial Condition. Loans increased $850 million during 2006 of which $551 million was attributable to the Cavalry acquisition. Thus, the net increase in our loan portfolio attributable to organic growth was $299 million. As we seek to increase our loan portfolio, we must also continue to monitor the risks inherent in our lending operations. If our allowance for loan losses is not sufficient to cover the estimated loan losses in our loan portfolio, increases to the allowance for loan losses would be required which would decrease our earnings.

We have successfully grown our total deposits to $1.622 billion at December 31, 2006 compared to $810 million at December 31, 2005, an increase of $812 million, of which $584 million was attributable to the Cavalry acquisition. As a result, we increased our deposits by $228 million, excluding the Cavalry acquisition. This growth in deposits had a higher funding cost due to rising rates and increased deposit pricing competition in 2006 compared to 2005. We typically adjust our loan yields at a faster rate than we adjust our deposit rates. As such, unless competitive pressures dictate, our deposit funding costs do not usually adjust as quickly as do revenues from interest income on floating rate earning assets.

We continue to believe there is broad acceptance of our business model within the Nashville MSA and in our target markets of small to mid-sized businesses and affluent clients, real estate professionals and consumers that desire a deep relationship with their bank.

Capital and Liquidity. At December 31, 2006, our capital ratios, including our bank's capital ratios, met regulatory minimum capital requirements. Additionally, at December 31, 2006, our bank would be considered to be "well-capitalized" pursuant to banking regulations. As our bank grows it will require additional capital from us over that which can be earned through operations. We anticipate that we will continue to use various capital raising techniques in order to support the growth of our bank.

In the past, we have been successful in procuring additional capital from the capital markets (via public and private offerings of trust preferred securities and common stock). This additional capital was required to support our growth. As of December 31, 2006, we believe we have sufficient capital to support our current growth plans. However, expansion by acquisition of other banks or by branching into a new geographic market could result in issuance of additional capital, including additional common shares.

Critical Accounting Estimates

The accounting principles we follow and our methods of applying these principles conform with United States generally accepted accounting principles and with general practices within the banking industry. In connection with the application of those principles, we have made judgments and estimates which, in the case of the determination of our allowance for loan losses, the adoption of SFAS No. 123 (revised 2004), "Share Based Payments" ("SFAS No. 123(R)") and the accounting for the Cavalry merger have been critical to the determination of our financial position and results of operations.

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

Larger balance commercial and commercial real estate loans are impaired when, based on current information and events, it is probable that we will be unable to collect all amounts due according to the contractual terms of the loan agreement. Collection of all amounts due according to the contractual terms means that both the contractual interest payments and the contractual principal payments of a loan will be collected as scheduled in the loan agreement.

An impairment loss is recognized if the present value of expected future cash flows from the loan is less than the recorded investment in the loan (recorded investment in the loan is the principal balance plus any accrued interest, net deferred loan fees or costs and unamortized premium or discount, and does not reflect any direct write-down of the investment). The impairment loss is recognized through the allowance. Loans that are impaired are recorded at the present value of expected future cash flows discounted at the loan’s effective interest rate, or if the loan is collateral dependent, impairment measurement is based on the fair value of the collateral, less estimated disposal costs. Income is recognized on impaired loans on a cash basis.

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

In assessing the adequacy of the consolidated allowance, we also consider the results of our ongoing independent loan review process. We undertake this process both to ascertain whether there are loans in the portfolio whose credit quality has weakened over time and to assist in our overall evaluation of the risk characteristics of the entire loan portfolio. Our loan review process includes the judgment of management, the input from our independent loan reviewer, and reviews that may have been conducted by bank regulatory agencies as part of their usual examination process. We incorporate loan review results in the determination of whether or not it is probable that we will be able to collect all amounts due according to the contractual terms of a loan.

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

The allowance allocation for commercial and commercial real estate loans begins with a process of estimating the probable losses inherent for these types of loans. The estimates for these loans are established by category and based on our internal system of credit risk ratings and historical loss data for industry and various peer bank groups. The estimated loan loss allocation rate for our internal system of credit risk grades for commercial and commercial real estate is based on management’s experience with similarly graded loans, discussions with banking regulators and our internal loan review processes. We then weight the allocation methodologies for the commercial and commercial real estate portfolios and determine a weighted average allocation for these portfolios.

The allowance allocation for consumer and consumer real estate loans which includes installment, home equity, consumer mortgages, automobiles and others is established for each of the categories by estimating losses inherent in that particular category of consumer and consumer real estate loans. The estimated loan loss allocation rate for each category is based on management's experience. Additionally, consumer and consumer real estate loans are analyzed based on our actual loss rates, industry loss rates and loss rates of various peer bank groups. Consumer and consumer real estate loans are evaluated as a group by category (i.e. retail real estate, installment, etc.) rather than on an individual loan basis because these loans are smaller and homogeneous. We weight the allocation methodologies for the consumer and consumer real estate portfolios and determine a weighted average allocation for these portfolios.

The estimated loan loss allocation for all four loan portfolio segments is then adjusted for management's estimate of probable losses for several "environmental" factors. The allocation for environmental factors is particularly subjective and does not lend itself to exact mathematical calculation. This amount represents estimated inherent credit losses which may exist, but have not yet been identified, as of the balance sheet date based upon quarterly trend assessments in delinquent and nonaccrual loans, unanticipated charge-offs, credit concentration changes, prevailing economic conditions, changes in lending personnel experience, changes in lending policies or procedures and other influencing factors. These environmental factors are considered for each of the four loan segments and the allowance allocation as determined by the processes noted above for each segment is increased or decreased based on the incremental assessment of these various "environmental" factors.

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

For the quarters ended March 31, 2006 and June 30, 2006, we assessed the allowance in two separate processes using methodologies for both the Pinnacle portfolios as the portfolios existed prior to the merger with Cavalry (the "Nashville market") and the Rutherford County portfolio. Our methodology for the first two quarters of 2006 was consistent with the past methodologies of Pinnacle Financial and Cavalry on a stand-alone basis. In view of the acquisition**,** we evaluated the respective assessment methodologies and made certain changes as noted above and implemented such changes during the third quarter of 2006. The revised assessment methodology did not significantly impact our recorded allowance for loan losses.

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

We adopted SFAS No. 123(R) using the modified prospective method which requires the application of the accounting standard as of January 1, 2006. The accompanying consolidated financial statements for 2006 reflect the impact of adopting SFAS No. 123(R). In accordance with the modified prospective method, the consolidated financial statements for prior periods have not been restated to reflect, and do not include, the impact of SFAS No. 123(R). Application of SFAS No. 123(R) required us to assess numerous factors including the historical volatility of our stock price, anticipated option forfeitures and estimates concerning the length of time that our options would remain unexercised. Many of these assessments impact the fair value of the underlying stock option more significantly than others and changes to these assessments in future periods could be significant. We believe the assumptions we have incorporated into our stock option fair value assessments are reasonable.

Accounting for the Cavalry Acquisition - We recorded the assets and liabilities of Cavalry as of March 15, 2006 at estimated fair value. Arriving at these fair values required numerous assumptions regarding the economic life of assets, decay rates for liabilities and other factors. We engaged a third party to assist us in valuing certain of the financial assets and liabilities of Cavalry. We also engaged a real estate appraisal firm to value the more significant properties that were acquired by us in the acquisition. We also engaged a firm to analyze the income tax implications of the assets and liabilities acquired as well as the deductibility of the various cash payments we and the former Cavalry made as a result of this merger. As a result, we consider the values we have assigned to the acquired assets and liabilities of Cavalry to be reasonable and consistent with the application of generally accepted accounting

principles. However, we are still in the process of obtaining and evaluating certain other information. Accordingly, we may have to reassess our purchase price allocations. We believe that we will conclude the allocation of the purchase price to the acquired net assets during the first quarter of 2007.

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

Goodwill and intangible assets that have indefinite useful lives are tested annually for impairment, and are tested for impairment more frequently if events and circumstances indicate that the asset might be impaired. An impairment loss is recognized to the extent that the carrying amount exceeds the asset's fair value. Our annual assessment date is September 30. Should we determine in a future period that the goodwill recorded in connection with our acquisition of Cavalry has been impaired, then a charge to our earnings will be recorded in the period such determination is made.

Results of Operations

Our results for fiscal years 2006, 2005 and 2004 were highlighted by the continued growth in loans and other earning assets and deposits, which resulted in increased revenues and expenses. The following is a summary of our results of operations (dollars in thousands):

	Years ended December 31,		2006-2005	Year ended December 31,	2005-2004
	2006	*2005*	*Percent Increase (Decrease)*	*2004*	*Percent Increase (Decrease)*
Interest income	$ 109,696	$ 46,308	*136.9%*	$ 27,679	*67.3%*
Interest expense	48,743	17,270	*182.2%*	7,415	*132.9%*
Net interest income	60,953	29,038	*109.9%*	20,264	*43.3%*
Provision for loan losses	3,732	2,152	*73.4%*	2,948	*(27.0%)*
Net interest income after provision for loan losses	57,221	26,886	*112.8%*	17,316	*55.3%*
Noninterest income	15,786	5,394	*192.7%*	4,978	*8.4%*
Noninterest expense	46,624	21,032	*121.7%*	14,803	*42.1%*
Net income before income taxes	26,383	11,248	*134.6%*	7,491	*50.2%*
Income tax expense	8,456	3,193	*164.8%*	2,172	*47.0%*
Net income	$ 17,927	$ 8,055	*122.6%*	$ 5,319	*51.4%*

Our results for the year ended December 31, 2006 included merger related expense. Excluding merger related expense from our net income resulted in diluted net income per common share for the year ended December 31, 2006 of $1.25. A comparison of these amounts to the same periods in 2005 and 2004 and a reconciliation of this non-GAAP financial measure follow:

Reconciliation of Non-GAAP financial measures:			
Net income	$ 17,927	$ 8,055	$ 5,319
Merger related expense net of tax of $642 for the year ended December 31, 2006	994	-	-
Net income excluding merger related expense	$ 18,921	$ 8,055	$ 5,319
Fully-diluted net income per common share	$ 1.18	$ 0.85	$ 0.61
Fully-diluted net income per common share, excluding merger related expense	$ 1.25	$ 0.85	$ 0.61

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

Pinnacle Financial believes that these non-GAAP financial measures excluding the impact of merger related expenses facilitate making period-to-period comparisons and are meaningful indications of its operating performance and because we believe that the information provides investors with additional information to evaluate our past financial results and ongoing operational performance.

Pinnacle Financial's management utilizes this non-GAAP financial information to compare our operating performance versus the comparable periods in 2005 and 2004 and utilized non-GAAP diluted earnings per share for the 2006 fiscal year (excluding the merger related expenses) in calculating whether or not we met the performance targets of our 2006 Annual Cash Incentive Plan and our earnings per share targets in our restricted stock award agreements.

Net Interest Income. Net interest income represents the amount by which interest earned on various earning assets exceeds interest paid on deposits and other interest bearing liabilities and is the most significant component of our earnings. For the year ended December 31, 2006, we recorded net interest income of $60,953,000, which resulted in a net interest margin of 3.90%. For the year ended December 31, 2005, we recorded net interest income of $29,038,000, which resulted in a net interest margin of 3.60%. For the year ended December 31, 2004, we recorded net interest income of $20,264,000, which resulted in a net interest margin of 3.62% for the year.

The following table sets forth the amount of our average balances, interest income or interest expense for each category of interest-earning assets and interest-bearing liabilities and the average interest rate for total interest-earning assets and total interest-bearing liabilities, net interest spread and net interest margin for each of the years in the three-year period ended December 31, 2006 (dollars in thousands):

	2006			***2005***			***2004***		
	Average Balances	***Interest***	***Rates/ Yields***	***Average Balances***	***Interest***	***Rates/ Yields***	***Average Balances***	***Interest***	***Rates/ Yields***
Interest-earning assets:									
Loans (1)	$ 1,226,803	$ 92,006	7.50%	$ 562,061	$ 35,167	6.26%	$ 373,287	$ 19,910	5.34%
Securities:									
Taxable	254,906	12,615	4.95%	204,532	9,086	4.44%	162,712	6,936	4.26%
Tax-exempt (2)	54,270	2,016	4.90%	31,578	1,116	4.66%	13,899	491	4.55%
Federal funds sold and other	53,562	3,059	6.87%	24,541	939	3.90%	17,610	342	1.94%
Total interest-earning assets	1,589,541	109,696	6.95%	822,712	46,308	5.68%	567,508	27,679	4.91%
Nonearning assets	189,675			47,322			29,872		
Total assets	$ 1,779,216			$ 870,034			$ 597,380		
Interest-bearing liabilities:									
Interest-bearing deposits:									
Interest checking	$ 171,637	$ 4,074	2.37%	$ 65,119	$ 659	1.01%	$ 38,544	$ 191	0.50%
Savings and money market	435,082	13,532	3.11%	250,136	4,860	1.94%	173,318	1,520	0.88%
Certificates of deposit	516,394	22,426	4.34%	256,056	8,171	3.19%	182,221	4,118	2.26%
Total deposits	1,123,113	40,032	3.56%	571,311	13,690	2.40%	394,083	5,829	1.48%
Securities sold under agreements to repurchase	101,144	4,329	4.28%	54,811	1,315	2.40%	20,466	104	0.51%
Federal funds purchased	1,260	66	5.26%	1,607	57	3.51%	1,705	24	1.43%
Federal Home Loan Bank advances	38,468	1,812	4.71%	42,326	1,222	2.89%	46,284	1,027	2.22%

Subordinated debt	37,372	2,504	6.70%	16,361	986	6.02%	10,310	431	4.18%
Total interest-bearing liabilities	1,301,357	48,743	3.75%	686,416	17,270	2.52%	472,848	7,415	1.57%
Noninterest-bearing deposits	259,585	-	-	120,007	-	-	78,616	-	-
Total deposits and interest-bearing liabilities	1,560,942	48,743	3.12%	806,423	17,270	2.14%	551,464	7,415	1.34%
Other liabilities	11,105			2,730			2,707		
Stockholders' equity	207,169			60,881			43,209		
	$ 1,779,216			$ 870,034			$ 597,380		
Net interest income		$ 60,953			$ 29,038			$ 20,264	
Net interest spread (3)			3.20%			3.16%			3.34%
Net interest margin			3.90%			3.60%			3.62%

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(1) Average balances of nonperforming loans are included in the above amounts.

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

(3) The net interest spread calculation excludes the impact of demand deposits. Had the impact of demand deposits been included, the net interest spread for the year ended December 31, 2006 would have been 3.83% compared to a net interest spread for the years ended December 31, 2005 and 2004 of 3.54% and 3.56%, respectively.

As noted above, the net interest margin for 2006 was 3.90% compared to a net interest margin of 3.60% for the same period in 2005. The net change in the net interest margin was significant because the net increases in the yield on interest-earning assets was approximately 127 basis points compared to the increase in the rate paid on interest-bearing liabilities of 123 basis points. The net interest margin for 2004 was 3.62%. Other matters related to the changes in net interest income, net interest yields and rates, and net interest margin are presented below:

· Our loan yields increased between 2006 and 2005 by 124 basis points. The pricing of a large portion of our loan portfolio is tied to our prime rate. Our weighted average prime rate for 2004 was 4.40% compared to 6.25% in 2005 and 8.02% in 2006. The rates were higher in 2006 and 2005 due to periodic increases in our prime lending rate which moves in concert with the Federal Reserve's changes to its Federal funds rate.

· We have been able to grow our funding base significantly. For asset/liability management purposes in 2005 and 2006, we elected to allocate a greater proportion of such funds to our loan portfolio versus our securities and shorter-term investment portfolio than in 2004. For 2006, average loan balances were 69% of total assets compared to 65% in 2005 and 62% in 2004. Loans generally have higher yields than do securities and other shorter-term investments. This change in allocation contributed to the increase in the overall total interest earning asset yields between the three years.

· During 2006, overall deposit rates were higher than those rates for the comparable period in 2005 and 2004. Changes in interest rates paid on such products as interest checking, savings and money market accounts, securities sold under agreements to repurchase and Federal funds purchased will generally increase or decrease in a manner that is consistent with changes in the short-term rate environment. During 2006, as was the case with our prime lending rate, short-term rates were higher than in 2005 and 2004. We also monitor the pricing of similar products by our primary competitors. The changes in the short-term rate environment and the pricing of our primary competitors required us to increase these rates in 2006 compared to the previous periods which resulted in increased rates paid on interest bearing liabilities.

· During 2006, the average balances of noninterest bearing deposit balances, interest bearing transaction accounts, savings and money market accounts and securities sold under agreements to repurchase amounted to 62% of our total funding compared to 61% in 2005 and 56% in 2004. These funding sources generally have lower rates than do other funding sources, such as certificates of deposit and other borrowings.

· Also impacting the net interest margin during 2006 compared to 2005 and 2004 was pricing of our floating rate subordinated indebtedness which comprises approximately $30 million of our aggregate subordinated indebtedness as of December 31, 2006. The interest rate charged on this indebtedness is generally higher than other funding sources. The rate charged on the floating rate portion of the indebtedness is determined in relation to the three-month LIBOR index and reprices quarterly. During 2006, the short-term interest rate environment was higher than previous years, and, as a result, the pricing for this funding source was higher in 2006. Additionally, in September 2005, we issued an additional $20 million in fixed rate subordinated indebtedness at a rate of 5.848% for the first five years with a floating rate determined in relation to three-month LIBOR thereafter.

Prior to the merger with Cavalry, Cavalry's net interest margin was higher than ours. As a result, since the merger date, our net interest margin is higher compared to the same periods last year due to the impact of the net assets of Cavalry being included with our net assets and because Cavalry's cost of funding were less than ours.

We believe that interest rates should remain fairly stable over the next few quarters. We also believe we will continue to increase net interest income through growth in earning assets with particular emphasis on floating rate lending. However, the additional revenues provided by increased floating rate loans may not be sufficient to overcome any immediate increases in funding costs such that we are unable to maintain our current net interest margin. As a result, even though our net interest income will continue to increase, our net interest margins will likely decrease due to new deposits being obtained at current market rates which are higher than our current average cost of funding and the continued competitive deposit pricing in our market area. We believe our net interest margin for 2007 should be within a range of 3.60% to 3.80%, compared to 3.74% for the fourth quarter of 2006.

Conversely, should interest rates begin to fluctuate over the next few quarters, we believe that in a rising interest rate environment we would be able to reprice our assets more quickly than our funding costs and thus we believe we would be able to grow our net interest income and net interest margins in such an environment. Conversely, in a falling rate environment, this would serve to have the opposite effect on our net interest income and net interest margins. In a falling rate environment, we may not be able to reduce our deposit funding costs as quickly as our assets would reprice due to market pressures, while our net interest income would not increase as fast as it would likely increase under a rising or stable interest rate environment.

Rate and Volume Analysis. Net interest income increased by $31,915,000 between the years ended December 31, 2006 and 2005 and by $8,774,000 between the years ended December 31, 2005 and 2004. The following is an analysis of the changes in our net interest income comparing the changes attributable to rates and those attributable to volumes (dollars in thousands):

	2006 Compared to 2005 Increase (decrease) due to			***2005 Compared to 2004 Increase (decrease) due to***		
	Rate	***Volume***	***Net***	***Rate***	***Volume***	***Net***
Interest-earning assets:						
Loans	$ 6,970	$ 49,869	$ 56,839	$ 3,434	$ 11,823	$ 15,257
Securities:						
Taxable	1,043	2,486	3,529	293	1,857	2,150
Tax-exempt	76	824	900	15	610	625
Federal funds sold	729	1,391	2,120	345	252	597
Total interest-earning assets	8,818	54,570	63,388	4,087	14,542	18,629
Interest-bearing liabilities:						
Interest-bearing deposits:						
Interest checking	$ 886	$ 2,529	$ 3,415	$ 197	$ 271	$ 468
Savings and money market	2,927	5,745	8,672	1,837	1,503	3,340
Certificates of deposit	2,945	11,310	14,255	1,695	2,358	4,053
Total deposits	6,758	19,584	26,342	3,729	4,132	7,861
Securities sold under agreements to repurchase	1,031	1,983	3,014	387	824	1,211
Federal funds purchased	28	(19)	9	35	(2)	33
Federal Home Loan Bank advances	770	(180)	590	310	(115)	195
Subordinated debt	111	1,407	1,518	190	365	555
Total interest-bearing liabilities	8,698	22,775	31,473	4,651	5,204	9,855
Net interest income	$ 120	$ 31,795	$ 31,915	$ (564)	$ 9,338	$ 8,774

Changes in net interest income are attributed to either changes in average balances (volume change) or changes in average rates (rate change) for earning assets and sources of funds on which interest is received or paid. Volume change is calculated as change in volume times the previous rate while rate change is change in rate times the previous volume. The change attributed to rates and volumes (change in rate times change in volume) is considered above as a change in volume.

Provision *for Loan Losses.* The provision for loan losses represents a charge to earnings necessary to establish an allowance for loan losses that, in our management's evaluation, should be adequate to provide coverage for the inherent losses on outstanding loans. The provision for loan losses amounted to $3,732,000, $2,152,000 and $2,948,000 for the years ended December 31, 2006, 2005 and 2004, respectively.

Based upon our management's evaluation of the loan portfolio, we believe the allowance for loan losses to be adequate to absorb our estimate of probable losses existing in the loan portfolio at December 31, 2006. A significant increase in loan growth and increased net-charge offs in 2006 were the primary reasons for the increased provision expense in 2006 when compared to 2005. A significant decrease in gross charge-offs, increases in recoveries of previously charged-off loans and improvement in the overall credit quality of our loan portfolio, net of the effect of an increase in loan volumes, were the primary causes for the decrease in our provision for loan losses in 2005 when compared to 2004.

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

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

The following is the makeup of our noninterest income for the years ended December 31, 2006, 2005 and 2004 (dollars in thousands):

	Years ended December 31,		***2006-2005 Percent Increase (Decrease)***	***Year ended December 31,***	***2005-2004 Percent Increase (Decrease)***
	2006	***2005***		***2004***	
Noninterest income:					
Service charges on deposit accounts	$ 4,645	$ 978	*374.9%*	$ 956	*2.3%*
Investment services	2,463	1,836	*34.2%*	1,657	*10.8%*
Gains on sales of loans and loan participations, net:					
Fees from the origination and sale of mortgage loans, net of sales commissions	1,448	1,096	*32.1%*	760	*44.2%*
Gains on loan participations sold, net	420	152	*176.3%*	514	*(70.4%)*
Insurance sales commissions	2,123	-	-	-	-
Gain on sale of investment securities, net	-	114	*(100.0%)*	357	*(68.1%)*
Trust fees	1,181	-	-	-	-
Other noninterest income:					
ATM and other consumer fees	1,796	90	*1895.6%*	58	*55.2%*

Letters of credit fees		506		527	*(4.0%)*	272	*93.8%*
Bank-owned life insurance		470		74	*535.1%*	78	*(5.1%)*
Equity in earnings of Collateral Plus, LLC		120		216	*(44.4%)*	9	-
Other noninterest income		614		311	*97.4%*	317	*(1.9%)*
Total noninterest income	$	15,786	$	5,394	*192.7%* $	4,978	*8.4%*

Service charge income for 2006 increased over that of 2005 and 2004 due to increased volumes from our Rutherford County market and an increase in the number of Nashville deposit accounts subject to service charges. However, for the Nashville accounts, the increase in service charges in 2006 when compared to 2005 and 2004 was offset by the earnings credit rate provided by Pinnacle National to its commercial deposit customers. This earnings credit rate serves to reduce the deposit service charges for our commercial customers and is based on the average balances of their checking accounts at Pinnacle National.

Also included in noninterest income are commissions and fees from our financial advisory unit, Pinnacle Asset Management, a division of Pinnacle National. At December 31, 2006, Pinnacle Asset Management was receiving commissions and fees in connection with approximately $597 million in brokerage assets held with Raymond James Financial Services, Inc. compared to $441 million at December 31, 2005. Additionally, at December 31, 2006, our trust department was receiving fees on approximately $395 million in assets and in 2006 we earned $2.1 million for insurance commissions. Following our merger with Cavalry, we now offer trust services through Pinnacle National's trust division and insurance services through Miller and Loughry Insurance and Services, Inc. which we believe will increase our noninterest income in future periods.

Additionally, mortgage related fees also provided for a significant portion of the increase in noninterest income between 2006 and previous periods. These mortgage fees are for loans originated in both the Nashville and Rutherford County markets that are subsequently sold to third-party investors. All of these loan sales transfer servicing rights to the buyer. Generally, mortgage origination fees increase in lower interest rate environments and decrease in rising interest rate environments. As a result, mortgage origination fees may fluctuate greatly in response to a changing rate environment.

We also sell certain commercial loan participations to our correspondent banks. Such sales are primarily related to new lending transactions in excess of internal loan limits or industry concentration limits. At December 31, 2006 and pursuant to participation agreements with these correspondents, we had participated approximately $95.4 million of originated loans to these other banks compared to $60.3 million at December 31, 2005. These participation agreements have various provisions regarding collateral position, pricing and other matters. Many of these agreements provide that we pay the correspondent less than the loan's contracted interest rate. Pursuant to SFAS No. 140, *"Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities — a replacement of FASB Statement No. 125,"* in those transactions whereby the correspondent is receiving a lesser amount of interest than the amount owed by the customer, we record a net gain along with a corresponding asset representing the present value of our net retained cash flows. The resulting asset is amortized over the term of the loan. Conversely, should a loan be paid prior to maturity, any remaining unamortized asset is charged as a reduction to gains on loan participations sold. We recorded gains, net of amortization expense related to the aforementioned retained cash flow asset, of $420,000, $152,000 and $234,000 during each of the years in the three-year period ended December 31, 2006 related to the loan participation transactions. We intend to maintain relationships with our correspondents in order to sell participations in future loans to these or other correspondents primarily due to limitations on loans to a single borrower or industry concentrations. In general, the Cavalry merger has resulted in an increase in capital which has resulted in increased lending limits for such items as loans to a single borrower and loans to a single industry such that our need to participate such loans in the future may be reduced. In any event, the timing of participations may cause the level of gains, if any, to vary significantly.

During 2004, we sold a loan to an individual and recorded a gain on the sale of this loan of $280,000, which is also included in gains on sale of loans. We had acquired this loan in a settlement agreement with a borrower for which we had no basis in the loan.

Also included in noninterest income for 2005 and 2004, were net gains of approximately $114,000 and $357,000 realized from the sale of available-for-sale securities.

Included in other noninterest income are miscellaneous consumer fees, such as ATM revenues, merchant card and other electronic banking revenues. We experienced a significant increase in these revenues in 2006 compared to previous periods due primarily to the merger with Cavalry as Cavalry had a larger presence in these business lines than we did.

Noninterest income from the cash surrender value of bank-owned life insurance increased significantly between 2006 and the previous periods. In connection with the Cavalry merger, we became the owner and beneficiary of several life

insurance policies on former Cavalry executives. These policies were acquired by Cavalry in connection with a supplemental retirement plan for these former Cavalry executives.

At the end of 2004, we formed a wholly-owned subsidiary, Pinnacle Credit Enhancement Holdings, Inc. (“PCEH”). PCEH owns a 24.5% interest in Collateral Plus, LLC. Collateral Plus, LLC serves as an intermediary between investors and borrowers in certain financial transactions whereby the borrowers require enhanced collateral in the form of guarantees or letters of credit issued by the investors for the benefit of banks and other financial institutions. Our equity in the earnings of Collateral Plus, LLC for the years ended December 31, 2006 and 2005 was $120,000 and $216,000, respectively.

Additional other noninterest income increased by approximately $303,000 during 2006 when compared to 2005 and decreased by $6,000 in 2005 when compared to 2004. Most of these revenues are for loan late charges and other fees.

Noninterest Expense. Noninterest expense consists of salaries and employee benefits, equipment and occupancy expenses, and other operating expenses. The following is the makeup of our noninterest expense for the years ended December 31, 2006, 2005 and 2004 (dollars in thousands):

	Years ended December 31,		***2006-2005 Percent Increase (Decrease)***	***Year ended December 31,***	***2005-2004 Percent Increase (Decrease)***
	2006	***2005***		***2004***	
Noninterest expense:					
Salaries and employee benefits:					
Salaries	$ 18,017	$ 8,592	*109.7%*	$ 5,897	*45.7%*
Commissions	1,298	714	*81.8%*	610	*17.0%*
Other compensation, primarily incentives	4,209	2,101	*100.3%*	1,217	*72.6%*
Equity compensation expenses	1,475	245	*502.0%*	43	*469.8%*
Employee benefits and other	2,470	1,479	*67.0%*	1,279	*15.6%*
Total salaries and employee benefits	27,469	13,131	*109.2%*	9,046	*45.2%*
Equipment and occupancy	7,522	3,767	*99.7%*	2,406	*56.6%*
Marketing and business development	1,234	698	*76.8%*	607	*15.0%*
Postage and supplies	1,510	618	*144.3%*	492	*25.6%*
Amortization of core deposit intangible	1,783	-	-	-	-
Other noninterest expense:					
Accounting and auditing	742	646	*14.9%*	540	*19.6%*
Consultants, including independent loan review	320	123	*160.2%*	182	*(32.4)%*
Legal, including borrower-related charges	310	245	*26.5%*	280	*(12.5)%*
OCC exam fees	257	182	*41.2%*	131	*38.9%*
Directors' fees	257	229	*12.2%*	138	*65.9%*
Insurance, including FDIC assessments	687	322	*113.4%*	256	*25.8%*
Other noninterest expense	2,897	1,071	*170.5%*	725	*47.7%*
Total other noninterest expense	5,470	2,818	*94.1%*	2,252	*25.1%*
Merger related expense	1,636	-	-	-	-
Total noninterest expense	$ 46,624	$ 21,032	*121.7%*	$ 14,803	*42.1%*

Expenses have generally increased between the above periods due to our merger with Cavalry, personnel additions occurring throughout each period, the continued development of our branch network and other expenses which increase in relation to our growth rate. We anticipate continued increases in our expenses in the future for such items as additional personnel, the opening of additional branches, audit expenses and other expenses which tend to increase in relation to our growth. Additionally, we adopted SFAS No. 123(R) in 2006 which addresses the accounting for employee equity based incentives. Our compensation expense will increase in all future periods as a result of adopting this accounting pronouncement. In 2006, approximately $1.01 million of compensation expense related to stock options is included in equity compensation expense.

At December 31, 2006, we employed 404.0 full time equivalent employees compared to 156.5 at December 31, 2005 and 122.0 at the end of 2004. We intend to continue to add employees to our work force for the foreseeable future,

which will cause our salary costs to increase in future periods.

We believe that variable pay incentives are a valuable tool in motivating an employee base that is focused on providing our clients effective financial advice and increasing shareholder value. As a result, and unlike many other financial institutions, substantially all of our employees are eligible to participate in an annual cash incentive plan. Included in the salary and employee benefits amounts for the years ended December 31, 2006, 2005 and 2004, were $4,104,000, $2,031,000 and $1,135,000, respectively, related to variable cash awards. This expense will fluctuate from year to year and quarter to quarter based on the estimation of achievement of performance targets and the increase in the number of associates eligible to receive the award. For 2006, the actual award to be paid to qualifying associates equaled 120% of their targeted award. For 2005, the actual award to be paid to associates equaled 100% of their targeted award compared to 80% in 2004. The incentive plan for 2007 is expected to be structured similarly to prior year plans in that the award is based on the achievement of soundness and earnings objectives. Because of the relative experience of our associates, our compensation costs are, and we expect will continue to be, higher on a per associate basis than other financial institutions of a similar asset size; however, we believe the experience and engagement of our associates also allows us to employ fewer people than most financial institutions our size.

Equipment and occupancy expenses in 2006 were greater than the 2005 amount by 99.7% due primarily to the additional branches and equipment acquired with the Cavalry merger. Additionally, during 2004, we opened a new branch office in the West End area of Nashville. In January of 2005 we opened an office in Franklin, Tennessee and in the second quarter of 2005 we opened an office in Hendersonville, Tennessee. We plan on opening an office in the Donelson area of Nashville, Tennessee in the first quarter of 2007. These branch additions contributed to the increase in our equipment and occupancy expenses throughout the three year period and will contribute to increases in expenses in the future.

Marketing and other business development and postage and supplies expenses are higher in 2006 compared to 2005 and 2004 due to increases in the number of customers and prospective customers; increases in the number of customer contact personnel and the corresponding increases in customer entertainment; and other business development expenses. The addition of customers from the Cavalry merger had a direct impact on these increased charges.

Other noninterest expenses increased 94.1% in 2006 over 2005 and 25.1% in 2005 over 2004. Most of these increases are attributable to increased audit and accounting fees, legal fees and insurance expenses. Also contributing to the increases in 2006 are incidental variable costs related to deposit gathering and lending. Examples include expenses related to ATM networks, correspondent bank service charges, check losses, appraisal expenses, closing attorney expenses and other items which have increased significantly as a result of the Cavalry merger.

Included in noninterest expense for 2006 is $1.78 million of amortization of the core deposit intangible and $1.64 million of merger related expenses directly associated with the Cavalry merger. In connection with the Cavalry merger, we recognized an intangible asset of $13.2 million related to the fair value of Cavalry's core deposit base as of the merger date. This identified intangible is being amortized over seven years using an accelerated method which anticipates the life of the underlying deposits to which the intangible is attributable. For the year ended December 31, 2006, approximately $1.78 million was recognized in the statement of income. Amortization expense associated with the core deposit intangible will approximate $1.8 million to $2.1 million per year for the next five years with lesser amounts for the remaining two years.

The merger related charges consisted of integration costs incurred in connection with the merger, including accelerated depreciation associated with software and other technology assets whose useful lives were shortened as a result of the Cavalry acquisition. We do not anticipate any additional merger related expenses associated with the Cavalry transaction in 2007.

Our efficiency ratio (ratio of noninterest expense to the sum of net interest income and noninterest income) was 60.8% in 2006 compared to 61.1% in 2005 and to 58.6% in 2004. The efficiency ratio measures the amount of expense that is incurred to generate a dollar of revenue.

Income Taxes. The effective income tax expense rate for the year ended December 31, 2006 was approximately 32.1%, compared to an effective income tax expense rate for years ended December 31, 2005 and 2004 of approximately 28.4% and 29.0%, respectively. The increase in the effective tax rate in 2006 was due primarily to the additional earnings being taxed at a higher rate as the various tax savings initiatives (e.g., municipal bond income) had a lesser impact in 2006 when compared to the previous periods. Additionally, the impact of our incentive stock options and their treatment pursuant to the adoption of SFAS No. 123(R) also contributed to the increase in our effective rate in 2006.

The lower effective tax rate in 2005 and 2004 was primarily due to additional tax-exempt investment income and the formation of a real estate investment trust during the fourth quarter of 2004, which provides us with an alternative vehicle for raising capital should we so desire. Additionally, the ownership structure of this real estate investment trust provides certain state income tax benefits which also lowered our effective tax rate. Also for 2005 and 2004 our

effective rate was impacted by Federal tax credits related to the New Markets Tax Credit program whereby a subsidiary of Pinnacle National has been awarded approximately $2.3 million in future Federal tax credits to be realized thru 2010. The credit available for each of the years in the three-year period ended December 31, 2006 was $300,000. Pinnacle Financial believes that it and its subsidiary has complied with the various regulatory provisions of the New Markets Tax Credit program and has claimed the credit in its 2004 and 2005 Federal income tax return and will claim the credit in 2006.

Financial Condition

Our consolidated balance sheet at December 31, 2006 reflects significant growth since December 31, 2004. Total assets grew from $727 million at December 31, 2004 to $1.02 billion at December 31, 2005 to $2.14 billion at December 31, 2006. Total deposits grew $812 million during 2006 and $239 million during 2005. Excluding the deposits acquired with the Cavalry acquisition on March 15, 2006 of $584 million, total deposits increased by $228 million in 2006. We invested substantially all of the additional deposits and other fundings in loans, which grew by $850 million (of which $551 million was acquired with the Cavalry acquisition) and $176 million during 2005, and securities, which increased by $67 million in 2006 (of which $39 million was acquired with the Cavalry acquisition) and $71 million in 2005.

Loans. The composition of loans at December 31 for each of the past five years and the percentage (%) of each classification to total loans are summarized as follows (dollars in thousands):

	2006		***2005***		***2004***		***2003***		***2002***	
	Amount	***Percent***	***Amount***	***Percent***	***Amount***	***Percent***	***Amount***	***Percent***	***Amount***	***Percent***
Commercial real estate - Mortgage	$ 284,302	19.0%	$148,102	22.9%	$117,123	24.8%	$ 68,507	23.1%	$ 58,965	28.1%
Commercial real estate - Construction	161,903	10.8%	30,295	4.7%	8,428	1.8%	8,211	2.8%	5,397	2.6%
Commercial - Other	608,530	40.6%	239,129	36.9%	189,456	40.1%	129,882	43.7%	98,722	47.1%
Total commercial	1,054,735	70.4%	417,526	64.4%	315,007	66.7%	206,600	69.6%	163,084	77.8%
Consumer real estate - Mortgage	299,627	20.0%	169,953	26.2%	126,907	26.9%	76,042	25.6%	37,533	17.9%
Consumer real estate - Construction	91,194	6.1%	37,372	5.8%	14,991	3.2%	3,077	1.0%	1,971	0.9%
Consumer - Other	52,179	3.5%	23,173	3.6%	15,457	3.3%	11,285	3.8%	7,155	3.4%
Total consumer	443,000	29.6%	230,498	35.6%	157,355	33.3%	90,404	30.4%	46,659	22.2%
Total loans	$ 1,497,735	100.0%	$648,024	100.0%	$472,362	100.0%	$297,004	100.0%	$209,743	100.0%

Primarily due to the Cavalry merger, we have increased the percentage of our outstanding loans in commercial real estate construction significantly. These types of loans require that we maintain effective credit and construction monitoring systems. Also as a result of the Cavalry merger, we have increased our resources in this area so that we can attempt to effectively manage this area of exposure through utilization of experienced professionals who are well-trained in this type of lending and who have significant experience in our geographic market.

The following table classifies our fixed and variable rate loans at December 31, 2006 according to contractual maturities of (1) one year or less, (2) after one year through five years, and (3) after five years. The table also classifies our variable rate loans pursuant to the contractual repricing dates of the underlying loans (dollars in thousands):

Amounts at December 31, 2006

	Fixed Rates	Variable Rates	Totals	At December 31, 2006	At December 31, 2005
Based on contractual maturity:					
Due within one year	$ 81,576	$ 531,615	$ 613,191	*40.9%*	*34.5%*
Due in one year to five years	444,357	152,627	596,984	*39.9%*	*39.4%*
Due after five years	79,557	208,003	287,560	*19.2%*	*26.0%*
Totals	$ 605,490	$ 892,245	$ 1,497,735	*100.0%*	*100.0%*
Based on contractual repricing dates:					
Daily floating rate	$ -	$ 689,954	$ 689,954	*46.1%*	*53.5%*
Due within one year	81,576	122,144	203,720	*13.6%*	*9.6%*
Due in one year to five years	444,357	68,203	512,560	*34.2%*	*28.8%*
Due after five years	79,557	11,944	91,501	*6.1%*	*8.1%*
Totals	$ 605,490	$ 892,245	$ 1,497,735	*100.0%*	*100.0%*

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

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

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

We discontinue the accrual of interest income when (1) there is a significant deterioration in the financial condition of the borrower and full repayment of principal and interest is not expected or (2) the principal or interest is more than 90 days past due, unless the loan is both well-secured and in the process of collection. At December 31, 2006, we had $7,070,000 in loans on nonaccrual compared to $460,000 at December 31, 2005. The increase in nonperforming loans between December 31, 2005 and December 31, 2006 was primarily related to loans acquired from Cavalry and identified as being impaired as discussed more fully below and several larger loans identified in the fourth quarter of 2006.

At December 31, 2006, we owned $995,000 in real estate which we had acquired from borrowers. Substantially all of this amount relates to homes that are in various stages of construction for which we believe we have adequate collateral.

There was approximately $737,000 in other loans 90 days past due and still accruing interest at December 31, 2006 compared to no loans at December 31, 2005. At December 31, 2006 and at December 31, 2005, no loans were deemed to be restructured loans. The following table is a summary of our nonperforming assets at December 31 for each of the years 2006, 2005, 2004, 2003 and 2002 (dollars in thousands):

		At December 31,			
	2006	***2005***	***2004***	***2003***	***2002***
Nonaccrual loans (1)	$ 7,070	$ 460	$ 561	$ 379	$ 1,845
Restructured loans	-	-	-	-	-
Other real estate owned	995	-	-	-	-
Total nonperforming assets	8,065	460	561	379	1,845
Accruing loans past due 90 days or more	737	0	146	182	22
Total nonperforming assets and accruing loans past due 90 days or more	8,802	460	707	561	1,867
Total loans outstanding	$ 1,497,735	$ 648,024	$ 472,362	$ 297,004	$ 209,743
Ratio of nonperforming assets and accruing loans past due 90 days or more to total loans outstanding at end of period	0.59%	0.07%	0.15%	0.19%	0.89%
Ratio of nonperforming assets and accruing loans past due 90 days or more to total allowance	54.61%	5.85%	12.51%	15.08%	69.74%

for loan losses at end of period

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(1) Interest income that would have been recorded in 2006 related to nonaccrual loans was $283,000 compared to $21,000 for the year ended December 31, 2005 and $41,000 for the year ended December 31, 2004, none of which is included in interest income or net income for the applicable periods.

Potential problem assets, which are not included in nonperforming assets, amounted to approximately $6.0 million, or 0.24% of total loans outstanding at December 31, 2006, compared to $1.3 million, or 0.20% of total loans outstanding at December 31, 2005. Potential problem assets represent those assets with a potential weakness or a well-defined weakness and where information about possible credit problems of borrowers has caused management to have serious doubts about the borrower's ability to comply with present repayment terms. This definition is believed to be substantially consistent with the standards established by the OCC, Pinnacle National's primary regulator for loans classified as substandard.

Allowance for Loan Losses (ALL). We maintain the ALL at a level that our management deems appropriate to adequately cover the inherent risks in the loan portfolio. As of December 31, 2006 and December 31, 2005, our allowance for loan losses was $16,118,000 and $7,858,000, respectively, which our management deemed to be adequate at each of the respective dates. The significant increase in our ALL was primarily the result of our merger with Cavalry. The judgments and estimates associated with our ALL determination are described under "Critical Accounting Estimates" above.

Approximately 70% of our loan portfolio at December 31, 2006 consisted of commercial loans compared to 64% at December 31, 2005. We periodically analyze our loan position with respect to our borrowers' industries to determine if a concentration of credit risk exists to any one or more industries. We have significant credit exposures arising from loans outstanding and unfunded lines of credit to borrowers in the home building and land subdividing industry, the trucking industry and to lessors of residential and commercial properties. We evaluate our exposure level to these industry groups periodically to determine the amount of additional allowance allocations due to these concentrations.

The following table sets forth, based on management's best estimate, the allocation of the ALL to types of loans as well as the unallocated portion as of December 31 for each of the past five years and the percentage of loans in each category to the total loans (dollars in thousands):

	2006		***2005***		***2004***		***2003***		***2002***	
	Amount	***Percent***	***Amount***	***Percent***	***Amount***	***Percent***	***Amount***	***Percent***	***Amount***	***Percent***
Commercial real estate - Mortgage	$ 4,550	19.0%	$ 1,488	22.9%	$ 1,205	24.8%	$ 723	23.1%	$ 508	28.1%
Commercial real estate - Construction	2,591	10.8%	630	4.7%	188	1.8%	103	2.8%	59	2.6%
Commercial - Other	6,517	40.6%	2,305	36.9%	1,711	40.1%	1,236	43.7%	977	47.1%
Total commercial	13,658	70.4%	4,423	64.4%	3,104	66.7%	2,062	69.6%	1,544	77.8%
Consumer real estate - Mortgage	913	20.0%	1,286	26.2%	869	26.9%	607	25.6%	392	17.9%
Consumer real estate - Construction	278	6.1%	60	5.8%	39	3.2%	10	1.0%	13	0.9%
Consumer - Other	870	3.5%	552	3.6%	396	3.3%	320	3.8%	193	3.4%
Total consumer	2,061	29.6%	1,898	35.6%	1,304	33.3%	937	30.4%	598	22.2%
Unallocated	399	NA	1,537	NA	1,242	NA	720	NA	535	NA
Total allowance for loan losses	$ 16,118	100.0%	$ 7,858	100.0%	$ 5,650	100.0%	$ 3,719	100.0%	$ 2,677	100.0%

In periods prior to 2006, the unallocated portion of the allowance consisted of dollar amounts specifically set aside for certain general factors influencing the allowance. These factors included ratio trends and other factors not specifically allocated to each category. Establishing the percentages for these factors was largely subjective but was supported by economic data, changes made in lending functions, and other support where appropriate. In 2006, the unallocated portion decreased significantly, due to a more comprehensive and refined model adopted to assess the adequacy of our allowance for loan losses. As a result, in 2006, the model was refined to embed many of the factors previously included in the unallocated portion of the allowance in the allocated amounts above for each category. This enhancement established a method whereby national and economic factors, concentrations in market segments, loan review and portfolio performance could be assigned to these specific categories.

The following is a summary of changes in the allowance for loan losses for the years ended December 31, 2006, 2005, 2004, 2003, and 2002 and the ratio of the allowance for loan losses to total loans as of the end of each period (dollars in thousands):

	For the year ended December 31,				
	2006	***2005***	***2004***	***2003***	***2002***
Balance at beginning of period	$ 7,858	$ 5,650	$ 3,719	$ 2,677	$ 1,832
Provision for loan losses	3,732	2,152	2,948	1,157	938
Allowance from Cavalry acquisition	5,102				
Charged-off loans:					
Commercial real estate - Mortgage	-	-	-	-	-
Commercial real estate - Construction	-	-	-	-	(91)
Commercial - Other	(436)	(61)	(50)	-	-
Consumer real estate - Mortgage	(46)	(38)	(834)	(123)	-
Consumer real estate - Construction	-	-	-	-	-
Consumer - Other	(336)	(109)	(148)	(44)	(2)
Total charged-off loans	(818)	(208)	(1,032)	(167)	(93)
Recoveries of previously charged-off loans:					
Commercial real estate - Mortgage	-	-	-	-	-
Commercial real estate - Construction	-	-	2	49	-
Commercial - Other	166	3	-	-	-
Consumer real estate - Mortgage	-	231	-	-	-
Consumer real estate - Construction	-	-	-	-	-
Consumer - Other	78	30	13	3	-
Total recoveries of previously charged-off loans	244	264	15	52	-
Net (charge-offs) recoveries	(574)	56	(1,017)	(115)	(93)
Balance at end of period	$ 16,118	$ 7,858	$ 5,650	$ 3,719	$ 2,677
Ratio of allowance for loan losses to total loans outstanding at end of period	1.08%	1.21%	1.20%	1.25%	1.28%
Ratio of net charge-offs (recoveries) to average loans outstanding for the period	0.05%	(0.01)%	0.27%	0.05%	0.05%

Included in charged-off loans in 2006 was one commercial borrower of approximately $404,000 which had been on nonaccruing status since the fourth quarter of 2005. Included in the charged-off loans during 2004 were two loans totaling approximately $884,000, $834,000 of which had been on nonaccrual status since June of 2004. We recovered approximately $231,000 of these particular charge-offs in 2005.

As a relatively new institution (excluding the impact of Cavalry), we do not have extensive loss experience comparable to more mature financial institutions; however, as our loan portfolio matures, we will have additional charge-offs as our losses materialize. We consider the amount and nature of our charge-offs in determining the adequacy of our allowance for loan losses.

Statement of Position 03-03, *Accounting for Certain Loans or Debt Securities Acquired in a Transfer* ("SOP 03-03") addresses accounting for differences between contractual cash flows and cash flows expected to be collected from an investor's initial investment in loans or debt securities (loans) acquired in a transfer if those differences are attributable, at least in part, to credit quality (i.e., "impaired loans"). SOP 03-03 does not apply to loans originated by us but does apply to the loans we acquired in our merger with Cavalry. Our assessment indicated that Cavalry had approximately $3.9 million of loans to which the application of the provisions of SOP 03-03 was required. As a result of the application of SOP 03-03, we recorded preliminary purchase accounting adjustments to reflect a reduction in loans and the allowance for loan losses of $1.0 million related to these impaired loans thus reducing the carrying value of these loans to $2.9 million at March 15, 2006. All of these loans were classified as nonperforming at December 31, 2006. The resulting impact on Cavalry's allowance for loan losses at March 15, 2006 was as follows:

Impact of SOP 03-03 on Rutherford County's allowance for loan losses at March 15, 2006	**Before Application of SOP 03-03**	**Impact of Application SOP 03-03**	**After Application of SOP 03-03**
Allowance for loan losses	$ 6,129	$ 1,027	$ 5,102
Fair value of Cavalry loans at acquisition date			$ 550,700
Allowance for loan losses to fair value of Cavalry loans at acquisition date	1.11%		0.93%

Investments. Our investment portfolio, consisting primarily of Federal agency bonds, state and municipal securities and mortgage-backed securities, amounted to $346.5 million, $279.1 million and $208.2 million at December 31, 2006, 2005 and 2004, respectively.

The following table shows the carrying value of investment securities according to contractual maturity classifications of (1) one year or less, (2) after one year through five years, (3) after five years through ten years, and (4) after ten years. Actual maturities may differ from contractual maturities of mortgage-backed securities because the mortgages underlying the securities may be called or prepaid with or without penalty. Therefore, these securities are not included in the maturity categories noted below as of December 31, 2006, 2005 and 2004 (dollars in thousands):

	At December 31,									
	U.S. Treasury securities		***U.S. government agency securities***		***State and Municipal securities***		***Corporate securities***		***Totals***	
	Amount	***Yield***	***Amount***	***Yield***	***Amount***	***Yield***	***Amount***	***Yield***	***Amount***	***Yield***
At December 31, 2006:										
Securities available-for-sale:										
Due in one year or less	$ -	-%	$ -	-%	$ 2,240	4.5%	$ 398	3.2%	$ 2,638	4.3%
Due in one year to five years	-	-%	30,105	4.7%	22,121	5.2%	1,427	3.4%	53,653	4.9%
Due in five years to ten years	-	-%	7,524	5.2%	28,848	5.4%	-	-%	36,372	5.4%
Due after ten years	-	-%	-	-%	8,750	5.7%	-	-%	8,750	5.7%
	$ -	-%	$ 37,629	4.8%	$ 61,959	5.3%	$ 1,825	3.4%	$ 101,413	5.1%
Securities held-to-maturity:										
Due in one year or less	$ -	-%	$ -	-%	$ 154	5.6%	$ -	-%	$ 154	5.6%
Due in one year to five years	-	-%	15,750	4.2%	5,777	4.9%	-	-%	21,527	4.4%
Due in five years to ten years	-	-%	1,997	4.8%	3,579	5.0%	-	-%	5,576	4.9%
Due after ten years	-	-%	-	-%	-	-%	-	-%	-	-%
	$ -	-%	$ 17,747	4.3%	$ 9,510	5.0%	$ -	-%	$ 27,257	4.5%
At December 31, 2005:										
Securities available-for-sale:										
Due in one year or less	$ -	-%	$ -	-%	$ -	-%	$ 404	3.3%	$ 404	3.3%
Due in one year to five years	-	-%	16,205	4.3%	5,105	4.5%	1,802	3.4%	23,112	4.3%
Due in five years to ten years	-	-%	14,315	5.1%	19,787	5.2%	-	-%	34,102	5.2%
Due after ten years	-	-%	-	-%	7,245	5.5%	-	-%	7,245	5.5%
	$ -	-%	$ 30,520	4.7%	$ 32,137	5.2%	$ 2,206	3.4%	$ 64,863	4.9%
Securities held-to-maturity:										
Due in one year or less	$ -	-%	$ -	-%	$ -	-%	$ -	-%	$ -	-%

Due in one year to five years	-	-%	15,750	4.2%	4,010	5.0%	-	-%	19,760	4.4%
Due in five years to ten years	-	-%	1,997	5.0%	5,574	5.0%	-	-%	7,571	5.0%
Due after ten years	-	-%	-	-%	-	-%	-	-%	-	-%
	$ -	-%	$ 17,747	4.3%	$ 9,584	5.0%	$ -	-%	$ 27,331	4.5%
At December 31, 2004:										
Securities available-for-sale:										
Due in one year or less	$ -	-%	$ -	-%	-	-%	-	-%	-	-%
Due in one year to five years	-	-%	2,982	3.5%	-	-%	2,270	3.4%	5,252	3.5%
Due in five years to ten years	-	-%	23,001	4.7%	7,409	5.0%	-	-%	30,410	4.8%
Due after ten years	-	-%	1,291	5.5%	5,094	5.4%	-	-%	6,385	5.4%
	$ -	-%	$ 27,274	4.6%	$ 12,503	5.2%	$ 2,270	3.4%	$ 42,047	4.7%
Securities held-to-maturity:										
Due in one year or less	$ -	-%	$ -	-%	$ -	-%	$ -	-%	$ -	-%
Due in one year to five years	-	-%	3,250	4.1%	844	4.3%	-	-%	4,094	4.1%
Due in five years to ten years	-	-%	14,496	4.3%	7,953	5.0%	-	-%	22,449	4.5%
Due after ten years	-	-%	-	-%	1,053	5.3%	-	-%	1,053	5.3%
	$ -	-%	$ 17,746	4.3%	$ 9,850	5.0%	$ -	-%	$ 27,596	4.5%

We computed yields using coupon interest, adding discount accretion or subtracting premium amortization, as appropriate, on a ratable basis over the life of each security. We computed the weighted average yield for each maturity range using the acquisition price of each security in that range.

Deposits and Other Borrowings. We had approximately $1.62 billion of deposits at December 31, 2006 compared to $810 million at December 31, 2005. Our deposits consist of noninterest and interest-bearing demand accounts, savings accounts, money market accounts and time deposits. Additionally, we entered into agreements with certain customers to sell certain of our securities under agreements to repurchase the security the following day. These agreements (which are typically associated with comprehensive treasury management programs for our commercial clients and provide them with short-term returns for their excess funds) amounted to $141.0 million at December 31, 2006 and $65.8 million at December 31, 2005. Additionally, at December 31, 2006, we had borrowed $53.7 million in advances from the Federal Home Loan Bank of Cincinnati compared to $41.5 million at December 31, 2005.

Generally, banks classify their funding base as either core funding or non-core funding. Core funding consists of all deposits other than time deposits issued in denominations of $100,000 or greater while all other funding is deemed to be non-core. The following table represents the balances of our deposits and other fundings and the percentage of each type to the total at December 31, 2006 and December 31, 2005 (dollars in thousands):

	December 31, 2006	Percent	December 31, 2005	Percent
Core funding:				
Noninterest-bearing deposit accounts	$ 300,978	*16.1%*	$ 155,811	*16.4%*
Interest-bearing demand accounts	236,674	*12.7%*	72,521	*7.6%*
Savings and money market accounts	485,936	*26.0%*	304,162	*32.1%*
Time deposit accounts less than $100,000	158,687	*8.5%*	31,408	*3.3%*
Total core funding	1,182,275	*63.3%*	563,902	*59.5%*
Non-core funding:				
Time deposit accounts greater than $100,000				
Public funds	98,286	*5.3%*	106,928	*11.3%*
Brokered deposits	61,718	*3.3%*	55,360	*5.8%*
Other time deposits	280,132	*15.0%*	83,961	*8.9%*
Securities sold under agreements to repurchase	141,016	*7.5%*	65,834	*6.9%*
Federal Home Loan Bank advances	53,726	*2.9%*	41,500	*4.4%*
Subordinated debt	51,548	*2.8%*	30,929	*3.3%*
Total non-core funding	686,426	*36.7%*	384,512	*40.5%*
Totals	$ 1,868,701	*100.0%*	$ 948,414	*100.0%*

The amount of time deposits issued in amounts of $100,000 or more as of December 31, 2006 and 2005 amounted to $440.1 million and $246.2 million, respectively. The following table shows our time deposits over $100,000 by category at December 31, 2006, based on time remaining until maturity of (1) three months or less, (2) over three but less than six months, (3) over six but less than twelve months and (4) over twelve months (dollars in thousands):

	At December 31, 2006
Three months or less	$ 176,732
Over three but less than six months	84,734
Over six but less than twelve months	81,186
Over twelve months	97,484
	$ 440,136

Subordinated debt. On December 29, 2003, we established PNFP Statutory Trust I; on September 15, 2005 we established PNFP Statutory Trust II; and on September 7, 2006 we established PNFP Statutory Trust III ("Trust I"; "Trust II"; "Trust III" or collectively, the "Trusts"). All are wholly-owned statutory business trusts. We are the sole sponsor of the Trusts and acquired each Trust's common securities for $310,000; $619,000 and $619,000, respectively. The Trusts were created for the exclusive purpose of issuing 30-year capital trust preferred securities ("Trust Preferred Securities") in the aggregate amount of $10,000,000 for Trust I; $20,000,000 for Trust II and

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$20,000,000 for Trust III and using the proceeds to acquire junior subordinated debentures (“Subordinated Debentures”) issued by Pinnacle Financial. The sole assets of the Trusts are the Subordinated Debentures. Our $1,548,000 investment in the Trusts is included in investments in unconsolidated subsidiaries in the accompanying consolidated balance sheets and our $51,548,000 obligation is reflected as subordinated debt.

The Trust I Preferred Securities bear a floating interest rate based on a spread over 3-month LIBOR (8.16% at December 31, 2006) which is set each quarter and matures on December 30, 2033. The Trust II Preferred Securities bear a fixed interest rate of 5.848% per annum thru September 30, 2010 at which time the securities will bear a floating rate set each quarter based on a spread over 3-month LIBOR. The Trust II securities mature on September 30, 2035. The Trust III Preferred Securities bear a floating interest rate based on a spread over 3-month LIBOR (7.02% at December 31, 2006) which is set each quarter and mature on September 30, 2036.

Distributions are payable quarterly. The Trust Preferred Securities are subject to mandatory redemption upon repayment of the Subordinated Debentures at their stated maturity date or their earlier redemption in an amount equal to their liquidation amount plus accumulated and unpaid distributions to the date of redemption. We guarantee the payment of distributions and payments for redemption or liquidation of the Trust Preferred Securities to the extent of funds held by the Trusts. Pinnacle Financial’s obligations under the Subordinated Debentures together with the guarantee and other back-up obligations, in the aggregate, constitute a full and unconditional guarantee by Pinnacle Financial of the obligations of the Trusts under the Trust Preferred Securities.

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

Subject to approval by the Federal Reserve Bank of Atlanta, the Trust Preferred Securities may be redeemed prior to maturity at our option on or after September 17, 2008 for Trust I; on or after September 30, 2010 for Trust II and September 30, 2011 for Trust III. 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.

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

Capital Resources. At December 31, 2006 and 2005, our stockholders’ equity amounted to $256.0 million and $63.4 million, respectively. The 2006 increase of $192.6 million was primarily attributable to $171.1 million of common stock issued in connection with the Cavalry acquisition and $18.8 million in comprehensive income, which was composed of $17.9 million in net income and $853,000 of net unrealized holding gains associated with our available-for-sale portfolio. During 2005, stockholders’ equity increased by $5.5 million due primarily to $8.1 million in net income offset by other comprehensive loss of $2.9 million attributable to the after tax decrease in the fair value of our available-for-sale securities portfolio.

Dividends. Pinnacle National is subject to restrictions on the payment of dividends to Pinnacle Financial under federal banking laws and the regulations of the Office of the Comptroller of the Currency. We, in turn, are also subject to limits on payment of dividends to our shareholders by the rules, regulations and policies of federal banking authorities and the laws of the State of Tennessee. We have not paid any dividends to date, nor do we anticipate paying dividends to our shareholders for the foreseeable future. Future dividend policy will depend on Pinnacle National's earnings, capital position, financial condition, anticipated growth rates and other factors.

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Market and Liquidity Risk Management

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

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

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

Economic value of equity. Our economic value of equity model measures the extent that estimated economic values of our assets, liabilities and off-balance sheet items will change as a result of interest rate changes. Economic values are determined by discounting expected cash flows from assets, liabilities and off-balance sheet items, which establishes a base case economic value of equity. To help limit interest rate risk, we have a guideline stating that for an instantaneous 200 basis point change in interest rates up or down, the economic value of equity will not change by more than 20 percent from the base case.

Gap analysis. An asset or liability is considered to be interest rate-sensitive if it will reprice or mature within the time period analyzed (e.g., within three months or one year). The interest rate-sensitivity gap is the difference between the interest-earning assets and interest-bearing liabilities scheduled to mature or reprice within such time period. A gap is considered positive when the amount of interest rate-sensitive assets exceeds the amount of interest rate-sensitive liabilities (i.e., "asset sensitive"). A gap is considered negative when the amount of interest rate-sensitive liabilities exceeds the interest rate-sensitive assets (i.e., "liability sensitive"). During a period of rising interest rates, a negative gap would tend to adversely affect net interest income, while a positive gap would tend to result in an increase in net interest income. Conversely, during a period of falling interest rates, a negative gap would tend to result in an increase in net interest income, while a positive gap would tend to adversely affect net interest income. If our assets and liabilities were equally flexible and moved concurrently, the impact of any increase or decrease in interest rates on net interest income would be minimal.

Each of the above analyses may not, on its own, be an accurate indicator of how our net interest income will be affected by changes in interest rates. Income associated with interest-earning assets and costs associated with interest-bearing liabilities may not be affected uniformly by changes in interest rates. In addition, the magnitude and duration of changes in interest rates may have a significant impact on net interest income. For example, although certain assets and liabilities may have similar maturities or periods of repricing, they may react in different degrees to changes in market interest rates. Interest rates on certain types of assets and liabilities fluctuate in advance of changes in general market rates, while interest rates on other types may lag behind changes in general market rates. In addition,

certain assets, such as adjustable rate mortgage loans, have features (generally referred to as "interest rate caps and floors") which limit changes in interest rates. Prepayment and early withdrawal levels also could deviate significantly from those assumed in calculating the maturity of certain instruments. The ability of many borrowers to service their debts also may decrease during periods of rising interest rates. ALCO reviews each of the

above interest rate sensitivity analyses along with several different interest rate scenarios as part of its responsibility to provide a satisfactory, consistent level of profitability within the framework of established liquidity, loan, investment, borrowing, and capital policies.

We may also use derivative financial instruments to improve the balance between interest-sensitive assets and interest-sensitive liabilities and as one tool to manage our interest rate sensitivity while continuing to meet the credit and deposit needs of our customers. At December 31, 2006 and 2005, we had not entered into any derivative contracts to assist managing our interest rate sensitivity.

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

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

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

In addition, Pinnacle National is a member of the Federal Home Loan Bank of Cincinnati. As a result, Pinnacle National receives advances from the Federal Home Loan Bank of Cincinnati, pursuant to the terms of various borrowing agreements, which assist it in the funding of its home mortgage and commercial real estate loan portfolios. Pinnacle National has pledged under the borrowing agreements with the Federal Home Loan Bank of Cincinnati certain qualifying residential mortgage loans and, pursuant to a blanket lien, all qualifying commercial mortgage loans as collateral. At December 31, 2006, Pinnacle National had received advances from the Federal Home Loan Bank of Cincinnati totaling $53.7 million at the following rates and maturities (dollars in thousands):

	Amount	Interest Rate Ranges
2007	$ 28,054	3.2% to 5.4%
2008	10,054	4.8%
2009	15,054	5.0%
2010-2019	564	2.3%
Total	$ 53,726	
Weighted average interest rate		5.0%

At December 31, 2006, brokered certificates of deposit approximated $61.7 million which represented 3.3% of total fundings compared to $55.4 million and 5.8% at December 31, 2005. We issue these brokered certificates through several different brokerage houses based on competitive bid. Typically, these funds are for varying maturities from six months to two years and are issued at rates which are competitive to rates we would be required to pay to attract

similar deposits from the local market as well as rates for Federal Home Loan Bank of Cincinnati advances of similar maturities. We consider these deposits to be a ready source of liquidity under current market conditions.

Our short-term borrowings (borrowings which mature within the next fiscal year) consist primarily of securities sold under agreements to repurchase (these agreements are typically associated with comprehensive treasury management programs for our clients and provide them with short-term returns for their excess funds), Federal Home Loan Bank of Cincinnati advances and Federal funds purchased. Information concerning our short-term borrowings as of and for each of the years in the three-year period ended December 31, 2006 is as follows (dollars in thousands):

	2006	2005	2004
Amounts outstanding at year-end:			
Securities sold under agreements to repurchase	$ 141,016	$ 65,834	$ 31,928
Federal Home Loan Bank advances	25,000	29,500	25,000
Weighted average interest rates at year-end:			
Securities sold under agreements to repurchase	4.33%	3.16%	0.90%
Federal Home Loan Bank advances	5.36%	3.21%	2.52%
Maximum amount of borrowings at any month-end:			
Securities sold under agreements to repurchase	$ 166,520	$ 69,767	$ 31,928
Federal funds purchased	9,985	18,702	10,000
Federal Home Loan Bank advances	25,000	35,500	31,000
Average balances for the year:			
Securities sold under agreements to repurchase	$ 101,144	$ 54,811	$ 20,466
Federal funds purchased	1,260	1,607	1,705
Federal Home Loan Bank advances	6,284	24,208	18,250
Weighted average interest rates for the year:			
Securities sold under agreements to repurchase	4.28%	2.40%	0.51%
Federal funds purchased	5.26%	3.51%	1.43%
Federal Home Loan Bank advances	4.70%	2.65%	2.01%

At December 31, 2006, we had no significant commitments for capital expenditures. However, we are in the process of developing our branch network or other office facilities in the Nashville MSA. As a result, we anticipate that we will enter into contracts to buy property or construct branch facilities and/or lease agreements to lease facilities in the Nashville MSA.

The following table presents additional information about our contractual obligations as of December 31, 2006, which by their terms have contractual maturity and termination dates subsequent to December 31, 2006 (dollars in thousands):

	Next 12 months	***13-36 months***	***37-60 months***	***More than 60 months***	***Totals***
Contractual obligations:					
Certificates of deposit	$ 462,839	$ 114,694	$ 21,280	$ 10	$ 598,823
Securities sold under agreements to repurchase	141,016	-	-	-	141,016
Federal Home Loan Bank advances	28,054	25,109	109	454	53,726
Subordinated debt	-	10,310	41,238	-	51,548
Minimum operating lease commitments	1,223	2,464	2,308	10,329	16,324
Totals	$ 633,132	$ 152,577	$ 64,935	$ 10,793	$ 861,437

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

Off-Balance Sheet Arrangements. At December 31, 2006, we had outstanding standby letters of credit of $53.0 million and unfunded loan commitments outstanding of $532.3 million. Because these commitments generally have fixed expiration dates and many will expire without being drawn upon, the total commitment level does not necessarily represent future cash requirements. If needed to fund these outstanding commitments, Pinnacle National has the ability to liquidate Federal funds sold or securities available-for-sale, or on a short-term basis to borrow and purchase Federal funds from other financial institutions. At December 31, 2006, Pinnacle National had accommodations with upstream correspondent banks for unsecured short-term advances. These accommodations have various covenants related to their term and availability, and in most cases must be repaid within less than a month. The following table presents additional information about our unfunded commitments as of December 31, 2006, which by their terms have contractual maturity dates subsequent to December 31, 2006 (dollars in thousands):

	Next 12 months	13-36 months	37-60 months	More than 60 months	Totals
Unfunded commitments:					
Lines of credit	$ 341,751	$ 85,698	$ 20,923	$ 84,011	$ 532,383
Letters of credit	44,555	8,219	187	-	52,961
Totals	$ 386,306	$ 93,917	$ 21,110	$ 84,011	$ 585,344

Impact of Inflation

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

Recent Accounting Pronouncements

SFAS No. 156, “Accounting for Servicing of Financial Assets - an amendment of FASB Statement No. 140.” SFAS No. 156 requires an entity to recognize a servicing asset or servicing liability each time it undertakes a contractual obligation to service a financial asset in certain circumstances. All separately recognized servicing assets and servicing liabilities are required to be initially measured at fair value. Subsequent measurement methods include the amortization method, whereby servicing assets or servicing liabilities are amortized in proportion to and over the period of estimated net servicing income or net servicing loss, or the fair value method, whereby servicing assets or servicing liabilities are measured at fair value at each reporting date and changes in fair value are reported in earnings in the period in which they occur. If the amortization method is used, an entity must assess servicing assets or servicing liabilities for impairment or increased obligation based on the fair value at each reporting date. SFAS No. 156 is effective for fiscal years beginning after December 15, 2006. We are currently evaluating the impact of SFAS No. 156 on its consolidated financial statements.

In July 2006, the FASB issued FASB Interpretation 48, “Accounting for Income Tax Uncertainties” (“FIN 48”). FIN 48 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. The recently issued literature also provides guidance on the derecognition, measurement and classification of income tax uncertainties, along with any related interest and penalties. FIN 48 also includes guidance concerning accounting for income tax uncertainties in interim periods and increases the level of disclosures associated with any recorded income tax uncertainties. FIN 48 is effective for fiscal years beginning after December 15, 2006. The differences between the amounts recognized in the statements of financial position prior to the adoption of FIN 48 and the amounts reported after adoption will be accounted for as a cumulative-effect adjustment recorded to the beginning balance of retained earnings. We are currently evaluating the impact of FIN 48 on its consolidated financial statements.

In June 2006, the Emerging Issues Task Force issued EITF No. 06-4, “Accounting for Deferred Compensation and Postretirement Benefits Aspects of Endorsement Split-Dollar Life Insurance Arrangements.” The EITF concluded that deferred compensation or postretirement benefit aspects of an endorsement split-dollar life insurance arrangement should be recognized as a liability by the employer and the obligation is not effectively settled by the purchase of a life insurance policy. The effective date is for fiscal years beginning after December 15, 2007. We are currently evaluating the impact of EITF No. 06-4 on its consolidated financial statements.

In June 2006, the Emerging Issues Task Force issued EITF No. 06-5, "Accounting for Purchases of Life Insurance - Determining the Amount that Could Be Realized in Accordance with FASB Tech Bulletin 85-4." The EITF concluded that a policyholder should consider any additional amounts included in the contractual terms of the life insurance policy in determining the "amount that could be realized under the insurance contract." For group policies with multiple certificates or multiple policies with a group rider, the EITF also concluded that the amount that could be realized should be determined at the individual policy or certificate level, i.e., amounts that would be realized only upon surrendering all of the policies or certificates would not be included when measuring the assets. The effective date is for fiscal years beginning after December 15, 2006. We are currently evaluating the impact of EITF No. 06-5 on its consolidated financial statements.

SFAS No. 157, "Fair Value Measurements" - SFAS No. 157 defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles and expands disclosures about fair value measurements. SFAS No. 157 applies only to fair-value measurements that are already required or permitted by other accounting standards and is expected to increase the consistency of those measurements. The definition of fair value focuses on the exit price, i.e., the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date, not the entry price, i.e., the price that would be paid to acquire the asset or received to assume the liability at the measurement date. The statement emphasizes that fair value is a market-based measurement; not an entity-specific measurement. Therefore, the fair value measurement should be determined based on the assumptions that market participants would use in pricing the asset or liability. The effective date for SFAS No. 157 is for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years. We are currently evaluating the impact of EITF 06-5 on its consolidated financial statements.

FASB Statement No. 158, "An Amendment to Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans" was issued September 29, 2006. SFAS No. 158 requires the recognition on the balance sheet of the overfunded or underfunded status of a defined benefit postretirement obligation measured as the difference between the fair value of plan assets and the benefit obligation. Recognition of "delayed" items should be considered in other comprehensive income. The effective date of SFAS No. 158 for public entities is for fiscal years ending after December 15, 2006. SFAS No. 158 did not have a material impact on Pinnacle Financial's 2006 consolidated financial statements.

In September 2006, the Securities and Exchange Commission ("SEC") issued Staff Accounting Bulletin No. 108, "Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements" ("SAB 108"). SAB 108 provides interpretive guidance on how the effects of the carryover or reversal of prior year misstatements should be considered in quantifying a current year misstatement. The SEC staff believes that registrants should quantify errors using both the balance sheet and income statement approach when quantifying a misstatement that, when all relevant quantitative and qualitative factors are considered, is material. SAB 108 is effective for Pinnacle Financial's fiscal year ending December 31, 2006. SAB 108 did not have a material impact on our 2006 consolidated financial statements.

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 44 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. is responsible for establishing and maintaining adequate internal control over financial reporting. Pinnacle Financial Partners, Inc.'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.

Pinnacle Financial Partners, Inc.'s management assessed the effectiveness of the Company's internal control over financial reporting as of December 31, 2006. 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. In conducting the Pinnacle Financial Partners, Inc.'s evaluation of the effectiveness of its internal control over financial reporting, the Company has excluded the acquisition of Cavalry Bancorp, Inc. (Cavalry), which was completed by Pinnacle Financial Partners, Inc. on March 15, 2006. At the acquisition date, total assets of Cavalry totaled $672 million. Further information concerning the acquisition of Cavalry appears in Note 2, Merger with Cavalry Bancorp, Inc., to the accompanying audited consolidated financial statements. Based on our assessment we believe that, as of December 31, 2006, the Company's internal control over financial reporting is effective based on those criteria.

Pinnacle Financial Partners, Inc.'s independent registered public accounting firm has issued an audit report on Pinnacle Financial Partners Inc.'s management's assessment of the company's internal control over financial reporting. This report appears on page 48 of this Annual Report on Form 10-K.

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

The Board of Directors
Pinnacle Financial Partners, Inc.:

We have audited the accompanying consolidated balance sheets of Pinnacle Financial Partners, Inc. and subsidiaries (the Company) as of December 31, 2006 and 2005, and the related consolidated statements of income, stockholders' equity and comprehensive income, and cash flows for each of the years in the three-year period ended December 31, 2006. 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 the Company as of December 31, 2006 and 2005, and the results of its operations and cash flows for each of the years in the three-year period ended December 31, 2006, in conformity with U.S. generally accepted accounting principles.

As discussed in notes 1 and 14 to the consolidated financial statements, in 2006 the Company changed its method of accounting for share-based payments.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the effectiveness of the Company's internal control over financial reporting as of December 31, 2006, 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 February 20, 2007 expressed an unqualified opinion on management's assessment of, and the effective operation of, internal control over financial reporting.

/s/ KPMG LLP

Nashville, Tennessee
February 20, 2007

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

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

We have audited management's assessment, included in the accompanying Report on Internal Control Over Financial Reporting, that Pinnacle Financial Partners, Inc. (the Company) maintained effective internal control over financial reporting as of December 31, 2006, 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. Our responsibility is to express an opinion on management's assessment and an opinion on the effectiveness of 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, evaluating management's assessment, testing and evaluating the design and operating effectiveness of internal control, 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, management's assessment that the Company maintained effective internal control over financial reporting as of December 31, 2006, is fairly stated, in all material respects, based on criteria established in *Internal Control—Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Also, in our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2006, based on criteria established in *Internal Control—Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO).

The Company acquired Cavalry Bancorp, Inc. (Cavalry) on March 15, 2006. Total assets of Cavalry at the acquisition date totaled $672 million. Management excluded Cavalry's internal control over financial reporting from its assessment of the effectiveness of the Company's internal control over financial reporting as of December 31, 2006. Our audit of internal control over financial reporting of the Company also excluded an evaluation of the internal

control over financial reporting of Cavalry.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets of the Company as of December 31, 2006 and 2005, and the related consolidated statements of income, stockholders' equity and comprehensive income, and cash flows for each of the years in the three-year period ended December 31, 2006, and our report dated February 20, 2007 expressed an unqualified opinion on those consolidated financial statements.

/s/ KPMG LLP

Nashville, Tennessee
February 20, 2007

PINNACLE FINANCIAL PARTNERS, INC. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS

	December 31,	
ASSETS	**2006**	**2005**
Cash and noninterest-bearing due from banks	$ 43,611,533	$ 25,935,948
Interest-bearing due from banks	1,041,174	839,960
Federal funds sold	47,866,143	31,878,362
Cash and cash equivalents	92,518,850	58,654,270
Securities available-for-sale, at fair value	319,237,428	251,749,094
Securities held-to-maturity (fair value of $26,594,235 and $26,546,297 at December 31, 2006 and December 31, 2005, respectively)	27,256,876	27,331,251
Mortgage loans held-for-sale	5,654,381	4,874,323
Loans	1,497,734,824	648,024,032
Less allowance for loan losses	(16,117,978)	(7,857,774)
Loans, net	1,481,616,846	640,166,258
Premises and equipment, net	36,285,796	12,915,595
Investments in unconsolidated subsidiaries and other entities	16,200,684	6,622,645
Accrued interest receivable	11,019,173	4,870,197
Goodwill	114,287,640	-
Core deposit intangible	11,385,006	-
Other assets	26,724,183	9,588,097
Total assets	$ 2,142,186,863	$ 1,016,771,730
LIABILITIES AND STOCKHOLDERS' EQUITY		
Deposits:		
Non-interest-bearing	300,977,814	155,811,214
Interest-bearing	236,674,425	72,520,757
Savings and money market accounts	485,935,897	304,161,625
Time	598,823,167	277,657,129
Total deposits	1,622,411,303	810,150,725
Securities sold under agreements to repurchase	141,015,761	65,834,232
Federal Home Loan Bank advances	53,725,833	41,500,000
Subordinated debt	51,548,000	30,929,000
Accrued interest payable	4,952,422	1,884,596
Other liabilities	12,516,523	3,036,752
Total liabilities	1,886,169,842	953,335,305
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; 15,446,074 issued and outstanding at December 31, 2006 and 8,426,551 issued and outstanding at December 31, 2005	15,446,074	8,426,551
Additional paid-in capital	211,502,516	44,890,912

Unearned compensation		-		(169,689)
Retained earnings		31,109,324		13,182,291
Accumulated other comprehensive loss net of taxes		(2,040,893)		(2,893,640)
Total stockholders' equity		256,017,021		63,436,425
Total liabilities and stockholders' equity	$	2,142,186,863	$	1,016,771,730

See accompanying notes to consolidated financial statements.

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

	For the years ended December 31,		
	2006	**2005**	**2004**
Interest income:			
Loans, including fees	$ 92,005,602	$ 35,166,671	$ 19,909,900
Securities:			
Taxable	12,614,623	9,086,134	6,935,902
Tax-exempt	2,016,044	1,115,486	490,757
Federal funds sold and other	3,059,750	939,369	342,470
Total interest income	109,696,019	46,307,660	27,679,029
Interest expense:			
Deposits	40,032,020	13,690,649	5,829,395
Securities sold under agreements to repurchase	4,329,327	1,315,122	104,085
Federal funds purchased and other borrowings	4,381,878	2,263,851	1,481,072
Total interest expense	48,743,225	17,269,622	7,414,552
Net interest income	60,952,794	29,038,038	20,264,477
Provision for loan losses	3,732,032	2,151,966	2,948,423
Net interest income after provision for loan losses	57,220,762	26,886,072	17,316,054
Noninterest income:			
Service charges on deposit accounts	4,645,685	977,386	955,851
Investment sales commissions	2,463,205	1,835,757	1,656,743
Insurance sales commissions	2,122,702	-	-
Gains on loans and loan participations sold	1,868,184	1,247,898	1,274,331
Trust fees	1,180,839	-	-
Gains on sales of investment securities, net	-	114,410	357,196
Other noninterest income	3,505,903	1,218,123	734,449
Total noninterest income	15,786,518	5,393,574	4,978,570
Noninterest expense:			
Salaries and employee benefits	27,469,275	13,130,779	9,046,490
Equipment and occupancy	7,521,602	3,766,593	2,405,613
Marketing and other business development	1,234,497	698,232	606,841
Postage and supplies	1,510,048	618,060	492,254
Amortization of core deposit intangible	1,783,230	-	-
Other noninterest expense	5,469,777	2,818,352	2,252,233
Merger related expense	1,635,831	-	-
Total noninterest expense	46,624,260	21,032,016	14,803,431
Net income before income taxes	26,383,020	11,247,630	7,491,193
Income tax expense	8,455,987	3,192,362	2,172,283
Net income	$ 17,927,033	$ 8,055,268	$ 5,318,910
Per share information:			
Basic net income per common share	$ 1.28	$ 0.96	$ 0.69

Diluted net income per common share	$	1.18	$	0.85	$	0.61
Weighted average common shares outstanding:						
Basic		13,954,077		8,408,663		7,750,943
Diluted		15,156,837		9,464,500		8,698,139

See accompanying notes to consolidated financial statements.

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

For the each of the years in the three-year period ended December 31, 2006

	Common Stock		Additional Paid-in	Unearned	Retained Earnings (Accumulated	Accumulated Other Comprehensive Income	Total Stockholders'
	Shares	Amount	Capital	Compensation	Deficit)	(Loss)	Equity
Balances, December 31, 2003	7,384,106	$ 7,384,106	$ 26,990,894	$ -	$ (189,155)	$ 150,536	$ 34,336,381
Exercise of employee incentive common stock options and related tax benefits	23,780	23,780	94,333	-	-	-	118,113
Proceeds from the sale of common stock (less offering expenses of $1,357,833)	977,500	977,500	17,214,667	-	-	-	18,192,167
Issuance of restricted common shares pursuant to 2004 Equity Incentive Plan	3,846	3,846	76,413	(80,259)	-	-	-
Compensation expense for restricted shares	-	-	-	43,009	-	-	43,009
Dividends paid to minority interest shareholders of PNFP Properties, Inc.	-	-	-	-	(2,732)	-	(2,732)
Comprehensive income:							
Net income	-	-	-	-	5,318,910	-	5,318,910
Net unrealized holding losses on available-for-sale securities, net of deferred tax benefit of $77,023	-	-	-	-	-	(125,673)	(125,673)
Total comprehensive income							5,193,237
	8,389,232	$ 8,389,232	$ 44,376,307	$ (37,250)	$ 5,127,023	$ 24,863	$ 57,880,175

Balances, December 31, 2004							
Exercise of employee incentive common stock options and related tax benefits	20,953	20,953	153,808	-	-	-	174,761
Issuance of restricted common shares pursuant to 2004 Equity Incentive Plan	16,366	16,366	360,797	(377,163)	-	-	-
Compensation expense for restricted shares	-	-	-	244,724	-	-	244,724
Comprehensive income:							
Net income	-	-	-	-	8,055,268	-	8,055,268
Net unrealized holding losses on available-for-sale securities, net of deferred tax benefit of $1,788,761	-	-	-	-	-	(2,918,503)	(2,918,503)
Total comprehensive income							5,136,765
Balances, December 31, 2005	8,426,551	$ 8,426,551	$ 44,890,912	$ (169,689)	$ 13,182,291	$ (2,893,640)	$ 63,436,425
Transfer of unearned compensation to additional paid-in capital upon adoption of SFAS 123(R)	-	-	(169,689)	169,689	-	-	-
Exercise of employee incentive common stock options and related tax benefits	130,168	130,168	1,240,724	-	-	-	1,370,892
Issuance of restricted common shares pursuant to 2004 Equity Incentive Plan	22,057	22,057	(22,057)	-	-	-	-
Exercise of director common stock warrants	11,000	11,000	44,000	-	-	-	55,000

Compensation expense for restricted shares	-	-	465,003	-	-	-	465,003
Compensation expense for stock options	-	-	1,009,958	-	-	-	1,009,958
Merger with Cavalry Bancorp, Inc.	6,856,298	6,856,298	164,231,274	-	-	-	171,087,572
Costs to register common stock issued in connection with the merger with Cavalry Bancorp, Inc.	-	-	(187,609)	-	-	-	(187,609)
Comprehensive income:							
Net income	-	-	-	-	17,927,033	-	17,927,033
Net unrealized holding gains on available-for-sale securities, net of deferred tax expense of $521,886	-	-	-	-	-	852,747	852,747
Total comprehensive income							18,779,780
Balances, December 31, 2006	15,446,074	$ 15,446,074	$ 211,502,516	$ -	$ 31,109,324	$ (2,040,893)	$ 256,017,021

See accompanying notes to consolidated financial statements.

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

	For the years ended December 31,		
	2006	**2005**	**2004**
Operating activities:			
Net income	$ 17,927,033	$ 8,055,268	$ 5,318,910
Adjustments to reconcile net income to net cash provided by operating activities:			
Net amortization of premiums on securities	629,634	1,130,766	1,050,687
Depreciation and net amortization	1,382,401	1,699,380	1,204,446
Provision for loan losses	3,732,032	2,151,966	2,948,423
Gains on sales of investment securities, net	-	(114,410)	(357,196)
Gain on loans and loan participations sold, net	(1,868,184)	(1,247,898)	(1,274,331)
Stock-based compensation expense	1,474,961	244,724	43,009
Deferred tax benefit	(1,164,336)	(575,755)	(922,286)
Tax benefit on exercise of stock awards	-	(50,535)	(1,912)
Excess tax benefit from stock compensation	(131,121)	-	-
Mortgage loans held for sale:			
Loans originated	(131,971,094)	(102,874,134)	(69,020,758)
Loans sold	134,301,622	100,730,532	70,009,143
Increase in other assets	(6,103,122)	(3,155,825)	(1,399,138)
Increase (decrease) in other liabilities	(6,303,665)	2,177,477	(856,925)
Net cash provided by operating activities	11,906,161	8,171,556	6,742,072
Investing activities:			
Activities in available for sale securities:			
Purchases	(62,760,686)	(116,361,069)	(132,755,709)
Sales	-	6,791,867	28,461,405
Maturities, prepayments and calls	35,568,504	32,935,215	35,172,378
Increase in loans, net	(297,565,733)	(175,606,019)	(176,375,116)
Purchases of premises and equipment and software	(4,649,676)	(3,438,916)	(5,144,869)
Cash and cash equivalents acquired in merger with Cavalry Bancorp, Inc., net of acquisition costs	36,230,539	-	-
Purchases of other assets	(6,107,658)	(2,708,000)	(881,719)
Net cash used in investing activities	(299,284,710)	(258,386,922)	(251,523,630)
Financing activities:			
Net increase in deposits	229,745,145	239,423,716	180,157,997
Net increase in repurchase agreements	75,181,529	33,906,372	16,877,750
Federal Home Loan Bank:			
Issuances	56,000,000	62,000,000	48,000,000
Payments	(61,540,828)	(74,000,000)	(39,000,000)
Proceeds from issuance of subordinated debt	20,619,000	20,619,000	-
Net proceeds from sale of common stock	-	-	18,192,167
Exercise of common stock warrants	55,000	-	-
Exercise of common stock options	1,239,771	174,761	118,113
Excess tax benefit from stock compensation	131,121	-	-

Costs incurred in connection with registration of common stock issued in merger		(187,609)		-		-
Other		-		-		(2,732)
Net cash provided by financing activities		321,243,129		282,123,849		224,343,295
Net increase (decrease) in cash and cash equivalents		33,864,580		31,908,483		(20,438,263)
Cash and cash equivalents, beginning of period		58,654,270		26,745,787		47,184,050
Cash and cash equivalents, end of period	$	92,518,850	$	58,654,270	$	26,745,787

See accompanying notes to consolidated financial statements.

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 National Bank (Pinnacle National). Pinnacle National is a commercial bank located in Nashville, Tennessee. Pinnacle National provides a full range of banking services in its primary market areas of Davidson, Rutherford, Williamson, Sumner and Bedford Counties.

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 Collateral Plus, LLC, are affiliates of Pinnacle Financial and are included in these consolidated financial statements pursuant to the equity method of accounting. Significant intercompany transactions and accounts are eliminated in consolidation.

Use of Estimates — The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities as of the balance sheet date and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. Material estimates that are particularly susceptible to significant change in the near term include the determination of the allowance for loan losses.

Impairment— Long-lived assets, including purchased intangible assets subject to amortization, such as Pinnacle Financial's core deposit intangible asset, are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset to estimated undiscounted future cash flows expected to be generated by the asset. If the carrying amount of an asset exceeds its estimated future cash flows, an impairment charge is recognized for the excess of the carrying amount over the fair value of the asset. Assets to be disposed of are reported at the lower of the carrying amount or fair value less costs to sell, and are no longer depreciated.

Goodwill and intangible assets that have indefinite useful lives are tested annually for impairment, and are tested for impairment more frequently if events and circumstances indicate that the asset might be impaired. An impairment loss is recognized to the extent that the carrying amount exceeds the asset's fair value. Pinnacle Financial's annual assessment date is as of September 30 such that the assessment will be completed during the fourth quarter of each year. Should we determine in a future period that the goodwill recorded in connection with our acquisition of Cavalry Bancorp, Inc. ("Cavalry") has been impaired, then a charge to our earnings will be recorded in the period such determination is made.

Cash and Cash Flows — Cash on hand, cash items in process of collection, amounts due from banks, Federal funds sold 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, 2006 as follows:

	For the years ended December 31,		
	2006	**2005**	**2004**
Cash Payments:			
Interest	$ 50,752,304	$ 16,154,326	$ 7,252,494
Income taxes	8,280,000	3,802,633	3,681,817
Noncash Transactions:			
Common stock and options issued to acquire Cavalry Bancorp, Inc. (see note 2)	171,087,572	-	-

Transfers of available-for-sale securities to held-to-maturity	-	-	27,655,669
Loans charged-off to the allowance for loan losses	818,467	207,647	1,032,378

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

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.

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 carrying amount to fair value. The impairment is charged to earnings and a new cost basis for the security is established. To determine whether impairment is other-than-temporary, management considers whether it has the ability and intent to hold the investment until a market price recovery and considers whether evidence indicating the cost of the investment is recoverable outweighs evidence to the contrary. Evidence considered in this assessment includes the reasons for the impairment, the severity and duration of the impairment, changes in value subsequent to year-end and forecasted performance of the investee.

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 not be the stated life of the security. Realized gains and losses from the sale of securities are determined using the specific identification method.

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 payments have been received and are reflected in the accompanying consolidated statement of income in gains on the sale of loans and loan participations sold.

Loans — Loans are reported at their outstanding principal balances less unearned income, the allowance for loan losses and any deferred fees or costs on originated loans. Interest income on loans is accrued based on the principal balance outstanding. Loan origination fees, net of certain loan origination costs, are deferred and recognized as an adjustment to the related loan yield using a method which approximates the interest method. At December 31, 2006 and 2005, net deferred loan fees of $3,393,000 and net deferred costs of $111,000, respectively, were included in loans on the accompanying consolidated balance sheets. Net deferred loan fees at December 31, 2006 includes the unamortized discount of $3,206,000 assigned to the loan portfolio acquired from the Cavalry acquisition as more fully discussed in "Note 2 - Merger with Cavalry Bancorp, Inc."

The accrual of interest on loans is discontinued when there is a significant deterioration in the financial condition of the borrower and full repayment of principal and interest is not expected or the principal or interest is more than 90 days past due, unless the loan is both well-secured and in the process of collection. Generally, all interest accrued but not collected for loans that are placed on nonaccrual status is reversed against current income. Interest income is subsequently recognized only to the extent cash payments are received.

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

expected to be received on any impaired loans. In addition, regulatory agencies, as an integral part of their examination process, will periodically review Pinnacle Financial's allowance for loan losses, and may require Pinnacle Financial to record adjustments to the allowance based on their judgment about information available to them at the time of their examinations.

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

A loan is considered to be impaired when it is probable Pinnacle Financial will be unable to collect all principal and interest payments due in accordance with the contractual terms of the loan agreement. Individually identified impaired loans are measured based on the present value of expected payments using the loan's original effective rate as the discount rate, the loan's observable market price, or the fair value of the collateral if the loan is collateral dependent. If the recorded investment in the impaired loan exceeds the measure of fair value, a valuation allowance may be established as a component of the allowance for loan losses. Changes to the valuation allowance are recorded as a component of the 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. 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 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 National 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. Several of these leases include rent escalation clauses. Pinnacle National expenses the costs associated with these escalating payments over the life of the expected lease term using the straight-line method. At December 31, 2006, the deferred liability associated with these escalating rentals was approximately $503,000 and is included in other liabilities in the accompanying consolidated balance sheets.

Investments in unconsolidated subsidiaries and other entities — In addition to investments in unconsolidated subsidiaries, Pinnacle Financial maintains certain investments, at cost, with certain regulatory and other entities in which Pinnacle Financial has an ongoing business relationship. These entities are the Federal Reserve Bank of Atlanta, the Bankers' Bank of Atlanta and the Federal Home Loan Bank of Cincinnati. At December 31, 2006 and 2005, the cost of these investments was $12,794,000 and $4,598,000, respectively. Pinnacle Financial determined that it is not practicable to estimate the fair value of these investments. Pinnacle Financial has not observed any events or changes in circumstances that would have had an adverse effect on the fair value of the investment. Such investments are reflected in the accompanying consolidated balance sheets in investments in unconsolidated subsidiaries and other entities.

Securities sold under agreements to repurchase — Pinnacle National 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.

Other Assets — Included in other assets as of December 31, 2006 and 2005, is approximately $765,000 and $742,000, 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, 2006, 2005 and 2004, Pinnacle Financial's amortization expense was approximately $281,000, $272,000 and $162,000, respectively. Software maintenance fees are capitalized in other assets and amortized over the term of the

maintenance agreement.

Included in other assets at December 31, 2006 is $995,000 of other real estate owned (OREO). Pinnacle National had no OREO at December 31, 2005. OREO represents properties acquired by Pinnacle National through loan defaults by customers. The property is recorded at the lower of cost or fair value minus estimated costs to sell at the date acquired. An allowance for losses on OREO may be maintained for subsequent valuation adjustments on a specific property basis, when necessary. Any gains or losses realized at the time of disposal are reflected in income.

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

Pinnacle National is the owner and beneficiary of various life insurance policies on certain key executives, including policies that were acquired in its merger with Cavalry. These policies are reflected in the accompanying consolidated balance sheets at their respective cash surrender values. At December 31, 2006 and 2005, the aggregate cash surrender value of these policies, which is reflected in other assets, was $14,802,000 and $2,084,000, respectively.

Also included in other assets at December 31, 2006 and 2005 is $770,000 and $477,000, respectively, which is related to loan participations which have been sold to correspondent banks. These amounts represent the present value, net of amortization, of the future net cash flows retained by Pinnacle Financial. These amounts are amortized against net interest income over the life of the loan. Amortization of these amounts was $127,000, $165,000 and $199,000 for the years ended December 31, 2006, 2005 and 2004, respectively.

Trust Fees - Trust fees are recognized when earned.

Insurance Sales Commissions - Insurance sales commissions are recognized as of the effective date of the policy and when the premium due under the policy can be reasonably estimated and when the premium is billable to the client, less a provision for commission refunds in the event of policy cancellation prior to termination date.

Income Taxes — Income tax expense consists of current and deferred taxes. Current income tax provisions approximate taxes to be paid or refunded for the applicable year. Deferred income tax assets and liabilities are determined using the balance sheet method. Under this method, the net deferred tax asset or liability is determined based on the tax effects of the differences between the book and tax bases of the various balance sheet assets and liabilities and gives current recognition to changes in tax rates and laws. Accordingly, the resulting net deferred tax asset or net deferred tax liability is included in the accompanying consolidated balance sheets in either other assets or other liabilities.

Recognition of deferred tax assets is based on management's belief that it is more likely than not that the tax benefit associated with certain temporary differences, tax operating loss carryforwards and tax credits will be realized. A valuation allowance is recorded for those deferred tax assets for which it is more likely than not that realization will not occur.

Pinnacle Financial and its wholly-owned subsidiaries file a consolidated income tax return. Each entity provides for income taxes based on its contribution to income or loss of the consolidated group.

Income Per Common Share — Basic earnings per share ("EPS") is computed by dividing net income by the weighted average common shares outstanding for the period. Diluted EPS reflects the dilution that could occur if securities or other contracts to issue common stock were exercised or converted. The difference between basic and diluted weighted average shares outstanding was attributable to common stock options, warrants and restricted shares. The dilutive effect of outstanding options, warrants and restricted shares is reflected in diluted earnings per share by application of the treasury stock method.

As of December 31, 2006 and 2005, there were common stock options outstanding to purchase 1,658,000 and 1,242,000 common shares, respectively. Most of these options have exercise prices (and in 2006, compensation costs attributable to current services), which when considered in relation to the average market price of Pinnacle Financial's common stock, are considered dilutive and are considered in Pinnacle Financial's diluted income per share calculation for each of the years in the three year period ended December 31, 2006. There were common stock options of 287,000, and 21,000 outstanding as of December 31, 2006 and 2005, respectively, which were considered anti-dilutive and thus have not been considered in the fully-diluted share calculations below. Additionally, as of December 31, 2006, 2005 and 2004, Pinnacle Financial had outstanding warrants to purchase 395,000, 406,000 and 406,000,

respectively, of common shares which have been considered in the calculation of Pinnacle Financial's diluted income per share for each of the years in the three-year period ended December 31, 2006.

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, 2006:

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

		2006		*2005*		*2004*
Basic earnings per share calculation:						
Numerator - Net income	$	17,927,033	$	8,055,268	$	5,318,910
Denominator - Average common shares outstanding		13,954,077		8,408,663		7,750,943
Basic net income per share	$	1.28	$	0.96	$	0.69
Diluted earnings per share calculation:						
Numerator - Net income	$	17,927,033	$	8,055,268	$	5,318,910
Denominator - Average common shares outstanding		13,954,077		8,408,663		7,750,943
Dilutive shares contingently issuable		1,202,760		1,055,837		947,196
Average diluted common shares outstanding		15,156,837		9,464,500		8,698,139
Diluted net income per share	$	1.18	$	0.85	$	0.61

Stock-Based Compensation — On January 1, 2006, Pinnacle Financial adopted Statement of Financial Accounting Standards (“SFAS”) No. 123 (revised 2004), “Share-Based Payment” (“SFAS No.123(R)”), that addresses the accounting for share-based payment transactions in which a company receives employee services in exchange for equity instruments. SFAS No. 123(R) eliminates the ability to account for share-based compensation transactions, as Pinnacle Financial formerly did, using the intrinsic value method as prescribed by Accounting Principles Board, (“APB”), Opinion No. 25, “Accounting for Stock Issued to Employees,” and generally requires that such transactions be accounted for using a fair-value-based method and recognized as expense in the accompanying consolidated statement of income.

Pinnacle Financial adopted SFAS No. 123(R) using the modified prospective method which requires the application of the accounting standard as of January 1, 2006. The accompanying consolidated financial statements as of and for the year ended December 31, 2006 reflect the impact of adopting SFAS No. 123(R). In accordance with the modified prospective method, consolidated financial statements for prior periods have not been restated to reflect, and do not include, the impact of SFAS No. 123(R). See Note 14 for further details.

Stock-based compensation expense recognized during the period is based on the value of the portion of stock-based payment awards that are ultimately expected to vest. Stock-based compensation expense recognized in the accompanying consolidated statement of income during 2006 included compensation expense for stock-based payment awards granted prior to, but not yet vested, as of January 1, 2006 and for the stock-based awards granted after January 1, 2006, based on the grant date fair value estimated in accordance with SFAS No. 123(R). As stock-based compensation expense recognized in the accompanying statement of income for 2006 is based on awards ultimately expected to vest, it has been reduced for estimated forfeitures. SFAS No. 123(R) requires forfeitures to be estimated at the time of grant and revised, if necessary, in subsequent periods if actual forfeitures differ from those estimates. In the pro forma information for 2005, which is also detailed in Note 14 we accounted for forfeitures as they occurred.

Comprehensive Income (Loss) —SFAS No. 130, “Reporting Comprehensive Income” describes comprehensive income as the total of all components of comprehensive income including net income. Other comprehensive income refers to revenues, expenses, gains and losses that under generally accepted accounting principles are included in comprehensive income but excluded from net income. Currently, Pinnacle Financial’s other comprehensive income (loss) consists of unrealized gains and losses, net of deferred income taxes, on available-for-sale securities.

Note 2. Merger with Cavalry Bancorp, Inc.

On March 15, 2006, Pinnacle Financial consummated its merger with Cavalry Bancorp, Inc. (“Cavalry”), a one-bank holding company located in Murfreesboro, Tennessee. Pursuant to the merger agreement, Pinnacle acquired all Cavalry common stock via a tax-free exchange whereby Cavalry shareholders received a fixed exchange ratio of 0.95 shares of Pinnacle Financial common stock for each share of Cavalry common stock, or approximately 6.9 million Pinnacle Financial shares. The accompanying consolidated financial statements include the activities of the former Cavalry since March 15, 2006.

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In accordance with SFAS No. 141, "Accounting for Business Combinations" ("SFAS No. 141"), SFAS No. 142, "Goodwill and Intangible Assets" ("SFAS No. 142") and SFAS No. 147, "Acquisition of Certain Financial Institutions" ("SFAS No. 147"), Pinnacle Financial recorded at fair value the following assets and liabilities of Cavalry as of March 15, 2006:

Cash and cash equivalents	$ 37,420,210
Investment securities - available-for-sale	39,476,178
Loans, net of an allowance for loan losses of $5,102,296	545,598,367
Goodwill	114,287,640
Core deposit intangible	13,168,236
Other assets	42,936,956
Total assets acquired	792,887,587
Deposits	583,992,422
Federal Home Loan Bank advances	17,766,661
Other liabilities	18,851,261
Total liabilities assumed	620,610,344
Total consideration paid for Cavalry	$ 172,277,243

As discussed more fully below, total consideration is comprised of $171.1 million in Pinnacle Financial common shares issued to former Cavalry shareholders and options issued to former Cavalry option holders and $1.2 million in acquisition costs. Pinnacle Financial is in the process of finalizing the allocation of the purchase price to the acquired net assets noted above. Accordingly, the above allocations should be considered preliminary as of December 31, 2006.

As noted above, total consideration for Cavalry approximates $172.3 million of which $171.1 million was in the form of Pinnacle Financial common shares and options to acquire Pinnacle Financial common shares and $1.2 million in investment banking fees, attorney's fees and other costs related to the acquisition which have been accounted for as a component of the purchase price. Pinnacle Financial issued 6,856,298 shares of Pinnacle Financial common stock to the former Cavalry shareholders. In accordance with EITF No. 99-12, "Determination of the Measurement Date for the Market Price of Acquirer Securities Issued in a Purchase Business Combination," the consideration shares were valued at $24.53 per common share which represents the average closing price of Pinnacle Financial common stock from the two days prior to the merger announcement on September 30, 2005 through the two days after the merger announcement. Aggregate consideration for the common stock issued was approximately $168.2 million. Additionally, Pinnacle Financial also has assumed the Cavalry Bancorp, Inc. 1999 Stock Incentive Plan (the "Cavalry Plan") pursuant to which Pinnacle is obligated to issue 195,551 shares of Pinnacle Financial common stock upon exercise of stock options awarded to certain former Cavalry employees who held outstanding options as of March 15, 2006. All of these options were fully vested prior to the merger announcement date and expire at various dates between 2011 and 2012. The exercise prices for these stock options range between $10.26 per share and $13.68 per share. In accordance with SFAS No. 141, Pinnacle Financial has considered the fair value of these options in determining the acquisition cost of Cavalry. The fair value of these vested options approximated $2.9 million which has been included as a component of the aggregate purchase price.

In accordance with SFAS Nos. 141 and 142, Pinnacle Financial has recognized $13.2 million as a core deposit intangible. This identified intangible is being amortized over seven years using an accelerated method which anticipates the life of the underlying deposits to which the intangible is attributable. For the year ended December 31, 2006, approximately $1.8 million was recognized in the accompanying statement of income as other noninterest expense. Amortization expense associated with this identified intangible will approximate $1.8 million to $2.1 million per year for the next five years with lesser amounts for the remaining two years.

Pinnacle Financial also recorded other adjustments to the carrying value of Cavalry's assets and liabilities in order to reflect the fair value of those net assets in accordance with generally accepted accounting principles, including a $4.8 million discount associated with the loan portfolio, a $2.9 million premium for Cavalry's certificates of deposit and a $4.6 million premium for Cavalry's land and buildings. Pinnacle Financial also recorded the corresponding deferred tax asset or liability associated with these adjustments. The discounts and premiums related to financial assets and liabilities are being amortized into our statements of income using a method that approximates the level yield method over the anticipated

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lives of the underlying financial assets or liabilities. For the year ended December 31, 2006, the accretion of the fair value discounts related to the acquired loans and certificates of deposit increased net interest income by approximately $3.7 million. Based on the estimated useful lives of the acquired loans and deposits, Pinnacle Financial expects to recognize increases in net interest income related to accretion of these purchase accounting adjustments of $4.0 million in subsequent years.

Statement of Position 03-03, *Accounting for Certain Loans or Debt Securities Acquired in a Transfer* ("SOP 03-03") addresses accounting for differences between contractual cash flows and cash flows expected to be collected from an investor's initial investment in loans or debt securities (loans) acquired in a transfer if those differences are attributable, at least in part, to credit quality. It includes loans acquired in purchase business combinations and applies to all nongovernmental entities, including not-for-profit organizations. The SOP does not apply to loans originated by the entity. At March 15, 2006, Pinnacle Financial identified $3.9 million in loans to which the application of the provisions of SOP 03-03 was required. The preliminary purchase accounting adjustments reflect a reduction in loans and the allowance for loan losses of $1.0 million related to Cavalry's impaired loans, thus reducing the carrying value of these loans to $2.9 million as of March 15, 2006. At December 31, 2006, the carrying value of these loans had been reduced to $2.6 million due to cash payments received from the borrowers.

The following pro forma income statements assume the merger was consummated on January 1, 2005. The pro forma information does not reflect Pinnacle Financial's results of operations that would have actually occurred had the merger been consummated on such date (dollars in thousands).

	Year ended December 31,			
		2006		2005(1)
Pro Forma Income Statements:				
Net interest income	$	65,071	$	56,932
Provision for loan losses		4,713		2,880
Noninterest income		18,183		17,726
Noninterest expense (2):				
Compensation		30,250		27,544
Other noninterest expense		19,988		19,918
Net income before taxes		28,303		24,316
Income tax expense		10,005		7,706
Net income	$	18,298	$	16,610
Pro Forma Per Share Information:				
Basic net income per common share	$	1.23	$	1.09
Diluted net income per common share	$	1.14	$	1.01
Weighted average shares outstanding:				
Basic		14,840,326		15,265,350
Diluted		16,043,087		16,426,733

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(1) In the first quarter of 2005, Cavalry recorded a tax benefit of $427,000 due to a cash distribution of dividends to the participants in their employee stock ownership plan. Excluding this benefit would have lowered pro forma net income for the year ended December 31, 2005 by $427,000 resulting in pro forma net income of $16,184,000 or

$1.06 per basic share and $0.99 per fully-diluted share.

(2) In preparation and as a result of the merger during 2006, Cavalry and Pinnacle Financial incurred significant merger related charges of approximately $11.7 million in the aggregate, primarily for severance benefits, accelerated vesting of defined compensation agreements, investment banker fees, etc. Including these charges would have decreased pro forma net income for year ended December 31, 2006 by $7.08 million resulting in net income of $11,217,000 and a basic and fully diluted pro forma net income per share of $0.76 and $0.70, respectively.

During the year ended December 31, 2006, Pinnacle Financial incurred merger integration expense related to the merger with Cavalry of $1,636,000. These expenses were directly related to the merger, recognized as incurred and reflected on the accompanying consolidated statement of income as merger related expense.

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Note 3. 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 its option, Pinnacle Financial maintains additional balances to compensate for clearing and other services. For the years ended December 31, 2006 and 2005, the average daily balance maintained at the Federal Reserve was approximately $600,000 and $593,000, respectively.

Note 4. Securities

The amortized cost and fair value of securities available-for-sale and held-to-maturity at December 31, 2006 and 2005 are summarized as follows:

	December 31, 2006			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Securities available-for-sale:				
U.S. Treasury securities	$ -	$ -	$ -	$ -
U.S. Government agency securities	38,076,428	9,739	457,321	37,628,846
Mortgage-backed securities	220,397,093	455,203	3,028,241	217,824,055
State and municipal securities	62,215,952	131,412	388,124	61,959,240
Corporate notes	1,887,475	-	62,188	1,825,287
	$ 322,576,948	$ 596,354	$ 3,935,874	$ 319,237,428
Securities held-to-maturity:				
U.S. government agency securities	$ 17,747,278	$ -	$ 378,528	$ 17,368,700
State and municipal securities	9,509,648	-	284,113	9,225,535
	$ 27,256,876	$ -	$ 662,641	$ 26,594,235

	December 31, 2005			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Securities available-for-sale:				
U.S. Treasury securities	$ -	$ -	$ -	$ -
U.S. Government agency securities	31,054,469	-	534,899	30,519,570
Mortgage-backed securities	190,708,007	44,378	3,866,210	186,886,175
State and municipal securities	32,583,283	19,044	464,984	32,137,343
Corporate notes	2,300,442	-	94,436	2,206,006
	$ 256,646,201	$ 63,422	$ 4,960,529	$ 251,749,094
Securities held-to-maturity:				
U.S. government agency securities	$ 17,746,883	$ -	$ 441,208	$ 17,305,675
State and municipal securities	9,584,368	-	343,746	9,240,622
	$ 27,331,251	$ -	$ 784,954	$ 26,546,297

Pinnacle Financial realized approximately $114,000 in net gains from the sale of $6,792,000 of available-for-sale securities during the year ended December 31, 2005. There were no losses on the sale of securities during the year ended December 31, 2005. Pinnacle Financial realized $357,000 in net gains on the sale of $28,461,000 of available-for-sale securities during the year ended December 31, 2004. During the year ended December 31, 2004,

gross realized gains amounted to $421,000 on the sale of $14.5 million of available-for-sale securities while gross realized losses amounted to $64,000 on the sale of $13.9 million of available-for-sale securities.

At December 31, 2006, approximately $275,464,000 of Pinnacle Financial's available-for-sale portfolio was pledged to secure public funds and other deposits and securities sold under agreements to repurchase.

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The amortized cost and fair value of debt securities as of December 31, 2006 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.

	Available-for-sale		Held-to-maturity	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
Due in one year or less	$ 2,645,238	$ 2,638,716	$ 153,894	$ 153,633
Due in one year to five years	54,183,409	53,652,713	21,527,276	21,029,557
Due in five years to ten years	36,609,387	36,372,441	5,575,706	5,411,045
Due after ten years	8,741,891	8,749,503	-	-
Mortgage-backed securities	220,397,093	217,824,055	-	-
	$ 322,576,948	$ 319,237,428	$ 27,256,876	$ 26,594,235

At December 31, 2006 and 2005, included in securities were the following investments with unrealized losses. The information below classifies these investments according to the term of the unrealized loss of less than twelve months or twelve months or longer:

	Investments with an Unrealized Loss of less than 12 months		Investments with an Unrealized Loss of 12 months or longer		Total Investments with an Unrealized Loss	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
At December 31, 2006:						
U.S. government agency securities	$ -	$ -	$ 47,988,246	$ 835,849	$ 47,988,246	$ 835,849
Mortgage-backed securities	13,959,080	68,965	149,496,521	2,959,276	163,455,601	3,028,241
State and municipal securities	13,975,595	47,071	35,660,379	625,166	49,635,974	672,237
Corporate notes	-	-	1,825,286	62,188	1,825,286	62,188
Total temporarily-impaired securities	$ 27,934,675	$ 116,036	$ 234,970,432	$ 4,482,479	$ 262,905,107	$ 4,598,515
At December 31, 2005:						
U.S. government agency securities	$ 28,605,270	$ 463,534	$ 19,219,975	$ 512,573	$ 47,825,245	$ 976,107
Mortgage-backed securities	110,636,351	1,586,394	69,512,865	2,279,816	180,149,216	3,866,210
State and municipal securities	22,692,062	341,869	14,074,344	466,861	36,766,406	808,730
Corporate notes	-	-	2,206,006	94,436	2,206,006	94,436
Total temporarily-impaired	$ 161,933,683	$ 2,391,797	$ 105,013,190	$ 3,353,686	$ 266,946,873	$ 5,745,483

securities

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

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Note 5. Loans and Allowance for Loan Losses

The composition of loans at December 31, 2006 and 2005 is summarized as follows:

	2006	2005
Commercial real estate - Mortgage	$ 284,301,650	$ 148,102,053
Commercial real estate - Construction	161,903,496	30,295,106
Commercial - Other	608,529,830	239,128,969
Total Commercial	1,054,734,976	417,526,128
Consumer real estate - Mortgage	299,626,769	169,952,860
Consumer real estate - Construction	91,193,738	37,371,834
Consumer - Other	52,179,341	23,173,210
Total Consumer	442,999,848	230,497,904
Total Loans	1,497,734,824	648,024,032
Allowance for loan losses	(16,117,978)	(7,857,774)
Loans, net	$ 1,481,616,846	$ 640,166,258

Pinnacle Financial periodically analyzes its commercial loan portfolio to determine if a concentration of credit risk exists to any one or more industries. Pinnacle Financial utilizes broadly accepted industry classification systems in order to classify borrowers into various industry classifications. During 2005, Pinnacle Financial changed from using the Standard Industry Code classification system to the North American Industry Classification System. Pinnacle Financial has a credit exposure (loans outstanding plus unfunded lines of credit) exceeding 25% of Pinnacle National's total risk-based capital to borrowers in the following industries at December 31, 2006 and 2005:

	2006	2005
Trucking industry	$ 89,862,000	$ 50,421,000
Lessors of nonresidential buildings	133,504,000	60,932,000
Lessors of residential buildings	65,791,000	17,956,000
Land subdividers	164,535,000	37,963,000
New housing operative builders	192,373,000	20,740,000

Changes in the allowance for loan losses for each of the years in the three-year period ended December 31, 2006 are as follows:

	2006	2005	2004
Balance at beginning of period	$ 7,857,774	$ 5,650,014	$ 3,718,598
Charged-off loans	(818,467)	(207,647)	(1,032,378)
Recovery of previously charged-off loans	244,343	263,441	15,371
Allowance from Cavalry acquisition (see note 2)	5,102,296	-	-
Provision for loan losses	3,732,032	2,151,966	2,948,423
Balance at end of period	$ 16,117,978	$ 7,857,774	$ 5,650,014

At December 31, 2006 and 2005, Pinnacle Financial had certain impaired loans on nonaccruing interest status. The principal balance of these nonaccrual loans amounted to $7,070,000 and $460,000 at December 31, 2006 and 2005, respectively. In each case, at the date such loans were placed on nonaccrual, Pinnacle Financial reversed all previously

accrued interest income against current year earnings. Had these loans been on accruing status, interest income would have been higher by $283,000, $21,000 and $41,000 for each of the years in the three-year period ended December 31, 2006, respectively. During the three year period ended December 31, 2006, the average balance of nonaccrual loans was $2,735,000, $387,000 and $776,000, respectively. As all loans that are deemed impaired were either on nonaccruing interest status during the entire year or were placed on nonaccruing status on the date they were deemed impaired, no interest income has been recognized on any impaired loans during the three year period ended December 31, 2006. At December 31, 2006 and 2005, Pinnacle Financial did not have an allowance loans considered to be impaired.

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At December 31, 2006, Pinnacle Financial had granted loans and other extensions of credit amounting to approximately $23,392,000 to certain directors, executive officers, and their related entities, of which approximately $16,858,000 had been drawn upon. At December 31, 2005, Pinnacle Financial had granted loans and other extensions of credit amounting to approximately $13,223,000 to certain directors, executive officers, and their related entities, of which $6,958,000 had been drawn upon. During 2006, $10,640,000 of new loans were made, $120,000 of loans were purchased through the Cavalry Banking, Inc. acquisition, and repayments totaled $860,000. The terms on these loans and extensions are on substantially the same terms customary for other persons for the type of loan involved. None of these loans to certain directors, executive officers, and their related entities, were impaired at December 31, 2006 or 2005.

During the three year period ended December 31, 2006, Pinnacle Financial sold participations in certain loans to correspondent banks at an interest rate that was less than that of the borrower's rate of interest. In accordance with generally accepted accounting principles, Pinnacle Financial has reflected a net gain on the sale of these participated loans for each of the years in the three year period ended December 31, 2006 of $420,000, $152,000 and $234,000, respectively, which is attributable to the present value of the future net cash flows of the difference between the interest payments the borrower is projected to pay Pinnacle Financial and the amount of interest that will be owed the correspondent banks based on their participation in the loan. At December 31 2006, Pinnacle Financial was servicing $106.8 million of loans for correspondent banks and other entities, of which $95.4 million was commercial loans.

Note 6. Premises and Equipment and Lease Commitments

Premises and equipment at December 31, 2006 and 2005 are summarized as follows:

	Range of Useful Lives	2006	2005
Land	-	$ 9,545,667	$ 2,502,524
Buildings	15 to 30 years	19,849,960	6,767,518
Leasehold improvements	15 to 20 years	1,954,028	1,232,973
Furniture and equipment	3 to 15 years	21,350,694	5,506,469
		52,700,349	16,009,484
Accumulated depreciation		(16,414,553)	(3,093,889)
		$ 36,285,796	$ 12,915,595

Depreciation expense was approximately $2,702,000, $997,000 and $657,000 for each of the years in the three-year period ended December 31, 2006.

Pinnacle Financial has entered into various operating leases, primarily for office space and branch facilities. Rent expense related to these leases for 2006, 2005 and 2004 totaled $1,161,000, $950,000 and $636,000, respectively. At December 31, 2006, the approximate future minimum lease payments due under the aforementioned operating leases for their base term is as follows:

2007	$ 1,223,000
2008	1,248,000
2009	1,216,000
2010	1,181,000
2011	1,127,000
Thereafter	10,329,000
	$ 16,324,000

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Note 7. Deposits

At December 31, 2006, the scheduled maturities of time deposits are as follows:

2007	$ 462,839,784
2008	73,778,670
2009	40,914,883
2010	13,321,854
2011	7,957,377
2012	10,599
	$ 598,823,167

Additionally, at December 31, 2006 and 2005, approximately $440,136,000 and $246,249,000, respectively, of time deposits had been issued in denominations of $100,000 or greater.

At December 31, 2006, Pinnacle Financial had $1.7 million of deposit accounts in overdraft status and thus have been reclassified to loans on the accompanying consolidated balance sheet.

Note 8. Federal Home Loan Bank Advances and Other Borrowings

Pinnacle National is a member of the Federal Home Loan Bank of Cincinnati ("FHLB") and as a result, Pinnacle National is eligible for advances from the FHLB, pursuant to the terms of various borrowing agreements, which assists Pinnacle National in the funding of its home mortgage and commercial real estate loan portfolios. Pinnacle National has pledged certain qualifying residential mortgage loans and, pursuant to a blanket lien, all qualifying commercial mortgage loans with an aggregate carrying value of $122,019,000 as collateral under the borrowing agreements with the FHLB.

At December 31, 2006 and 2005, Pinnacle National had received advances from the FHLB totaling $53,726,000 and $41,500,000, respectively. At December 31, 2006, the scheduled maturities of these advances and interest rates are as follows:

	Scheduled Maturities	Interest Rate Ranges
2007	$ 28,054,437	3.2% to 5.4%
2008	10,054,437	5.0%
2009	15,054,437	5.0%
2010-2019	562,515	2.3%
	$ 53,725,833	
Weighted average interest rate		5.0%

At December 31, 2006, Pinnacle National has accommodations which allow it to 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. There were no outstanding balances at December 31, 2006 or 2005 under these arrangements.

Note 9. Investments in Affiliated Companies

On December 29, 2003, we established PNFP Statutory Trust I; on September 15, 2005 we established PNFP Statutory Trust II; and on September 7, 2006 we established PNFP Statutory Trust III ("Trust I"; "Trust II"; "Trust III" or collectively, the "Trusts"). All are wholly-owned statutory business trusts. Pinnacle Financial is the sole sponsor of the Trusts and acquired each Trust's common securities for $310,000; $619,000 and $619,000, respectively. The Trusts were created for the exclusive purpose of issuing 30-year capital trust preferred securities ("Trust Preferred Securities") in the aggregate amount of $10,000,000 for Trust I; $20,000,000 for Trust II and $20,000,000 for Trust III and using the proceeds to acquire junior subordinated debentures ("Subordinated Debentures") issued by Pinnacle Financial. The sole assets of the Trusts are the Subordinated Debentures. Pinnacle Financial's aggregate $1,548,000 investment in the Trusts is included in investments in unconsolidated subsidiaries and other entities in the accompanying consolidated balance sheet at December 31, 2006 and the $51,548,000 obligation of Pinnacle Financial is reflected as subordinated debt at December 31, 2006.

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The Trust I Preferred Securities bear a floating interest rate based on a spread over 3-month LIBOR (8.16% at December 31, 2006) which is set each quarter and mature on December 30, 2033. The Trust II Preferred Securities bear a fixed interest rate of 5.848% per annum thru September 30, 2010 at which time the securities will bear a floating rate set each quarter based on a spread over 3-month LIBOR. The Trust II securities mature on September 30, 2035. The Trust III Preferred Securities bear a floating interest rate based on a spread over 3-month LIBOR (7.02% at December 31, 2006) which is set each quarter and mature on September 30, 2036.

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. Pinnacle Financial 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 Pinnacle Financial's ability to pay dividends on our common shares will be restricted.

Subject to approval by the Federal Reserve Bank of Atlanta, the Trust Preferred Securities may be redeemed prior to maturity at our option on or after September 17, 2008 for Trust I; on or after September 30, 2010 for Trust II and September 30, 2011 for Trust III. 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.

The Trust Preferred Securities for the Trusts qualify as Tier I capital under current regulatory definitions subject to certain limitations. Debt issuance costs associated with Trust I of $105,000 consisting primarily of underwriting discounts and professional fees are included in other assets in the accompanying consolidated balance sheet. These debt issuance costs are being amortized over ten years using the straight-line method. There were no debt issuance costs associated with Trust II or Trust III.

Combined summary financial information for the Trusts follows (dollars in thousands):

Combined Summary Balance Sheets

	December 31, 2006		December 31, 2005	
Asset - Investment in subordinated debentures issued by Pinnacle Financial	$	51,548	$	30,929
Liabilities	$	-	$	-
Stockholder's equity - Trust preferred securities		50,000		30,000

Common securities (100% owned by Pinnacle Financial)		1,548		929
Total stockholder’s equity		51,548		30,929
Total liabilities and stockholder’s equity	$	51,548	$	30,929

Combined Summary Income Statement

	Year ended December 31,					
	2006		**2005**		**2004**	
Income - Interest income from subordinated debentures issued by Pinnacle Financial	$	2,504	$	986	$	431
Net Income	$	2,504	$	986	$	431

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Combined Summary Statement of Stockholder's Equity

	Trust Preferred Securities	Total Common Stock	Retained Earnings	Stockholder's Equity
Balances, December 31, 2003	$ 10,000	$ 310	$ -	$ 10,310
Net income	-	-	431	431
Dividends:				
Trust preferred securities	-	-	(418)	(418)
Common paid to Pinnacle Financial	-	-	(13)	(13)
Balances, December 31, 2004	$ 10,000	$ 310	$ -	$ 10,310
Net income	-	-	986	986
Issuance of trust preferred securities	20,000	619	-	20,619
Dividends:				
Trust preferred securities	-	-	(956)	(956)
Common paid to Pinnacle Financial	-	-	(30)	(30)
Balances, December 31, 2005	$ 30,000	$ 929	$ -	$ 30,929
Net income	-	-	2,504	2,504
Issuance of trust preferred securities	20,000	619	-	20,619
Dividends:				
Trust preferred securities	-	-	(2,428)	(2,428)
Common paid to Pinnacle Financial	-	-	(76)	(76)
Balances, December 31, 2006	$ 50,000	$ 1,548	$ -	$ 51,548

Note 10. Income Taxes

Income tax expense attributable to income from continuing operations for each of the years in the three-year period ended December 31, 2006 consists of the following:

	2006	2005	2004
Current tax expense:			
Federal	$ 9,073,193	$ 3,589,487	$ 2,677,582
State	547,130	178,630	416,987
Total current tax expense	9,620,323	3,768,117	3,094,569
Deferred tax benefit:			
Federal	(971,418)	(479,072)	(765,139)
State	(192,918)	(96,683)	(157,147)
Total deferred tax benefit	(1,164,336)	(575,755)	(922,286)
	$ 8,455,987	$ 3,192,362	$ 2,172,283

Pinnacle Financial's income tax expense differs from the amounts computed by applying the Federal income tax statutory rates of 35% in 2006 and 34% in 2005 and 2004 to income before income taxes. A reconciliation of the

differences for each of the years in the three-year period ended December 31, 2006 is as follows:

	2006	2005	2004
Income taxes at statutory rate	$ 9,234,057	$ 3,824,194	$ 2,547,006
State tax expense, net of federal tax effect	230,238	54,085	171,494
Federal tax credits	(300,000)	(300,000)	(300,000)
Tax-exempt securities	(602,100)	(339,900)	(156,354)
Other items	(106,208)	(46,017)	(89,863)
Income tax expense	$ 8,455,987	$ 3,192,362	$ 2,172,283

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The effective tax rate for all years is impacted by Federal tax credits related to the New Markets Tax Credit program whereby a subsidiary of Pinnacle National has been awarded approximately $2.3 million in future Federal tax credits which are available thru 2010. Tax benefits related to these credits will be recognized for financial reporting purposes in the same periods that the credits are recognized in the Company's income tax returns. The credit that is available for each of the years in the three year period ended December 31, 2006 was $300,000. Pinnacle Financial believes that it and its subsidiary have complied with the various regulatory provisions of the New Markets Tax Credit program in each of these years. Also, during 2004, Pinnacle National formed a real estate investment trust which provides Pinnacle Financial with an alternative vehicle for raising capital. Additionally, the ownership structure of this real estate investment trust provides certain state income tax benefits to Pinnacle National and Pinnacle Financial.

The components of deferred income taxes included in other assets in the accompanying consolidated balance sheets at December 31, 2006 and 2005 are as follows:

	2006	2005
Deferred tax assets:		
Loan loss allowance	$ 6,654,334	$ 3,019,094
Loans	1,337,983	44,316
Securities	1,251,636	1,773,521
Accrued liability for supplemental retirement agreements	1,535,688	-
Deposits	585,568	-
Other deferred tax assets	340,296	130,500
	11,705,505	4,967,431
Deferred tax liabilities:		
Depreciation and amortization	1,563,078	417,207
Core deposit intangible asset	4,473,076	-
FHLB dividends	770,156	-
Other deferred tax liabilities	440,642	139,602
	7,246,952	556,809
Net deferred tax assets	$ 4,458,553	$ 4,410,622

In assessing the realizability of deferred tax assets, management considers whether it is more likely than not that some portion or all of the deferred tax assets will not be realized. The ultimate realization of deferred tax assets is dependent upon the generation of future taxable income during the periods in which those temporary differences become deductible. Management considers the scheduled reversal of deferred tax liabilities, projected future taxable income, and tax planning strategies in making this assessment. Based upon the level of historical taxable income and projections for future taxable income over the periods in which the deferred tax assets are deductible, management believes it is more likely than not that Pinnacle Financial will realize the benefit of these deductible differences. However, the amount of the deferred tax asset considered realizable could be reduced in the near term if estimates of future taxable income during the carryforward period are reduced.

Note 11. 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.

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

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

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

A summary of Pinnacle Financial's total contractual amount for all off-balance sheet commitments at December 31, 2006 is as follows:

Commitments to extend credit	$ 532,383,000
Standby letters of credit	52,961,000

At December 31, 2006, the fair value of Pinnacle Financial's standby letters of credit was $159,000. This amount represents the unamortized fee associated with these standby letters of credit and is included in the consolidated balance sheet of Pinnacle Financial. This fair value will decrease over time as the existing standby letters of credit approach their expiration dates.

Various legal claims also arise from time to time in the normal course of business. In the opinion of management, the resolution of claims outstanding at December 31, 2006 will not have a material effect on Pinnacle Financial's consolidated financial statements.

Note 12. Common Stock Offerings and Warrants

During 2004, Pinnacle Financial concluded a follow-on offering of its common stock to the general public. As a result of this offering, Pinnacle Financial, through its underwriters, sold 850,000 shares of common stock to the general public at $20 per share. The underwriters also exercised an over-allotment option and purchased an additional 127,500 shares at $20 per share, less the applicable underwriting discount. Net proceeds from the offering were approximately $18.2 million.

Three executives of Pinnacle Financial (the Chairman of the Board, the President and Chief Executive Officer and the Chief Administrative Officer) along with nine members of Pinnacle Financial's Board of Directors and two other

organizers of Pinnacle Financial were awarded warrants to acquire 406,000 shares of common stock at $5.00 per share. During 2006, 11,000 warrants were exercised and, as a result, 395,000 unexercised warrants were outstanding and exercisable at December 31, 2006.

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Note 13. Salary Deferral Plans and Cavalry Supplemental Executive Retirement Agreements

Pinnacle Financial has a 401(k) retirement plan covering all employees who elect to participate, subject to certain eligibility requirements. The Plan allows employees to defer up to 15% of their salary subject to regulatory limitations with Pinnacle Financial matching 100% of the first 4% in Pinnacle Financial stock during 2006. In 2005 and 2004, the match was calculated at 50% of the first 6% deferred in Pinnacle Financial stock. Subsequent to the merger with Cavalry Bancorp, Inc. from March 15, 2006 through December 29, 2006, certain employees participated in the Cavalry Bancorp 401(k) plan. On December 29, 2006, the Cavalry Bancorp 401(k) plan was merged into the Pinnacle Financial 401(k) plan. Pinnacle Financial's expense associated with the matching component of the plan(s) for each of the years in the three-year period ended December 31, 2006 was approximately $762,000, $259,000 and $199,000, respectively, and is included in the accompanying statements of income in salaries and employee benefits expense.

Prior to the merger with Pinnacle Financial, Cavalry maintained an employee stock ownership plan for the benefit of certain employees (the "Cavalry ESOP"). The Cavalry ESOP is a noncontributory retirement plan adopted by Cavalry in 1998 for the benefit of certain employees who meet minimum eligibility requirements. Cavalry Bancorp, Inc. was the Plan Sponsor and with the merger with Pinnacle Financial, Pinnacle Financial became the Plan Sponsor on March 15, 2006. On March 15, 2006, the Cavalry ESOP owned approximately 683,000 common shares of Pinnacle Financial. The Cavalry ESOP had no liabilities as of March 15, 2006, thus all of the Pinnacle Financial shares owned by the Cavalry ESOP were available for distribution to the participants in the Cavalry ESOP pursuant to the terms of the plan. The terms of the Cavalry ESOP did not change as a result of the merger with Pinnacle Financial.

Pursuant to the terms of the Cavalry ESOP, participation in the plan has been frozen as of March 15, 2006 and all participants in the plan were fully vested prior to the merger date. All assets of the plan were allocated to the participants pursuant to the plan's provisions. Thus, Pinnacle Financial is not required to make future contributions to the Cavalry ESOP. Distributions to participants are only made upon the termination from employment from Pinnacle Financial or the participant's death, at which time, distributions will be made to the participant's beneficiaries.

Pinnacle National serves as the Trustee of the Cavalry ESOP. During 2006, Pinnacle National assessed the Cavalry ESOP no fees as Trustee. Additionally, Pinnacle National incurred administrative expenses of $15,000, primarily auditing and consulting expenses, to maintain the plan.

Prior to the merger with Pinnacle Financial, Cavalry had adopted nonqualified noncontributory supplemental retirement agreements (the "Cavalry SRAs") for certain of the directors and executive officers of Cavalry. Cavalry invested in and, as a result of the Cavalry merger, Pinnacle Financial is the owner of single premium life insurance policies on the life of each participant and is the beneficiary of the policy value. When a participant retires, the accumulated gains on the policy allocated to such participant, if any, will be distributed to the participant in equal installments for 15 years (the "Primary Benefit"). In addition, any annual gains after the retirement date of the participant will be distributed on an annual basis for the lifetime of the participant (the "Secondary Benefit"). As a result of the merger with Pinnacle Financial, all participants became fully vested in the Cavalry SRAs. No new participants have been added to the Cavalry SRAs as a result of the merger with Pinnacle Financial.

The Cavalry SRAs also provides the participants with death benefits, which is a percentage of the net death proceeds for the policy, if any, applicable to the participant. The death benefits are not taxable to Pinnacle Financial or the participant's beneficiary.

Pinnacle Financial recognized approximately $163,000 in compensation expense in the year ended December 31, 2006 related to the Cavalry SRAs. Additionally, Pinnacle Financial incurred approximately $5,000 in administrative

expenses to maintain the Cavalry SRA during the year ended December 31, 2006. At December 31, 2006, included in other liabilities is $3,915,000 which represents the net present value of the future obligations owed the participants in the Cavalry SRAs using a discount rate of 5.5%.

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Note 14. Stock Option Plan and Restricted Shares

Pinnacle Financial has two equity incentive plans under which it has granted stock options to its employees to purchase common stock at or above the fair market value on the date of grant and granted restricted share awards to employees and directors. During the first quarter of 2006 and in connection with its merger with Cavalry, Pinnacle Financial assumed a third equity incentive plan, the 1999 Cavalry Bancorp, Inc. Stock Option Plan (the "Cavalry Plan"). All options granted under the Cavalry Plan were fully vested prior to Pinnacle Financial's merger with Cavalry and expire at various dates between January 2011 and June 2012. In connection with the merger, all options to acquire Cavalry common stock were converted to options to acquire Pinnacle Financial common stock at the 0.95 exchange ratio. The exercise price of the outstanding options under the Cavalry Plan was adjusted using the same exchange ratio. All other terms of the Cavalry options were unchanged. There were 195,551 Pinnacle shares which could be acquired by the participants in the Cavalry Plan at exercise prices that ranged between $10.26 per share and $13.68 per share.

As of December 31, 2006, of the 1,658,000 stock options outstanding, 1,298,000 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 361,000 options would be deemed non-qualified stock options and thus not subject to favorable tax treatment to the option holder. All stock options under the plans vest in equal increments over five years from the date of grant and are exercisable over a period of ten years from the date of grant.

A summary of the activity within the three equity incentive plans during the twelve months ended December 31, 2006 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, 2003	**907,400**	**$ 5.39**		
Granted	189,080	14.65		
Exercised	(23,780)	4.89		
Forfeited	(4,350)	7.86		
Outstanding at December 31, 2004	**1,068,350**	**$ 7.03**		
Granted	209,482	23.74		
Exercised	(20,953)	5.93		
Forfeited	(14,486)	14.93		
Outstanding at December 31, 2005	**1,242,393**	**$ 9.78**		
Additional stock option grants resulting from assumption of the Cavalry Plan	195,551	10.80		
Granted	365,519	24.00		
Exercised	(130,168)	9.69		
Forfeited	(14,836)	15.45		
Outstanding at December 31, 2006	**1,658,459**	**$ 12.93**	**6.4**	**$ 31,848**
Outstanding and expected to vest at December 31, 2006	**1,630,134**	**$ 13.88**	**6.4**	**$ 31,563**

Options exercisable at December 31, 2006	**922,524**	**$ 7.40**	**5.0**	**$ 23,780**

(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 $33.18 per common share for the 1.6 million options that were in-the-money at December 31, 2006.

During the year ended December 31, 2006, 155,000 option awards vested at an average exercise price of $12.46 and an intrinsic value of approximately $5.14 million. On January 19, 2007, Pinnacle Financial granted options to purchase 234,000 common shares to certain employees at an exercise price of $31.25 per share. These options, which were issued as non-qualified stock options, will vest in varying increments over five years beginning one year after the date of the grant and are exercisable over a period of ten years from the date of grant.

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During the years ended December 31, 2006, 2005 and 2004, the aggregate intrinsic value of options exercised under our equity incentive plans was $1,694,000, $354,000 and $6,000, respectively, determined as of the date of option exercise. As of December 31, 2006, there was approximately $4.39 million of total unrecognized compensation cost related to unvested stock options granted under our equity incentive plans. That cost is expected to be recognized over a weighted-average period of 3.9 years.

Pinnacle Financial adopted SFAS No. 123(R) using the modified prospective transition method on January 1, 2006. Accordingly, during the year ended December 31, 2006, we recorded stock-based compensation expense using the Black-Scholes valuation model for awards granted prior to, but not yet vested, as of January 1, 2006 and for stock-based awards granted after January 1, 2006, based on fair value estimated using the Black-Scholes valuation model. For these awards, we have recognized compensation expense using a straight-line amortization method. As SFAS No. 123(R) requires that stock-based compensation expense be based on awards that are ultimately expected to vest, stock-based compensation for the year ended December 31, 2006 has been reduced for estimated forfeitures. The impact on our results of operations (compensation and employee benefits expense) and earnings per share of recording stock-based compensation in accordance with SFAS No. 123(R) (related to stock option awards) for the year ended December 31, 2006 was as follows:

	Awards granted with the intention to be classified as incentive stock options	Non-qualified stock option awards	Totals
Stock-based compensation expense	$ 586,923	$ 423,034	$ 1,009,957
Deferred income tax benefit	-	165,956	165,956
Impact of stock-based compensation expense after deferred income tax benefit	$ 586,923	$ 257,078	$ 844,001
Impact on earnings per share:			
Basic -weighted average shares outstanding	$ 0.042	$ 0.018	$ 0.060
Fully diluted - weighted average shares outstanding	$ 0.039	$ 0.017	$ 0.056

For purposes of these calculations, the fair value of options granted for each of the years in the three-year period ended December 31, 2006 was estimated using the Black-Scholes option pricing model and the following assumptions:

	2006	*2005*	*2004*
Risk free interest rate	4.65%	2.57%	1.11%
Expected life of options	6.50 years	6.50 years	6.50 years
Expected dividend yield	0.00%	0.00%	0.00%
Expected volatility	23.1%	24.1%	21.4%
Weighted average fair value	$10.44	$7.30	$3.62

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

expected life of the stock option issuances in effect at the time of grant.

Additionally, Pinnacle Financial's 2004 Equity Incentive Plan provides for the granting of restricted share awards and other performance or market-based awards, such as stock appreciation rights. There were no market-based awards or stock appreciation rights outstanding as of December 31, 2006. During 2006, 2005 and 2004, Pinnacle Financial awarded 18,057 shares, 16,366 shares and 3,846 shares, respectively, of restricted common stock to certain executives of Pinnacle Financial. The fair value of these awards as of the date of grant was $34.96, $24.98 and $22.62 per share, respectively. The forfeiture restrictions on the restricted shares lapse in three separate traunches should Pinnacle Financial achieve certain earnings and soundness targets over the subsequent three year period, excluding the impact of any merger related expenses in 2006 and thereafter. Compensation expense

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associated with the restricted share awards is recognized over the time period that the restrictions associated with the awards lapse based on a graded vesting schedule such that each traunche is amortized separately. Earnings and soundness targets for the 2006, 2005 and 2004 fiscal years were achieved and the restrictions related to 12,753, 6,734 shares and 1,282 shares, respectively, were released. For each year in the three-year period ended December 31, 2006, Pinnacle Financial recognized approximately $360,000, $245,000 and $43,000, respectively, in compensation costs attributable to these awards. Accumulated compensation costs since the date these shares were awarded have amounted to approximately $648,000 through December 31, 2006.

During 2006, the Board of Directors of Pinnacle Financial awarded 4,400 shares of restricted common stock to the outside members of the board in accordance with their 2006 board compensation package. Each board member received an award of 400 shares. The restrictions on these shares lapsed subsequent to December 31, 2006 on the one year anniversary date of the award based on each individual board member meeting their attendance goals for the various board and board committee meetings to which each member was scheduled to attend during the fiscal year ended December 31, 2006 with the exception of one outside board member who resigned his board seat and forfeited his restricted share award. The weighted average fair value of all restricted share awards granted to our directors as of the date of grant was $26.14 per share. For the year ended December 31, 2006, Pinnacle Financial recognized approximately $105,000, in compensation costs attributable to these awards.

A summary of activity for restricted share awards for the year ended December 31, 2006 follows:

	Executive Management Awards			***Board of Director Awards***		
(number of share awards)	***Vested***	***Unvested***	***Totals***	***Vested***	***Unvested***	***Totals***
Balances at December 31, 2005	8,016	12,196	20,212	-	-	-
Granted	-	18,057	18,057	-	4,400	4,400
Forfeited	-	-	-	-	(400)	(400)
Vested	12,753	(12,753)	-	-	-	-
Balances at December 31, 2006	20,769	17,500	38,269	-	4,000	4,000

A summary of compensation expense, net of the impact of income taxes, related to restricted stock awards for the three-year period ended December 31, 2006, follows:

	2006	**2005**	**2004**
Stock-based compensation expense	$ 465,003	$ 244,724	$ 43,009
Income tax benefit	182,421	93,705	16,468
Impact of stock-based compensation expense, net of income tax benefit	$ 282,582	$ 151,019	$ 26,541
Impact on earnings per share:			
Basic -weighted average shares outstanding	$ 0.020	$ 0.018	$ 0.003
Fully diluted - weighted average shares outstanding	$ 0.019	$ 0.016	$ 0.003

Prior to January 1, 2006, Pinnacle Financial applied APB Opinion No. 25 and related interpretations in accounting for its stock option plans. All option grants carry exercise prices equal to or above the fair value of the common stock on the date of grant. Accordingly, no compensation cost had been recognized for such periods. Had compensation cost

for Pinnacle Financial's equity incentive plans been determined based on the fair value at the grant dates for awards under the plans consistent with the method prescribed in SFAS No. 123(R), Pinnacle Financial's net income and net income per share would have been adjusted to the pro forma amounts indicated below for the years ended December 31, 2005 and 2004:

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			2005		2004
Net income, as reported		$	8,055,268	$	5,318,910
Add: Compensation expense recognized in the accompanying consolidated statement of income, net of related tax effects			167,981		32,252
Deduct: Total stock-based compensation expense determined under the fair value based method for all awards, net of related tax effects			(859,350)		(458,405)
Pro forma net income		$	7,363,899	$	4,892,757
Per share information:					
Basic net income	As reported	$	0.96	$	0.69
	Pro forma		0.88		0.63
Diluted net income	As reported	$	0.85	$	0.61
	Pro forma		0.78		0.56

Note 15. Employment Contracts

Pinnacle Financial has entered into four continuously automatic-renewing three-year 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 will always have a three-year term unless any of the parties to the agreements gives notice of intent not to renew the agreement. The agreements specify that in certain defined “Terminating Events,” Pinnacle Financial will be obligated to pay each of the four senior executives a certain amount which is based on their annual salaries and bonuses. These Terminating Events include disability, change of control and other events.

Pinnacle Financial has entered into an employment agreement with one of its directors who served as the former Chief Executive Officer of Cavalry. This agreement shall have an initial term that expires on April 25, 2007 (the 65th birthday of the director/employee). The agreement specifies that in certain defined “Terminating Events,” Pinnacle Financial will be obligated to pay this director/executive a certain amount which is based on his annual salary and bonus. These Terminating Events include disability, change of control and other events. Furthermore, pursuant to the employment agreement the director/employee has agreed to a noncompetition and nonsolicitation clause for a period of three years following his employment.

Note 16. Related Party Transactions

A local public relations company, of which one of Pinnacle Financial’s directors is a principal, provides various services for Pinnacle Financial. For the years ended December 31, 2006, 2005, and 2004, Pinnacle Financial incurred approximately $195,000, $187,000 and $141,000, respectively, in expense for services rendered by this public relations company. Another director is an officer in an insurance firm that serves as an agent in securing insurance in such areas as Pinnacle Financial’s property and casualty insurance and other insurance policies.

During 2004, Pinnacle Financial’s wholly-owned subsidiary, Pinnacle Credit Enhancement Holdings, Inc. (“PCEH”), acquired a 24.5% membership interest in Collateral Plus, LLC. Collateral Plus, LLC serves as an intermediary between investors and borrowers in certain financial transactions whereby the borrowers require enhanced collateral in the form of guarantees or letters of credit issued by the investors for the benefit of banks and other financial institutions. An employee of Pinnacle National also owns a 24.5% interest in Collateral Plus, LLC. PCEH’s 24.5%

ownership of Collateral Plus, LLC resulted in pre-tax earnings of $120,000 in 2006, $216,000 in 2005and $9,000 in 2004.

Also see "Note 5-Loans and Allowance for Loan Losses" concerning loans and other extensions of credit to certain directors, officers, and their related entities.

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Note 17. Fair Value of Financial Instruments

The following methods and assumptions were used by Pinnacle Financial in estimating its fair value disclosures for financial instruments. 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 and estimates of future cash flows. In that regard, the derived fair value estimates cannot be substantiated by comparison to independent markets and, in many cases, could not be realized in immediate settlement of the instrument. The use of different methodologies may have a material effect on the estimated fair value amounts. The fair value estimates presented herein are based on pertinent information available to management as of December 31, 2006 and 2005. 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.

Cash, Due From Banks and Fed Funds Sold - The carrying amounts of cash, due from banks, and federal funds sold approximate their fair value.

Securities - Estimated fair values for securities available for sale and securities held to maturity are based on quoted market prices where available. If quoted market prices are not available, estimated fair values are based on quoted market prices of comparable instruments.

Loans - For variable-rate loans that reprice frequently and have no significant change in credit risk, fair values are equal to carrying values. For fixed rate loans that reprice within one year, fair values are equal to carrying values. 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. Fair values for impaired loans are estimated using discounted cash flow models or based on the fair value of the underlying collateral.

Deposits, Securities Sold Under Agreements to Repurchase, Advances from the Federal Home Loan Bank and Subordinated Debt - 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 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 and standby letters of credit do not represent a significant value to Pinnacle Financial until such commitments are funded. Pinnacle Financial has determined that the fair value of commitments to extend credit is not significant.

The carrying amounts and estimated fair values of Pinnacle Financial's financial instruments at December 31, 2006 and 2005 were as follows (in thousands):

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

	December 31, 2006		December 31, 2005	
	Carrying Amount	Estimated Fair Value	Carrying Amount	Estimated Fair Value
Financial assets:				
Cash, due from banks, and Federal funds sold	$ 92,519	$ 92,519	$ 58,654	$ 58,654
Securities available-for-sale	319,237	319,237	251,749	251,749
Securities held-to-maturity	27,257	26,594	27,331	26,546
Mortgage loans held-for-sale	5,654	5,654	4,874	4,874
Loans, net	1,481,617	1,469,642	640,166	630,586
Financial liabilities:				
Deposits and securities sold under agreements to repurchase	$ 1,763,427	$ 1,761,178	$ 875,985	$ 873,635
Federal Home Loan Bank advances	53,726	53,481	41,500	40,889
Subordinated debt	51,548	52,110	30,929	30,427
	Notional Amount		Notional Amount	
Off-balance sheet instruments:				
Commitments to extend credit	$ 532,383	$ -	$ 252,617	$ -
Standby letters of credit	52,961	159	57,550	227

Note 18. Regulatory Matters

Pinnacle National is subject to restrictions on the payment of dividends to Pinnacle Financial under federal banking laws and the regulations of the Office of the Comptroller of the Currency. Pinnacle Financial is also subject to limits on payment of dividends to its shareholders by the rules, regulations and policies of federal banking authorities. Pinnacle Financial has not paid any cash dividends since inception, and it does not anticipate that it will consider paying dividends until Pinnacle National generates sufficient capital from operations to support both anticipated asset growth and dividend payments. At December 31, 2006, pursuant to federal banking regulations, Pinnacle National had approximately $28.8 million of net retained profits from the previous two years available for dividend payments to Pinnacle Financial. At December 31, 2006, Pinnacle National had accumulated earnings of $34.3 million, thus approximately $5.5 million of Pinnacle National's net retained profits are unavailable for the payment of dividends to Pinnacle Financial.

Pinnacle Financial and Pinnacle National 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 National 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 National'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 Pinnacle National to maintain minimum amounts and ratios of Total and Tier I capital to risk-weighted assets and of Tier I capital to average assets. Management believes, as of December 31, 2006 and December 31, 2005, that Pinnacle Financial and Pinnacle National met all capital adequacy requirements to which they are subject. To be categorized as well-capitalized, Pinnacle National must maintain minimum Total risk-based, Tier I risk-based, and Tier I leverage ratios as set forth in the following table. Pinnacle Financial and Pinnacle National's actual capital amounts and ratios are presented in the following table (dollars in thousands):

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

	Actual		Minimum Capital Requirement		Minimum To Be Well-Capitalized Under Prompt Corrective Action Provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
At December 31, 2006						
Total capital to risk weighted assets:						
Pinnacle Financial	$ 202,881	11.8%	$ 137,638	8.0%	not applicable	
Pinnacle National	$ 175,159	10.2%	$ 137,340	8.0%	$ 171,676	10.0%
Tier I capital to risk weighted assets:						
Pinnacle Financial	$ 186,763	10.9%	$ 68,819	4.0%	not applicable	
Pinnacle National	$ 159,031	9.3%	$ 68,670	4.0%	$ 103,005	6.0%
Tier I capital to average assets (*):						
Pinnacle Financial	$ 186,763	9.5%	$ 79,021	4.0%	not applicable	
Pinnacle National	$ 159,031	8.1%	$ 79,056	4.0%	$ 98,820	5.0%
At December 31, 2005						
Total capital to risk weighted assets:						
Pinnacle Financial	$ 105,101	12.6%	$ 66,521	8.0%	not applicable	
Pinnacle National	$ 90,215	10.9%	$ 66,334	8.0%	$ 82,917	10.0%
Tier I capital to risk weighted assets:						
Pinnacle Financial	$ 97,243	11.7%	$ 33,261	4.0%	not applicable	
Pinnacle National	$ 82,357	9.9%	$ 33,167	4.0%	$ 49,751	6.0%
Tier I capital to average assets (*):						
Pinnacle Financial	$ 97,243	9.9%	$ 39,444	4.0%	not applicable	
Pinnacle National	$ 82,357	8.4%	$ 39,444	4.0%	$ 49,305	5.0%

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

Note 19. Business Segment Information

Pinnacle Financial has four reporting segments comprised of commercial banking, trust and investment services, mortgage origination and insurance services. Pinnacle Financial's primary segment is commercial banking which consists of commercial loan and deposit services as well as the activities of Pinnacle National's branch locations. Pinnacle Financial's segments were changed in 2006 as a result of the acquisition of Cavalry to include Trust with our Investment Services segment and to add a new segment for Insurance Services. Trust and investment services include trust services offered by Pinnacle National and all brokerage and investment activities associated with Pinnacle Asset

Management, an operating unit within Pinnacle National. Mortgage origination is also a separate unit within Pinnacle National and focuses on the origination of residential mortgage loans for sale to investors in the secondary residential mortgage market. Insurance Services reflect the activities of Pinnacle National's wholly owned subsidiary, Miller and Loughry. Miller and Loughry is a general insurance agency located in Murfreesboro, Tennessee and is licensed to sell various commercial and consumer insurance products. The following tables present financial information for each reportable segment as of December 31, 2006 and 2005 and for each year in the three-year period ended December 31, 2006 (dollars in thousands):

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

	Commercial Banking	Trust and Investment Services	Mortgage Origination	Insurance Services	Total Company
For the year ended December 31, 2006:					
Net interest income	$ 60,953	$ -	$ -	$ -	$ 60,953
Provision for loan losses	3,732	-	-	-	3,732
Noninterest income	8,705	3,316	1,647	2,119	15,787
Noninterest expense	41,930	2,375	976	1,343	46,624
Income tax expense	7,508	369	263	317	8,457
Net income	$ 16,488	$ 572	$ 408	$ 459	$ 17,927
For the year ended December 31, 2005:					
Net interest income	$ 29,038	$ -	$ -	$ -	$ 29,038
Provision for loan losses	2,152	-	-	-	2,152
Noninterest income	2,675	1,573	1,146	-	5,394
Noninterest expense	19,315	1,171	546	-	21,032
Income tax expense	2,809	154	230	-	3,193
Net income	$ 7,437	$ 248	$ 370	$ -	$ 8,055
For the year ended December 31, 2004:					
Net interest income	$ 20,264	$ -	$ -	$ -	$ 20,264
Provision for loan losses	2,948	-	-	-	2,948
Noninterest income	2,348	1,313	1,317	-	4,978
Noninterest expense	12,884	1,004	915	-	14,803
Income tax expense	1,900	118	154	-	2,172
Net income	$ 4,880	$ 191	$ 248	$ -	$ 5,319
As of December 31, 2006:					
End of period assets	$ 2,138,269	$ -	$ -	$ 3,918	$ 2,142,187
As of December 31, 2005:					
End of period assets	$ 1,016,772	$ -	$ -	$ -	$ 1,016,772

At December 31, 2006, Pinnacle Financial had approximately $125.7 million in goodwill and core deposit intangible assets, all of which had been assigned to the Commercial Banking segment.

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

Note 20. Parent Company Only Financial Information

The following information presents the condensed balance sheets, statements of income, and cash flows of Pinnacle Financial as of December 31, 2006 and 2005 and for each of the years in the three-year period ended December 31, 2006:

CONDENSED BALANCE SHEETS

	2006	2005
Assets:		
Cash	$ 24,803,538	$ 12,679,759
Investments in consolidated subsidiaries:		
Pinnacle National	277,481,220	79,463,336
Pinnacle Advisory Services.	124,716	107,086
Pinnacle Credit Enhancement Holdings	185,325	123,431
PNFP Insurance	477,473	-
Investment in unconsolidated subsidiaries:		
PNFP Statutory Trust I	310,000	310,000
PNFP Statutory Trust II	619,000	619,000
PNFP Statutory Trust III	619,000	-
Income taxes receivable from subsidiaries	1,298,299	676,886
Current income tax receivable	1,049,604	-
Other assets	786,846	618,650
	$ 307,755,021	$ 94,598,148
Liabilities and stockholders’ equity:		
Current income taxes payable	-	232,723
Subordinated debt	51,548,000	30,929,000
Other liabilities	190,000	-
Stockholders’ equity	256,017,021	63,436,425
	$ 307,755,021	$ 94,598,148

CONDENSED STATEMENTS OF INCOME

	2006	2005	2004
Revenues - Interest income	$ 267,154	$ 133,748	$ 63,121
Expenses:			
Interest expense - subordinated debentures	2,504,033	985,645	431,318
Stock-based compensation expense	1,474,960	244,724	43,009
Other expense	245,528	58,772	100,179
Loss before income taxes and equity in income of subsidiaries	(3,957,367)	(1,155,393)	(511,385)
Income tax expense	1,632,738	438,270	198,516
Loss before equity in income of subsidiaries	(2,324,629)	(717,123)	(312,869)
Equity in income of subsidiaries	20,251,662	8,772,391	5,631,779
Net income	$ 17,927,033	$ 8,055,268	$ 5,318,910

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

CONDENSED STATEMENTS OF CASH FLOWS

	2006	2005	2004
***Operating activities*:**			
Net income	$ 17,927,033	$ 8,055,268	$ 5,318,910
Adjustments to reconcile net income to net cash provided (used) by operating activities:			
Stock-based compensation expense	1,474,960	244,724	43,009
Decrease (increase) in income tax receivable, net	(1,921,194)	1,000,352	(1,449,903)
Decrease (increase) in other assets	1,118,127	(479,474)	12,365
Increase (decrease) in other liabilities	190,000	99,726	(4,832)
Tax benefit from exercise of stock awards	-	(50,535)	(1,912)
Excess tax benefit from stock compensation	(131,121)		
Deferred tax benefit	(232,866)	-	-
Equity in income of subsidiaries	(20,251,662)	(8,772,391)	(5,631,779)
Net cash provided (used) by operating activities	(1,826,723)	97,670	(1,714,142)
Investing activities -			
Investment in unconsolidated subsidiaries	(619,000)	(619,000)	-
Investment in consolidated subsidiaries:			
Pinnacle National	(10,000,000)	(15,500,000)	(17,556,000)
Other subsidiaries	(350,250)	(183,721)	(57,812)
Investments in other entities	(65,647)	-	-
Cash and cash equivalents acquired in merger with Cavalry	3,128,116	-	-
Net cash used by investing activities	(7,906,781)	(16,302,721)	(17,613,812)
Financing activities -			
Proceeds from issuance of subordinated debt	20,619,000	20,619,000	-
Net proceeds from sale of common stock	-	-	18,192,167
Exercise of common stock warrants	55,000	-	-
Exercise of common stock options	1,239,771	174,761	118,113
Excess tax benefit from stock compensation arrangements	131,121	-	-
Costs incurred in connection with registration of common stock issued in merger	(187,609)	-	-
Net cash provided by financing activities	21,857,283	20,793,761	18,310,280
Net increase (decrease) in cash	12,123,779	4,588,710	(1,017,674)
Cash, beginning of year	12,679,759	8,091,049	9,108,723
Cash, end of year	$ 24,803,538	$ 12,679,759	$ 8,091,049

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

Note 21. 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, 2006 follows:

(in thousands, except per share data)	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
2006				
Interest income	$ 16,811	$ 28,305	$ 31,340	$ 33,241
Net interest income	9,507	16,895	17,159	17,391
Provision for loan losses	387	1,707	587	1,051
Net income before taxes	3,839	6,463	7,942	8,139
Net income	2,612	4,322	5,347	5,646
Basic net income per share	*$ 0.27*	*$ 0.28*	*$ 0.35*	*$ 0.37*
Diluted net income per share	*$ 0.24*	*$ 0.26*	*$ 0.32*	*$ 0.34*
2005				
Interest income	$ 9,270	$ 10,544	$ 12,379	$ 14,118
Net interest income	6,503	6,795	7,456	8,287
Provision for loan losses	601	483	366	702
Net income before taxes	2,499	2,762	2,867	3,119
Net income	1,780	1,959	2,078	2,238
Basic net income per share	*$ 0.21*	*$ 0.23*	*$ 0.25*	*$ 0.27*
Diluted net income per share	*$ 0.19*	*$ 0.21*	*$ 0.22*	*$ 0.24*
2004				
Interest income	$ 5,666	$ 6,225	$ 7,214	$ 8,574
Net interest income	4,152	4,536	5,299	6,278
Provision for loan losses	354	449	1,012	1,134
Net income before taxes	1,611	1,655	1,961	2,263
Net income	1,071	1,168	1,391	1,689
Basic net income per share	*$ 0.15*	*$ 0.16*	*$ 0.18*	*$ 0.20*
Diluted net income per share	*$ 0.13*	*$ 0.14*	*$ 0.16*	*$ 0.18*

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

None.

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 46 of this Annual Report on Form 10-K. The attestation of Pinnacle Financial’s independent registered public accounting firm related to the report is set forth on page 48 of this Annual Report on Form 10-K.

Changes in Internal Controls

For the three months ended December 31, 2006, Pinnacle Financial continued to expand its internal control system over financial reporting to incorporate procedures specifically related to its merger with Cavalry Bancorp, Inc. We reviewed the financial information obtained from Cavalry from April 1, 2006 thru the date such information was integrated into Pinnacle Financial’s financial data systems and performed additional procedures with respect to such information in order to determine its accuracy and reliability.

There were no changes in Pinnacle Financial’s internal control over financial reporting during Pinnacle Financial’s fiscal quarter ended December 31, 2006 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 17, 2007, which will be filed on or before March 14, 2007 under the headings “Corporate Governance,” “Proposal #1 Election of Directors,” “Executive Management Information,” "Section 16A Beneficial

Ownership Reporting Compliance" and “Security Ownership of Certain Beneficial Owners and Management” 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 17, 2007, which will be filed on or before March 14, 2007 under the heading, "Executive Compensation" 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 will be included in Pinnacle Financial's Proxy Statement for the Annual Meeting of Shareholders to be held April 17, 2007, which will be filed on or before March 14, 2007 under the headings, "Security Ownership of Certain Beneficial Owners and Management," and "Executive Compensation," and are incorporated herein by reference.

The following table summarizes information concerning the Company's equity compensation plans at December 31, 2006:

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 (Excluding Securities Reflected in First Column)
Equity compensation plans approved by shareholders:			
2000 Stock Incentive Plan	909,225	$7.51	-
2004 Equity Incentive Plan	634,185	$23.06	609,922
1999 Cavalry Bancorp, Inc. Stock Option Plan	115,049	$10.79	-
Equity compensation plans not approved by shareholders	N/A	N/A	N/A
Total	1,658,459	$12.93	609,922

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 17, 2007, which will be filed on or before March 14, 2007 under the headings, "Security Ownership of Certain Beneficial Owners and Management - Certain Relationships and Related Transactions," "Executive Compensation," 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 17, 2007, which will be filed on or before March 14, 2007 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	Merger Agreement, dated September 30, 2005, by and between Pinnacle Financial Partners, Inc. and Cavalry Bancorp, Inc. (schedules and exhibits to which been omitted pursuant to Items 601(b)(2) of Regulations S-K **(1)**
3.1	Amended and Restated Charter **(2)**
3.2	Bylaws **(3)**
4.1.1	Specimen Common Stock Certificate **(4)**
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
10.1	Lease Agreement by and between TMP, Inc. (former name of Pinnacle Financial Partners, Inc.) and Commercial Street Associates dated March 16, 2000 (main office) **(4)**
10.4	Form of Pinnacle Financial Partners, Inc.'s Organizers' Warrant Agreement **(4)**
10.7	Employment Agreement dated as of August 1, 2000 by and between Pinnacle National Bank, Pinnacle Financial Partners, Inc. and Robert A. McCabe, Jr. **(4) ***
10.8	Employment Agreement dated as of April 1, 2000 by and between Pinnacle National Bank, Pinnacle Financial Partners, Inc. and Hugh M. Queener **(4) ***
10.9	Letter Agreement dated March 14, 2000 and accepted March 16, 2000 by and between Pinnacle Financial Corporation (now known as Pinnacle Financial Partners, Inc.) and Atkinson Public Relations **(4)**
10.14	Employment Agreement dated March 1, 2000 by and between Pinnacle National Bank, Pinnacle Financial Partners, Inc. and M. Terry Turner **(4)** *
10.15	Pinnacle Financial Partners, Inc. 2000 Stock Incentive Plan **(4)** *
10.16	Form of Pinnacle Financial Partners, Inc.'s Stock Option Award **(4)** *
10.18	Agreement for Assignment of Lease by and between Franklin National Bank and TMP, Inc., now known as Pinnacle Financial Partners, Inc., effective July 17, 2000 **(4)**
10.19	Form of Assignment of Lease and Consent of Landlord by Franklin National Bank, Pinnacle Financial Partners, Inc., formerly TMP, Inc., and Stearns Investments, Jack J. Stearns and Edna Stearns, General Partners **(4)**
10.21	Green Hills Office Lease **(5)**
10.23	Form of Restricted Stock Award Agreement **(6)**
10.24	Form of Incentive Stock Option Agreement **(6)**
10.25	Lease Agreement for West End Lease **(7)**
10.26	Lease Amendments for Commerce Street location **(7)**
10.27	Pinnacle Financial Partners, Inc. 2004 Equity Incentive Plan **(8) ***
10.28	2005 Annual Cash Incentive Plan **(2) ***
10.29	Fourth Amendment to Commerce Street Lease **(2)**
10.30	Employment Agreement by and between Pinnacle National Bank and Ed C. Loughry, Jr. **(9) ***
10.31	Employment Agreement by and between Pinnacle National Bank and William S. Jones **(9) ***
10.32	Consulting Agreement by and between Pinnacle National Bank and Ronnie F. Knight **(9) ***
10.33	2006 Director Compensation Summary **(10) ***
10.34	Form of Restricted Stock Agreement for non-employee directors **(10) ***

10.35	Form of Non-Qualified Stock Option Agreement **(11)** *
10.36	2006 Annual Cash Incentive Plan **(12)***
10.37	Employment Agreement dated as of March 14, 2006 by and among Pinnacle Financial Partners, Inc., Pinnacle National Bank and Harold R. Carpenter **(12)***
10.38	Calvary Bancorp, Inc. 1999 Stock Option Plan **(13)***
10.39	Amendment No. 1 to Calvary Bancorp, Inc. 1999 Stock Option Plan **(13)***
10.40	Form of Non-Qualified Stock Option Agreement **(13)***
10.41	Amendment No. 1 to Pinnacle Financial Partners, Inc. 2000 Stock Incentive Plan **(13)***
10.42	Amendment No. 3 to Pinnacle Financial Partners, Inc. 2004 Equity Incentive Plan **(13)***
10.43	2007 Named Executive Officer Summary*
10.44	Form of Restricted Stock Award Agreement*
21.1	Subsidiaries of Pinnacle Financial Partners, Inc.
23.1	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

(*) Management compensatory plan or arrangement

(1) Registrant hereby incorporates by reference to Registrant's Current Report on Form 8-K filed on October 3, 2005.
(2) Registrant hereby incorporates by reference to Registrant's Form 10-Q for the quarter ended March 31, 2005.
(3) Registrant hereby incorporates by reference to Registrant's Form 10-KSB for the fiscal year ended December 31, 2002 as filed with the SEC on March 6, 2003.
(4) Registrant hereby incorporates by reference to the Registrant's Registration Statement on Form SB-2, as amended (File No. 333-38018).
(5) Registrant hereby incorporates by reference to the Registrant's Form 10-KSB for the fiscal year ended December 31, 2000 as filed with the SEC on March 29, 2001.
(6) Registrant hereby incorporates by reference to Registrant's Form 10-Q for the quarter ended September 30, 2004.
(7) Registrant hereby incorporates by reference to Registrant's Form 10-K for the fiscal year ended December 31, 2004 as filed with the SEC on February 28, 2005.
(8) Registrant hereby incorporates by reference to Registrant's Current Report on Form 8-K filed on April 19, 2005.
(9) Registrant hereby incorporates by reference to Registrant's Registration Statement on Form S-4, as amended (File No. 333-129076).
(10) Registrant hereby incorporates by reference to Registrant's Current Report on Form 8-K filed on January 23, 2006.
(11) Registrant hereby incorporates by reference to Registrant's Form 10-K for the fiscal year ended December 31, 2005 as filed with the SEC on February 24, 2006.
(12) Registrant hereby incorporates by reference to Registrant's Current Report on Form 8-K filed on March 20, 2006.
(13) Registrant hereby incorporates by reference to Registrant's Form 10-Q for the quarter ended on September 30, 2006.

Pinnacle Financial is a party to certain agreements entered into in connection with the offering by PNFP Statutory Trust I, PNFP Statutory Trust II and PNFP Statutory Trust III of an aggregate of $50,000,000 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
President and Chief Executive Officer

Date: February 27, 2007

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, 2007
/s/ M. Terry Turner M. Terry Turner	Director, President and Chief Executive Officer (Principal Executive Officer)	February 27, 2007
/s/ Harold R. Carpenter Harold R. Carpenter	Chief Financial Officer (Principal Financial and Accounting Officer)	February 27, 2007
/s/ Sue R. Atkinson Sue R. Atkinson	Director	February 27, 2007
/s/ Gregory L. Burns Gregory L. Burns	Director	February 27, 2007
/s/ James C. Cope James C. Cope	Director	February 27, 2007
/s/ Colleen Conway-Welch Colleen Conway-Welch	Director	February 27, 2007
/s/ Clay T. Jackson Clay T. Jackson	Director	February 27, 2007

/s/ William H. Huddleston William H. Huddleston	Director	February 27, 2007
/s/ Ed C. Loughry, Jr. Ed C. Loughry, Jr.	Director	February 27, 2007
/s/ Hal N. Pennington Hal N. Pennington	Director	February 27, 2007
/s/ Dale W. Polley Dale W. Polley	Director	February 27, 2007
/s/ James L. Shaub, II James L. Shaub, II	Director	February 27, 2007
/s/ Reese L. Smith, III Reese L. Smith, III	Director	February 27, 2007

EXHIBIT INDEX

Exhibit No.	Description
2.1	Merger Agreement, dated September 30, 2005, by and between Pinnacle Financial Partners, Inc. and Cavalry Bancorp, Inc. (schedules and exhibits to which been omitted pursuant to Items 601(b)(2) of Regulations S-K **(1)**
3.1	Amended and Restated Charter **(2)**
3.2	Bylaws **(3)**
4.1.3	Specimen Common Stock Certificate **(4)**
4.1.4	See Exhibits 3.1 and 3.2 for provisions of the Charter and Bylaws defining rights of holders of the Common Stock
10.1	Lease Agreement by and between TMP, Inc. (former name of Pinnacle Financial Partners, Inc.) and Commercial Street Associates dated March 16, 2000 (main office) **(4)**
10.4	Form of Pinnacle Financial Partners, Inc.'s Organizers' Warrant Agreement **(4)**
10.7	Employment Agreement dated as of August 1, 2000 by and between Pinnacle National Bank, Pinnacle Financial Partners, Inc. and Robert A. McCabe, Jr. **(4) ***
10.8	Employment Agreement dated as of April 1, 2000 by and between Pinnacle National Bank, Pinnacle Financial Partners, Inc. and Hugh M. Queener **(4) ***
10.9	Letter Agreement dated March 14, 2000 and accepted March 16, 2000 by and between Pinnacle Financial Corporation (now known as Pinnacle Financial Partners, Inc.) and Atkinson Public Relations **(4)**
10.14	Employment Agreement dated March 1, 2000 by and between Pinnacle National Bank, Pinnacle Financial Partners, Inc. and M. Terry Turner **(4)** *
10.15	Pinnacle Financial Partners, Inc. 2000 Stock Incentive Plan **(4)** *
10.16	Form of Pinnacle Financial Partners, Inc.'s Stock Option Award **(4)** *
10.18	Agreement for Assignment of Lease by and between Franklin National Bank and TMP, Inc., now known as Pinnacle Financial Partners, Inc., effective July 17, 2000 **(4)**
10.19	Form of Assignment of Lease and Consent of Landlord by Franklin National Bank, Pinnacle Financial Partners, Inc., formerly TMP, Inc., and Stearns Investments, Jack J. Stearns and Edna Stearns, General Partners **(4)**
10.22	Green Hills Office Lease **(5)**
10.23	Form of Restricted Stock Award Agreement **(6)**
10.24	Form of Incentive Stock Option Agreement **(6)**
10.25	Lease Agreement for West End Lease **(7)**
10.26	Lease Amendments for Commerce Street location **(7)**
10.27	Pinnacle Financial Partners, Inc. 2004 Equity Incentive Plan **(8) ***
10.28	2005 Annual Cash Incentive Plan **(2) ***
10.29	Fourth Amendment to Commerce Street Lease **(2)**
10.30	Employment Agreement by and between Pinnacle National Bank and Ed C. Loughry, Jr. **(9) ***
10.31	Employment Agreement by and between Pinnacle National Bank and William S. Jones **(9) ***
10.32	Consulting Agreement by and between Pinnacle National Bank and Ronnie F. Knight **(9) ***
10.33	2006 Director Compensation Summary **(10) ***
10.34	Form of Restricted Stock Agreement for non-employee directors **(10) ***
10.35	Form of Non-Qualified Stock Option Agreement **(11)***

10.36	2006 Annual Cash Incentive Plan **(12)***
10.37	Employment Agreement dated as of March 14, 2006 by and among Pinnacle Financial Partners, Inc., Pinnacle National Bank and Harold R. Carpenter **(12)***
10.38	Calvary Bancorp, Inc. 1999 Stock Option Plan **(13)***
10.39	Amendment No. 1 to Calvary Bancorp, Inc. 1999 Stock Option Plan **(13)***
10.40	Form of Non-Qualified Stock Option Agreement **(13)***
10.41	Amendment No. 1 to Pinnacle Financial Partners, Inc. 2000 Stock Incentive Plan **(13)***
10.42	Amendment No. 3 to Pinnacle Financial Partners, Inc. 2004 Equity Incentive Plan **(13)***
10.43	2007 Named Executive Officer Summary*
10.44	Form of Restricted Stock Award Agreement*
21.1	Subsidiaries of Pinnacle Financial Partners, Inc.
23.1	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

(*) Management compensatory plan or arrangement