PINNACLE FINANCIAL PARTNERS INC
Form 10QSB
November 06, 2003

Table of Contents

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-QSB

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

For the Quarterly Period Ended September 30, 2003

OR

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

For the Transition Period from _____ to ___

Commission File No: 000-31225

Pinnacle Financial Partners, Inc.

(Exact name of small business issuer as specified in its charter)

Tennessee	62-1812853
(State or jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

The Commerce Center, 211 Commerce Street, Suite 300, Nashville, Tennessee 37201

(Address of principal executive offices)

(615) 744-3700

(Issuer s telephone number)

Not Applicable

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

APPLICABLE ONLY TO CORPORATE ISSUERS

State the number of shares outstanding of each of the issuer s classes of common equity, as of the latest practicable date:

3,692,053 shares of common stock, $1.00 par value per share, issued and outstanding as of October 31, 2003.

Transitional Small Business Disclosure Format (check one): YES [ ] NO **[X]**

TABLE OF CONTENTS

Table of Contents

Pinnacle Financial Partners, Inc.
Report on Form 10-QSB
September 30, 2003

TABLE OF CONTENTS

FORWARD-LOOKING STATEMENTS

Pinnacle Financial Partners, Inc. (Pinnacle Financial) may from time to time make written or oral statements, including statements contained in this report which may constitute forward-looking statements within the meaning of Section 21E of the Securities Exchange Act of 1934 (the Exchange Act). The words expect , anticipate , intend , consider , plan , believe , seek , should , estimate , and similar expressions a identify such forward-looking statements, but other statements may constitute forward-looking statements. These statements should be considered subject to various risks and uncertainties. Such forward-looking statements are made based upon management s belief as well as assumptions made by, and information currently available to, management pursuant to safe harbor provisions of the Private Securities Litigation Reform Act of 1995. Pinnacle Financial s actual results may differ materially from the results anticipated in forward-looking statements due to a variety of factors. Such factors are described below and include, without limitation, (i) unanticipated deterioration in the financial condition of borrowers resulting in significant increases in loan losses and provisions for those losses, (ii) increased competition with other financial institutions, (iii) lack of sustained growth in the economy in the Nashville, Tennessee area, (iv) rapid fluctuations or unanticipated changes in interest rates, (v) the inability of Pinnacle Financial to satisfy regulatory requirements for its expansion plans, (vi) changes in the legislative and regulatory environment and (vii) other risk factors including those discussed in Pinnacle Financial s annual report on Form 10-KSB and other reports filed by Pinnacle Financial with the Securities and Exchange Commission. Many of such factors are beyond Pinnacle Financial s ability to control or predict, and readers are cautioned not to put undue reliance on such forward-looking statements. Pinnacle Financial does not intend to update or reissue any forward-looking statements contained in this report as a result of new information or other circumstances that may become known to Pinnacle Financial.

Table of Contents

PINNACLE FINANCIAL PARTNERS, INC. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS UNAUDITED

	September 30, 2003	December 31, 2002
ASSETS		
Cash and noninterest-bearing due from banks	$ 11,633,943	$ 8,061,300
Interest-bearing due from banks	453,637	4,195,647
Federal funds sold and securities purchased under agreements to resell	20,097,042	685,182
Cash and cash equivalents	32,184,622	12,942,129
Securities available-for-sale, at fair value	115,421,439	73,980,054
Mortgage loans held-for-sale	2,220,020	
Loans	279,701,750	209,743,436
Less allowance for loan losses	(3,491,767)	(2,677,043)
Loans, net	276,209,983	207,066,393
Premises and equipment, net	6,284,822	3,611,504
Other assets	8,372,521	7,678,894
Total assets	$440,693,407	$305,278,974
LIABILITIES AND STOCKHOLDERS EQUITY		
Deposits:		
Noninterest-bearing demand	$ 55,255,123	$ 31,599,897
Interest-bearing demand	25,567,490	13,234,956
Savings and money market accounts	121,430,122	75,995,881
Time	144,938,528	113,185,655
Total deposits	347,191,263	234,016,389
Securities sold under agreements to repurchase	19,290,587	15,050,208
Federal Home Loan Bank advances	39,500,000	21,500,000
Other liabilities	1,466,833	2,308,730
Total liabilities	407,448,683	272,875,327
Commitments and contingent liabilities		
Stockholders equity:		
Preferred stock, no par value; 10,000,000 shares authorized; no shares issued and outstanding		
Common stock, par value $1.00; 10,000,000 shares authorized; 3,692,053 issued and outstanding at September 30, 2003 and December 31, 2002	3,692,053	3,692,053
Additional paid-in capital	30,682,947	30,682,947
Accumulated deficit	(1,047,380)	(2,743,794)
Accumulated other comprehensive income (loss), net	(82,896)	772,441
Total stockholders equity	33,244,724	32,403,647
Total liabilities and stockholders equity	$440,693,407	$305,278,974

See accompanying notes to consolidated financial statements.

Table of Contents

PINNACLE FINANCIAL PARTNERS, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF OPERATIONS UNAUDITED

	Three months ended September 30, 2003	Three months ended September 30, 2002	Nine months ended September 30, 2003	Nine months ended September 30, 2002
Interest income:				
Loans, including fees	$3,674,712	$2,833,005	$ 9,995,068	$7,565,360
Securities, available-for-sale:				
Taxable	918,112	535,022	2,756,584	1,159,472
Tax-exempt	57,875	11,567	138,262	11,567
Federal funds sold and other	51,895	46,480	127,996	138,108
Total interest income	4,702,594	3,426,074	13,017,910	8,874,507
Interest expense:				
Deposits	1,069,381	996,584	3,261,641	2,729,158
Securities sold under agreements to repurchase	15,267	23,443	42,233	65,173
Federal funds purchased and other borrowings	232,615	125,982	707,803	299,810
Total interest expense	1,317,263	1,146,009	4,011,677	3,094,141
Net interest income	3,385,331	2,280,065	9,006,233	5,780,366
Provision for loan losses	318,068	247,000	953,360	688,000
Net interest income after provision for loan losses	3,067,263	2,033,065	8,052,873	5,092,366
Noninterest income:				
Service charges on deposit accounts	137,097	80,166	359,211	200,631
Investment services	324,663	220,721	656,888	677,282
Fees from origination of mortgage loans	244,912		489,005	
Gain on loan participations sold	75,238	13,038	201,466	57,997
Gain on sale of investment securities, net	113,707		247,978	
Other noninterest income	128,860	182,604	409,158	323,033
Total noninterest income	1,024,477	496,529	2,363,706	1,258,943
Noninterest expense:				
Compensation and employee benefits	1,882,344	1,427,251	5,010,942	3,764,462
Equipment and occupancy	480,216	370,495	1,323,002	1,049,435
Marketing and other business development	84,570	70,723	263,834	162,118
Administrative	177,812	134,393	491,465	323,275
Postage and supplies	93,676	59,404	273,167	184,913
Other noninterest expense	145,335	119,265	418,835	274,433
Total noninterest expense	2,863,953	2,181,531	7,781,245	5,758,636
Income before income taxes	1,227,787	348,063	2,635,334	592,673
Income tax expense	441,218	136,585	938,920	229,436
Net income	$ 786,569	$ 211,478	$ 1,696,414	$ 363,237

Per share information:				
Basic net income per common share	$ 0.21	$ 0.06	$ 0.46	$ 0.13
Diluted net income per common share	$ 0.20	$ 0.06	$ 0.44	$ 0.13
Weighted average shares outstanding:				
Basic	3,692,053	3,692,053	3,692,053	2,841,943
Diluted	3,972,327	3,745,272	3,898,200	2,873,334

See accompanying notes to consolidated financial statements.

Table of Contents

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

	Nine months ended September 30, 2003	2002
Operating activities:		
Net income	$ 1,696,414	$ 363,237
Adjustments to reconcile net income to net cash provided by operating activities:		
Net amortization of available-for-sale securities	679,837	111,194
Depreciation and amortization	669,814	521,363
Provision for loan losses	953,360	688,000
Gain on sale of investment securities, net	(247,978)	
Gain on participations sold	(201,466)	(57,997)
Deferred tax expense	555,530	229,436
Mortgage loans held-for-sale:		
Loans originated	(28,379,295)	
Loans sold	26,159,275	
Increase in other assets	(309,199)	(374,302)
Increase (decrease) in other liabilities	(458,507)	421,973
Net cash provided by operating activities	1,117,785	1,902,904
Investing activities:		
Activities in securities available-for-sale:		
Purchases	(102,989,447)	(42,572,668)
Sales	23,125,263	
Maturities, prepayments and calls	36,611,365	6,347,851
	(43,252,819)	(36,224,817)
Net increase in loans	(70,096,950)	(56,952,991)
Purchases of premises and equipment and software	(3,154,776)	(531,553)
Purchases of other assets	(786,000)	(2,158,500)
Net cash used in investing activities	(117,290,545)	(95,867,861)
Financing activities:		
Net increase in deposits	113,174,874	79,655,405
Net increase in securities sold under agreements to repurchase	4,240,379	2,062,539
Advances from Federal Home Loan Bank	18,000,000	7,000,000
Net proceeds from the sale of common stock		12,745,000
Net cash provided by financing activities	135,415,253	101,462,944
Net increase in cash and cash equivalents	19,242,493	7,497,987
Cash and cash equivalents, beginning of period	12,942,129	14,582,076
Cash and cash equivalents, end of period	$ 32,184,622	$ 22,080,063
Supplemental disclosure:		
Cash paid for interest	$ 4,151,808	$ 3,015,224

Cash paid for income taxes	$	$

See accompanying notes to consolidated financial statements.

Table of Contents

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

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Nature of Business Pinnacle Financial Partners, Inc. (Pinnacle Financial) was formed on February 28, 2000 (inception) and is a bank holding company whose business is conducted by its wholly-owned subsidiary, Pinnacle National Bank (Pinnacle National). Additionally, PFP Title Company and Pinnacle Community Development, Inc. are wholly-owned subsidiaries of 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 area of Davidson County and the surrounding counties. Pinnacle National commenced its banking operations on October 27, 2000. PFP Title Company sells title insurance polices to Pinnacle National customers and others.

Basis of Presentation These consolidated financial statements include the accounts of Pinnacle Financial. Significant intercompany transactions and accounts are eliminated in consolidation.

The accompanying unaudited consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States for interim financial information and with the instructions to Form 10-QSB. Accordingly, they do not include all the information and footnotes required by accounting principles generally accepted in the United States of America for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included. Operating results for the three and nine months ended September 30, 2003 are not necessarily indicative of the results that may be expected for the year ending December 31, 2003. For further information, refer to the consolidated financial statements and footnotes thereto included in Pinnacle Financial s Form 10-KSB for the fiscal year ended December 31, 2002 as filed with the Securities and Exchange Commission.

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 and valuation of deferred income tax assets.

Stock-Based Compensation In December 2002, the FASB issued SFAS No. 148, Accounting for Stock-Based Compensation Transition and Disclosure, an amendment of FASB Statement No. 123 . This Statement amends Statement No. 123, Accounting for Stock-Based Compensation , to provide alternative methods of transition for a voluntary change to the fair value method of accounting for stock-based employee compensation. In addition, this Statement amends the disclosure requirements of Statement No. 123 to require prominent disclosures in both annual and interim financial statements. Certain of the disclosure modifications are required for fiscal years ending after December 15, 2002 and are included below.

Pinnacle Financial applies APB Opinion 25 and related interpretations in accounting for its stock option plan. 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 has been recognized. Had compensation cost for Pinnacle Financial s stock option plan been determined based on the fair value at the grant dates for awards under the plan consistent with the method prescribed in SFAS No. 123, Accounting for Stock-Based Compensation, Pinnacle Financial s net income and net income per share would have been adjusted to the pro forma amounts indicated below for the three and nine months ended September 30, 2003 and 2002:

Table of Contents

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

		Three months ended September 30, 2003	Three months ended September 30, 2002	Nine months ended September 30, 2003	Nine months ended September 30, 2002
Net income, as reported		$786,569	$211,478	$1,696,414	$ 363,237
Deduct: Total stock-based compensation expense determined under the fair value based method for all awards, net of related tax effects		(51,676)	(39,923)	(145,644)	(112,632)
Pro forma net income		$734,893	$171,555	$1,550,770	$ 250,605
Per share information:					
Basic net income	As reported	$ 0.21	$ 0.06	$ 0.46	$ 0.13
Pro forma		$ 0.20	$ 0.05	$ 0.42	$ 0.09
Diluted net income	As reported	$ 0.20	$ 0.06	$ 0.44	$ 0.13
Pro forma		$ 0.19	$ 0.05	$ 0.41	$ 0.09

For purposes of these calculations, the fair value of options granted for the nine months ended September 30, 2003 and 2002 was estimated using the Black-Scholes option pricing model and the following assumptions:

	2003	2002
Risk free interest rate	1.19%	1.74%
Expected life of the options	5.0 years	5.0 years
Expected dividend yield	0.0%	0.0%
Expected volatility	41.1%	69.7%
Weighted average fair value	$5.37	$5.83

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 and warrants.

The basic net income per share information for the three and nine months ended September 30, 2002 was computed based on 2,312,053 common shares outstanding from January 1, 2002 through June 14, 2002. On June 14, 2002, Pinnacle Financial issued 1,200,000 additional common shares in conjunction with a common stock offering to the general public and then on June 24, 2002 issued an additional 180,000 shares in conjunction with the underwriters exercise of the over-allotment option. As a result, 3,692,053 common shares were outstanding on September 30, 2002 and, since no new shares have been issued since that date, 3,692,053 common shares were outstanding for the three and nine months ended September 30, 2003.

As of September 30, 2003 and 2002, there were common stock options outstanding to purchase common shares. Substantially all of these shares have exercise prices which, when considered in relation to the average market price of Pinnacle Financial s common stock for the respective reporting period, are considered dilutive and are considered in Pinnacle Financial s diluted income per share calculation for the three and nine months ended September 30, 2003 and 2002. Additionally, as of September 30, 2003, Pinnacle Financial had dilutive warrants outstanding to purchase 203,000 common shares which have also been considered in the calculation of Pinnacle Financial s diluted income per share for the three and nine months ended September 30, 2003 and 2002.

Table of Contents

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

The following is a summary of the basic and diluted earnings per share calculation for the three and nine months ended September 30, 2003 and 2002:

	Three months ended September 30, 2003	Three months ended September 30, 2002	Nine months ended September 30, 2003	Nine months ended September 30, 2002
Basic earnings per share calculation:				
Numerator Net income	$ 786,569	$ 211,478	$ 1,696,414	$ 363,237
Denominator Average common shares outstanding	3,692,053	3,692,053	3,692,053	2,841,943
Basic net income per share	$ 0.21	$ 0.06	$ 0.46	$ 0.13
Diluted earnings per share calculation:				
Numerator Net income	$ 786,569	$ 211,478	$ 1,696,414	$ 363,237
Denominator Average common shares outstanding	3,692,053	3,692,053	3,692,053	2,841,943
Dilutive shares contingently issuable	280,274	53,219	206,147	31,391
Average dilutive common shares outstanding	3,972,327	3,745,272	3,898,200	2,873,334
Diluted net income per share	$ 0.20	$ 0.06	$ 0.44	$ 0.13

Comprehensive Income Statement of Financial Accounting Standards (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 consists of unrealized holding gains and losses, net of deferred income taxes, on available-for-sale securities. The following is a summary of other comprehensive income for the three and nine months ended September 30, 2003 and 2002.

	Three months ended September 30, 2003	Three months ended September 30, 2002	Nine months ended September 30, 2003	Nine months ended September 30, 2002
Net income, as reported	$ 786,569	$ 211,478	$ 1,696,414	$ 363,237
Other comprehensive income Net unrealized holding gains (losses) from available-for-sale securities	(1,169,183)	451,000	(855,337)	691,000
Total comprehensive income (loss)	$ (382,614)	$ 662,478	$ 841,077	$ 1,054,237

Business Segments Pinnacle Financial operates in one business segment, commercial banking, and has no additional individually significant business segments.

Recent Accounting Pronouncements In November 2002, the FASB issued Interpretation No. 45, *Guarantor s Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness to Others, an interpretation of FASB Statements No. 5, 57, and 107 and a rescission of FASB Interpretation No. 34*. This Interpretation elaborates on the disclosures to be made by a guarantor in its interim and annual financial statements about its obligations under guarantees issued. The Interpretation also clarifies that a guarantor is required to recognize, at inception of a guarantee, a liability for the fair value of the obligation undertaken. The initial recognition and measurement provisions of the Interpretation are applicable to guarantees issued or modified after December 31, 2002 and are not expected to have a material effect on Pinnacle Financial s financial statements. The disclosure requirements are effective for financial statements of interim and annual periods ending after December 15, 2002. Pinnacle Financial adopted this new standard on January 1, 2003. The adoption of this new standard had no effect on the consolidated

Table of Contents

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

financial position or results of operations of Pinnacle Financial as of and for the three and nine months ended September 30, 2003.

In January 2003, the FASB issued Interpretation No. 46, *Consolidation of Variable Interest Entities, an interpretation of ARB No. 51.* This Interpretation addresses the consolidation by business enterprises of variable interest entities as defined in the Interpretation. The Interpretation applies immediately to variable interests in variable interest entities created after January 31, 2003, and to variable interests in variable interest entities obtained after January 31, 2003. For public enterprises, such as Pinnacle Financial, with a variable interest in a variable interest entity created before February 1, 2003, the Interpretation is applied to the enterprise no later than the end of the first annual reporting period beginning after June 15, 2003. The Interpretation requires certain disclosures in financial statements issued after January 31, 2003 if it is reasonably possible that Pinnacle Financial will consolidate or disclose information about variable interest entities when the Interpretation becomes effective. The application of this Interpretation is not expected to have a material effect on Pinnacle Financial s financial statements.

In May 2003, the FASB issued FASB Statement No. 150, *Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity*. This Statement establishes standards for how an issuer classifies and measures certain financial instruments with characteristics of both liabilities and equity. It requires that an issuer classify a financial instrument that is within its scope as a liability (or an asset in some circumstances). Many of those instruments were previously classified as equity. The provisions of this Statement are effective for financial instruments entered into or modified after May 31, 2003, and otherwise are effective at the beginning of the first interim period beginning after June 15, 2003. It is to be implemented by reporting the cumulative effect of a change in an accounting principle for financial instruments created before May 15, 2003 and still existing at the beginning of the interim period of adoption. The adoption of this new standard is not expected to have an impact on the consolidated financial position or results of operations of Pinnacle Financial.

Reclassifications Certain previous amounts have been reclassified to conform to the 2003 presentation. Such reclassifications had no impact on net income or loss during any period.

NOTE 2. SECURITIES AVAILABLE-FOR-SALE

The amortized cost and fair value of securities available-for-sale at September 30, 2003 and December 31, 2002 are summarized as follows:

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Securities available-for-sale - 2003:				
U.S. government and agency securities	$ 24,029,876	$ 349,695	$(122,138)	$ 24,257,433
Mortgage-backed securities	83,893,906	359,349	(749,477)	83,503,778
State and municipal securities	7,631,358	88,317	(59,447)	7,660,228
	$115,555,140	$ 797,361	$(931,062)	$115,421,439
Securities available-for-sale - 2002:				
U.S. government and agency securities	$ 14,588,520	$ 455,021	$ (18,355)	$ 15,025,186
Mortgage-backed securities	54,566,041	815,806	(8,149)	55,373,698
State and municipal securities	3,579,620	13,066	(11,516)	3,581,170
	$ 72,734,181	$1,283,893	$ (38,020)	$ 73,980,054

Pinnacle Financial realized approximately $248,000 in net gains from the sale of $23,125,000 of available-for-sale securities during the nine months ended September 30, 2003. At September 30, 2003, approximately $69,318,000 of Pinnacle Financial s available-for-sale portfolio was pledged to secure public fund deposits and securities sold under agreements to repurchase.

Table of Contents

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

NOTE 3. LOANS AND ALLOWANCE FOR LOAN LOSSES

The composition of loans at September 30, 2003 and December 31, 2002 is summarized as follows:

	2003	2002
Commercial real estate Mortgage	$ 66,491,475	$ 58,964,823
Commercial real estate Construction	8,623,115	5,396,697
Commercial Other	125,053,786	98,722,136
Total Commercial	200,168,376	163,083,656
Consumer real estate Mortgage	67,982,633	37,533,445
Consumer real estate Construction	2,106,983	1,971,152
Consumer Other	9,443,758	7,155,183
Total Consumer	79,533,374	46,659,780
Total Loans	279,701,750	209,743,436
Allowance for loan losses	(3,491,767)	(2,677,043)
Loans, net	$276,209,983	$207,066,393

Using standard industry codes, 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 has a meaningful credit exposure (loans outstanding plus unfunded lines of credit) to borrowers in the trucking industry and to operators of nonresidential buildings. Credit exposure to the trucking industry approximated $32.0 million and $27.1 million, while credit exposure to operators of nonresidential buildings approximated $14.2 million and $9.6 million at September 30, 2003 and December 31, 2002, respectively. Levels of exposure to these industry groups are periodically evaluated in order to determine if additional allowance allocations are warranted.

At September 30, 2003 and 2002, Pinnacle Financial had certain impaired loans on nonaccruing interest status. The principal balance of these nonaccrual loans amounted to $1,095,000 and $70,000 at September 30, 2003 and 2002, respectively. In each case, 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 $68,000 and $7,000 for the nine months ended September 30, 2003 and 2002, respectively.

Changes in the allowance for loan losses for the nine months ended September 30, 2003 and for the year ended December 31, 2002 are as follows:

	2003	2002
Balance at beginning of period	$2,677,043	$1,832,000
Charged-off loans	(139,710)	(92,957)
Recovery of previously charged-off loans	1,074	
Provision for loan losses	953,360	938,000
Balance at end of period	$3,491,767	$2,677,043

At September 30, 2003, Pinnacle Financial has granted loans and other extensions of credit, in the normal course of its banking business, amounting to approximately $6,366,000 to certain directors, executive officers, and their related entities of which $4,239,000 had been drawn upon. The terms on these loans and extensions are on substantially the same terms customary for other persons for the type of loan involved.

During the three and nine months ended September 30, 2003 and 2002, 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 gain on the sale of these participated loans for the three months ended September 30, 2003 and 2002 of approximately $75,000 and $13,000, respectively, and $201,000 and $58,000 for the nine months ended September 30, 2003 and 2002, 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 based on their future participation in the loan.

Table of Contents

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

NOTE 4. INCOME TAXES

Income tax expense for the three and nine months ended September 30, 2003 and 2002 consists of the following:

	Three months ended September 30, 2003	2002	Nine months ended September 30, 2003	2002
Current tax expense:				
Federal	$319,463	$	$319,463	$
State	63,927		63,927	
Total current tax expense	383,390		383,390	
Deferred tax expense:				
Federal	46,884	22,624	460,133	38,560
State	10,944	113,961	95,397	190,876
Total deferred tax expense	57,828	136,585	555,530	229,436
Total income tax expense	$441,218	$136,585	$938,920	$229,436

Pinnacle Financial s income tax expense differs from the amounts computed by applying the Federal income tax statutory rates of 34% in 2003 and 2002 to income before income taxes. A reconciliation of the differences for the nine months ended September 30, 2003 and 2002 is as follows:

	2003	2002
Income taxes at statutory rate	$896,014	$201,509
State taxes, net of federal tax effect	105,154	27,927
Other items	(62,248)	
Income tax expense	$938,920	$229,436

The components of deferred income taxes included in other assets in the accompanying consolidated balance sheets at September 30, 2003 and December 31, 2002 are as follows:

	2003	2002
Deferred tax assets:		
Loan loss allowance	$1,366,687	$1,015,703
Securities available-for-sale	50,807	
Other accruals	128,921	169,846
Net operating loss carryforward		690,219
	1,546,415	1,875,768

Deferred tax liabilities:		
Loans and lending	114,691	
Depreciation and amortization	227,397	166,719
Securities available-for-sale		473,432
	342,088	640,151
Net deferred tax assets	$1,204,327	$1,235,617

NOTE 5. OFF-BALANCE SHEET 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.

Table of Contents

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

Other typical lines of credit are related to home equity loans granted to consumers. Commitments to extend credit generally have fixed expiration dates or other termination clauses and may require payment of a fee.

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

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

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

A summary of Pinnacle Financial s total contractual amount for all off-balance sheet commitments at September 30, 2003 is as follows:

Commitments to extend credit	$ 87,301,000
Standby letters of credit	28,519,000

At September 30, 2003, the fair value of Pinnacle Financial s standby letters of credit was $81,000. 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.

In the normal course of business, Pinnacle Financial may become involved in various legal proceedings. As of September 30, 2003, the management of Pinnacle Financial is not aware of any such proceedings against Pinnacle Financial.

NOTE 6. COMMON STOCK

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 (collectively, Pinnacle Financial s Founders) purchased an aggregate of 406,000 shares of common stock during the initial public offering, which represented approximately 21% of the initial public offering. The Founders were awarded common stock warrants which allow each individual the ability to purchase the common stock of Pinnacle Financial at $10 per share. Each person was given a warrant equal to one common share for every two shares purchased in connection with the initial public offering of the stock. As a group, 203,000 warrants were awarded. The warrants vest in one-third increments over a three-year period that began on August 18, 2000 and are exercisable until August 18, 2010. As of September 30, 2003, all warrants were exercisable.

Pinnacle Financial has a stock option plan under which it has granted options to its employees to purchase common stock at or above the fair market value on the date of grant. All of the options are intended

Table of Contents

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

to be incentive stock options qualifying under Section 422 of the Internal Revenue Code for favorable tax treatment. Options under the plan 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. The shareholders of Pinnacle Financial approved an allocation of 520,000 common shares toward this plan.

A summary of the plan changes during the nine months ended September 30, 2003 and for the year ended December 31, 2002 is as follows:

	Number	Weighted-Average Exercise Price
Outstanding at December 31, 2001	**239,200**	**$ 9.48**
Granted	129,700	10.01
Exercised		
Forfeited	(6,550)	9.08
Outstanding at December 31, 2002	**362,350**	**$ 9.67**
Granted	85,400	14.32
Exercised		
Forfeited	(1,200)	10.88
Outstanding at September 30, 2003	**446,550**	**$10.56**

The following table summarizes information about Pinnacle Financial s stock option plan at September 30, 2003.

Grant date	Number of Shares Outstanding	Remaining Contractual Life in Years	Exercise Price	Number of Shares Exercisable
December, 2000	184,550	7.25	$10.00	73,820
March, 2001	49,300	7.50	7.64	19,720
November, 2001	1,050	8.25	7.75	210
February, 2002	121,700	8.50	9.92	24,340
September, 2002	2,300	9.00	11.50	460
December, 2002	2,500	9.25	12.91	
February, 2003	42,700	9.50	13.30	
April, 2003	23,450	9.50	13.43	
June, 2003	3,850	9.75	16.25	
September, 2003	15,150	10.00	18.00	
	446,550	8.09	$10.56	118,550

NOTE 7. REGULATORY MATTERS

Pinnacle National is subject to certain restrictions on the amount of dividends that may be declared without prior regulatory approval. At September 30, 2003, no dividends could be declared by Pinnacle National without regulatory approval.

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 September 30, 2003 and December

Table of Contents

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

31, 2002, Pinnacle Financial and Pinnacle National met all capital adequacy requirements to which they were 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):

	Actual		Minimum Capital Requirement		Minimum To Be Well-Capitalized Under Prompt Corrective Action Provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
At September 30, 2003						
Total capital to risk weighted assets:						
Pinnacle Financial	$36,829	10.6%	$27,737	8.0%	not applicable	
Pinnacle National	$36,531	10.5%	$27,737	8.0%	$34,671	10.0%
Tier I capital to risk weighted assets:						
Pinnacle Financial	$33,328	9.6%	$13,869	4.0%	not applicable	
Pinnacle National	$33,030	9.5%	$13,869	4.0%	$20,803	6.0%
Tier I capital to average assets (*):						
Pinnacle Financial	$33,328	8.2%	$16,250	4.0%	not applicable	
Pinnacle National	$33,030	8.1%	$16,248	4.0%	$20,311	5.0%
At December 31, 2002						
Total capital to risk weighted assets:						
Pinnacle Financial	$34,318	13.8%	$19,960	8.0%	not applicable	
Pinnacle National	$30,777	12.3%	$19,960	8.0%	$24,951	10.0%
Tier I capital to risk weighted assets:						
Pinnacle Financial	$31,631	12.7%	$ 9,980	4.0%	not applicable	
Pinnacle National	$28,090	11.3%	$ 9,980	4.0%	$14,970	6.0%
Tier I capital to average assets (*):						
Pinnacle Financial	$31,631	11.1%	$11,437	4.0%	not applicable	
Pinnacle National	$28,090	9.8%	$11,437	4.0%	$14,296	5.0%

(*) Average assets for the above calculations were based on average assets for the immediately preceding quarter.

Table of Contents

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

Unless this Management s Discussion and Analysis of Financial Condition and Results of Operations indicates otherwise or the context otherwise requires, the terms we, our, us, Pinnacle Financial Partners or Pinnacle Financial as used herein refer to Pinnacle Financial Partners, Inc. and its subsidiary Pinnacle National Bank, which we sometimes refer to as Pinnacle National, our bank subsidiary or our bank.

The following is a discussion of our financial condition at September 30, 2003 and December 31, 2002 and our results of operations for the three and nine months ended September 30, 2003 and 2002. The purpose of this discussion is to focus on information about our financial condition and results of operations which is not otherwise apparent from the annual audited consolidated financial statements or the unaudited interim consolidated financial statements. You should read the following discussion and analysis along with our consolidated financial statements and the related notes included in our 2002 Annual Report on Form 10-KSB.

Critical Accounting Policies

The accounting principles we follow and our methods of applying these principles conform with accounting principles generally accepted in the United States 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 (ALL) and the recognition of our deferred income tax assets, have been critical to the determination of our financial position and results of operations.

Allowance for Loan Losses (ALL). Our management assesses the adequacy of the ALL 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 ALL consists of two portions (1) an allocated amount representative of specifically identified credit exposure and exposures readily predictable by historical or comparative experience; and (2) an unallocated amount representative of inherent loss which is not readily identifiable. Even though the ALL is composed of two components, the entire ALL is available to absorb any credit losses.

We establish the allocated amount separately for two different risk groups (1) unique loans (commercial loans, including those loans considered impaired); and (2) homogeneous loans (generally consumer loans). We base the allocation for unique loans primarily on risk rating grades assigned to each of these loans as a result of our loan management and review processes. We then assign each risk-rating grade a loss ratio, which is determined based on the experience of management, discussions with banking regulators and our independent loan review process. We estimate losses on impaired loans based on estimated cash flows discounted at the loan s original effective interest rate or based on the underlying collateral value. Based on management s experience, we also assign loss ratios to our consumer portfolio. These loss ratios are assigned to the various homogenous categories of the consumer portfolio (e.g., automobile, residential mortgage, home equity).

The unallocated amount is particularly subjective and does not lend itself to exact mathematical calculation. The unallocated amount represents estimated inherent credit losses which may exist, but have not yet been identified, as of the balance sheet date. In estimating the unallocated amount, such matters as changes in the local or national economy, the depth or experience in the lending staff, any concentrations of credit in any particular industry group, and new banking laws or regulations. After we assess applicable factors, we evaluate the aggregate unallocated amount based on our management s experience.

Table of Contents

We then test the resulting ALL balance by comparing the balance in the ALL to historical trends 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 ALL in its entirety. The audit committee of our board of directors reviews the assessment prior to the filing of quarterly and annual financial information.

In assessing the adequacy of the ALL, we also rely on an 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, who is not an employee of Pinnacle National, and reviews that may have been conducted by bank regulatory agencies as part of their usual examination process.

Deferred Income Tax Assets. During the period from inception through December 31, 2001, we incurred net operating losses and, as a result, recorded deferred tax assets associated with these loss carryforwards. However, prior to the fourth quarter of 2001, we also recorded a full valuation allowance against our net deferred tax assets, and we did not recognize any income tax benefit in our statement of operations. Our judgment was based on our inability to conclude that it was more likely than not that we could be sufficiently profitable in the future to recognize these tax benefits. In the fourth quarter of 2001, this judgment changed, and we determined that based upon our evaluation of our recent operating results and future projections, it was more likely than not that we would realize such assets. We therefore, in that quarter, eliminated the full amount of the valuation allowance and recorded in our statement of operations a deferred tax benefit equal to the deferred tax asset.

Results of Operations - Three and Nine Months Ended September 30, 2003 and 2002

Our results for the three and nine months ended September 30, 2003, when compared to the three and nine months ended September 30, 2002, were highlighted by the continued growth of our earning assets which resulted in increased net interest income and growth in noninterest income. Net income for the three months ended September 30, 2003 was $787,000 compared to net income of $211,000 for the three months ended September 30, 2002. Net income for the nine months ended September 30, 2003 was $1,696,000 compared to net income of $363,000 for the nine months ended September 30, 2002. The following is a more detailed discussion of results of our operations which focuses primarily on comparing, for each major item in the results, the third quarter of 2003 to the third quarter of 2002 and the nine months ended September 30, 2003 to the nine months ended September 30, 2002.

Net Interest Income. Net interest income represents the amount by which interest earned on various earning assets exceeds interest paid on deposits and other interest bearing liabilities and is the most significant component of our earnings. For the three months ended September 30, 2003, we recorded net interest income of $3,385,000 which resulted in a net interest margin of 3.51% for the third quarter of 2003. For the three months ended September 30, 2002, we recorded net interest income of $2,280,000 which resulted in a net interest margin of 3.97% for the third quarter of 2002. For the nine months ended September 30, 2003, we recorded net interest income of $9,006,000 which resulted in a net interest margin of 3.48%. For the nine months ended September 30, 2002, we recorded net interest income of $5,780,000 which resulted in a net interest margin of 3.93%.

Table of Contents

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 yield on average interest-earning assets for the three and nine months ended September 30, 2003 and 2002 (dollars in thousands):

	Three months ended September 30, 2003			Three months ended September 30, 2002		
	Average Balances	**Interest**	**Yield/ Rate(1)**	**Average Balances**	**Interest**	**Yield/ Rate(1)**
Interest-earning assets:						
Loans	$269,703	$3,675	5.41%	$181,005	$2,833	6.21%
Securities, available-for-sale:						
Taxable	100,519	918	3.62	40,844	535	5.16
Tax-exempt	6,642	58	4.10	1,163	12	5.21
Federal funds sold and securities purchased under agreements to resell	7,735	18	0.91	5,063	28	2.23
Other	2,224	34	6.57	1,250	18	5.71
Total interest-earning assets	386,823	4,703	4.88	229,325	3,426	5.93
Non-earning assets	19,319			13,959		
Total assets	$406,142			$243,284		
Interest-bearing liabilities:						
Interest-bearing deposits:						
Interest checking	19,391	17	0.35%	10,075	26	1.04%
Savings and money market	106,405	195	0.73	60,934	268	1.75
Certificates of deposit	142,425	858	2.39	88,427	703	3.15
Total interest-bearing deposits	268,221	1,069	1.58	159,436	997	2.48
Securities sold under agreements to repurchase	16,136	15	0.38	13,091	23	0.71
Federal funds purchased	1,127	4	1.31	1,143	6	2.17
Federal Home Loan Bank advances	40,239	229	2.26	14,196	120	3.35
Total interest-bearing liabilities	325,723	1,317	1.60	187,866	1,146	2.42
Non-interest bearing demand deposits	46,633			22,408		
Total deposits and interest-bearing liabilities	372,356	1,317	1.40	210,274	1,146	2.16
Other liabilities	1,244			1,202		
Stockholders equity	32,542			31,808		
Total liabilities and stockholders equity	$406,142			$243,284		
Net interest income		$3,385			$2,280	
Net interest spread (2)			3.28%			3.51%
Net interest margin (3)			3.51%			3.97%

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

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

(3) Net interest margin is the result of annualized net interest income divided by average interest-earning assets for the period.

Table of Contents

	Nine months ended September 30, 2003			Nine months ended September 30, 2002		
	Average Balances	Interest	Yield/ Rate(1)	Average Balances	Interest	Yield/ Rate(1)
Interest-earning assets:						
Loans	$243,244	$ 9,995	5.48%	$160,828	$7,565	6.27%
Securities, available-for-sale:						
Taxable	91,404	2,757	4.02	28,382	1,159	5.42
Tax-exempt	5,142	138	4.19	391	12	5.21
Federal funds sold and securities purchased under agreements to resell	5,983	42	0.94	6,160	92	2.00
Other	2,120	86	5.78	1,112	46	5.47
Total interest-earning assets	347,893	13,018	5.00	196,873	8,874	6.00
Nonearning assets	17,986			11,750		
Total assets	$365,879			$208,623		
Interest-bearing liabilities:						
Interest-bearing deposits:						
Interest checking	16,502	62	0.50%	9,278	75	1.08%
Savings and money market	92,084	643	0.93	56,014	763	1.81
Certificates of deposit	131,623					