PINNACLE FINANCIAL PARTNERS INC
Form 10QSB
November 07, 2002

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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, 2002

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	6711	62-1812853
(State or jurisdiction of incorporation or organization)	(Primary Standard Industrial Classification Code Number)	(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)

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

YES [**X**] NO [ ]

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, 2002.

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

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SIGNATURES

Certification President and Chief Executive Officer

Certification Chief Financial Officer

EXHIBIT INDEX

Certifications pursuant to...Sarbanes-Oxley Act

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Report on Form 10-QSB
September 30, 2002

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FORWARD-LOOKING STATEMENTS

The Company 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 27A of the Securities Exchange Act of 1934 (the Exchange Act). The words expect , anticipate , intend , plan , believe , seek , estimate , and similar expressions are intended to identify such forward-looking statements, but othe 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. The Company s actual results may differ materially from the results anticipated in forward-looking statements due to a variety of factors, including unanticipated deterioration in the financial condition of borrowers resulting in significant increases in loan losses and provisions for those losses, governmental monetary and fiscal policies, deposit levels, loan demand, loan collateral values, securities portfolio values, interest rate risk management, the effects of competition from other financial institutions operating in the Company s market area and elsewhere, changes in governmental regulation relating to the banking industry, failure of assumptions underlying the establishment of reserves for loan losses, including the value of collateral underlying delinquent loans and other factors. The Company cautions that such factors are not exclusive. The Company 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 the Company.

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

	September 30, 2002	December 31, 2001
ASSETS		
Cash and due from banks	$ 10,797,280	$ 5,686,226
Federal funds sold and securities purchased under agreements to resell	11,282,783	8,895,850
Cash and cash equivalents	22,080,063	14,582,076
Securities available-for-sale, at fair value	57,062,184	19,885,834
Loans	191,299,676	134,439,642
Less allowance for loan losses	(2,427,043)	(1,832,000)
Loans, net	188,872,633	132,607,642
Premises and equipment, net	3,582,342	3,418,463
Other assets	7,153,020	4,945,346
Total assets	$278,750,242	$175,439,361
LIABILITIES AND STOCKHOLDERS EQUITY		
Deposits:		
Noninterest-bearing demand	$ 33,156,014	$ 16,860,835
Interest-bearing demand	15,081,672	8,615,076
Savings and money market accounts	67,610,667	54,077,238
Time	97,066,103	53,705,902
Total deposits	212,914,456	133,259,051
Securities sold under agreements to repurchase	16,720,232	14,657,693
Federal Home Loan Bank advances	15,500,000	8,500,000
Other liabilities	1,525,742	731,815
Total liabilities	246,660,430	157,148,559
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, 2002 and 2,312,053 issued and outstanding at December 31, 2001	3,692,053	2,312,053
Additional paid-in capital	30,682,947	19,317,947
Accumulated deficit	(3,028,617)	(3,391,854)
Accumulated other comprehensive income, net	743,429	52,656
Total stockholders equity	32,089,812	18,290,802
Total liabilities and stockholders equity	$278,750,242	$175,439,361

See accompanying notes to consolidated financial statements.

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

	Three months ended September 30,		Nine months ended September 30,	
	2002	2001	2002	2001
Interest income:				
Loans, including fees	$2,833,005	1,446,169	7,565,360	2,970,999
Securities, available-for-sale:				
Taxable	535,022	249,450	1,159,472	643,014
Tax-exempt	11,567		11,567	
Federal funds sold and other	46,480	66,255	138,108	243,386
Total interest income	3,426,074	1,761,874	8,874,507	3,857,399
Interest expense:				
Deposits	996,584	725,145	2,729,158	1,633,926
Securities sold under agreements to repurchase	23,443	58,398	65,173	122,150
Federal funds purchased and other borrowings	125,982	16,599	299,810	31,160
Total interest expense	1,146,009	800,142	3,094,141	1,787,236
Net interest income	2,280,065	961,732	5,780,366	2,070,163
Provision for loan losses	247,000	298,000	688,000	1,022,622
Net interest income after provision for loan losses	2,033,065	663,732	5,092,366	1,047,541
Noninterest income:				
Service charges on deposit accounts	80,166	27,290	200,631	47,187
Investment services	220,721	155,050	677,282	562,497
Gain on loan participations sold, net	13,038	58,636	57,997	58,636
Other noninterest income	182,604	51,673	323,033	175,026
Total noninterest income	496,529	292,649	1,258,943	843,346
Noninterest expense:				
Compensation and employee benefits	1,427,251	1,052,948	3,764,462	3,214,461
Equipment and occupancy	370,495	282,228	1,049,435	814,862
Marketing and other business development	70,723	43,025	162,118	133,521
Postage and supplies	59,404	50,124	184,913	106,119
Other noninterest expense	253,658	179,396	597,708	490,304
Total noninterest expense	2,181,531	1,607,721	5,758,636	4,759,267
Income (loss) before income taxes	348,063	(651,340)	592,673	(2,868,380)
Income tax expense	136,585		229,436	
Net income (loss)	$ 211,478	(651,340)	363,237	(2,868,380)
Per share information:				
Basic net income (loss) per common share	$ 0.06	(0.34)	0.13	(1.50)
Diluted net income (loss) per common share	$ 0.06	(0.34)	0.13	(1.50)

Weighted average shares outstanding:				
Basic	3,692,053	1,910,000	2,841,943	1,910,000
Diluted	3,745,272	1,910,000	2,873,334	1,910,000

See accompanying notes to consolidated financial statements.

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

For the nine months ended September 30, 2002 and 2001

	2002	2001
Operating activities:		
Net income (loss)	$ 363,237	$ (2,868,380)
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities:		
Net amortization (accretion) of available-for-sale securities	111,194	(4,302)
Depreciation and amortization	521,363	446,658
Provision for loan losses	688,000	1,022,622
Gain on participations sold	(57,997)	(58,636)
Deferred tax expense	229,436	
Increase in other assets	(374,302)	(441,283)
Increase in other liabilities	421,973	447,675
Net cash provided by (used in) operating activities	1,902,904	(1,455,646)
Investing activities:		
Activities in securities available-for-sale:		
Purchases	(42,572,668)	(17,511,065)
Maturities, prepayments and calls	6,347,851	3,728,386
Net increase in loans	(56,952,991)	(82,475,665)
Purchases of premises and equipment and software	(531,553)	(1,156,576)
Purchases of other assets	(2,158,500)	
Net cash used in investing activities	(95,867,861)	(97,414,920)
Financing activities:		
Net increase in deposits	79,655,405	77,853,024
Net increase in securities sold under agreements to repurchase	2,062,539	10,809,581
Advances from Federal Home Loan Bank	7,000,000	1,500,000
Decrease in Federal funds purchased		(406,000)
Net proceeds from sale of common stock	12,745,000	3,597,479
Net cash provided by financing activities	101,462,944	93,354,084
Net increase (decrease) in cash and cash equivalents	7,497,987	(5,516,482)
Cash and cash equivalents, beginning of period	14,582,076	15,188,462
Cash and cash equivalents, end of period	$ 22,080,063	$ 9,671,980
Supplemental disclosure:		
Cash paid for interest	$ 3,015,224	$ 1,414,549
Cash paid for income taxes	$	$

See accompanying notes to consolidated financial statements.

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

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

NATURE OF BUSINESS - Pinnacle Financial Partners, Inc. (the Parent) is a bank holding company whose business is conducted by its wholly-owned subsidiary, Pinnacle National Bank (the Bank). The Parent and the Bank are collectively referred to as the Company . The Bank is a commercial bank located in Nashville, Tennessee. The Bank provides a full range of banking services in its primary market area of Davidson County and surrounding counties.

BASIS OF PRESENTATION - These unaudited consolidated financial statements include the accounts of the Company. 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 month periods ended September 30, 2002 are not necessarily indicative of the results that may be expected for the year ending December 31, 2002. For further information, refer to the consolidated financial statements and footnotes thereto included in the Company s Form 10-KSB/A for the fiscal year ended December 31, 2001 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 relate to the determination of the allowance for loan losses and valuation of deferred income tax assets.

EARNINGS (LOSS) PER COMMON SHARE Basic earnings (loss) per share (EPS) is computed by dividing net income (loss) 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 whose exercise price was less than the weighted average market price of the Company s common stock for the respective periods.

The basic and diluted EPS information for the three and nine months ended September 30, 2001 was computed based on weighted average shares outstanding of 1,910,000.

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 accounting principles generally accepted in the United States of America are included in comprehensive income but excluded from net income. Currently, the Company s other comprehensive income consists solely of unrealized gains and losses, net of deferred income taxes, on available-for-sale securities. Other comprehensive income for the three and nine months ended September 30, 2002 was $451,000 and $691,000, respectively, compared to other comprehensive income for the three and nine months ended September 30, 2001 of $102,000 and $169,000, respectively.

ACCOUNTING PRONOUNCEMENTS On July 30, 2002, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards Statement No. 146, *Accounting for Costs Associated with Exit or Disposal Activities* (SFAS No. 146). The standard replaces EITF Issue No. 94-3, Liability Recognition for Certain Employee Termination Benefits and Other Costs to Exit an Activity (including

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

Certain Costs Incurred in a Restructuring) and requires companies to recognize costs associated with exit or disposal activities when they are incurred rather than at the date of a commitment to an exit or disposal plan. Examples of costs covered by the standard include lease termination costs and certain employee severance costs that are associated with a restructuring, discontinued operation, plant closing, or other exit or disposal activity. SFAS 146 is effective prospectively to exit or disposal activities initiated after December 31, 2002.

RECLASSIFICATIONS Certain 2001 amounts have been reclassified to conform to the 2002 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, 2002 and December 31, 2001 are summarized as follows:

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Securities available-for-sale September 30, 2002:				
U.S. government and agency securities	$ 8,067,432	$ 499,023	$	$ 8,566,455
Mortgage-backed securities	46,698,294	640,284	(39,764)	47,298,814
State and municipal securities	1,152,722	44,193		1,196,915
	$55,918,448	$1,183,500	$(39,764)	$57,062,184
Securities available-for-sale December 31, 2001:				
U.S. government and agency securities	$ 2,991,784	$ 72,328	$	$ 3,064,112
Mortgage-backed securities	16,813,040	97,011	(88,329)	16,821,722
State and municipal securities				
	$19,804,824	$ 169,339	$(88,329)	$19,885,834

The Company realized no gains or losses from the sale of securities as no such transactions occurred during the nine months ended September 30, 2002 or during the year ended December 31, 2001. At September 30, 2002, approximately $34,153,000 of the Company s available-for-sale portfolio was pledged to secure public fund deposits and securities sold under agreements to repurchase.

NOTE 3. LOANS AND ALLOWANCE FOR LOAN LOSSES

The composition of loans at September 30, 2002 and December 31, 2001 is summarized as follows:

	September 30, 2002	December 31, 2001
Commercial real estate Mortgage	$ 48,995,941	$ 36,179,133
Commercial real estate Construction	2,987,591	5,975,670
Commercial Other	87,955,112	59,839,406

	139,938,644	101,994,209
Consumer real estate Mortgage	41,274,997	26,535,273
Consumer real estate Construction	2,465,645	381,212
Consumer Other	7,620,390	5,528,948
	51,361,032	32,445,433
	191,299,676	134,439,642
Allowance for loan losses	(2,427,043)	(1,832,000)
	$ 188,872,633	$ 132,607,642

Using standard industry codes, the Company periodically analyzes its commercial loan portfolio to determine if a concentration of credit risk exists to any one or more industries. The Company has a meaningful credit exposure (loans outstanding plus unfunded lines of credit) to borrowers in the trucking industry and to operators of commercial, income-producing real estate properties. Credit exposure to the trucking industry approximated $27.1 million and $21.1 million at September 30, 2002 and December 31, 2001, respectively, while credit exposure to operators of commercial, income-producing real estate properties approximated $7.6 million at September 30, 2002 and $8.2 million at December 31, 2001. Levels of

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

exposure to these industry groups are periodically evaluated in order to determine if additional loan loss allowances are warranted for credit concentrations.

At September 30, 2002, nonaccrual loans amounted to $70,000 compared to $250,000 at December 31, 2001. There were no valuation allowances associated with these or any other loans at September 30, 2002. There was a $150,000 valuation allowance at December 31, 2001 associated with a particular nonaccrual loan. During the second quarter of 2002, this valuation allowance was eliminated.

Changes in the allowance for loan losses for the nine months ended September 30, 2002 and for the year ended December 31, 2001 was as follows:

	2002	2001
Balance at beginning of period	$1,832,000	$ 162,378
Charged-off loans	(92,957)	
Recovery of previously charged-off loans		
Provision for loan losses	688,000	1,669,622
Balance at end of period	$2,427,043	$1,832,000

At September 30, 2002, the Company has granted loans and other extensions of credit, in the normal course of its banking business, amounting to approximately $7,039,000 to certain directors, executive officers, and their related entities of which $4,743,000 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, 2002, the Company 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 accounting principles generally accepted in the United States of America, the Company has reflected a net gain on the sale of these participated loans of approximately $13,000 and $58,000, for the three and nine month periods, 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 the Company and the amount of interest that will be paid by the Company to the correspondent based on their future participation in the loan. During the three and nine months ended September 30, 2001, the Company reflected a gain on the sale of participated loans of approximately $59,000.

NOTE 4. INCOME TAXES

Income tax expense for the nine months ended September 30, 2002 and 2001 consists of the following:

	2002	2001
Current	$	$
Deferred	229,436	
Income tax expense	$229,436	$

The Company s income tax expense differs from the amounts computed by applying the Federal income tax statutory rates of 34% to income before income taxes. A reconciliation of the differences for the nine months ended September 30, 2002 and 2001 is as follows:

	2002	2001
Income taxes at statutory rate	$201,509	$ (975,250)
State income taxes, net	27,927	(114,735)
Change in valuation allowance		1,089,985
Income tax expense	$229,436	$

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

At September 30, 2002, the Company had a net deferred tax asset of approximately $1.4 million included in other assets in the accompanying consolidated balance sheet compared to a net deferred tax asset of approximately $2.0 million at December 31, 2001. The components of deferred income taxes included in other assets in the accompanying consolidated balance sheet at September 30, 2002 and December 31, 2001 are as follows:

	September 30, 2002	December 31, 2001
Deferred tax assets:		
Loans, primarily due to the allowance for loan losses	$ 936,693	$ 695,427
Other accruals	188,153	230,066
Net operating loss carryforward	897,136	1,288,035
	2,021,982	2,213,528
Deferred tax liabilities:		
Depreciation and amortization	186,248	148,358
Securities available-for-sale	400,308	28,354
	586,556	176,712
	1,435,426	2,036,816
Less: Valuation allowance		
Net deferred tax assets	$1,435,426	$2,036,816

Based upon recent and projected future operating results, the Company determined in the fourth quarter of 2001 that it was more likely than not that its deferred tax assets were realizable. As a result, the Company eliminated the valuation allowance established against those assets and recorded a deferred income tax benefit of $2.1 million in the fourth quarter of 2001. At September 30, 2002, the Company has available net operating loss carryforwards of approximately $2,325,000 for Federal income tax purposes. If unused, the carryforwards will expire beginning in 2020.

NOTE 5. COMMITMENTS AND CONTINGENT LIABILITIES

In the normal course of business, the Company has entered into off-balance-sheet financial instruments that are not reflected in the consolidated financial statements. These financial instruments include commitments to extend credit and standby letters of credit. Such financial instruments are included in the consolidated financial statements when funds are disbursed or the instruments become payable. These instruments involve, to varying degrees, elements of credit risk in excess of the amount recognized in the consolidated balance sheets.

The Company s exposure to credit loss in the event of nonperformance by the other party to the financial instrument for commitments to extend credit and standby letters of credit is represented by the contractual amount of those instruments. A summary of the Company s commitments at September 30, 2002, is as follows:

Commitments to extend credit	$60,601,000
Standby letters of credit	12,810,000

Commitments to extend credit generally have fixed expiration dates or other termination clauses and may require payment of a fee. Since many of the commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. The credit risk involved in issuing these financial instruments is essentially the same as that involved in extending loans to customers. The Company evaluates each customer s creditworthiness on a case-by-case basis. The amount of collateral obtained, if deemed necessary by the Company upon extension of credit, is based on management s credit evaluation of the customer. Collateral held varies but may include real estate and improvements, marketable securities, accounts receivable, inventory, equipment, and personal property.

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

In the normal course of business, the Company may become involved in various legal proceedings. As of September 30, 2002, the management of the Company is not aware of any material proceedings against the Company.

NOTE 6. COMMON STOCK

During June 2002, the Company concluded a follow-on offering of its common stock to the general public. As a result of this offering, the Company, through its underwriters, sold 1.2 million shares of common stock to the general public at $10.25 per share. The underwriters also exercised an over-allotment option and purchased an additional 180,000 shares at $10.25 per share, less the applicable underwriting discount. Net proceeds from the offering were approximately $12.7 million.

During September 2001, the Company concluded a private placement of its common stock to certain accredited investors. Pursuant to the private placement, the Company received approximately $3,597,000, net of offering expenses, from the subscription of 402,053 shares at $9 per share for its common stock. These shares were issued on October 26, 2001. The stock issued in connection with the private placement has not been registered under the Securities Act of 1933, as amended, and may not be offered or sold in the U.S. absent registration or an applicable exemption from the registration requirements.

In August of 2000, the Company, through its underwriters, sold 1,875,000 common shares to the general public through an initial public offering at a price of $10 per share. The underwriters also exercised an over-allotment option and purchased an additional 35,000 shares at $10 per share, less the applicable underwriting discount. Net proceeds from the offering were approximately $18 million.

Three executives of the Company (the Chairman of the Board, the President and Chief Executive Officer and the Chief Administrative Officer) along with nine members of the Company s Board of Directors and two other organizers of the Company (collectively, the Company s Founders) purchased an aggregate of 406,000 shares of common stock during the initial public offering, which represented approximately 21% of the offering. The Founders were awarded common stock warrants which allow each individual the ability to purchase the common stock of the Company 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, 2002, two thirds of the warrants for approximately 135,300 shares were exercisable.

The Company 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 to be incentive stock options under Section 422 of the Internal Revenue Code. 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.

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

A summary of the plan at September 30, 2002 and December 31, 2001 and 2000 and changes during the nine months ended September 30, 2002 and during the year ended December 31, 2001 is as follows:

	Number	Weighted-Average Exercise Price
Outstanding at December 31, 2000	186,450	$ 10.00
Granted	53,400	7.65
Exercised		
Forfeited	(550)	9.14
Outstanding at December 31, 2001	239,300	9.48
Granted	127,200	9.96
Exercised		
Forfeited	(3,190)	9.09
Outstanding at September 30, 2002	363,310	$ 9.64

The following table summarizes information about the Company s stock option plan at September 30, 2002:

Grant date	Number of Shares Outstanding	Remaining Contractual Life in Years	Exercise Price	Number of Shares Exercisable
December, 2000	184,970	8.22	$ 10.00	37,020
March, 2001	49,540	8.42	7.64	9,960
November, 2001	2,800	9.18	7.75	
February, 2002	123,700	9.35	9.92	
October, 2002	2,300	10.00	11.50	
Totals	363,310	8.65	$ 9.64	46,980

NOTE 7. REGULATORY MATTERS

The Bank is subject to certain restrictions on the amount of dividends that may be declared without prior regulatory approval. At September 30, 2002, no dividends could be declared by the Bank without regulatory approval.

The Parent and the Bank are subject to various regulatory capital requirements administered by federal banking agencies. Failure to meet minimum capital requirements can initiate certain mandatory, and possibly additional discretionary actions by regulators that, if undertaken, could have a direct material effect on the consolidated financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, the Parent and Bank must meet specific capital guidelines that involve quantitative measures of the assets, liabilities, and certain off-balance-sheet items as calculated under regulatory accounting practices. The Parent s and Bank s capital amounts and classification are also subject to qualitative judgments by the regulators about components, risk weightings, and other factors.

Quantitative measures established by regulation to ensure capital adequacy require the Parent and Bank 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, 2002, the Parent and the Bank meet all capital adequacy requirements to which they are subject.

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

To be categorized as well capitalized, pursuant to banking regulations, the Bank must maintain minimum Total risk-based, Tier I risk-based, and Tier I capital to average asset ratios as set forth in the following table. The Parent and Bank s actual capital amounts and ratios at September 30, 2002 and December 31, 2001 are presented in the following table (dollars in thousands):

(*) Average assets for the above computation were computed using average balances for the quarter ended September 30, 2002 and December 31, 2001.

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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, 2002 and December 31, 2001 and our results of operations for the three and nine months ended September 30, 2002 and 2001. 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 2001 Annual Report on Form 10-KSB/A.

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 to the determination of our allowance for loan losses (ALL) and the recognition of our deferred income tax assets, we have made judgments and estimates which have significantly impacted our financial position and results of operations.

Allowance for Loan Losses. Our management assesses the adequacy of the ALL prior to the end of each calendar quarter. This assessment includes procedures to estimate the ALL 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 allowance 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) homogenous 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. Each risk-rating grade is assigned an estimated loss ratio, which is determined based on the experience of management, discussions with banking regulators, historical and current economic conditions 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 the underlying collateral value. We also assign estimated loss ratios to our consumer portfolio. However, we base the estimated loss ratios for these homogenous loans on the category of consumer credit (e.g., automobile, residential mortgage, home equity) and not on the results of individual loan reviews.

The unallocated amount is particularly subjective and does not lend itself to exact mathematical calculation. We use the unallocated amount to absorb inherent losses which may exist as of the balance sheet date for 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.

We then test the resulting ALL balance by comparing the balance in the allowance account 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 independent loan reviewer and the audit committee of our board of directors review the assessment prior to the filing of quarterly financial information.

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In assessing the adequacy of the ALL, we also rely on an ongoing 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 operating 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 would 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 a deferred tax benefit in our statement of operations equal to the deferred tax asset. Unless our judgment changes as to the likelihood of realizing these deferred tax assets, we will continue to recognize such assets in our consolidated financial statements.

Results of Operations   Three and Nine Months Ended September 30, 2002 and 2001

Our results for the three and nine months ended September 30, 2002, when compared to the three and nine months ended September 30, 2001, were highlighted by the continued growth of our earning assets which resulted in increased net interest income and growth in noninterest income. Total revenues, which are comprised of net interest income and noninterest income, for the three months ended September 30, 2002, were $2,777,000, compared to total revenues for the three months ended September 30, 2001 of $1,255,000. Total revenues for the nine months ended September 30, 2002, were $7,039,000, compared to total revenues for the nine months ended September 30, 2001 of $2,914,000. The provision for loan losses was $247,000 for the third quarter of 2002 compared to $298,000 for the third quarter of 2001. The provision for loan losses was $688,000 for the nine months ended September 30, 2002 compared to $1,023,000 for the nine months ended September 30, 2001. The decreases in the provision were primarily attributable to reduced loan growth in the more recent periods when compared to previous periods.

Noninterest expenses were $2,182,000 for the three months ended September 30, 2002, compared to $1,608,000 for the three months ended September 30, 2001. Noninterest expenses were $5,759,000 for the nine months ended September 30, 2002, compared to $4,759,000 for the nine months ended September 30, 2001. Noninterest expense increased due to additional compensation expenses, the addition of the Green Hills branch which occurred in the latter part of 2001 and other expenses associated with increased volumes. Net income for the three months ended September 30, 2002 was $211,000 compared to a net loss of $651,000 for the three months ended September 30, 2001. Net income for the nine months ended September 30, 2002 was $363,000 compared to a net loss of $2,868,000 for the nine months ended September 30, 2001.

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 2002 to the third quarter of 2001 and the first nine months of 2002 to the first nine months of 2001.

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. 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, the average interest rate for total interest-earning assets and total interest-bearing liabilities, and net interest spread and net interest margin on average interest-earning assets for the three months ended

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September 30, 2002 compared to the three months ended September 30, 2001 and for the nine months ended September 30, 2002 compared to the nine months ended September 30, 2001 (dollars in thousands):

	Three Months Ended September 30, 2002			Three Months Ended September 30, 2001		
	Average Balances	Interest	Yield/ Rate	Average Balances	Interest	Yield/ Rate
	(dollars in thousands)					
Interest-earning assets:						
Loans	$181,005	$2,833	6.21%	$ 78,152	$1,446	7.34%
Securities, available-for-sale						
Taxable	40,844	535	5.16	16,320	250	6.06
Tax-exempt	1,163	12	5.21			
Federal funds sold and securities purchased under agreements to resell	5,063	28	2.23	5,801	56	3.86
Other	1,250	18	5.71	687	10	5.68
Total interest-earning assets	229,325	3,426	5.93	100,960	1,762	6.92
Nonearning assets	13,959			6,749		
Total assets	$243,284			$107,709		
Interest-bearing liabilities:						
Interest-bearing deposits:						
Interest checking	$ 10,075	26	1.04%	$ 5,598	29	2.05%
Savings and money market	60,934	268	1.75	38,648	338	3.47
Certificates of deposit	88,427	703	3.15	29,852	358	4.75
Total interest-bearing deposits	159,436	997	2.48	74,098	725	3.88
Securities sold under agreements to repurchase	13,091	23	0.71	8,741	58	2.65
Federal funds purchased	1,143	6	2.17	289	1	1.88
Federal Home Loan Bank advances	14,196	120	3.35	1,500	16	4.03
Total interest-bearing liabilities	187,866	1,146	2.42	84,628	800	3.75
Demand deposits	22,408			9,245		
Total deposits and interest-bearing liabilities	210,274	1,146	2.16	93,873	800	3.38
Other liabilities	1,202			688		
Stockholders equity	31,808			13,148		
Total liabilities and stockholders equity	$243,284			$107,709		
Net interest income (1)		$2,280			$ 962	
Net interest spread			3.51%			3.17%
Net interest margin			3.97%			3.81%

	Nine Months Ended September 30, 2002			Nine Months Ended September 30, 2001		
	Average Balances	Interest	Yield/ Rate	Average Balances	Interest	Yield/ Rate
			(dollars in thousands)			
Interest-earning assets:						
Loans	$160,828	$7,565	6.27%	$52,260	$2,971	7.57%
Securities, available-for-sale						
Taxable	28,382	1,159	5.42	13,635	643	6.28
Tax-exempt	391	12	5.21			
Federal funds sold and securities purchased under agreements to resell	6,160	92	2.00	6,049	217	4.79
Other	1,112	46	5.47	603	26	5.69
Total interest-earning assets	196,873	8,874	6.00	72,547	3,857	7.08
Nonearning assets	11,750			6,079		
Total assets	$208,623			$78,626		
Interest-bearing liabilities:						
Interest-bearing deposits:						
Interest checking	$ 9,278	75	1.08%	$ 4,056	69	2.29%
Savings and money market	56,014	763	1.81	28,366	856	4.02
Certificates of deposit	76,028	1,891	3.31	18,585	709	5.08
Total interest-bearing deposits	141,320	2,729	2.57	51,007	1,634	4.27
Securities sold under agreements to repurchase	11,409	65	0.76	5,301	122	3.07
Federal funds purchased	965	15	2.05	606	16	3.97
Federal Home Loan Bank advances	11,432	285	3.32	511	15	3.50
Total interest-bearing liabilities	165,126	3,094	2.50	57,425	1,787	4.15
Demand deposits	18,103			6,657		
Total deposits and interest-bearing liabilities	183,229	3,094	2.25	64,082	1,787	3.71
Other liabilities	912			471		
Stockholders equity	24,482			14,073		
Total liabilities and stockholders equity	$208,623			$78,626		
Net interest income (1)		$5,780			$2,070	
Net interest spread			3.50%			2.93%
Net interest margin			3.93%			3.83%

(1) The impact of deferred loan fees or costs was not material to the above results. Yields on all investment securities were computed based on the carrying value of those securities. Interest yields for tax-exempt securities were computed on a tax equivalent basis. Net interest spread is the difference between the yield earned on average interest-earning assets less the rate paid on interest-bearing liabilities. Net interest margin is calculated by dividing net interest income by average interest-earning assets.

Rate and Volume Analysis. The following table presents the dollar change in interest income and interest expense comparing the nine month periods ended September 30, 2002 and 2001 for the major components of interest-earning assets and interest-bearing liabilities and distinguishes between the increase (decrease) related to higher outstanding balances and the volatility of interest rates.

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Dollar change in interest income and expense	Increase (decrease) due to Volume	Rate	Total increase (decrease)
	(dollars in thousands)		
Interest-earning assets:			