PINNACLE FINANCIAL PARTNERS INC
Form 10KSB
February 20, 2004

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SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-KSB

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

For the fiscal year ended December 31, 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.

(Name of small business issuer in its charter)

Tennessee	62-1812853
(State of 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)

Securities registered pursuant to Section 12 (b) of the Exchange Act: NONE

Securities registered pursuant to Section 12(g) of the Exchange Act: COMMON STOCK, PAR VALUE $1.00

Check whether the issuer: (1) filed all reports required to be filed by Section 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 [ ]

Check if disclosure of delinquent filers in response to Item 405 of Regulation S-B is not contained in this form, and no disclosure will be contained, to the best of registrant s knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-KSB or any amendment to this Form 10-KSB. [ ]

State issuer s revenues for its most recent fiscal year: $21,549,391

Aggregate market value of the voting stock held by non-affiliates (for purposes of this calculation, affiliates are considered to be the directors of the issuer) computed by reference to the price at which the stock was sold, or the average bid and asked prices of such stock, as of a specified date within the past 60 days: $92,424,000 as of February 13, 2004.

APPLICABLE ONLY TO CORPORATE REGISTRANTS

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 as of February 15, 2004.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the Proxy Statement for the Annual Meeting of Shareholders, scheduled to be held April 20, 2004, are incorporated by reference into Part III of this Form 10-KSB.

Transitional Small Business Disclosure format (check one): Yes [ ] No[X]

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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 our bank subsidiary, Pinnacle National Bank (Pinnacle National) to satisfy regulatory requirements for its expansion plans, and (vi) changes in the legislative and regulatory environment. 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. Forward-looking statements made by us in this report are also subject to those risks identified within the section entitled Risk Factors beginning on page 15.

PART I

Unless this Form 10-KSB 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. References herein to the fiscal years 2001, 2002 and 2003 mean our fiscal years ended December 31, 2001, 2002 and 2003, respectively.

ITEM 1. DESCRIPTION OF BUSINESS

OVERVIEW

Pinnacle Financial is a Tennessee corporation that was incorporated on February 28, 2000 to organize and serve as the holding company for Pinnacle National, a national bank chartered under the laws of the United States. Pinnacle National commenced its banking operations on October 27, 2000, and operates as a community bank in an urban market emphasizing personalized banking relationships with individuals and businesses located within the Nashville metropolitan statistical area (MSA). We own 100% of the capital stock of Pinnacle National.

FDIC information as of September 30, 2003, reflects that there are 178 commercial banks which are currently active and were also chartered in the United States in 2000, excluding those institutions that appear to have transferred an existing charter to a new charter. Based on FDIC information as of September 30, 2003, Pinnacle National was the largest and fastest growing of these banks in terms of total assets. We believe that one of the principal factors contributing to our rapid growth thus far has been our ability to effectively position ourselves as a locally managed community bank committed to providing outstanding service and trusted financial advice.

Opportunity. We believe there are three major trends in the Nashville MSA that strengthen our strategic market position as a locally managed community bank:

> Customers generally perceive that service levels at banks are declining. We believe this is largely attributable to integration issues resulting from consolidation in the bank and brokerage industries. Additionally, small business owners want a reliable point of contact that is knowledgeable about their business and the financial products and services that are important to the success of their business. In fact, Nashville is dominated by three large regional bank holding companies, all of whom are experiencing declining market share trends over

the last six years.

Client usage of more sophisticated financial products continues to grow, causing traditional banks to lose market share to other types of financial services companies, such as mutual fund companies and securities brokerage firms.

There is significant growth in the demand for convenient access to financial services, particularly through ATMs, telephone banking and Internet banking.

We believe that our primary market segments, which are small businesses with annual sales from $1 million to $25 million and affluent households with investable assets over $250,000, are more likely to be disaffected by the banking industry s perceived decline in customer service and lack of financial product sophistication. To overcome these customer perceptions and attract business from these market segments, we seek to hire only seasoned professionals, from both the banking and brokerage industries, and strategically designed our banking, investment and insurance products to meet the expected needs of our targeted market segments. Accordingly, our marketing philosophy is centered on delivering exceptional service and effective financial advice through highly trained personnel who understand and care about the broad financial needs and objectives of our clients.

Business Strategies. To carry out our marketing philosophy, our specific business strategies have been and will continue to be:

Hire and retain highly experienced and qualified banking and financial professionals with successful track records and, for client contact personnel, established books of business with small businesses and affluent households within the Nashville MSA. During our first three years of operation, we have attracted approximately 90 associates to our firm, including 37 during 2003. Substantially all of these associates have been employed in similar positions in the Nashville MSA for at least 10 years. Many of our senior customer contact personnel have in excess of 20 years experience in Nashville. We have also been successful in maintaining a retention ratio of our personnel of approximately 95% during this same time period. We believe we will continue to experience success in attracting new associates and retaining associates to our firm.

Provide individualized attention with consistent, local decision-making authority.

Offer a full line of financial services to include traditional depository and credit products, as well as, sophisticated investment and insurance products. As of December 31, 2003, Pinnacle Asset Management had accumulated approximately $319 million in brokerage assets.

Capitalize on customer dissatisfaction that we believe exists and that has been caused by what we believe to be our competitors less than satisfactory response to the financial needs of today s sophisticated consumers and small- to medium-sized businesses. Since we began our company, we have historically surveyed our customers on numerous matters related to their relationship with us. Consistently, these surveys indicate that our service quality is significantly better than their prior banking relationships.

Build on our directors and officers diverse personal and business contacts, community involvement and professional expertise.

Establish a distribution strategy designed to prudently expand our physical and virtual market presence, thereby providing convenient banking access for our clients 24 hours a day. We opened two new offices in 2003 and intend to open two more offices in 2004. Our courier deposit pickup service consistently receives high marks from our small business customers. We now have approximately 48.6% of our commercial clients utilizing our Internet banking product which we believe to be well over the industry averages and exceptional given we are only three years old.

Use technology and strategic alliances, including those established through Pinnacle National s brokerage division, Pinnacle Asset Management, to provide a broad array of sophisticated and convenient products and services.

We believe that our business strategies allow us to effectively distinguish ourselves from other financial institutions operating within the Nashville MSA and successfully attract and retain business relationships with small businesses and affluent households.

Market Area. Pinnacle National s primary service area, which comprises the Nashville metropolitan statistical area, includes the following counties:

Cheatham County	Davidson County
Dickson County	Robertson County
Rutherford County	Sumner County
Williamson County	Wilson County

This area represents a geographic area that covers approximately 4,000 square miles and a population in excess of 1.2 million people.

Nashville is a large, fast growing metropolitan market. It is the capital of Tennessee and, according to a Lehman Brothers research report, was one of the fastest growing MSAs in the United States during the 1990 s, ranking 18th among the 100 largest MSAs in terms of population growth. Nashville is projected by this report to be the 4th fastest growing MSA in terms of per capita income growth from 2000 to 2005 and to remain within the top twenty in future population growth for the same period.

Pinnacle National s main office is located in Nashville s central business district in downtown Nashville. The downtown market consists of a variety of commercial establishments and entertainment venues. We believe that the downtown area is an important location for financial institutions requiring visibility within Nashville s prominent commercial and private banking markets. Accordingly, we believe that this location is well suited for our bank s business development efforts.

In November 2000, Pinnacle National opened a branch office in Brentwood in Williamson County. In September 2001, Pinnacle National opened a second branch office in the Green Hills area of Nashville. Pinnacle National opened a third branch office in the Rivergate area of Davidson County in April of 2003 and a fourth branch office in the Cool Springs area of Williamson County in October of 2003. Pinnacle National intends to open two additional branch officers in 2004. One of these offices will be in the West End area of Nashville and the other is anticipated to be in the Franklin, Tennessee area. Management believes these additional offices will continue to strengthen Pinnacle National s market presence, allowing it to grow its customer base more rapidly.

The economic success of Pinnacle National s primary service area depends heavily upon the economic viability of the metropolitan Nashville, Tennessee area. Nashville is the capital of Tennessee and a city that we believe is an important transportation, business and tourism center within the United States. Additionally, the metropolitan Nashville area has attracted a number of significant business relocations resulting in an expansion of its labor force into many different industry sectors. In January of 2004, Expansion Management magazine noted that Nashville ranked second behind Atlanta among seventy cities in the nation for companies that are looking to expand or relocate.

Our primary service area s economic strength comes from its large employer base, which includes several large enterprises such as Vanderbilt University and Medical Center, HCA Inc., Saturn Corporation and Nissan Motor Manufacturing Corporation USA. Additionally, according to the Nashville Area Chamber of Commerce, the regional economy has outperformed the state and national economies during the most recent economic slowdown and continues to benefit from low unemployment, consistent job growth, substantial outside investment and expansion and a well trained and growing labor force. We anticipate that these factors will continue to cause more businesses to relocate to, or start operations in, the Nashville MSA and, in turn, will increase the demand for depository and lending services within our market at a pace faster than national averages.

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Competition. According to FDIC data, bank and thrift deposits in the Nashville MSA grew from approximately $12.9 billion in June 1995 to more than $20.2 billion in June 2003. As of June 30, 2003, approximately 77% of this deposit base was controlled by large, multi-state banks headquartered outside of Nashville, which included AmSouth (headquartered in Birmingham, Alabama), Bank of America (headquartered in Charlotte, North Carolina), USBancorp (headquartered in Milwaukee, Wisconsin), SunTrust (headquartered in Atlanta, Georgia) and Union Planters Corporation (headquartered in Memphis, Tennessee). According to FDIC deposit information, the collective market share of deposits in the Nashville MSA of AmSouth (including the acquired First American National Bank), Bank of America and SunTrust declined from 59.5% to 52.0% during the six years ended June 30, 2003. Consequently, while large, multi-state institutions are well established in our market area, we believe the general trends indicate that a majority of the community banks in the Nashville MSA have been able to increase their deposit market share in recent years at the expense of these larger, multi-state banks.

We also believe that positioning Pinnacle National solely as a community bank will not be enough to compete in today s financial industry. In the wake of modern technology and the prosperity of the United States financial markets over the past decade, banking clients have generally become more sophisticated in their approach to selecting financial services providers. We believe that the most important criteria to our bank s targeted clients when selecting a bank is their desire to receive exceptional customer service while being able to enjoy convenient access to a broad array of sophisticated financial products. Additionally, when presented with a choice, we believe that many of our bank s targeted clients would prefer to deal with a locally-owned institution headquartered in Nashville, like Pinnacle National, as opposed to a large, multi-state bank, where many important decisions regarding a client s financial affairs are made elsewhere.

Lending Services

Pinnacle National offers a full range of lending products, including commercial, real estate and consumer loans to individuals and small-to medium-sized businesses and professional entities. It competes for these loans with competitors who are well established in the Nashville MSA.

Pinnacle National s loan approval policies provide for various levels of officer lending authority. When the amount of total loans to a single borrower exceeds that individual officer s lending authority, officers with a higher lending limit, Pinnacle National s board of directors or the executive committee of the board will determine whether to approve the loan request.

Pinnacle National s lending activities are subject to a variety of lending limits imposed by federal law. Differing limits apply based on the type of loan or the nature of the borrower, including the borrower s relationship to Pinnacle National. In general, however, at December 31, 2003, Pinnacle National is able to loan any one borrower a maximum amount equal to approximately $5.8 million plus an additional $3.9 million, or a total of approximately $9.7 million, for loans that meet certain additional federal collateral guidelines. These legal limits will increase or decrease as Pinnacle National s capital increases or decreases as a result of its earnings or losses, the injection of additional capital or other reasons. In addition to these regulatory limits, Pinnacle National imposes upon itself an internal lending limit which is less than the prescribed legal lending limit, thus further reducing its exposure to any single borrower.

The principal economic risk associated with each category of loans that Pinnacle National expects to make is the creditworthiness of the borrower. General economic factors affecting a commercial or consumer borrower s ability to repay include interest, inflation and employment rates, as well as other factors affecting a borrower s assets, clients, suppliers and employees. Many of Pinnacle National s commercial loans are made to small- to medium-sized businesses that are sometimes less able to withstand competitive, economic and financial pressures than larger borrowers. During periods of economic weakness, these businesses may be more adversely affected than larger enterprises, and may cause increased levels of nonaccrual or other problem loans, loan charge-offs and higher provision for loan losses.

Pinnacle National s commercial clients borrow for a variety of purposes. The terms of these loans will vary by purpose and by type of any underlying collateral and include equipment loans and working capital loans. Commercial loans may be unsecured or secured by accounts receivable or by other business assets. Pinnacle

National also makes a variety of commercial real estate loans, residential real estate loans and real estate construction and development loans.

Pinnacle National also makes a variety of loans to individuals for personal, family, investment and household purposes, including secured and unsecured installment and term loans, residential first mortgage loans, home equity loans and home equity lines of credit.

Investment Securities

In addition to loans, Pinnacle National has other investments primarily in obligations of the United States government, obligations guaranteed as to principal and interest by the United States government and other securities. No investment in any of those instruments exceeds any applicable limitation imposed by law or regulation. The executive committee of the board of directors reviews the investment portfolio on an ongoing basis in order to ensure that the investments conform to Pinnacle National s asset liability management policy as set by the board of directors.

Asset and Liability Management

Our Asset Liability Management Committee (ALCO) is composed of senior managers of Pinnacle National, manages Pinnacle National s assets and liabilities and strives to provide a stable, optimized net interest income and margin, adequate liquidity and ultimately a suitable after-tax return on assets and return on equity. ALCO conducts these management functions within the framework of written policies that Pinnacle National s board of directors has adopted. ALCO works to maintain a balanced position between rate sensitive assets and rate sensitive liabilities.

Additionally, we may use derivative financial instruments to improve the balance between interest-sensitive assets and interest-sensitive liabilities. We may use derivatives as one tool to manage our interest rate sensitivity while continuing to meet the credit and deposit needs of our customers. At December 31, 2003 and 2002, we had not entered into any derivative contracts to assist managing our interest rate sensitivity.

Deposit Services

Pinnacle National seeks to establish a broad base of core deposits, including savings, checking, interest-bearing checking, money market and certificate of deposit accounts. To attract deposits, Pinnacle National has employed a marketing plan in its overall service area and features a broad product line and competitive rates and services. The primary sources of deposits are residents of, and businesses and their employees located in the Nashville MSA. Pinnacle National generally obtains these deposits through personal solicitation by its officers and directors.

Investment Services

Pinnacle National contracts with Raymond James Financial Service, Inc. (RJFS), a registered broker-dealer and investment adviser, to offer and sell various securities and other financial products to the public from Pinnacle National s locations through Pinnacle National employees that are also RJFS employees. RJFS is a subsidiary of Raymond James Financial, Inc. Prior to the alliance with RJFS, Pinnacle National entered into a similar arrangement in 2000 with LM Financial Partners, or LMFP, an affiliate of Legg Mason Wood Walker, Inc., the principal broker-dealer subsidiary of Legg Mason, Inc. During 2002, RJFS acquired LMFP from Legg Mason Wood Walker, Inc.

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Pinnacle National offers, through RJFS, non-FDIC insured investment products in order to assist Pinnacle National s clients in achieving their financial objectives consistent with their risk tolerances. Pinnacle National s suite of investment products include:

Mutual Funds	Fixed Annuities
Variable Annuities	Stocks
Money Market Instruments	Financial Planning
Treasury Securities	Asset Management Accounts
Bonds	Listed Options

All of the financial products listed above are offered by RJFS from Pinnacle National s main office and its other offices. Additionally, we believe that the brokerage and investment advisory program offered by RJFS complements Pinnacle National s general banking business, and further supports its business philosophy and strategy of delivering to our clients those products and services that meet their financial needs. In addition to the compliance monitoring provided by RJFS, Pinnacle National has developed its own compliance-monitoring program to further ensure that Pinnacle National personnel deliver these products in a manner consistent with the various regulations governing such activities.

Pinnacle National receives a minimum lease payment each month for each leased area, plus a percentage of commission credits and fees generated by the program. Pinnacle National remains responsible for various expenses associated with the program, including promotional expenses, furnishings and equipment expenses for the leased areas, and general personnel costs.

Other Banking Services

Given client demand for increased convenience in accessing banking and investment services, Pinnacle National also offers a broad array of convenience-centered products and services, including 24 hour telephone and Internet banking, debit cards, direct deposit and cash management services for small- to medium-sized businesses. Additionally, Pinnacle National is associated with a nationwide network of automated teller machines that our clients are able to use throughout Tennessee and other regions. In most cases, Pinnacle National reimburses its clients for any fees that may be charged to the client for utilizing the nationwide ATM network which enables us to demonstrate greater convenience as compared to our competitors. Pinnacle National does not plan to exercise trust powers during its initial years of operation, but may do so in the future subject to the approval of the Office of the Comptroller of the Currency.

Pinnacle National also offers its targeted commercial clients a courier service which picks up non-cash deposits from the client s place of business which also enables us to demonstrate convenience greater than most of the larger regional competitors. Pinnacle National provides this service through a third party that is approved by the State of Tennessee Public Service Commission for bank-related work.

Employees

At February 15, 2004, Pinnacle National employed 96 employees of which 93 were full time. Pinnacle National considers its relationship with all employees to be excellent. Our opinion is based in large part on the results of our annual work environment surveys that our employees complete. These surveys consist of several statements whereby employees agree or disagree with the statements pursuant to a grading scale. The statements address various aspects of their relationship with Pinnacle Financial including whether they understand what the company expects of the associate, whether they feel there are opportunities for them to be successful, whether their co-workers are committed to quality work, etc. Additionally, during 2003, the Nashville Business Journal named Pinnacle Financial as the Best Place to Work in Nashville among mid-sized firms.

We are also one of a relatively small number of financial firms in the country that provides all associates an opportunity to participate in a broad-based stock option plan. We believe this broad-based stock option plan directly aligns our employee base with our shareholders and thus our associates have become even more engaged toward the creation of shareholder value over the intermediate- and long-terms. Information concerning these plans are included in the Notes to the Consolidated Financial Statements and Management s Discussion and Analysis of Financial Condition and Results of Operations .

Additionally, all of our non-commission based employees participate in an annual cash incentive plan whereby they receive a certain percentage of their salary should the firm meet certain soundness thresholds and obtain a pre-determined earnings per share target for the year. Our results for 2003 provided for a target payout of the cash incentive plan for all participants.

SUPERVISION AND REGULATION

Both Pinnacle Financial and Pinnacle National are subject to extensive state and federal banking laws and regulations that impose restrictions on and provide for general regulatory oversight of Pinnacle Financial s and Pinnacle National s operations. These laws and regulations are generally intended to protect depositors and not shareholders. The following discussion describes the material elements of the regulatory framework which apply.

Pinnacle Financial

We are a bank holding company under the federal Bank Holding Company Act of 1956. As a result, we are subject to the supervision, examination, and reporting requirements of the Bank Holding Company Act and the regulations of the Federal Reserve.

Acquisition of Banks. The Bank Holding Company Act requires every bank holding company to obtain the Federal Reserve s prior approval before:

- Acquiring direct or indirect ownership or control of any voting shares of any bank if, after the acquisition, the bank holding company will directly or indirectly own or control more than 5% of the bank s voting shares;
- Acquiring all or substantially all of the assets of any bank; or
- Merging or consolidating with any other bank holding company.

Additionally, the Bank Holding Company Act provides that the Federal Reserve may not approve any of these transactions if it would substantially lessen competition or otherwise function as a restraint of trade, or result in or tend to create a monopoly, unless the anticompetitive effects of the proposed transaction are clearly outweighed by the public interest in meeting the convenience and needs of the communities to be served. The Federal Reserve is also required to consider the financial and managerial resources and future prospects of the bank holding companies and banks concerned and the convenience and needs of the communities to be served. The Federal Reserve s consideration of financial resources generally focuses on capital adequacy, which is discussed below.

Under the Bank Holding Company Act, if adequately capitalized and adequately managed, we or any other bank holding company located in Tennessee may purchase a bank located outside of Tennessee. Conversely, an adequately capitalized and adequately managed bank holding company located outside of Tennessee may purchase a bank located inside Tennessee. In each case, however, state law restrictions may be placed on the acquisition of a bank that has only been in existence for a limited amount of time or will result in specified concentrations of deposits. For example, Tennessee law currently prohibits a bank holding company from acquiring control of a Tennessee-based financial institution until the target financial institution has been in operation for three years.

Change in Bank Control. Subject to various exceptions, the Bank Holding Company Act and the Federal Change in Bank Control Act, together with related regulations, require Federal Reserve approval prior to any person or company acquiring control of a bank holding company. Control is conclusively presumed to exist if an individual or company acquires 25% or more of any class of voting securities of the bank holding company. Control is rebuttably presumed to exist if a person or company acquires 10% or more, but less than 25%, of any class of voting securities and either:

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- The bank holding company has registered securities under Section 12 of the Securities Exchange Act of 1934; or
- No other person owns a greater percentage of that class of voting securities immediately after the transaction.

Our common stock is registered under the Securities Exchange Act of 1934. The regulations provide a procedure for challenge of the rebuttable control presumption.

Permitted Activities. The Gramm-Leach-Bliley Act of 1999 amends the Bank Holding Company Act and expands the activities in which bank holding companies and affiliates of banks are permitted to engage. The Gramm-Leach-Bliley Act eliminates many federal and state law barriers to affiliations among banks and securities firms, insurance companies, and other financial service providers. Generally, if we qualify and elect to become a financial holding company, which is described below, we may engage in activities that are:

- Financial in nature;
- Incidental to a financial activity; or
- Complementary to a financial activity and do not pose a substantial risk to the safety or soundness of depository institutions or the financial system generally.

The Gramm-Leach-Bliley Act expressly lists the following activities as financial in nature:

- Lending, trust and other banking activities;
- Insuring, guaranteeing, or indemnifying against loss or harm, or providing and issuing annuities, and acting as principal, agent, or broker for these purposes, in any state;
- Providing financial, investment, or advisory services;
- Issuing or selling instruments representing interests in pools of assets permissible for a bank to hold directly;
- Underwriting, dealing in or making a market in securities;
- Activities that the Federal Reserve has determined to be so closely related to banking or managing or controlling banks as to be a proper incident to banking or managing or controlling banks;
- Activities permitted outside of the United States that the Federal Reserve has determined to be usual in connection with banking or other financial operations abroad;
- Merchant banking through securities or insurance affiliates; and
- Insurance company portfolio investments.

The Gramm-Leach-Bliley Act also authorizes the Federal Reserve, in consultation with the Secretary of the Treasury, to determine activities in addition to those listed above that are financial in nature or incidental to such financial activity. In determining whether a particular activity is financial in nature or incidental or complementary to a financial activity, the Federal Reserve must consider (1) the purpose of the Bank Holding Company and Gramm-Leach-Bliley Acts, (2) changes or reasonably expected changes in the marketplace in which financial holding companies compete and in the technology for delivering financial services, and (3) whether the activity is necessary or appropriate to allow financial holding companies to effectively compete with other financial service providers and to efficiently deliver information and services.

To qualify to become a financial holding company, any of our depository institution subsidiaries must be well capitalized and well managed and must have a Community Reinvestment Act rating of at least satisfactory. Additionally, we must file an election with the Federal Reserve to become a financial holding company and provide the Federal Reserve with 30 days written notice prior to engaging in a permitted financial activity. Although we do not have any immediate plans to file an election with the Federal Reserve to become a financial holding company, one of the primary reasons we selected the holding company structure was to have increased flexibility. Accordingly, if deemed appropriate in the future, we may seek to become a financial holding company.

Under the Bank Holding Company Act, a bank holding company, which has not qualified or elected to become a financial holding company, is generally prohibited from engaging in or acquiring direct or indirect control of more than 5% of the voting shares of any company engaged in nonbanking activities unless, prior to the enactment of the Gramm-Leach-Bliley Act, the Federal Reserve found those activities to be so closely related to banking as to be a proper incident to the business of banking. Activities that the Federal Reserve has found to be so closely related to banking as to be a proper incident to the business of banking include:

- Factoring accounts receivable;
- Acquiring or servicing loans;
- Leasing personal property;
- Conducting discount securities brokerage activities;
- Performing selected data processing services;
- Acting as agent or broker in selling credit life insurance and other types of insurance in connection with credit transactions; and
- Performing selected insurance underwriting activities.

Despite prior approval, the Federal Reserve may order a bank holding company or its subsidiaries to terminate any of these activities or to terminate its ownership or control of any subsidiary when it has reasonable cause to believe that the bank holding company s continued ownership, activity or control constitutes a serious risk to the financial safety, soundness, or stability of any of its bank subsidiaries.

Support of Subsidiary Institutions. Under Federal Reserve policy, we are expected to act as a source of financial strength for our subsidiary, Pinnacle National, and to commit resources to support Pinnacle National. This support may be required at times when, without this Federal Reserve policy, we might not be inclined to provide it. In the unlikely event of our bankruptcy, any commitment by us to a federal bank regulatory agency to maintain the capital of Pinnacle National would be assumed by the bankruptcy trustee and entitled to a priority of payment.

Pinnacle National

Pinnacle National is a national bank chartered under the federal National Bank Act. As a result, it is subject to the supervision, examination and reporting requirements of the National Bank Act and the regulations of the Office of the Comptroller of the Currency (the OCC). The OCC regularly examines Pinnacle National s operations and has the authority to approve or disapprove mergers, the establishment of branches and similar corporate actions. The OCC also has the power to prevent the continuance or development of unsafe or unsound banking practices or other violations of law. Additionally, Pinnacle National s deposits are insured by the FDIC to the maximum extent provided by law. Pinnacle National also is subject to numerous state and federal statutes and regulations that will affect its business, activities and operations.

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Branching. While the OCC has authority to approve branch applications, national banks are required by the National Bank Act to adhere to branching laws applicable to state chartered banks in the states in which they are located. With prior regulatory approval, Tennessee law permits banks based in the state to either establish new or acquire existing branch offices throughout Tennessee. Pinnacle National and any other national or state-chartered bank generally may branch across state lines by merging with banks in other states if allowed by the applicable states laws. Tennessee law, with limited exceptions, currently permits branching across state lines either through interstate merger or branch acquisition. Tennessee, however only permits an out-of-state bank, short of an interstate merger, to branch into Tennessee through branch acquisition if the state of the out-of-state bank permits Tennessee based banks to acquire branches there.

FDIC Insurance. The FDIC has adopted a risk-based assessment system for insured depository institutions that takes into account the risks attributable to different categories and concentrations of assets and liabilities. The system assigns an institution to one of three capital categories: (1) well capitalized; (2) adequately capitalized; and (3) undercapitalized. These three categories are substantially similar to the prompt corrective action categories described below, with the undercapitalized category including institutions that are undercapitalized, significantly undercapitalized, and critically undercapitalized for prompt corrective action purposes. The FDIC also assigns an institution to one of three supervisory subgroups based on a supervisory evaluation that the institution s primary federal regulator provides to the FDIC and information that the FDIC determines to be relevant to the institution s financial condition and the risk posed to the deposit insurance funds.

The FDIC may terminate its insurance of deposits if it finds that the institution has engaged in unsafe and unsound practices, is in an unsafe or unsound condition to continue operations, or has violated any applicable law, regulation, rule, order or condition imposed by the FDIC.

Capital Adequacy

Both Pinnacle Financial and Pinnacle National are required to comply with the capital adequacy standards established by the Federal Reserve, in our case, and the OCC, in the case of Pinnacle National. The Federal Reserve has established a risk-based and a leverage measure of capital adequacy for bank holding companies. Pinnacle National is also subject to risk-based and leverage capital requirements adopted by the OCC, which are substantially similar to those adopted by the Federal Reserve for bank holding companies.

The risk-based capital standards are designed to make regulatory capital requirements more sensitive to differences in risk profiles among banks and bank holding companies, to account for off-balance-sheet exposure, and to minimize disincentives for holding liquid assets. Assets and off-balance-sheet items, such as letters of credit and unfunded loan commitments, are assigned to broad risk categories, each with appropriate risk weights. The resulting capital ratios represent capital as a percentage of total risk-weighted assets and off-balance-sheet items.

The minimum guideline for the ratio of total capital to risk-weighted assets is 8%. Total capital consists of two components, Tier 1 capital and Tier 2 capital. Tier 1 capital generally consists of common stock, minority interests in the equity accounts of consolidated subsidiaries, noncumulative perpetual preferred stock, and a limited amount of cumulative perpetual preferred stock, less goodwill and other specified intangible assets. Tier 1 capital must equal at least 4% of risk-weighted assets. Tier 2 capital generally consists of subordinated debt, other preferred stock, and a limited amount of loan loss reserves. The total amount of Tier 2 capital is limited to 100% of Tier 1 capital. At December 31, 2003, our ratio of total capital to risk-weighted assets was 12.8% and our ratio of Tier 1 capital to risk-weighted assets was 11.8%.

In addition, the Federal Reserve has established minimum leverage ratio guidelines for bank holding companies. These guidelines provide for a minimum ratio of Tier 1 capital to average assets, less goodwill and other specified intangible assets, of 3% for bank holding companies that meet specified criteria, including having the highest regulatory rating and implementing the Federal Reserve s risk-based capital measure for market risk. All other bank holding companies generally are required to maintain a leverage ratio of at least 4%. At December 31, 2003, our leverage ratio was 9.7%. The guidelines also provide that bank holding companies experiencing high internal growth, as is our case, or making acquisitions will be expected to maintain strong capital positions substantially above the minimum supervisory levels. Furthermore, the Federal Reserve has indicated that it will consider a bank holding company s Tier 1 capital leverage ratio, after deducting all intangibles, and other indicators of capital strength in evaluating proposals for expansion or new activities.

If our growth rate continues, as we presently anticipate, our assets will grow faster than our capital and our capital ratios will decline. In order to maintain capital at Pinnacle National at appropriate levels, we may be required to incur borrowings or issue additional equity securities. We have committed to the Federal Reserve Bank of Atlanta that we will obtain its approval before Pinnacle Financial incurs any indebtedness. In 2003, the Federal Reserve Bank of Atlanta granted such an approval in connection with Pinnacle Financial s issuance of trust preferred securities. In connection with such approval, Pinnacle Financial s Chairman of the Board, President and Chief Executive Officer and Chief Administrative Officer committed to the Federal Reserve Bank of Atlanta that if required to enable Pinnacle Financial to make interest payments in 2004 on its subordinated debentures under certain circumstances, they would exercise up to 92,500 warrants to acquire Pinnacle Financial common stock held by them to provide funds for such payment.

Failure to meet capital guidelines could subject a bank or bank holding company to a variety of enforcement remedies, including issuance of a capital directive, the termination of deposit insurance by the FDIC, a prohibition on accepting brokered deposits, and other restrictions on its business. As described above, significant additional restrictions can be imposed on FDIC-insured depository institutions that fail to meet applicable capital requirements.

Prompt Corrective Action

The Federal Deposit Insurance Corporation Improvement Act of 1991 establishes a system of prompt corrective action to resolve the problems of undercapitalized financial institutions. Under this system, the federal banking regulators have established five capital categories (well capitalized, adequately capitalized, undercapitalized, significantly undercapitalized and critically undercapitalized) into one of which all institutions are placed. Federal banking regulators are required to take various mandatory supervisory actions and are authorized to take other discretionary actions with respect to institutions in the three undercapitalized categories. The severity of the action depends upon the capital category in which the institution is placed. Generally, subject to a narrow exception, the banking regulator must appoint a receiver or conservator for an institution that is critically undercapitalized. The federal banking agencies have specified by regulation the relevant capital level for each category.

An institution that is categorized as undercapitalized, significantly undercapitalized, or critically undercapitalized is required to submit an acceptable capital restoration plan to its appropriate federal banking agency. A bank holding company must guarantee that a subsidiary depository institution meets its capital restoration plan, subject to various limitations. The controlling holding company s obligation to fund a capital restoration plan is limited to the lesser of 5% of an undercapitalized subsidiary s assets or the amount required to meet regulatory capital requirements. An undercapitalized institution is also generally prohibited from increasing its average total assets, making acquisitions, establishing any branches or engaging in any new line of business, except under an accepted capital restoration plan or with FDIC approval. The regulations also establish procedures for downgrading an institution and a lower capital category based on supervisory factors other than capital. As of December 31, 2003, we believe Pinnacle National would be considered well capitalized by its primary regulator.

Payment of Dividends

We are a legal entity separate and distinct from Pinnacle National. The principal sources of our cash flow, including cash flow to pay dividends to our shareholders, are dividends that Pinnacle National pays to us as its sole shareholder. Statutory and regulatory limitations apply to Pinnacle National s payment of dividends to us as well as to our payment of dividends to our shareholders.

Pinnacle National is required by federal law to obtain the prior approval of the OCC for payments of dividends if the total of all dividends declared by our board of directors in any year will exceed (1) the total of Pinnacle National s net profits for that year, plus (2) Pinnacle National s retained net profits of the preceding two years, less any required transfers to surplus. Since Pinnacle National had an accumulated deficit at December 31, 2003, of $111,000, we do not expect that Pinnacle National will be able to pay dividends to us until after the first quarter of 2004. Furthermore, we do not anticipate that Pinnacle Financial will require any dividends from Pinnacle National in 2004.

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The payment of dividends by us and Pinnacle National may also be affected by other factors, such as the requirement to maintain adequate capital above regulatory guidelines. If, in the opinion of the OCC, Pinnacle National was engaged in or about to engage in an unsafe or unsound practice, the OCC could require, after notice and a hearing, that Pinnacle National stop or refrain from engaging in the practice. The federal banking agencies have indicated that paying dividends that deplete a depository institution s capital base to an inadequate level would be an unsafe and unsound banking practice. Under the Federal Deposit Insurance Corporation Improvement Act of 1991, a depository institution may not pay any dividend if payment would cause it to become undercapitalized or if it already is undercapitalized. Moreover, the federal agencies have issued policy statements that provide that bank holding companies and insured banks should generally only pay dividends out of current operating earnings. See Prompt Corrective Action above.

Restrictions on Transactions with Affiliates

Both Pinnacle Financial and Pinnacle National are subject to the provisions of Section 23A of the Federal Reserve Act. Section 23A places limits on the amount of:

- A bank s loans or extensions of credit to affiliates;
- A bank s investment in affiliates;
- Assets a bank may purchase from affiliates, except for real and personal property exempted by the Federal Reserve;
- The amount of loans or extensions of credit to third parties collateralized by the securities or obligations of affiliates; and
- A bank s guarantee, acceptance or letter of credit issued on behalf of an affiliate.

The total amount of the above transactions is limited in amount, as to any one affiliate, to 10% of a bank s capital and surplus and, as to all affiliates combined, to 20% of a bank s capital and surplus. In addition to the limitation on the amount of these transactions, each of the above transactions must also meet specified collateral requirements. Pinnacle National must also comply with other provisions designed to avoid the taking of low-quality assets.

Pinnacle Financial and Pinnacle National are also subject to the provisions of Section 23B of the Federal Reserve Act which, among other things, prohibits an institution from engaging in the above transactions with affiliates unless the transactions are on terms substantially the same, or at least as favorable to the institution or its subsidiaries, as those prevailing at the time for comparable transactions with nonaffiliated companies.

Pinnacle National is also subject to restrictions on extensions of credit to its executive officers, directors, principal shareholders and their related interests. These extensions of credit (1) must be made on substantially the same terms, including interest rates and collateral, as those prevailing at the time for comparable transactions with third parties, and (2) must not involve more than the normal risk of repayment or present other unfavorable features.

Community Reinvestment

The Community Reinvestment Act requires that, in connection with examinations of financial institutions within their respective jurisdictions, the Federal Reserve, the OCC or the FDIC shall evaluate the record of each financial institution in meeting the credit needs of its local community, including low- and moderate-income neighborhoods. These facts are also considered in evaluating mergers, acquisitions, and applications to open a branch or facility. Failure to adequately meet these criteria could impose additional requirements and limitations on Pinnacle National. Additionally, banks are required to publicly disclose the terms of various Community Reinvestment Act-related agreements.

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Privacy

Under the Gramm-Leach-Bliley Act, financial institutions are required to disclose their policies for collecting and protecting confidential information. Customers generally may prevent financial institutions from sharing personal financial information with nonaffiliated third parties except for third parties that market the institutions own products and services. Additionally, financial institutions generally may not disclose consumer account numbers to any nonaffiliated third party for use in telemarketing, direct mail marketing or other marketing through electronic mail to consumers. Pinnacle National has established a privacy policy to ensure compliance with federal requirements.

Other Consumer Laws and Regulations

Interest and other charges collected or contracted for by Pinnacle National are subject to state usury laws and federal laws concerning interest rates. For example, under the Soldiers and Sailors Civil Relief Act of 1940, a lender is generally prohibited from charging an annual interest rate in excess of 6% on any obligations for which the borrower is a person on active duty with the United States military. Pinnacle National s loan operations are also subject to federal laws applicable to credit transactions, such as the:

Federal Truth-In-Lending Act, governing disclosures of credit terms to consumer borrowers;

Home Mortgage Disclosure Act of 1975, requiring financial institutions to provide information to enable the public and public officials to determine whether a financial institution is fulfilling its obligation to help meet the housing needs of the community it serves;

Equal Credit Opportunity Act, prohibiting discrimination on the basis of race, creed or other prohibited factors in extending credit;

Fair Credit Reporting Act of 1978, governing the use and provision of information to credit reporting agencies;

Fair Debt Collection Act, governing the manner in which consumer debts may be collected by collection agencies;

Soldiers and Sailors Civil Relief Act of 1940, governing the repayment terms of, and property rights underlying, secured obligations of persons in military service; and

Rules and regulations of the various federal agencies charged with the responsibility of implementing the federal laws.

Pinnacle National s deposit operations are subject to the:

Right to Financial Privacy Act, which imposes a duty to maintain confidentiality of consumer financial records and prescribes procedures for complying with administrative subpoenas of financial records; and

Electronic Funds Transfer Act and Regulation E issued by the Federal Reserve to implement that act, which govern automatic deposits to and withdrawals from deposit accounts and customers rights and liabilities arising from the use of automated teller machines and other electronic banking services.

Anti-Terrorism Legislation

On October 26, 2001, the President of the United States signed the Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism (USA PATRIOT) Act of 2001. Under the USA PATRIOT Act, financial institutions are subject to prohibitions against specified financial transactions and account relationships as well as enhanced due diligence and know your customer standards in their dealings with foreign financial institutions and foreign customers.

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In addition, the USA PATRIOT Act authorizes the Secretary of the Treasury to adopt rules increasing the cooperation and information sharing between financial institutions, regulators, and law enforcement authorities regarding individuals, entities and organizations engaged in, or reasonably suspected based on credible evidence of engaging in, terrorist acts or money laundering activities. Any financial institution complying with these rules will not be deemed to have violated the privacy provisions of the Gramm-Leach-Bliley Act, as discussed above. Pinnacle National currently has policies and procedures in place designed to comply with the USA PATRIOT Act.

Proposed Legislation and Regulatory Action

New regulations and statutes are regularly proposed that contain wide-ranging proposals for altering the structures, regulations and competitive relationships of the nation s financial institutions. We cannot predict whether or in what form any proposed regulation or statute will be adopted or the extent to which our business may be affected by any new regulation or statute.

Effect of Governmental Monetary Policies

Our earnings are affected by domestic economic conditions and the monetary and fiscal policies of the United States government and its agencies. The Federal Reserve s monetary policies have had, and are likely to continue to have, an important impact on the operating results of commercial banks through the Federal Reserve s statutory power to implement national monetary policy in order, among other things, to curb inflation or combat a recession. The Federal Reserve, through its monetary and fiscal policies, affects the levels of bank loans, investments and deposits through its control over the issuance of United States government securities, its regulation of the discount rate applicable to member banks and its influence over reserve requirements to which member banks are subject. We cannot predict the nature or impact of future changes in monetary and fiscal policies.

RISK FACTORS

Investing in our common stock involves various risks which are particular to our company, our industry and our market area. Several risk factors regarding investing in our common stock are discussed below. This listing should not be considered as all-inclusive. If any of the following risks were to occur, we may not be able to conduct our business as currently planned and our financial condition or operating results could be negatively impacted. All of which might cause the trading price of our common stock to decline.

We do expect to continue to grow rapidly and should our growth exceed our expectations such growth may require us to raise additional capital.

Our plans are to grow at a rate that is more than that normally contemplated for banks which have been in business for longer periods of time. To continue to grow, we will need to provide sufficient capital to Pinnacle National through earnings generation, additional equity offerings or we will need to incur indebtedness from a third party and invest the proceeds into Pinnacle National or any combination of the three. Should we incur such indebtedness, we are required to obtain certain regulatory approvals beforehand. Should our growth exceed our expectations, as has been the case to-date, we may need to raise additional capital over our projected capital needs. Additionally, our current plan involves increasing our branch network. However, this will also require certain regulatory approvals. Should we not be able to obtain such approvals or otherwise not be able grow our asset base; our ability to attain our long-term profitability goals will be more difficult.

If our allowance for loan losses is not sufficient to cover actual loan losses, our earnings will decrease.

If loan customers with significant loan balances fail to repay their loans according to the terms of these loans, our earnings would suffer. We make various assumptions and judgments about the collectibility of our loan portfolio, including the creditworthiness of our borrowers and the value of any collateral securing the repayment of our loans. We maintain an allowance for loan losses in an attempt to cover the inherent risks associated with lending. In determining the size of this allowance, we rely on an analysis of our loan portfolio based on volume and types of loans, internal loan classifications, trends in classifications, volume and trends in delinquencies and nonaccruals,

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national and local economic conditions, other factors and other pertinent information. If our assumptions are inaccurate, our current allowance may not be sufficient to cover potential loan losses, and additional provisions may be necessary which would decrease our earnings.

In addition, federal and state regulators periodically review our loan portfolio and may require us to increase our provision for loan losses or recognize loan charge-offs. Their conclusions about the quality of our loan portfolio may be different than ours. Any increase in our allowance for loan losses or loan charge-offs as required by these regulatory agencies could have a negative effect on our operating results.

Fluctuations in interest rates could reduce our profitability.

We realize income primarily from the difference between interest earned on loans and investments and interest paid on deposits and other borrowings. Interest rate fluctuations are caused by many factors which, for the most part, are not under our direct control. For example, national monetary policy plays a significant role in the determination of interest rates. Additionally, competitor pricing and the resulting negotiations that occur with our customers also impact the rates we collect on loans and the rates we pay on deposits.

As interest rates change, we expect that we will periodically experience gaps in the interest rate sensitivities of our assets and liabilities, meaning that either our interest-bearing liabilities will be more sensitive to changes in market interest rates than our interest-earning assets, or vice versa. In either event, if market interest rates should move contrary to our position, this gap may work against us, and our earnings may be negatively affected.

We are geographically concentrated in the Nashville, Tennessee MSA, and changes in local economic conditions impact our profitability.

We operate primarily in the Nashville, Tennessee MSA, and substantially all of our loan customers and most of our deposit and other customers live or have operations in the Nashville MSA. Our profitability is impacted by the changes in general economic conditions in this market.

We have a concentration of credit exposure to borrowers in the trucking industry and to borrowers that operate nonresidential buildings.

If either of these industries experience an economic slowdown and, as a result, the borrowers are unable to perform their obligations under their existing loan agreements, our earnings could be negatively impacted. Additional information regarding our concentration in these two areas can be found in Item 6. Management s Discussion and Analysis of Financial Condition and Results of Operations .

Loss of our senior executive officers or other key employees could impair our relationship with our customers and adversely affect our business.

We have assembled a senior management team which has a substantial background and experience in banking and financial services in the Nashville market. Loss of these key personnel could negatively impact our earnings because of their skills, customer relationships and/or the potential difficulty of promptly replacing them.

Competition with other banking institutions could adversely affect our profitability.

A number of banking institutions in the Nashville market have higher lending limits, more banking offices, and a larger market share. In addition, our asset management division competes with numerous brokerage firms and mutual fund companies which are also much larger. In some respects, this may place these competitors in a competitive advantage, although many of our customers have selected us because of service quality concerns at the larger enterprises.

We are subject to various statutes and regulations that may limit our ability to take certain actions.

As a relatively new financial institution, we are subject to regulatory restrictions on, among other things, dividends, capital and borrowings that are more fully described in Supervision and Regulation herein.

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ITEM 2. DESCRIPTION OF PROPERTIES

Pinnacle Financial s principal offices are located at 211 Commerce Street in Nashville, Tennessee in Davidson County. Pinnacle National leases these offices from an unrelated third party.

Pinnacle National leases the land for its Brentwood branch office building located in Williamson County, Tennessee, from an unrelated third party but owns the building and leasehold improvements. Pinnacle National also leases the land for its Green Hills office location in Davidson County from an unrelated third party, but also owns the building and leasehold improvements. Pinnacle National owns the land and buildings for its Rivergate and Cool Springs branch offices.

Other than normal real estate commercial lending activities of Pinnacle National, the acquisition of mortgage-related securities held in Pinnacle National s investment securities portfolio, the ownership of branch office facilities, and consumer mortgage lending, Pinnacle National generally does not invest in real estate, interests in real estate or securities of or interests in persons primarily engaged in real estate activities.

ITEM 3. LEGAL PROCEEDINGS

As of the date hereof, there are no material pending legal proceedings to which Pinnacle Financial or Pinnacle National is a party or of which any of its properties are subject; nor are there material proceedings known to Pinnacle Financial or Pinnacle National to be contemplated by any governmental authority; nor are there material proceedings known to Pinnacle Financial or Pinnacle National, pending or contemplated, in which any director, officer or affiliate or any principal security holder of Pinnacle Financial or Pinnacle National or any associate of any of the foregoing, is a party or has an interest adverse to Pinnacle Financial or Pinnacle National.

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

None.

PART II

ITEM 5. MARKET FOR REGISTRANT S COMMON EQUITY AND RELATED STOCKHOLDER MATTERS

Since August 14, 2002, Pinnacle Financial s common stock has been traded on the Nasdaq National Market. Pinnacle Financial s common stock was traded on the Nasdaq SmallCap Market from May 28, 2002 to August 13, 2002 after initially being traded on the OTC Bulletin Board. The following table shows the high and low bid price information for Pinnacle Financial s common stock for each quarter in 2003 and 2002. For the periods when the common stock was traded on the OTC Bulletin Board, these quotations reflect inter-dealer prices, without retail markup, markdown, or commission, and may not represent actual transactions.

	Bid Price Per Share	
	High	**Low**
2003:		
First quarter	$14.14	$12.76
Second quarter	17.00	13.05
Third quarter	19.94	16.00
Fourth quarter	25.90	19.35
2002:		
First quarter	$10.50	$ 8.75
Second quarter	11.82	9.75
Third quarter	11.75	10.90
Fourth quarter	13.30	11.01

As of February 15, 2004, Pinnacle Financial had approximately 60 shareholders of record and, additionally, approximately 800 beneficial owners.

Pinnacle Financial has not paid any cash dividends since inception, and it does not anticipate that it will consider paying dividends until Pinnacle National has achieved positive retained earnings and a level of profitability appropriate to fund such dividends and support asset growth. See Item 1. Description of Business Supervision and Regulation Payment of Dividends and Item 6. Management s Discussion and Analysis of Financial Condition and Results of Operations for additional information on dividend restrictions applicable to Pinnacle Financial.

ITEM 6. MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following is a discussion of our financial condition at December 31, 2003 and 2002 and our results of operations for the years ended December 31, 2003, 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 consolidated financial statements. You should read the following discussion and analysis along with our consolidated financial statements and the related notes included elsewhere herein.

Overview

General. Pinnacle Financial s rapid growth from its inception through the fourth quarter of 2003 has had, and continues to have, a material impact on Pinnacle Financial s financial condition and results of operations. This rapid growth resulted in net income for the year ended December 31, 2003 of $0.65 per diluted share as compared to $0.21 per diluted share for the twelve months ended December 31, 2002. At December 31, 2003, loans totaled $297 million, as compared to $210 million at December 31, 2002, while total deposits increased from $234 million at December 31, 2002 to $391 million at December 31, 2003.

Financial Condition. The $87 million increase in loans for 2003 contributed to the increase in Pinnacle Financial s net income for the twelve months ended December 31, 2003 when compared to 2002. This increase in volume

offset the decrease in average yields on loans between 2003 and 2002. As Pinnacle Financial seeks to increase its loan portfolio it must also continue to monitor the risks inherent in its lending operations. If Pinnacle Financial s allowance for loan losses is not sufficient to cover loan losses in Pinnacle Financial s loan portfolio, increases to the allowance for loan losses may be required which would decrease Pinnacle Financial s earnings.

Additionally, in 2003, for asset/liability management purposes, Pinnacle Financial elected to allocate a greater portion of its funding base to its investment portfolio versus its loan portfolio as securities available-for-sale increased by 89% from end of year 2002 to end of year 2003. These investment securities typically have lower yields than do loans, but the significant increase in balances added additional interest income for Pinnacle Financial.

Pinnacle Financial has successfully grown its total deposits to $391 million at December 31, 2003. This growth in deposits has allowed Pinnacle Financial to fund its asset growth at a lower cost than in 2002. While rates paid on deposits decreased during fiscal 2003, Pinnacle Financial, for competitive reasons, has typically adjusted its deposit rates more slowly than its loan yields during a period of declining interest rates. As such, Pinnacle Financial s deposit funding costs do not decrease as quickly as do revenues from interest income on earning assets thus reducing Pinnacle Financial s net interest margin. In addition, Pinnacle Financial believes that in certain cases rates paid on deposits have decreased to such levels that further reductions could put Pinnacle Financial at a competitive disadvantage as customers seek higher returns on their balances.

Results of Operations. Pinnacle Financial s net interest income increased from $8.2 million in 2002 to $12.9 million in 2003. However, the net interest margin (the ratio of net interest income to average earning assets for the period) decreased from 3.81% in 2002 to 3.53% in 2003. This was due, in large part, to the rate environment which all financial services companies find themselves operating in today. Generally, the yields Pinnacle Financial earned on its assets decreased more than the rates we paid on our interest-bearing liability balances.

The increase in loan volume for 2003 was also the primary cause for the $219,000 increase in Pinnacle Financial s provision for loan losses for the twelve months ended December 31, 2003 over the prior year s period. As Pinnacle Financial s loan portfolio continues to grow, Pinnacle Financial expects that it will continue to record a provision for loan losses consistent with the growth in the loan portfolio.

Noninterest income for Pinnacle Financial also increased by 90% from 2002 to 2003. Much of the increase was due to Pinnacle Financial initiating a mortgage origination unit during 2003 which contributed $667,000 in fees during the year. We also recorded $248,000 in gains on the sales of securities available-for-sale and increased gains on the sale of loans.

Pinnacle Financial s continued growth in 2003 resulted in an increase of approximately $3.1 million in noninterest expense related to salaries and employee benefits, equipment and occupancy expenses and other operating expenses. As Pinnacle Financial increased its number of full-time equivalent employees from 55.5 at December 31, 2002 to 89.5 at December 31, 2003, Pinnacle Financial experienced an approximately $2.0 million increase in compensation and employee benefit expense. Pinnacle Financial expects to add additional employees in 2004 which will cause Pinnacle Financial s compensation and employee benefit expense to increase in future periods. Pinnacle Financial s branch expansion efforts in 2003 also resulted in increased noninterest expense for 2003. The increased operational expenses for the branches opened in 2003 and the expected opening of two additional branches in 2004 will continue to result in increased noninterest expense in future periods. Although Pinnacle Financial s expenses increased in 2003, Pinnacle Financial s efficiency ratio, the ratio of noninterest expense to the sum of net interest income and noninterest income, decreased from 80.4% for the year ended December 31, 2002 compared to 68.3% for the year ended December 31, 2003.

Capital and Liquidity. On December 30, 2003, Pinnacle Financial issued $10 million in trust preferred securities which bear interest at a floating rate based on a spread over 3-month LIBOR, which is set each quarter, and mature on December 30, 2033. Pinnacle Financial believes that the proceeds from this offering should provide, under current regulatory guidelines, the regulatory capital Pinnacle Financial needs to support its anticipated growth in 2004 and the foreseeable future.

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Critical Accounting Estimates

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), 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.

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.

Results of Operations

Our results for fiscal years 2003, 2002 and 2001 were highlighted by the continued growth in loans and other earning assets and deposits, which resulted in increased revenues and expenses. The net income for the years ended December 31, 2003 and 2002 was $2,555,000 and $648,000, respectively, compared to a net loss for the year ended December 31, 2001 of $1,137,000. The following is a more detailed discussion of results of our operations.

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

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earnings. For the year ended December 31, 2003, we recorded net interest income of $12,899,000 which resulted in a net interest margin of 3.53% for the year. For the year ended December 31, 2002, we recorded net interest income of $8,199,000 which resulted in a net interest margin of 3.81% for the year. For the year ended December 31, 2001, we recorded net interest income of $3,490,000 which resulted in a net interest margin of 3.95% for the year. During 2001, the Federal Reserve lowered its Federal funds rate 475 basis points and in 2002 another 50 basis points in an effort to provide stimulus to the national economy. Our management believes the interest rate environment had a negative impact on our net interest income during these periods as a significant number of our customers are adjustable rate borrowers with their lines of credit tied primarily to our prime lending rate which declined in lock-step with the Federal funds rate declines.

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 each of the years in the three-year period ended December 31, 2003 (dollars in thousands):

	2003			2002			2001		
	Average Balances	Interest	Yields/ Rates (1)	Average Balances	Interest	Yields/ Rates	Average Balances	Interest	Yields/ Rates
Interest-earning assets:									
Loans (2)	$254,550	$13,709	5.39%	$170,943	$10,510	6.15%	$67,150	$4,864	7.24%
Securities available-for-sale:									
Taxable	100,547	4,158	4.14	36,475	1,838	5.04	15,348	934	6.09
Tax exempt	6,172	217	4.37	892	35	4.71			
Federal funds sold and other	8,584	178	2.07	7,011	178	2.64	5,850	271	4.63
Total interest-earning assets	369,853	18,262	4.96	215,321	12,561	5.84	88,348	6,069	6.87
Nonearning assets	18,231			12,627			6,677		
Total assets	$388,084			$227,948			$95,025		
Interest-bearing liabilities:									
Interest-bearing deposits:									
Interest checking	$ 19,324	$ 95	0.49%	$ 9,844	$ 99	1.01%	$ 4,835	$ 94	1.94%
Savings and money market	100,032	870	0.87	59,274	1,002	1.69	33,566	1,115	3.32
Certificates of deposit	136,203	3,384	2.48	83,873	2,712	3.23	24,439	1,133	4.64
Total interest-bearing deposits	255,559	4,349	1.70	152,991	3,813	2.49	62,840	2,342	3.73
Securities sold under agreements to repurchase	14,496	66	0.45	12,728	91	0.71	6,584	155	2.35
Federal funds purchased	2,926	44	1.51	1,163	23	1.98	886	25	2.82
Federal Home Loan Bank advances	38,000	904	2.38	13,088	435	3.32	1,704	57	3.35
Total interest-bearing liabilities	310,981	5,363	1.72	179,970	4,362	2.42	72,014	2,579	3.58
Noninterest-bearing liabilities:									
Demand deposits	42,308			20,480			7,912		
Other liabilities	1,635			1,095			573		
Stockholders equity	33,160			26,403			14,526		
Total liabilities and stockholders equity	$388,084			$227,948			$95,025		

Net interest income	$12,899	$ 8,199	$3,490
Net interest spread (3)	3.23%	3.42%	3.29%
Net interest margin	3.53%	3.81%	3.95%

(1) We computed yields based on the carrying value of those tax exempt instruments on a fully tax equivalent basis. The impact of tax exempt instruments was insignificant prior to 2002.

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

(3) Net interest spread above excludes impact of demand deposits, including demand deposits in the average balances which would have produced a net interest spread for the year ended December 31, 2003 of 3.44% compared to a net interest spread for the years ended December 31, 2002 and 2001 of 3.67% and 3.64%, respectively.

Several factors contributed to the decline in net interest margin for 2003 when compared to the same period in 2002, including the following:

Our loan yields decreased from 6.15% for 2002 to 5.39% for 2003, a decrease of 76 basis points. Several factors contributed to this decrease.

As of December 31, 2003, approximately 53% of our loans were floating rate loans. The interest rates on most of these loans were tied in some way to Pinnacle National s prime lending rate and reprice immediately with adjustments to such rate. Pinnacle National s prime lending rate for the period from

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January 1, 2003 through June 25, 2003 was 4.25% and then was reduced to 4.00% for the period from June 25, 2003 to December 31, 2003. This compares to a consistent 4.75% for the same period in 2002.

Also contributing to the decrease in loan yields was the change in the overall composition of loans between the two periods. Generally, floating rate loans have a lower yield compared to fixed or variable rate loans, which was the case for 2003 when compared 2002. At December 31, 2003, approximately 53% of the loan portfolio was tied to floating rate indexes compared to 46% at December 31, 2002.

Our remaining loan portfolio consists of fixed rate loans (which do not reprice during their term) or variable rate loans (which reprice at some point prior to their maturity date, usually annually or after five years and then annually thereafter). Generally, our fixed and variable rate loans are priced in relation to the yield curve for US Treasury securities for similar maturities, which resulted in lower yields for 2003 compared to 2002. The average yield of the five year US Treasury securities for the 2003 was 3.99% compared to an average yield of 4.58% for 2002, a decline of approximately 59 basis points between the two periods.

During 2003, we were able to grow our funding base significantly. For asset/liability management purposes in 2003, we elected to allocate a greater proportion of such funds to our securities available-for-sale portfolio versus our loan portfolio than in 2002. Our securities available-for-sale generally have lower yields than do loans. Our securities available-for-sale yields decreased from 5.03% for 2002 to 4.15% for 2003, a decrease of 88 basis points. We have consistently maintained most of our securities available-for-sale in mortgage-backed securities. These mortgage-backed securities are comprised of pools of individual mortgage loans granted to homeowners. During periods of falling rates, these mortgage-backed securities experience principal paydowns at a more rapid rate than in a flat or rising interest rate environment as homeowners take advantage of the lower interest rates by either purchasing a new home or refinancing their existing mortgage. In either event, the existing mortgages are paid-off and, in turn, the mortgage-backed security which includes these mortgages is paid down. Accordingly, any premium amortization associated with these securities also escalates causing the yields on these securities to decrease. This was particularly true in the second and third quarters of 2003 as a significant number of homeowners refinanced their existing mortgage loans. Additionally, we have also invested in various bonds issued by US government agencies which are callable at a certain predetermined time in the future at the option of the issuing agency. During periods of falling rates, the issuing agencies will routinely call these bonds, pay the holder of the bond in full and subsequently reissue the bond at a lower rate. In these cases, we receive full payment on a higher-yielding investment and, usually, replace the called bond with a lower yielding investment.

Although deposit rates decreased between the two periods, our deposit rates typically adjust more slowly than our loan yields during a period of declining interest rates due to competitive market pressures. Thus, deposit-funding costs typically do not decrease as quickly as do revenues from interest income on earning assets. Additionally, during 2003, overall deposit rates were less than those rates for the comparable period in 2002. In some cases, rates for 2003 have decreased to such levels that further decreases in deposit rates approach what we term embedded floors or rates that it is not reasonable or practical to go below, such that further decreases in deposit rates could place us in a competitive disadvantage as customers seek higher returns on their balances.

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Rate and Volume Analysis. As noted above, net interest income increased by $4,700,000 between the years ended December 31, 2003 and 2002 and by $4,709,000 between the years ended December 31, 2002 and 2001. The following is an analysis of the changes in our net interest income comparing the changes attributable to rates and those attributable to volumes (dollars in thousands):

	2003 Compared to 2002 Increase (Decrease) due to			2002 Compared to 2001 Increase (Decrease) due to		
	Rate	Volume	Net	Rate	Volume	Net
Interest-earning assets:						
Loans	$(396)	$3,595	$3,199	$ (841)	$6,487	$5,646
Securities, available-for-sale:						
Taxable	(85)	2,405	2,320	(185)	1,089	904
Nontaxable		182	182		35	35
Federal funds sold and other	(52)	52		(139)	46	(93)
Total interest-earning assets	(533)	6,234	5,701	(1,165)	7,657	6,492
Interest-bearing liabilities:						
Interest checking	$ (35)	$ 31	$ (4)	$ (60)	$ 65	$ 5
Savings and money market	(339)	207	(132)	(711)	598	(113)
Certificates of deposit	(276)	948	672	(435)	2,014	1,579
Total interest-bearing deposits	(650)	1,186	536	(1,206)	2,677	1,471
Securities sold under agreements to repurchase	(28)	3	(25)	(151)	87	(64)
Federal funds purchased	(2)	23	21	(9)	7	(2)
Federal Home Loan Bank advances	(46)	515	469		378	378
Total interest-bearing liabilities	(726)	1,727	1,001	(1,366)	3,149	1,783
Net interest income	$ 193	$4,507	$4,700	$ 201	$4,508	$4,709

Changes in net interest income are attributed to either changes in average balances (volume change) or changes in average rates (rate change) for earning assets and sources of funds on which interest is received or paid. Volume change is calculated as change in volume times the previous rate while rate change is change in rate times the previous volume. The change attributed to rates and volumes (change in rate times change in volume) is allocated between volume change and rate change at the ratio of how much each component bears to the absolute value of their total.

Provision for Loan Losses. The provision for loan losses represents a charge to earnings necessary to establish an allowance for loan losses that, in our management s evaluation, should be adequate to provide coverage for the inherent losses on outstanding loans. The provision for loan losses amounted to $1,157,000; $938,000 and $1,670,000 for the years ended December 31, 2003, 2002 and 2001, respectively.

Based upon our management s evaluation of the loan portfolio, our management believes the allowance for loan losses to be adequate to absorb our estimate of probable losses existing in the loan portfolio at the balance sheet date. The increase in the provision for loan losses for the year ended December 31, 2003 when compared to the year ended December 31, 2002 was primarily due to the increase in loans throughout 2003 when compared to 2002. The decrease in the provision for loan losses in 2002 when compared to 2001 was due to the relative decrease in the rate of loan growth in 2002 when compared to 2001. Based upon our management s assessment of the loan portfolio, we adjust our ALL to an amount deemed appropriate to adequately cover inherent risks in the loan portfolio. While our policies and procedures used to estimate the ALL, as well as the resultant provision for loan losses charged to operations, are considered adequate by our management and are reviewed from time to time by Pinnacle National s regulators, they are necessarily approximate and imprecise. There exist factors beyond our control, such as general economic conditions both locally and nationally, which may negatively impact, materially, the adequacy of our ALL and, thus, the resulting provision for loan losses.

Noninterest Income. Pinnacle Financial s noninterest income is composed of several components, some of which vary significantly between quarterly periods. Service charges on deposit accounts and other noninterest income generally reflect Pinnacle Financial s growth, while investment services and fees from the origination of mortgage loans will often reflect market conditions and fluctuate from period to period. The opportunities for recognition of gains on loan participations sold and gain on sales of investment securities may also vary widely from quarter to quarter.

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The following is the makeup of our noninterest income for the years ended December 31, 2003, 2002 and 2001 (dollars in thousands):

	2003	2002	2001
Noninterest income:			
Service charges on deposit accounts	$ 513	$ 281	$ 90
Investment sales commissions	998	810	839
Fees from origination of mortgage loans	667		
Gain on loan participations sold	334	120	191
Gain on sale of investment securities, net	248		
Other noninterest income	527	521	221
Total noninterest income	$3,287	$1,732	$1,341

As shown, the largest component of noninterest income is commissions and fees from our financial advisory unit, Pinnacle Asset Management, a division of Pinnacle National. At December 31, 2003, Pinnacle Asset Management was receiving commissions and fees in connection with approximately $319 million in brokerage assets held with Raymond James Financial Services, Inc. compared to $171 million at December 31, 2002 and $136 million at December 31, 2001.

Service charge income for 2003 increased over that of 2002 due to an increase in both the balance and number of deposit accounts subject to service charges. Additionally, mortgage related fees, attributable to Pinnacle National beginning a mortgage origination unit during the first quarter of 2003, also provided for a significant portion of the increase in noninterest income between 2003 and 2002. These mortgage fees are for loans originated by Pinnacle National and subsequently sold to third-party investors. All loans are sold whereby servicing rights transfer to the buyer. Generally, mortgage origination fees increase in lower interest rate environments and decrease in rising interest rate environments. As a result, mortgage origination fees may fluctuate greatly in response to a changing rate environment.

Another noninterest income item for the years ended December 31, 2003, 2002 and 2001 was related to our sale of certain loan participations to our correspondent banks which were primarily related to new lending transactions in excess of internal loan limits. At December 31, 2003 and pursuant to participation agreements with these correspondents, we had participated approximately $52 million of originated loans to these other banks. These participation agreements have various provisions regarding collateral position, pricing and other matters. Many of these agreements provide that we pay the correspondent less than the loan s contracted interest rate. Pursuant to Statement of Financial Accounting Standards No. 140, Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities a replacement of FASB Statement No. 125, we recorded $334,000, which represents the net present value of these future net revenues, as a gain on sale of participations in our results of operations during the year ended December 31, 2003 compared to $120,000 and $191,000 during the years ended December 31, 2002 and 2001, respectively. We intend to maintain relationships with our correspondents in order to participate future loans to these correspondents in a similar manner. However, the timing of participations may cause the level of gains, if any, to vary significantly.

Also included in noninterest income for the year ended December 31, 2003, were net gains of approximately $248,000 realized from the sale of approximately $23.1 million of available-for-sale securities.

During the year ended December 31, 2002, Pinnacle National acquired life insurance policies on five key executives. Pinnacle National is the beneficiary of the death proceeds from these policies. To acquire these policies, Pinnacle National paid a one-time premium of $1.8 million and, in return, Pinnacle National was guaranteed an initial crediting rate for the first year of the contracts which is then reset quarterly thereafter. This crediting rate serves to increase the cash surrender value of the policies over the life of the policies and amounted to approximately $90,000 and $42,000 during the years ended December 31, 2003 and 2002, respectively. At December 31, 2003, the aggregate cash surrender value of these policies, which is reflected in other assets on our consolidated balance sheet, was $1,931,000. Pinnacle National has not borrowed any funds against these policies as of December 31, 2003.

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Noninterest Expense. Noninterest expense consists of salaries and employee benefits, equipment and occupancy expenses, and other operating expenses. The following is the makeup of our noninterest expense for the years ended December 31, 2003, 2002 and 2001 (dollars in thousands):

	2003	2002	2001
Noninterest expense:			
Salaries and employee benefits	$ 7,261	$ 5,237	$ 4,138
Equipment and occupancy	1,827	1,442	1,132
Marketing and business development	387	244	208
Administrative	656	437	412
Postage and supplies	348	256	163
Other noninterest expense	570	373	310
Total noninterest expense	$ 11,049	$ 7,989	$ 6,363

Expenses have increased during the above periods due to personnel additions occurring throughout the periods, incentives, the continued development of our branch network and other expenses which increase in relation to our growth rate. We anticipate increases in our expenses during 2004 for such items as additional personnel, the opening of additional branches, and other expenses which tend to increase in relation to our growth.

At the end of 2003, we employed 89.5 full time equivalent employees compared to 55.5 at the end of 2002. We intend to continue to add employees to our work force during 2004, which will cause our salary costs to increase in future periods. Also, during 2003 we opened two new branch offices in the Rivergate area of Nashville and in the Cool Springs area of Williamson County. The additional costs to operate these branches also served to increase our occupancy and equipment expenses in 2003 over that of 2002 and will also cause these expenses to increase in 2004 over those of 2003 due to the branches only being open for partial years in 2003. Our intent is to open additional branch offices in 2004 which will also cause expenses to increase in future periods.

Our efficiency ratio (ratio of noninterest expense to the sum of net interest income and noninterest income) was 68.3% in 2003 compared to 80.4% in 2002 and 131.7% in 2001. Basically, the efficiency ratio is a way to analyze the amount of expense that is incurred to generate a dollar of revenue. Although our absolute expense level increased between the three periods, the efficiency ratio improved.

We believe that variable pay incentives are a valuable tool in motivating an employee base that is focused on providing our clients effective financial advice and increasing shareholder value. As a result, and in what we believe differentiates us from many other financial institutions, substantially all of our employees are eligible for variable pay incentives. Included in the year ended December 31, 2003 and 2002 personnel expense amounts above are $1,167,000 and $720,000 in costs related to these variable pay awards. The 2003 and 2002 awards approximated a budgeted target award for the employee base. The award for 2001, which was less than target, amounted to $50,000. The increase in awards in 2003 from the previous years was primarily due to increases in number of personnel and the achievement of pre-established performance goals. The incentive plan for 2004 is structured similarly to that of the 2003 plan. Because of the relative experience of our associates, our compensation costs are and will continue to be higher on a per associate basis than most financial institutions. However, we believe that we are able to translate that into shareholder value as evidenced by the fact that the average bank our size requires approximately twice as many people according to America s Community Banker 2003 Compensation Survey.

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Income Taxes. The effective income tax expense rate for the year ended December 31, 2003 was approximately 35.8% compared to an effective income tax expense rate for the year ended December 31, 2002 of approximately 35.5%. For all quarters prior to the fourth quarter of 2001, we did not recognize an income tax benefit because we recorded a full valuation allowance against our net deferred tax assets. In the fourth quarter of 2001, we determined that it was more likely than not that we would realize the tax benefits of our accumulated net operating losses and other charges. As a result, during the quarter, we eliminated all of the valuation allowance and recorded a deferred income tax benefit of $2,065,000 in our results of operations for the year ended December 31, 2001. This resulted in an effective tax benefit rate of 64% for the year ended December 31, 2001.

Quarterly Information. The following is a summary of quarterly balance sheet and results of operations information for the last six quarters (dollars in thousands, except per share data).

	December 2003	September 2003	June 2003	March 2003	December 2002	September 2002
Balance sheet data, at quarter end:						
Total assets	$ 498,421	440,693	403,229	348,366	305,279	278,750
Total loans	297,004	279,702	255,448	228,842	209,743	191,299
Allowance for loan losses	(3,719)	(3,492)	(3,189)	(2,860)	(2,677)	(2,427)
Securities available-for-sale	139,944	115,421	99,968	94,600	73,980	57,062
Total deposits	390,569	347,191	309,089	266,732	234,016	212,914
Securities sold under agreements to repurchase	15,050	19,291	17,803	15,846	15,050	16,720
Advances from FHLB	44,500	39,500	41,500	32,500	21,500	15,500
Total stockholders equity	34,336	33,245	33,627	32,403	32,404	32,089
Balance sheet data, quarterly averages:						
Total assets	$ 454,700	406,142	365,385	326,108	285,929	243,284
Total loans	283,387	269,703	245,383	217,690	201,290	181,005
Securities available-for-sale	137,243	107,162	95,351	87,124	63,150	42,007
Total deposits	356,030	314,302	277,592	243,545	215,617	181,844
Securities sold under agreements to repurchase	16,013	16,136	11,728	14,106	16,685	13,091
Advances from FHLB	43,630	40,239	38,137	29,994	18,054	14,196
Total stockholders equity	33,935	32,542	32,944	32,675	32,167	31,808
Statement of operations data, for the three months ended:						
Interest income	$ 5,244	4,702	4,369	3,946	3,691	3,425
Interest expense	1,351	1,317	1,385	1,310	1,268	1,146
Net interest income	3,893	3,385	2,984	2,636	2,423	2,279
Provision for loan losses	204	318	347	288	250	247
Net interest income after provision for loan losses	3,689	3,067	2,637	2,348	2,173	2,032
Noninterest income	924	1,025	877	462	469	497
Noninterest expense	3,268	2,864	2,675	2,242	2,230	2,182
Net income before taxes	1,345	1,228	839	568	412	347
Income tax expense	487	441	302	195	127	136
Net income	$ 858	787	537	373	285	211
Per share data:						
Earnings basic	$ 0.23	0.21	0.15	0.10	0.08	0.06
Earnings diluted	$ 0.21	0.20	0.14	0.10	0.08	0.06
Book value at quarter end	$ 9.19	9.00	9.11	8.78	8.78	8.69

Weighted avg. shares basic	3,692,053	3,692,053	3,692,053	3,692,053	3,692,053	3,692,053
Weighted avg. shares diluted	4,057,444	3,972,327	3,880,642	3,841,631	3,795,967	3,745,272
Common shares outstanding	3,692,053	3,692,053	3,692,053	3,692,053	3,692,053	3,692,053

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Financial Condition

Our consolidated balance sheet at December 31, 2003 reflects significant growth since December 31, 2002. Total assets grew from $305 million at December 31, 2002 to $498 million at December 31, 2003, a 63% increase. Total deposits grew $157 million during 2003, an increase of 67%. We invested substantially all of the additional deposits and other fundings in loans, which grew by $87 million during 2003, and securities available-for-sale which increased by $66 million in the same period.

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

	2003		2002		2001		2000	
	Amount	%	Amount	%	Amount	%	Amount	%
Commercial real estate Mortgage	$ 68,507	23.1%	$ 58,965	28.1%	$ 36,179	26.9%	$ 32	0.3%
Commercial real estate Construction	8,211	2.8	5,397	2.6	5,977	4.4		
Commercial Other	129,882	43.7	98,722	47.1	59,839	44.5	11,618	93.6
Total commercial	206,600	69.6	163,084	77.8	101,995	75.8	11,650	93.9
Consumer real estate Mortgage	76,042	25.6	37,533	17.9	26,535	19.7	92	0.7
Consumer real estate Construction	3,077	1.0	1,971	0.9	381	0.3		
Consumer Other	11,285	3.8	7,155	3.4	5,529	4.2	665	5.4
Total consumer	90,404	30.4	46,659	22.2	32,445	24.2	757	6.1
Total loans	$297,004	100.0%	$209,743	100.0%	$134,440	100.0%	$12,407	100.0%

The following table classifies our fixed and variable rate loans at December 31, 2003 according to contractual maturities of (1) one year or less, (2) after one year through five years, and (3) after five years. The table also classifies our variable rate loans pursuant to the contractual repricing dates of the underlying loans (dollars in thousands):

	Amounts at December 31, 2003			Percentages to total loans	
	Fixed Rates	Variable Rates	Total	at Dec. 31, 2003	at Dec. 31, 2002
Based on contractual maturities:					
Due within one year	$ 4,214	$ 89,795	$ 94,009	31.7%	29.4%
Due in one year through five years	73,566	57,260	130,826	44.0	45.6
Due after five years	10,369	61,800	72,169	24.3	25.0
	$88,149	$208,855	$297,004	100.0%	100.0%
Based on contractual repricing dates:					
Daily floating rate	$	$156,531	$156,531	52.7%	45.7%
Reprice within one year	4,214	21,426	25,640	8.6	11.8
Reprice in one year through five years	73,566	30,874	104,440	35.2	38.9
Reprice after five years	10,369	24	10,393	3.5	3.6

	$88,149	$208,855	$297,004	100.0%	100.0%

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

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

We attempt to reduce these economic and credit risks by adherence to loan to value guidelines for collateralized loans, by investigating the creditworthiness of the borrower and by monitoring the borrower s financial position. Also, we establish and periodically review our lending policies and procedures. Banking regulations limit our exposure by prohibiting loan relationships that exceed 15% of Pinnacle National s statutory capital in the case of loans that are not fully secured by readily marketable or other permissible types of collateral.

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Pinnacle National discontinues the accrual of interest income when (1) there is a significant deterioration in the financial condition of the borrower and full repayment of principal and interest is not expected or (2) the principal or interest is more than 90 days past due, unless the loan is both well-secured and in the process of collection. At December 31, 2003, we had $379,000 in loans on nonaccrual compared to $1,845,000 at December 31, 2002.

There were approximately $182,000 in other loans at December 31, 2003 which were 90 days past due and still accruing interest. At December 31, 2003, 2002, 2001 and 2000 no loans were deemed to be a restructured loan. Additionally, we had no repossessed real estate properties classified as Other Real Estate Owned at December 31, 2003, 2002, 2001 and 2000. The following table is a summary of our nonperforming assets at December 31 for each of the four years we have been existence (dollars in thousands):

	2003	2002	2001	2000
Nonaccrual loans (1)	$ 379	$ 1,845	$ 250	$
Restructured loans				
Other real estate owned				
Total nonperforming assets	379	1,845	250	
Accruing loans past due 90 days or more	182	22		
Total nonperforming assets and accruing loans past due 90 days or more	$ 561	$ 1,867	$ 250	$
Total loans outstanding	$297,004	$209,743	$134,440	$12,407
Ratio of total nonperforming assets and accruing loans past due 90 days or more to total loans outstanding at end of period	0.19%	0.89%	0.19%	
Ratio of total nonperforming assets and accruing loans past due 90 days or more to total allowance for loan losses at end of period	15.08%	69.74%	13.65%	

(1) Interest income that would have been recorded in 2003 related to nonaccrual loans was $75,000 compared to $43,000 for the year ended December 31, 2002 and $5,000 for the year ended December 31, 2001, none of which is included in interest income or net income for the applicable periods.

Potential problem assets, which are not included in nonperforming assets, amounted to $1,687,000 or 0.57% of total loans at December 31, 2003 compared to $77,000 or 0.04% at December 31, 2002. Potential problem assets represent those assets with a potential weakness or a well-defined weakness and where information about possible credit problems of borrowers has caused management to have serious doubts about the borrower s ability to comply with present repayment terms. This definition is believed to be substantially consistent with the standards established by Pinnacle National s primary regulator for loans classified as substandard.

Allowance for Loan Losses (ALL). We maintain the ALL at a level that our management deems appropriate to adequately cover the inherent risks in the loan portfolio. As of December 31, 2003 and 2002, our allowance for loan losses was $3,719,000 and $2,677,000, respectively. Our management deemed these amounts to be adequate. The judgments and estimates associated with our ALL determination are described under Critical Accounting Estimates above.

Approximately 70% of our loan portfolio at December 31, 2003 consisted of commercial loans compared to 78% at December 31, 2002. Using standard industry codes, we periodically analyze our loan position with respect to our borrowers industries to determine if a concentration of credit risk exists to any one or more industries. We do have a significant credit exposure of loans outstanding plus unfunded lines of credit to borrowers in the trucking industry and to operators of nonresidential buildings at December 31, 2003 and 2002. Credit exposure to the trucking industry approximated $35.0 million at December 31, 2003 and $27.1 million at December 31, 2002. Credit exposure to operators of nonresidential buildings approximated $16.6 million at December 31, 2003 and $9.6 million at December 31, 2002. We evaluate our exposure level to these industry groups periodically in order to determine if additional allowance allocations are warranted. At December 31, 2003 and 2002, we determined that we did not have any excessive exposure to any single industry which would warrant additional allowance allocations.

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

	2003		2002		2001		2000	
	Amount	%	Amount	%	Amount	%	Amount	%
Commercial	$2,329	0.78%	$1,744	0.83%	$1,077	0.80%	$ 91	0.73%
Consumer	670	0.23	398	0.19	298	0.22	12	0.10
Unallocated	720	0.24	535	0.26	457	0.34	59	0.48
	$3,719	1.25%	$2,677	1.28%	$1,832	1.36%	$162	1.31%

The following is a summary of changes in the allowance for loan losses for the years ended December 31, 2003, 2002, 2001 and 2000 and the ratio of the allowance for loan losses to total loans as of the end of each period (dollars in thousands):

	2003	2002	2001	2000
Balance at beginning of period	$2,677	$1,832	$ 162	$
Provision for loan losses	1,157	938	1,670	162
Charged-off loans	(167)	(93)		
Recoveries of previously charged-off loans	52			
Balance at end of period	$3,719	$2,677	$1,832	$ 162
Ratio of the allowance for loan losses to total loans outstanding at end of period	1.25%	1.28%	1.36%	1.31%
Ratio of net charge-offs to average loans outstanding for the period	0.05%	0.05%		

During 2003, we charged-off $88,000 related to a particular commercial loan, which prior to the charge-off date, had been on nonaccrual status. Additionally, we charged-off $79,000 during 2003 related to several other consumer loans. During 2002, we charged-off $93,000 related to a single commercial loan. As a relatively new institution, we do not have loss experience comparable to more mature financial institutions; however, as our loan portfolio matures, we will have additional charge-offs and we will consider the amount and nature of our charge-offs in determining the adequacy of our allowance for loan losses.

During the fourth quarter of 2003, the collateral supporting a loan, which had previously been charged-off, was sold at a public auction. The results of this auction provided Pinnacle National approximately $119,000, of which $70,000 was applied to the balance of the remaining book value of the loan, while $49,000 was credited to the ALL as a recovery of previously-charged off amounts.

Investments. Our investment portfolio, consisting primarily of Federal agency bonds and mortgage-backed securities, amounted to $139.9 million and $74.0 million at December 31, 2003 and 2002, respectively. The following table summarizes the amortized cost and fair value of our securities at those dates, all of which we classify as available-for-sale (dollars in thousands):

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value

Securities available-for-sale 2003:				
U.S. government and agency securities	$ 27,023	$ 353	$ (104)	$ 27,272
Mortgage-backed securities	103,088	507	(617)	102,978
State and municipal securities	9,590	143	(39)	9,694
	$ 139,701	$ 1,003	$ (760)	$ 139,944
Securities available-for-sale 2002:				
U.S. government and agency securities	$ 14,588	$ 455	$ (18)	$ 15,025
Mortgage-backed securities	54,566	816	(8)	55,374
State and municipal securities	3,580	13	(12)	3,581
	$ 72,734	$ 1,284	$ (38)	$ 73,980

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During 2003, we sold $23.1 million of available-for-sale securities at a net gain of $248,000. At December 31, 2003, approximately $82 million of our available-for-sale portfolio was pledged to secure public fund and other deposits and securities sold under agreements to repurchase.

The following table shows the carrying value of investment securities according to contractual maturity classifications of (1) one year or less, (2) after one year through five years, (3) after five years through ten years, and (4) after ten years. Actual maturities may differ from contractual maturities of mortgage-backed securities because the mortgages underlying the securities may be called or prepaid with or without penalty. Therefore, these securities are not included in the maturity categories noted below as of December 31, 2003 and 2002 (dollars in thousands):

	U.S. government and agency securities		State and municipal securities		Mortgage-backed securities		Totals	
	Amount	Yield	Amount	Yield	Amount	Yield	Amount	Yield
Securities available-for-sale December 31, 2003:								
Due in one year or less	$	%	$	%	$	%	$	%
Due in one year to five years	4,036	4.0%	2,005	4.8%			6,041	4.3%
Due in five years to ten years	23,236	4.4%	7,221	5.0%			30,457	4.6%
Due after ten years			468	5.2%			468	5.2%
Mortgage-backed securities					102,978	4.4%	102,978	4.4%
	$27,272	4.3%	$9,694	4.9%	$102,978	4.4%	$139,944	4.5%
Securities available-for-sale December 31, 2002:								
Due in one year or less	$	%	$	%	$	%	$	%
Due in one year to five years	3,217	4.5%	165	4.3%			3,382	4.4%
Due in five years to ten years	11,808	4.7%	2,923	5.4%			14,731	4.9%
Due after ten years			493	5.8%			493	5.8%
Mortgage-backed securities					55,374	4.8%	55,374	4.8%
	$15,025	4.6%	$3,581	5.4%	$ 55,374	4.8%	$ 73,980	4.8%

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

Deposits and Other Borrowings. We had approximately $390.6 million of deposits at December 31, 2003 compared to $234.0 million at December 31, 2002. Our deposits consist of noninterest and interest-bearing demand accounts, savings, money market and time deposits. Additionally, we entered into agreements with certain customers to sell certain of our securities under agreements to repurchase the security the following day. These agreements (which provide customers with short-term returns for their excess funds) amounted to $15.1 million at both December 31, 2003 and 2002. Additionally, at December 31, 2003, we had borrowed $44.5 million in advances from the Federal Home Loan Bank of Cincinnati compared to $21.5 million at December 31, 2002.

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Generally, banks classify their funding base as either core funding or non-core funding. Core funding consists of all deposits other than time deposits issued in denominations of $100,000 or greater while all other funding is deemed to be non-core. The following table represents the balances of our deposits and other fundings and the percentage of each type to the total at December 31, 2003 and 2002 (dollars in thousands):

	December 31, 2003		December 31, 2002	
	Amount	**Percentage**	**Amount**	**Percentage**
Core funding:				
Noninterest-bearing demand deposits	$ 60,796	13.2%	$ 31,600	11.7%
Interest-bearing demand deposits	31,407	6.8	13,235	4.9
Savings and money market deposits	140,384	30.5	75,996	28.1
Time deposits less than $100,000	43,996	9.6	25,746	9.5
Total core funding	276,583	60.1	146,577	54.2
Non-core funding:				
Time deposits greater than $100,000				
Public funds	26,812	5.8	14,423	5.3
Brokered deposits	39,364	8.5	42,700	15.8
Other time deposits greater than $100,000	47,810	10.4	30,316	11.2
Securities sold under agreements to repurchase	15,050	3.3	15,050	5.6
Federal Home Loan Bank advances	44,500	9.7	21,500	7.9
Subordinated debt	10,310	2.2		
Total non-core funding	183,846	39.9	123,989	45.8
	$460,429	100.0%	$270,566	100.0%

The amount of time deposits issued in amounts of $100,000 or more as of December 31, 2003 and 2002 amounted to $114.0 million and $87.4 million, respectively. The following table shows our time deposits over $100,000 by category at December 31, 2003 and 2002, based on time remaining until maturity of (1) three months or less, (2) over three but less than six months, (3) over six but less than twelve months and (4) over twelve months (dollars in thousands):

	December 31, 2003	**December 31, 2002**
Three months or less	$ 32,054	$ 20,470
Over three but less than six months	28,109	22,288
Over six but less than twelve months	28,502	25,386
Over twelve months	25,321	19,295
	$113,986	$ 87,439

Subordinated debt. On December 29, 2003, we established PNFP Statutory Trust I (Trust), a wholly-owned statutory business trust. Pinnacle Financial is the sole sponsor of the trust and owns $310,000 of the Trust s common securities. The Trust was created for the exclusive purpose of issuing 30-year capital trust preferred securities (Trust Preferred Securities) in the aggregate amount of $10,000,000 and using the proceeds from the issuance of the common and preferred securities to purchase $10,310,000 of junior subordinated debentures (Subordinated Debentures) issued by Pinnacle Financial. The sole assets of the Trust are the Subordinated Debentures. Pinnacle Financial s $310,000 investment in the Trust is included in other assets in the accompanying consolidated balance sheet and the $10,310,000 obligation of Pinnacle Financial is included in subordinated debt.

The Trust Preferred Securities bear a floating interest rate based on a spread over 3-month LIBOR which is set each quarter and matures on December 30, 2033. Distributions are payable quarterly. The Trust Preferred Securities are subject to mandatory redemption upon repayment of the Subordinated Debentures at their stated maturity date or their earlier redemption in an amount equal to their liquidation amount plus accumulated and unpaid distributions to the date of redemption. Pinnacle Financial guarantees the payment of distributions and payments for redemption or liquidation of the Trust Preferred Securities to the extent of funds held by the Trust. Pinnacle Financial s obligations under the Subordinated Debentures together with the guarantee and other back-up obligations, in the aggregate, constitute a full and unconditional guarantee by Pinnacle Financial of the obligations of the Trust under the Trust Preferred Securities.

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The Subordinated Debentures are unsecured, bear an interest rate based on a spread over 3-month LIBOR (equal to the spread paid by the Trust on the Trust Preferred Securities) which is set each quarter and matures on December 30, 2033. Interest is payable quarterly. Pinnacle Financial may defer the payment of interest at any time for a period not exceeding 20 consecutive quarters provided that deferral period does not extend past the stated maturity. During any such deferral period, distributions on the Trust Preferred Securities will also be deferred and Pinnacle Financial s ability to pay dividends on our common shares will be restricted.

Subject to approval by the Federal Reserve Bank of Atlanta, the Trust Preferred Securities may be redeemed prior to maturity at our option on or after September 17, 2008. The Trust Preferred Securities may also be redeemed at any time in whole (but not in part) in the event of unfavorable changes in laws or regulations that result in (1) the Trust becoming subject to federal income tax on income received on the Subordinated Debentures, (2) interest payable by the parent company on the Subordinated Debentures becoming non-deductible for federal tax purposes, (3) the requirement for the Trust to register under the Investment Company Act of 1940, as amended, or (4) loss of the ability to treat the Trust Preferred Securities as Tier I capital under the Federal Reserve capital adequacy guidelines.

The Trust Preferred Securities qualify as Tier I capital under current regulatory interpretations. However, banking regulators are currently reviewing such treatment, the outcome of which is not known. Should the banking regulators determine that treatment of trust preferred securities shall not be treated as Tier 1 capital, such determination would have an impact on Pinnacle Financial, however Pinnacle Financial s capital structure, at the present time and based on our current growth projections, is such that utilization of the Trust Preferred Securities as Tier II capital is more critical to Pinnacle Financial. To our knowledge, there has been no discussion by banking regulators to disqualify trust preferred securities as Tier II capital.

Capital Resources. At December 31, 2003 and 2002, our stockholders equity amounted to $34.3 million and $32.4 million, respectively. The change in stockholders equity was attributable to our net income for the year ended December 31, 2003 of $2,555,000 and the net decrease in comprehensive income of $622,000 attributable to the decrease in fair value of our available-for-sale securities portfolio.

Generally, banking laws and regulations require banks and bank holding companies to maintain certain minimum capital ratios in order to engage in certain activities or be eligible for certain types of regulatory relief. At December 31, 2003 and 2002, our capital ratios, including Pinnacle National s capital ratios, met regulatory minimum capital requirements. At December 31, 2003 and 2002, Pinnacle National was categorized as well-capitalized . 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. Additionally, Pinnacle Financial and Pinnacle National must maintain certain minimum capital ratios for regulatory purposes. The following table presents actual, minimum and well-capitalized capital amounts and ratios at December 31, 2003 and 2002:

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	Actual		Minimum Capital Requirement		Minimum To Be Well-Capitalized Under Prompt Corrective Action Provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
At December 31, 2003						
Total capital to risk weighted assets:						
Pinnacle Financial	$47,914	12.8%	$29,981	8.0%	not applicable	
Pinnacle National	$38,617	10.3%	$29,944	8.0%	$37,430	10%
Tier I capital to risk weighted assets:						
Pinnacle Financial	$44,185	11.8%	$14,990	4.0%	not applicable	
Pinnacle National	$34,888	9.3%	$14,972	4.0%	$22,458	6%
Tier I capital to average assets (*):						
Pinnacle Financial	$44,185	9.7%	$18,188	4.0%	not applicable	
Pinnacle National	$34,888	7.7%	$18,188	4.0%	$22,735	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.

In connection with approving Pinnacle Financial s issuance of Trust Preferred Securities, the Federal Reserve Bank of Atlanta (FRB-Atlanta) required Pinnacle Financial to maintain a Total capital to risk-weighted assets ratio of 10%, a Tier 1 capital to risk-weighted assets ratio of 6% and a Tier 1 capital to average-assets ratio of 5% during the period ended December 31, 2004. In connection with such approval, Pinnacle Financial s President and Chief Executive Officer, Chairman and Chief Administrative Officer committed to the FRB-Atlanta that if required to enable Pinnacle Financial to make interest payments in 2004 on its Subordinated Debentures under certain circumstances, they would exercise up to 92,500 warrants to acquire Pinnacle Financial common stock held by them to provide funds for such payment.

Dividends. Pinnacle National is subject to restrictions on the payment of dividends to Pinnacle Financial under federal banking laws and the regulations of the Office of the Comptroller of the Currency, or the OCC . Currently, Pinnacle National cannot pay Pinnacle Financial any dividends without prior approval of the OCC.

We, in turn, are also subject to limits on payment of dividends to our shareholders by the rules, regulations and policies of federal banking authorities. We have not paid any dividends to date, nor do we anticipate paying dividends to our shareholders for the foreseeable future. In order to pay such dividends, we will need to receive dividends from Pinnacle National or have other sources of funds. As a national bank, Pinnacle National will not be able to pay dividends to us until it has a positive retained earnings account. At December 31, 2003, Pinnacle National s accumulated deficit was approximately $111,000. Future dividend policy will depend on Pinnacle National s earnings, capital position, financial condition and other factors.

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Return on Assets and Stockholders Equity. The following table shows return on average assets (net income divided by average total assets), return on average equity (net income divided by average stockholders equity), dividend payout ratio (dividends declared per share divided by net income per share) and stockholders equity to asset ratio (average stockholders equity divided by average total assets) for each year in the three-year period ended December 31, 2003.

	2003	2002	2001
Return on average assets	0.66%	0.29%	(1.19)%
Return on average equity	7.70%	2.47%	(7.93)%
Dividend payout ratio	%	%	%
Average equity to average assets ratio	8.54%	11.58%	15.29%

Market and Liquidity Risk Management

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

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

Earnings simulation model. We believe that interest rate risk is best measured by our earnings simulation modeling. Forecasted levels of earning assets, interest-bearing liabilities, and off-balance sheet financial instruments are combined with ALCO forecasts of interest rates for the next 12 months and are combined with other factors in order to produce various earnings simulations. To limit interest rate risk, we have guidelines for our earnings at risk which seek to limit the variance of net income to less than 10 percent for a 200 basis point change up or down in rates from management s most likely interest rate forecast over the next twelve months. We have operated within this guideline since inception.

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

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

At December 31, 2003, our cumulative twelve-month interest rate-sensitivity gap ratio of earning assets to interest bearing liabilities was 85% (compared to 82% at December 31, 2002), which was within our targeted ratio of 75% to 125% in this time horizon. Since the ratio is less than 100%, the ratio indicates that our interest-bearing liabilities will reprice during this period at a rate faster than our interest-earning assets absent the factors mentioned previously. There is a general view in credit markets that interest rates will eventually rise over the next 12 months which, given our gap position, could have a negative impact on our net interest income. However, deposit pricing will generally lag both in degree and timing with any upward interest rate adjustments. Thus, our management believes we are in an acceptable position to manage our net interest margins through an upward rate environment.

Each of the above analyses may not, on their own, be an accurate indicator of how our net interest income will be affected by changes in interest rates. Income associated with interest-earning assets and costs associated with interest-bearing liabilities may not be affected uniformly by changes in interest rates. In addition, the magnitude and duration of changes in interest rates may have a significant impact on net interest income. For example, although certain assets and liabilities may have similar maturities or periods of repricing, they may react in different degrees to changes in market interest rates. Interest rates on certain types of assets and liabilities fluctuate in advance of changes in general market rates, while interest rates on other types may lag behind changes in general market rates. In addition, certain assets, such as adjustable rate mortgage loans, have features (generally referred to as interest rate caps and floors), which limit changes in interest rates. Prepayment and early withdrawal levels also could deviate significantly from those assumed in calculating the maturity of certain instruments. The ability of many borrowers to service their debts also may decrease during periods of rising interest rates. ALCO reviews each of the above interest rate sensitivity analyses along with several different interest rate scenarios as part of its responsibility to provide a satisfactory, consistent level of profitability within the framework of established liquidity, loan, investment, borrowing, and capital policies.

We may also use derivative financial instruments to improve the balance between interest-sensitive assets and interest-sensitive liabilities and as one tool to manage our interest rate sensitivity while continuing to meet the credit and deposit needs of our customers. At December 31, 2003 and 2002, we had not entered into any derivative contracts to assist managing our interest rate sensitivity.

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

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

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

In addition, Pinnacle National is a member of the Federal Home Loan Bank of Cincinnati. As a result, Pinnacle National receives advances from the Federal Home Loan Bank of Cincinnati, pursuant to the terms of various borrowing agreements, which assist it in the funding of its home mortgage and commercial real estate loan portfolios. Pinnacle National has pledged under the borrowing agreements with the Federal Home Loan Bank of

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Cincinnati certain qualifying residential mortgage loans and, pursuant to a blanket lien, all qualifying commercial mortgage loans as collateral. At December 31, 2003, Pinnacle National had received advances from the Federal Home Loan Bank of Cincinnati totaling $44.5 million at the following rates and maturities (dollars in thousands):

	Amount	Interest Rate
January 28, 2004	$ 5,000	1.14%
March 29, 2004	3,000	4.38
April 14, 2004	7,000	1.13
June 18, 2004	3,000	1.25
July 28, 2004	2,000	1.88
July 30, 2004	4,000	2.94
September 15, 2004	5,000	1.28
January 28, 2005	2,000	2.18
October 14, 2005	3,000	3.10
December 30, 2005	3,000	2.40
January 27, 2006	2,000	2.79
April 17, 2006	2,000	2.64
April 28, 2006	1,500	2.52
January 26, 2007	2,000	3.24
	$44,500	
Weighted average interest rate		2.12%

At December 31, 2003, brokered certificates of deposit approximated $39.4 million which represented 8.5% of total fundings compared to $42.7 million and 15.8% at December 31, 2002. We issue these brokered certificates through several different brokerage houses based on competitive bid. Typically, these funds are for varying maturities from six months to two years and are issued at rates which are competitive to rates we would be required to pay to attract similar deposits from the local market as well as rates for Federal Home Loan Bank of Cincinnati advances of similar maturities. We consider these deposits to be a ready source of liquidity under current market conditions.

At December 31, 2003, we had no significant commitments for capital expenditures. However, we are in the process of developing our branch network in Davidson, Williamson and surrounding counties. As a result, we anticipate that we will enter into contracts to buy property or construct branch facilities and/or lease agreements to lease property and/or rent currently constructed facilities in Davidson, Williamson and surrounding counties.

The following table presents additional information about our contractual obligations as of December 31, 2003, which by their terms have contractual maturity and termination dates subsequent to December 31, 2003 (dollars in thousands):

	Next 12 Months	13-36 Months	37-60 Months	More than 60 Months	Totals
Contractual obligations:					
Certificates of deposit	$116,286	$41,402	$ 294	$	$157,982
Securities sold under agreements to repurchase	15,050				15,050
Federal Home Loan Bank advances	29,000	13,500	2,000		44,500
Subordinated debt				10,310	10,310
Minimum operating lease commitments	408	848	896	1,456	3,608
Totals	$160,744	$55,750	$3,190	$11,766	$231,450

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

Off-Balance Sheet Arrangements. At December 31, 2003, we had outstanding standby letters of credit of $30.3 million and unfunded loan commitments outstanding of $95.6 million. Because these commitments generally have fixed expiration dates and many will expire without being drawn upon, the total commitment level does not necessarily represent future cash requirements. If needed to fund these outstanding commitments, Pinnacle National has the ability to liquidate Federal funds sold or securities available-for-sale or on a short-term basis to borrow and

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purchase Federal funds from other financial institutions. At December 31, 2003, Pinnacle National had accommodations with upstream correspondent banks for unsecured short-term advances. These accommodations have various covenants related to their term and availability, and in most cases must be repaid within less than a month. The following table presents additional information about our unfunded commitments as of December 31, 2003, which by their terms have contractual maturity dates subsequent to December 31, 2003 (dollars in thousands):

	Next 12 Months	13-36 Months	37-60 Months	More than 60 Months	Totals
Unfunded commitments:					
Letters of credit	$29,425	$ 892	$	$	$ 30,317
Lines of credit	63,094	8,678	5,242	18,601	95,615
Totals	$92,519	$9,570	$5,242	$18,601	$125,932

Impact of Inflation

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

Recent Accounting Pronouncements

In December 2003, the FASB issued FASB Interpretation No. 46 (revised December 2003), *Consolidation of Variable Interest Entities*, which addresses how a business enterprise should evaluate whether it has a controlling financial interest in an entity through means other than voting rights and accordingly should consolidate the entity. FIN 46R replaces FASB Interpretation No. 46, *Consolidation of Variable Interest Entities*, which was issued in January 2003. Pinnacle Financial will be required to apply FIN 46R to all entities subject to this Interpretation no later than the end of the first reporting period that end after December 15, 2004. This interpretation must be applied to those entities that are considered to be special-purpose entities no later than as of the end of the first reporting period that ends after December 15, 2003.

For any variable interest entities (VIEs) that must be consolidated under FIN 46R that were created before January 1, 2004, the assets, liabilities and noncontrolling interests of the VIE initially would be measured at their carrying amounts with any difference between the net amount added to the balance sheet and any previously recognized interest being recognized as the cumulative effect of an accounting change. If determining the carrying amounts is not practicable, fair value at the date FIN 46R first applies may be used to measure the assets, liabilities and noncontrolling interest of the VIE.

Pinnacle Financial has applied FIN 46R in accounting for PNFP Statutory Trust I (Trust), established on December 29, 2003. Accordingly, in the accompanying balance sheet, we have included, in other assets, our investment in the Trust of $310,000 and also included, in subordinated debt, the balance owed the Trust of $10,310,000. Except as related to the Trust, the application of this Interpretation is not expected to have a material effect on Pinnacle Financial s consolidated 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.

In December 2003, the Accounting Standards Executive Committee issued Statement of Position 03-3, *Accounting for Certain Loans or Debt Securities Acquired in a Transfer* (SOP 03-3). SOP 03-3 addresses accounting for differences between contractual cash flows and cash flows expected to be collected from an investor s initial investment in loans or debt securities (loans) acquired in a transfer if those differences are attributable, at least in part, to credit quality. SOP 03-3 includes loans acquired in purchase business combinations, but does not apply to loans originated by the entity. SOP 03-3 is effective for loans acquired in fiscal years beginning after December 15, 2004 although earlier adoption is encouraged. The adoption of this new statement of position is not expected to have a material impact on the consolidated financial position or results of operations of Pinnacle Financial.

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ITEM 7. FINANCIAL STATEMENTS

Pinnacle Financial Partners, Inc. and Subsidiary

Consolidated Financial Statements

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REPORT OF INDEPENDENT PUBLIC ACCOUNTANTS

The Board of Directors
Pinnacle Financial Partners, Inc.:

We have audited the accompanying consolidated balance sheets of Pinnacle Financial Partners, Inc. and Subsidiaries as of December 31, 2003 and 2002, and the related consolidated statements of operations, stockholders equity and comprehensive income (loss), and cash flows for each of the years in the three-year period ended December 31, 2003. These consolidated financial statements are the responsibility of the Company s management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

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

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Pinnacle Financial Partners, Inc. and Subsidiaries as of December 31, 2003 and 2002, and the results of their operations and their cash flows for each of the years in the three-year period ended December 31, 2003, in conformity with accounting principles generally accepted in the United States of America.

/s/ KPMG LLP

Nashville, Tennessee
January 20, 2004

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PINNACLE FINANCIAL PARTNERS, INC. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS

	December 31,	
	2003	2002
ASSETS		
Cash and noninterest-bearing due from banks	$ 13,768,278	$ 8,061,300
Interest-bearing due from banks	1,180,371	4,195,647
Federal funds sold	32,235,401	685,182
Cash and cash equivalents	47,184,050	12,942,129
Securities available-for-sale, at fair value	139,944,238	73,980,054
Mortgage loans held-for-sale	1,582,600	
Loans	297,004,110	209,743,436
Less allowance for loan losses	(3,718,598)	(2,677,043)
Loans, net	293,285,512	207,066,393
Premises and equipment, net	6,911,359	3,611,504
Other assets	9,512,899	7,678,894
Total assets	$498,420,658	$305,278,974
LIABILITIES AND STOCKHOLDERS EQUITY		
Deposits:		
Noninterest-bearing demand	$ 60,796,396	$ 31,599,897
Interest-bearing demand	31,407,213	13,234,956
Savings and money market accounts	140,383,878	75,995,881
Time	157,981,525	113,185,655
Total deposits	390,569,012	234,016,389
Securities sold under agreements to repurchase	15,050,110	15,050,208
Federal Home Loan Bank advances	44,500,000	21,500,000
Subordinated debt	10,310,000	
Other liabilities	3,655,155	2,308,730
Total liabilities	464,084,277	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 December 31, 2003 and 2002	3,692,053	3,692,053
Additional paid-in capital	30,682,947	30,682,947
Accumulated deficit	(189,155)	(2,743,794)
Accumulated other comprehensive income, net	150,536	772,441
Total stockholders equity	34,336,381	32,403,647
Total liabilities and stockholders equity	$498,420,658	$305,278,974

See accompanying notes to consolidated financial statements.

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

	For the years ended December 31,		
	2003	2002	2001
Interest income:			
Loans, including fees	$13,709,159	$10,509,655	$ 4,863,803
Securities, available-for-sale:			
Taxable	4,158,064	1,837,574	934,188
Tax-exempt	217,284	35,085	
Federal funds sold and other	177,404	178,618	271,103
Total interest income	18,261,911	12,560,932	6,069,094
Interest expense:			
Deposits	4,349,365	3,813,019	2,342,282
Securities sold under agreements to repurchase	65,716	91,034	154,702
Federal funds purchased and other borrowings	948,023	457,576	82,404
Total interest expense	5,363,104	4,361,629	2,579,388
Net interest income	12,898,807	8,199,303	3,489,706
Provision for loan losses	1,157,280	938,000	1,669,622
Net interest income after provision for loan losses	11,741,527	7,261,303	1,820,084
Noninterest income:			
Service charges on deposit accounts	513,074	281,009	89,933
Investment sales commissions	998,119	809,837	838,558
Fees from origination of mortgage loans	666,853		
Gains on loan participations sold	334,249	120,297	191,020
Gains on sales of investment securities, net	247,978		
Other noninterest income	527,207	520,800	221,894
Total noninterest income	3,287,480	1,731,943	1,341,405
Noninterest expense:			
Salaries and employee benefits	7,260,982	5,236,792	4,137,863
Equipment and occupancy	1,827,260	1,442,288	1,132,422
Marketing and other business development	386,905	244,500	207,804
Administrative	655,729	436,984	411,994
Postage and supplies	347,684	255,624	163,428
Other noninterest expense	570,062	372,874	309,812
Total noninterest expense	11,048,622	7,989,062	6,363,323
Net income (loss) before income taxes	3,980,385	1,004,184	(3,201,834)
Income tax expense (benefit)	1,425,746	356,124	(2,065,169)
Net income (loss)	$ 2,554,639	$ 648,060	$(1,136,665)
Per share information:			
Basic net income (loss) per common share	$ 0.69	$ 0.21	$ (0.57)

Diluted net income (loss) per common share	$ 0.65	$ 0.21	$ (0.57)
Weighted average common shares outstanding:			
Basic	3,692,053	3,054,471	1,981,598
Diluted	3,938,003	3,118,422	1,981,598

See accompanying notes to consolidated financial statements.

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PINNACLE FINANCIAL PARTNERS, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF STOCKHOLDERS EQUITY
AND COMPREHENSIVE INCOME (LOSS)

For the each of the years in the three-year period ended December 31, 2003

	Common Stock		Additional		Accumulated Other	Total
	Shares	Amount	Paid-in Capital	Accumulated Deficit	Comprehensive Income (Loss)	Stockholders Equity
Balances, December 31, 2000	1,910,000	1,910,000	16,122,521	(2,255,189)	(6,467)	15,770,865
Proceeds from the sale of stock (less offering expenses of$20,998)	402,053	402,053	3,195,426			3,597,479
Comprehensive loss:						
Net loss				(1,136,665)		(1,136,665)
Net unrealized holding gains on available-for-sale securities, net of deferred tax expense of $31,837					59,123	59,123
Total comprehensive loss						(1,077,542)
Balances, December 31, 2001	2,312,053	2,312,053	19,317,947	(3,391,854)	52,656	18,290,802
Proceeds from the sale of stock (less offering expenses of $1,400,000)	1,380,000	1,380,000	11,365,000			12,745,000
Comprehensive income:						
Net income				648,060		648,060
Net unrealized holding gains on available-for-sale securities, net of deferred tax expense of $445,078					719,785	719,785
Total comprehensive income						1,367,845
Balances, December 31, 2002	3,692,053	$3,692,053	$30,682,947	$(2,743,794)	$ 772,441	$32,403,647
Comprehensive income:						
Net income				2,554,639		2,554,639
Net unrealized holding losses on available-for-sale securities, net of deferred tax benefit of $381,171					(621,905)	(621,905)
Total comprehensive income						1,932,734
Balances, December 31, 2003	3,692,053	$3,692,053	$30,682,947	$ (189,155)	$ 150,536	$34,336,381

See accompanying notes to consolidated financial statements.

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

	For the years ended December 31,		
	2003	2002	2001
Operating activities:			
Net income (loss)	$ 2,554,639	$ 648,060	$ (1,136,665)
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities:			
Net amortization of available-for-sale securities	858,412	256,471	16,781
Depreciation and amortization	953,819	693,663	616,022
Provision for loan losses	1,157,280	938,000	1,669,622
Gains on sales of investment securities, net	(247,978)		
Gain on loan participations sold	(334,249)	(120,297)	(191,020)
Deferred tax expense (benefit)	569,987	356,124	(2,065,169)
Mortgage loans held for sale:			
Loans originated	(38,527,408)		
Loans sold	36,944,808		
Increase in other assets	(641,998)	(509,006)	(520,407)
Increase in other liabilities	1,346,425	1,131,837	405,031
Net cash provided by (used in) operating activities	4,333,737	3,394,852	(1,205,805)
Investing activities:			
Activities in securities available-for-sale:			
Purchases	(132,340,115)	(67,909,017)	(22,083,058)
Sales	23,125,263		
Maturities, prepayments and calls	41,637,158	14,723,189	9,387,345
	(67,577,694)	(53,185,828)	(12,695,713)
Increase in loans, net	(87,376,399)	(75,396,751)	(122,032,534)
Purchases of premises and equipment and software	(3,910,748)	(677,323)	(1,314,861)
Purchases of capital securities of unconsolidated subsidiary	(310,000)		
Purchases of life insurance policies		(1,800,000)	
Purchases of other assets	(929,500)	(869,750)	(427,051)
Net cash used in investing activities	(160,004,341)	(131,929,652)	(136,470,159)
Financing activities:			
Net increase in deposits	156,552,623	100,757,338	110,720,406
Net increase (decrease) in repurchase agreements	(98)	392,515	14,251,693
Advances from Federal Home Loan Bank:			
Issuances	34,500,000	13,000,000	8,500,000
Payments	(11,500,000)		
Proceeds from issuance of subordinated debt	10,310,000		
Debt issuance costs related to issuance of subordinated debt	(150,000)		
Net proceeds from sale of common stock		12,745,000	3,597,479
Net cash provided by financing activities	189,712,525	126,894,853	137,069,578

Net increase (decrease) in cash and cash equivalents	34,241,921	(1,639,947)	(606,386)
Cash and cash equivalents, beginning of period	12,942,129	14,582,076	15,188,462
Cash and cash equivalents, end of period	$ 47,184,050	$ 12,942,129	$ 14,582,076
Supplemental disclosure:			
Cash paid for interest	$ 5,341,687	$ 4,245,453	$ 2,049,763
Cash paid for income taxes	$	$	$

See accompanying notes to consolidated financial statements.

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

Note 1. Summary of Significant Accounting Policies

Nature of Business Pinnacle Financial Partners, Inc. (Pinnacle Financial) 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 is a wholly-owned subsidiary 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 policies to Pinnacle National customers and others. PNFP Statutory Trust I is a wholly-owned subsidiary of Pinnacle Financial was created for the exclusive purpose of issuing capital trust preferred securities.

Basis of Presentation These consolidated financial statements include the accounts of Pinnacle Financial. Significant intercompany transactions and accounts are eliminated in consolidation, other than the accounts of PNFP Statutory Trust I which are included in these consolidated financial statements pursuant to the equity method of accounting.

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.

Cash and Cash Equivalents Cash on hand, cash items in process of collection, amounts due from banks, Federal funds sold and securities purchased under agreements to resell, with original maturities within ninety days, are included in cash and cash equivalents.

Securities Securities are classified based on management s intention on the date of purchase. All debt securities classified as available-for-sale are recorded at fair value with any unrealized gains and losses reported in other comprehensive income (loss), net of the deferred income tax effects. Securities that Pinnacle Financial has both the positive intent and ability to hold to maturity would be classified as held to maturity and would be carried at historical cost and adjusted for amortization of premiums and accretion of discounts unless there is a decline in value which is considered to be other than temporary, in which case the cost basis of the security is written down to fair value and the amount of the write-down included in the statement of operations. At December 31, 2003 and 2002, Pinnacle Financial had no held to maturity securities in its portfolio.

Interest and dividends on securities, including amortization of premiums and accretion of discounts calculated under the effective interest method, are included in interest income. Realized gains and losses from the sale of securities are determined using the specific identification method.

Loans Held for Sale Loans originated and intended for sale are carried at the lower of cost or estimated fair value in the aggregate. Net unrealized loss, if any, are recognized through a valuation allowance by charges to income.

Loans Loans are reported at their outstanding principal balances less unearned income, the allowance for loan losses and any deferred fees or costs on originated loans. Interest income on loans is accrued based on the principal balance outstanding. Loan origination fees, net of certain loan origination costs, are deferred and recognized as an adjustment to the related loan yield using the interest method.

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

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

The allowance for loan losses is maintained at a level that management believes to be adequate to absorb losses inherent in the loan portfolio. Loan losses are charged against the allowance when they are known. Subsequent recoveries are credited to the allowance. Management s determination of the adequacy of the allowance is based on an evaluation of the portfolio, current economic conditions, volume, growth, composition of the loan portfolio, homogeneous pools of loans, risk ratings of specific loans, identified impaired loans and other factors related to the portfolio. This evaluation is performed quarterly and is inherently subjective, as it requires material estimates that are susceptible to significant change including the amounts and timing of future cash flows expected to be received on any impaired loans. In addition, regulatory agencies, as an integral part of their examination process, will periodically review Pinnacle Financial s allowance for loan losses, and may require Pinnacle Financial to record adjustments to the allowance based on their judgment about information available to them at the time of their examinations.

A loan is considered to be impaired when it is probable Pinnacle Financial will be unable to collect all principal and interest payments due in accordance with the contractual terms of the loan agreement. Individually identified impaired loans are measured based on the present value of expected payments using the loan s original effective rate as the discount rate, the loan s observable market price, or the fair value of the collateral if the loan is collateral dependent. If the recorded investment in the impaired loan exceeds the measure of fair value, a valuation allowance is established as a component of the allowance for loan losses. Changes to the valuation allowance are recorded as a component of the provision for loan losses.

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

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

Other Assets Included in other assets as of December 31, 2003 and 2002 is approximately $535,000 and $435,000, respectively, net of amortization, related to amounts paid to certain individuals to secure their employment with Pinnacle Financial. These amounts are subject to certain agreements whereby a certain pro rata amount will be owed Pinnacle Financial should the employee leave the employ of Pinnacle Financial within six years of their employment date. Pinnacle Financial is amortizing the amounts to salaries and employee benefits expense on a straight-line basis over 36 to 72 months.

Also included in other assets as of December 31, 2003 and 2002, is approximately $250,000 and $303,000, respectively, of computer software related assets, net of amortization. This software supports Pinnacle Financial s primary data systems and relates to amounts paid to vendors for installation and development of such systems. These amounts are amortized on a straight-line basis over periods of three to seven years. For the years ended December 31, 2003, 2002 and 2001, Pinnacle Financial amortized approximately $122,000, $102,000, and $93,000, respectively, related to these costs. Software maintenance fees are capitalized in other assets and amortized over the term of the maintenance agreement.

Additionally, Pinnacle Financial maintains certain investments, at cost, with certain regulatory and other entities in which Pinnacle Financial has an ongoing business relationship. These entities are the Federal Reserve Bank of Atlanta, the Bankers Bank of Atlanta and the Federal Home Loan Bank of Cincinnati. At December 31, 2003 and 2002, the cost of these investments, which is included in other assets was $2,391,000 and $1,811,000, respectively.

During the year ended December 31, 2002, Pinnacle National acquired life insurance policies on five key executives. Pinnacle National is the beneficiary of the death proceeds from these policies. To acquire these policies, Pinnacle National paid a one-time premium of $1.8 million. Pinnacle National increases the value of the polices based on a crediting rate which is then reset quarterly thereafter. This crediting rate serves to increase the cash surrender value of the policies over the life of the policies. At December 31, 2003 and 2002, the aggregate

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

cash surrender value of these policies, which is reflected in other assets, was $1,931,000 and $1,842,000, respectively. Pinnacle National has not borrowed any funds against these policies.

Also included in other assets at December 31, 2003 and 2002 is $456,000 and $264,000, respectively, which is related to loans which have been sold to correspondent banks. These amounts represent the present value, net of amortization, 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 participation in the loan. Amortization of these amounts was $143,000 and $47,000 for the years ended December 31, 2003 and 2002, respectively.

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

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

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

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 the 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 (loss) and net income (loss) per share would have been adjusted to the pro forma amounts indicated below for each of the years in the three-year period ended December 31, 2003:

		2003	2002	2001
Net income (loss), as reported		$2,554,639	$ 648,060	$(1,136,665)
Deduct: Total stock-based compensation expense determined under the fair value based method for all awards, net of related tax effects		(197,320)	(152,905)	(61,704)
Pro forma net income (loss)		$2,357,319	$ 495,155	$(1,198,369)
Per share information:				
Basic net income (loss)	As reported	$ 0.69	$ 0.21	$ (0.57)
	Pro forma	$ 0.64	$ 0.16	$ (0.60)
Diluted net income (loss)	As reported	$ 0.65	$ 0.21	$ (0.57)
	Pro forma	$ 0.60	$ 0.16	$ (0.60)

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

For purposes of these calculations, the fair value of options granted for each of the years in the three-year period ended December 31, 2003 was estimated using the Black-Scholes option pricing model and the following assumptions:

	2003	2002	2001
Risk free interest rate	1.18%	1.74%	4.88%
Expected life of the options	5.0 years	5.0 years	8.0 years
Expected dividend yield	0.00%	0.00%	0.00%
Expected volatility	41.6%	69.7%	40.0%
Weighted average fair value	$ 5.75	$ 5.69	$ 4.12

Income (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.

As of December 31, 2003 and 2002, there were common stock options outstanding to purchase up to 453,700 and 362,350 common shares, respectively. Substantially all of these shares have exercise prices, which when considered in relation to the average market price of Pinnacle Financial s common stock, are considered dilutive and are considered in Pinnacle Financial s diluted income per share calculation for the years ended December 31, 2003 and 2002. Additionally, as of December 31, 2003 and 2002, Pinnacle Financial had granted warrants to purchase 203,000 common shares which have been considered in the calculation of Pinnacle Financial s diluted income per share for the years ended December 31, 2003 and 2002.

As of December 31, 2001, there were common stock options outstanding to purchase up to 239,200 common shares and warrants to purchase 203,000 common shares. However, due to Pinnacle Financial s net loss and the exercise prices in relation to the average market price of Pinnacle Financial s common stock, the stock options and warrants were anti-dilutive and have not been considered in the calculation of Pinnacle Financial s diluted loss per share for the year ended December 31, 2001.

The following is a summary of the basic and diluted earnings per share calculation for each of the years in the three-year period ended December 31, 2003:

	2003	2002	2001
Basic earnings per share calculation:			
Numerator - Net income (loss)	$2,554,639	$ 648,060	$(1,136,665)
Denominator - Average common shares outstanding	3,692,053	3,054,471	1,981,598
Basic earnings (loss) per share	$ 0.69	$ 0.21	$ (0.57)
Diluted earnings per share calculation:			
Numerator - Net income (loss)	$2,554,639	$ 648,060	$(1,136,665)
Denominator - Average common shares outstanding	3,692,053	3,054,471	1,981,598
Dilutive shares contingently issuable	245,950	63,951	
Average dilutive common shares outstanding	3,938,003	3,118,422	1,981,598
Diluted earnings (loss) per share	$ 0.65	$ 0.21	$ (0.57)

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

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

Comprehensive Income (Loss) 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 (loss) consists of unrealized gains and losses, net of deferred income taxes, on available-for-sale securities. The following is a summary of other comprehensive income for each of the years in the three-year period ended December 31, 2003.

	2003	2002	2001
Net income, as reported	$2,554,639	$ 648,060	$(1,136,665)
Other comprehensive income Net unrealized holding gains (losses) from available-for-sale securities	(621,905)	719,785	59,123
Total comprehensive income (loss)	$1,932,734	$1,367,845	$(1,077,542)

Recent Accounting Pronouncements In December 2003, the FASB issued FASB Interpretation No. 46 (revised December 2003), *Consolidation of Variable Interest Entities (FIN 46R)*, which addresses how a business enterprise should evaluate whether it has a controlling financial interest in an entity through means other than voting rights and accordingly should consolidate the entity. FIN 46R replaces FASB Interpretation No. 46, *Consolidation of Variable Interest Entities*, which was issued in January 2003. Pinnacle Financial will be required to apply FIN 46R to all entities subject to this Interpretation no later than the end of the first reporting period that end after December 15, 2004. This interpretation must be applied to those entities that are considered to be special-purpose entities no later than as of the end of the first reporting period that ends after December 15, 2003.

For any variable interest entities (VIEs) that must be consolidated under FIN 46R that were created before January 1, 2004, the assets, liabilities and noncontrolling interests of the VIE initially would be measured at their carrying amounts with any difference between the net amount added to the balance sheet and any previously recognized interest being recognized as the cumulative effect of an accounting change. If determining the carrying amounts is not practicable, fair value at the date FIN 46R first applies may be used to measure the assets, liabilities and noncontrolling interest of the VIE.

Pinnacle Financial has applied FIN 46R in accounting for PNFP Statutory Trust I (Trust), established on December 29, 2003. Accordingly, in the accompanying balance sheet, we have included, in other assets, our investment in the Trust of $310,000 and also included, in subordinated debt, the balance owed the Trust of $10,310,000. Except as related to the Trust, the he application of this Interpretation is not expected to have a material effect on Pinnacle Financial s consolidated 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.

In December 2003, the Accounting Standards Executive Committee issued Statement of Position 03-3, *Accounting for Certain Loans or Debt Securities Acquired in a Transfer* (SOP 03-3). SOP 03-3 addresses accounting for differences between contractual cash flows and cash flows expected to be collected from an investor s initial investment in loans or debt securities (loans) acquired in a transfer if those differences are attributable, at least in part, to credit quality. SOP 03-3 includes loans acquired in purchase business combinations, but does not apply to loans originated by the entity. SOP 03-3 is effective for loans acquired in fiscal years beginning after December 15, 2004 although earlier adoption is encouraged. The adoption of this new statement of

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

position is not expected to have a material 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. Restricted Cash Balances

Regulation D of the Federal Reserve Act requires that banks maintain reserve balances with the Federal Reserve Bank based principally on the type and amount of their deposits. At its option, Pinnacle Financial maintains additional balances to compensate for clearing and other services. For the years ended December 31, 2003 and 2002, the average daily balance maintained at the Federal Reserve was approximately $1,703,000 and $781,000, respectively.

Note 3. Securities Available-For-Sale

The amortized cost and fair value of securities available-for-sale at December 31, 2003 and 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	$ 27,023,126	$ 353,204	$ (104,354)	$ 27,271,976
Mortgage-backed securities	103,087,958	506,881	(616,953)	102,977,886
State and municipal securities	9,590,357	142,970	(38,951)	9,694,376
	$ 139,701,441	$ 1,003,055	$ (760,258)	$ 139,944,238
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 $23,126,000 of available-for-sale securities during the year ended December 31, 2003. Gross realized gains amounted to $263,000 on the sale of $20.5 million of available-for-sale securities while gross realized losses amounted to $15,000 on the sale of $2.6 million of available-for-sale securities during the year ended December 31, 2003. Pinnacle Financial realized no gains or losses from the sale of securities as no such transactions occurred during the years ended December 31, 2002 or 2001. At December 31, 2003, approximately $81,972,000 of Pinnacle Financial s available-for-sale portfolio was pledged to secure public fund and other deposits and securities sold under agreements to repurchase.

The amortized cost and fair value of debt securities as of December 31, 2003 by contractual maturity are shown below. Actual maturities may differ from contractual maturities of mortgage-backed securities since the mortgages underlying the securities may be called or prepaid with or without penalty. Therefore, these securities are not included in the maturity categories in the following summary.

	Amortized Cost	Fair Value
Due in one year or less	$	$

Due in one year to five years	5,813,900	6,041,010
Due in five years to ten years	30,325,526	30,457,236
Due after ten years	474,057	468,106
Mortgage-backed securities	103,087,958	102,977,886
	$139,701,441	$139,944,238

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At December 31, 2003, included in securities available-for-sale were the following investments with unrealized losses classified according to the term of the unrealized loss of less than twelve months or twelve months or longer as follows:

	Less than 12 months		12 months or longer		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
U.S. government and agency securities	$ 9,936,645	$104,354	$	$	$ 9,936,645	$104,354
Mortgage-backed securities	52,671,658	616,953			52,671,658	616,953
State and municipal securities	2,616,888	38,951			2,616,888	38,951
Total temporarily-impaired securities	$65,225,289	$760,258	$	$	$65,225,289	$760,258

Management evaluates securities for other-than-temporary impairment on at least a quarterly basis, and more frequently when economic or market concerns warrant such evaluation. Consideration is given to (1) the length of time and the extent to which the fair value has been less than cost, (2) the financial condition and near-term prospects of the issuer, and (3) the intent and ability of the Pinnacle Financial to retain its investment in the issuer for a period of time sufficient to allow for any anticipated recovery in fair value.

The unrealized loss approximates 1.2% of the fair value of the temporarily impaired securities at December 31, 2003 and includes thirty-eight issuances as follows:

> The unrealized loss on investments in U.S. government and agency securities consists of six securities which were caused by market interest rate increases since the time at which these investments were acquired. The contractual terms of these investments do not permit the issuer to settle the securities at a price less than the amortized cost of the investment.
>
> Pinnacle Financial had twenty mortgage-backed securities with unrealized losses which were also caused by increases in market interest rates. The contractual cash flows of these securities are guaranteed by the issuing agency and, with respect to Government National Mortgage Association issuances, by the U.S. government. It is not expected that the securities would be settled at a price less than the amortized cost of the investment.
>
> The unrealized loss on investments in state and municipal securities consists of twelve securities and was also caused by increases in market interest rates since the time the investments were acquired. These securities were related to a variety of jurisdictions within the State of Tennessee and, in most cases, were credit enhanced via an agreement from an national insurance underwriting agency. It is not expected that the securities will be settled at a price less than the unamortized cost of the investment.

Because the declines in fair value were attributable to increases in interest rates and not attributable to credit quality and because Pinnacle Financial has the ability and intent to hold all of these investments until a market price recovery or maturity, these investments were not considered other-than-temporarily impaired.

Note 4. Loans and Allowance for Loan Losses

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

	2003	2002
Commercial real estate Mortgage	$ 68,507,350	$ 58,964,823
Commercial real estate Construction	8,210,646	5,396,697
Commercial Other	129,881,732	98,722,136

Total Commercial	206,599,728	163,083,656
Consumer real estate Mortgage	76,041,526	37,533,445
Consumer real estate Construction	3,077,656	1,971,152
Consumer Other	11,285,200	7,155,183
Total Consumer	90,404,382	46,659,780
Total Loans	297,004,110	209,743,436
Allowance for loan losses	(3,718,598)	(2,677,043)
Loans, net	$293,285,512	$207,066,393

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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 $35.0 million and $27.1 million, while credit exposure to operators of nonresidential buildings approximated $16.6 million and $9.6 million at December 31, 2003 and 2002, respectively. Levels of exposure to these industry groups are periodically evaluated in order to determine if additional allowance allocations are warranted.

At December 31, 2003 and 2002, Pinnacle Financial had certain impaired loans on nonaccruing interest status. The principal balance of these nonaccrual loans amounted to $379,000; $1,845,000 and $250,000 at December 31, 2003, 2002 and 2001, 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 $75,000, $43,000 and $5,000 for each of the years in the three-year period ended December 31, 2003. Pinnacle Financial had no impaired loans with an assigned valuation allowance at December 31, 2003 or at December 31, 2002. As to the nonaccruing loan at December 31, 2001, Pinnacle Financial assigned a valuation allowance as follows:

	Recorded Investment	Valuation Allowance
Valuation allowance required	$250,000	$150,000
No valuation allowance required		
Balance at end of period	$250,000	$150,000

During the years ended December 31, 2003 and 2002, the average balance of all impaired loans amounted to $1,160,000 and $144,000, respectively. The average balance of impaired loans during the year ended December 31, 2001 was insignificant as the sole loan was not deemed impaired until the end of 2001. As all loans that were deemed impaired were either on nonaccruing interest status during the entire year or were placed on nonaccruing status on the date they were deemed impaired, no interest income has been recognized on any impaired loans during the three-year period ended December 31, 2003.

Changes in the allowance for loan losses for each of the years in the three-year period ended December 31, 2003 are as follows:

	2003	2002	2001
Balance at beginning of period	$2,677,043	$1,832,000	$ 162,378
Charged-off loans	(167,023)	(92,957)	
Recovery of previously charged-off loans	51,298		
Provision for loan losses	1,157,280	938,000	1,669,622
Balance at end of period	$3,718,598	2,677,043	$1,832,000

At December 31, 2003, Pinnacle Financial has granted loans and other extensions of credit amounting to approximately $6,484,000 to certain directors, executive officers, and their related entities, of which $3,522,000 had been drawn upon. At December 31, 2002, Pinnacle Financial has granted loans and other extensions of credit amounting to approximately $6,970,000 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 2003, 2002 and 2001, 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 years ended December 31, 2003, 2002 and 2001 of approximately $334,000, $120,000 and $191,000, respectively, which is attributable to the present value of the future net cash flows of the difference between the interest payments the borrower is projected to pay Pinnacle Financial and the amount of interest that will be owed the correspondent based on their future participation in the loan.

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Note 5. Premises and Equipment and Lease Commitments

Premises and equipment at December 31, 2003 and 2002 are summarized as follows:

	Range of Useful Lives	2003	2002
Land		$ 1,239,552	$
Buildings and leasehold improvements	15 to 30 years	3,809,939	2,203,775
Furniture and equipment	3 to 15 years	3,301,777	2,305,280
		8,351,268	4,509,055
Accumulated depreciation		(1,439,909)	(897,551)
		$ 6,911,359	$ 3,611,504

Depreciation expense was approximately $542,000, $461,000 and $381,000 for each of the years in the three-year period ended December 31, 2003.

Pinnacle Financial has entered into various operating leases, primarily for office space and branch facilities. Rent expense related to these leases for 2003, 2002 and 2001 totaled $449,000, $399,000 and $374,000, respectively. At December 31, 2003, the approximate future minimum lease payments due under the aforementioned operating leases for their initial term is as follows:

2004	$ 408,000
2005	419,000
2006	429,000
2007	441,000
2008	455,000
Thereafter	1,456,000
	$ 3,608,000

Note 6. Deposits

At December 31, 2003, the scheduled maturities of time deposits are as follows:

2004	$ 116,286,000
2005	30,396,000
2006	11,006,000
2007	
2008	294,000
	$ 157,982,000

Additionally, at December 31, 2003 and 2002, approximately $113,986,000 and $87,439,000, respectively, of time deposits had been issued in denominations of $100,000 or greater.

Note 7. Federal Home Loan Bank Advances and Other Borrowings

During 2001, Pinnacle National became a member of the Federal Home Loan Bank of Cincinnati (FHLB). As a result, Pinnacle National is eligible for advances from the FHLB, pursuant to the terms of various borrowing agreements, which assists Pinnacle National in the funding of Pinnacle National s home mortgage and commercial real estate loan portfolios. Pinnacle National has pledged certain qualifying residential mortgage loans and, pursuant to a blanket lien, all qualifying commercial mortgage loans as collateral under the borrowing agreements with the FHLB.

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At December 31, 2003 and 2002, Pinnacle National had received advances from the FHLB totaling $44,500,000 and $21,500,000, respectively. At December 31, 2003, the scheduled maturities of these advances and interest rates are as follows:

	Scheduled Maturities	Interest Rate Ranges
2004	$29,000,000	1.1% to 4.4%
2005	8,000,000	2.2% to 3.1%
2006	5,500,000	2.5% to 2.8%
2007	2,000,000	3.2%
	$44,500,000	
Weighted average interest rate		2.1%

On December 29, 2003, we established PNFP Statutory Trust I (Trust), a wholly-owned statutory business trust. Pinnacle Financial is the sole sponsor of the trust and acquired the Trust s common securities for $310,000. The Trust was created for the exclusive purpose of issuing 30-year capital trust preferred securities (Trust Preferred Securities) in the aggregate amount of $10,000,000 and using the proceeds to purchase $10,310,000 of junior subordinated debentures (Subordinated Debentures) issued by Pinnacle Financial. The sole assets of the Trust are the Subordinated Debentures. Pinnacle Financial s $310,000 investment in the Trust is included in other assets in the accompanying consolidated balance sheet and the $10,310,000 obligation of Pinnacle Financial is included in subordinated debt.

The Trust Preferred Securities bear a floating interest rate based on a spread over 3-month LIBOR which is set each quarter and matures on December 30, 2033. Distributions are payable quarterly. The Trust Preferred Securities are subject to mandatory redemption upon repayment of the Subordinated Debentures at their stated maturity date or their earlier redemption in an amount equal to their liquidation amount plus accumulated and unpaid distributions to the date of redemption. Pinnacle Financial guarantees the payment of distributions and payments for redemption or liquidation of the Trust Preferred Securities to the extent of funds held by the Trust. Pinnacle Financial s obligations under the Subordinated Debentures together with the guarantee and other back-up obligations, in the aggregate, constitute a full and unconditional guarantee by Pinnacle Financial of the obligations of the Trust under the Trust Preferred Securities.

The Subordinated Debentures are unsecured, bear an interest rate based on a spread over 3-month LIBOR (equal to the spread paid by the Trust on the Trust Preferred Securities) which is set each quarter and matures on December 30, 2033. Interest is payable quarterly. Pinnacle Financial may defer the payment of interest at any time for a period not exceeding 20 consecutive quarters provided that deferral period does not extend past the stated maturity. During any such deferral period, distributions on the Trust Preferred Securities will also be deferred and Pinnacle Financial s ability to pay dividends on our common shares will be restricted.

Subject to approval by the Federal Reserve Bank of Atlanta, the Trust Preferred Securities may be redeemed prior to maturity at our option on or after September 17, 2008. The Trust Preferred Securities may also be redeemed at any time in whole (but not in part) in the event of unfavorable changes in laws or regulations that result in (1) the Trust becoming subject to federal income tax on income received on the Subordinated Debentures, (2) interest payable by the parent company on the Subordinated Debentures becoming non-deductible for federal tax purposes, (3) the requirement for the Trust to register under the Investment Company Act of 1940, as amended, or (4) loss of the ability to treat the Trust Preferred Securities as Tier I capital under the Federal Reserve capital adequacy guidelines.

The Trust Preferred Securities qualify as Tier I capital under current regulatory definitions. Debt issuance costs of $150,000 consisting primarily of underwriting discounts and professional fees are included in other assets in the accompanying consolidated balance sheet as of December 31, 2003. These debt issuance costs are being amortized over ten years using the straight-line method.

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At December 31, 2003, Pinnacle National has accommodations which allow Pinnacle National to purchase Federal funds from several of its correspondent banks on an overnight basis at prevailing overnight market rates. These accommodations are subject to various restrictions as to their term and availability, and in most cases, must be repaid within less than a month. There were no outstanding balances at December 31, 2003 or 2002 under these arrangements.

Note 8. Income Taxes

Income tax expense (benefit) attributable to income (losses) from continuing operations for each of the years in the three-year period ended December 31, 2003 consists of the following:

	2003	2002	2001
Current tax expense:			
Federal	$710,749	$	$
State	145,010	–	–
Total current tax expense	855,759	–	