SUMMIT FINANCIAL GROUP INC
Form 10-Q
August 11, 2008

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

FORM 10 – Q

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

For the quarterly period ended June 30, 2008.
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 Number 0-16587

Summit Financial Group, Inc.
(Exact name of registrant as specified in its charter)

West Virginia	55-0672148
(State or other jurisdiction of incorporation or organization)	(IRS Employer Identification No.)

300 North Main Street
Moorefield, West Virginia 26836
(Address of principal executive offices) (Zip Code)

(304) 530-1000
(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Sections 13 or 15(d) of the Securities and Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.
Yes þ No o

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of “accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act. (Check one):
Large accelerated filer o Accelerated filerþ Non-accelerated filer o

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

Indicate the number of shares outstanding of each of the issuer’s classes of Common Stock as of the latest practicable date.

Common Stock, $2.50 par value
7,410,791 shares outstanding as of August 8, 2008

Summit Financial Group, Inc. and Subsidiaries
Table of Contents

			Page
PART I.	FINANCIAL INFORMATION		
	Item 1.	Financial Statements	
		Consolidated balance sheets June 30, 2008 (unaudited), December 31, 2007, and June 30, 2007 (unaudited)	4
		Consolidated statements of income for the three months and six months ended June 30, 2008 and 2007 (unaudited)	5
		Consolidated statements of shareholders’ equity for the six months ended June 30, 2008 and 2007 (unaudited)	6
		Consolidated statements of cash flows for the six months ended June 30, 2008 and 2007 (unaudited)	7-8
		Notes to consolidated financial statements (unaudited)	9-26
	Item 2.	Management's Discussion and Analysis of Financial Condition and Results of Operations	27-38
	Item 3.	Quantitative and Qualitative Disclosures about Market Risk	37
	Item 4.	Controls and Procedures	38

Summit Financial Group, Inc. and Subsidiaries
Table of Contents

PART II.	OTHER INFORMATION			
	Item 1.	Legal Proceedings		39
	Item 1A.	Risk Factors		39
	Item 2.	Changes in Securities and Use of Proceeds		None
	Item 3.	Defaults upon Senior Securities		None
	Item 4.	Submission of Matters to a Vote of Security Holders		39
	Item 5.	Other Information		None
	Item 6.	Exhibits		
		Exhibits		
		Exhibit 11	Statement re: Computation of Earnings per Share – Information contained in Note 5 to the Consolidated Financial Statements on page 14 of this Quarterly Report is incorporated herein by reference.	
		Exhibit 31.1	Sarbanes-Oxley Act Section 302 Certification of Chief Executive Officer	
		Exhibit 31.2	Sarbanes-Oxley Act Section 302 Certification of Chief Financial Officer	
		Exhibit 32.1	Sarbanes-Oxley Act Section 906 Certification of Chief Executive Officer	
		Exhibit 32.2	Sarbanes-Oxley Act Section 906 Certification of Chief Financial Officer	
SIGNATURES				40

Summit Financial Group, Inc. and Subsidiaries
Consolidated Balance Sheets (unaudited)

Dollars in thousands	June 30, 2008 (unaudited)	December 31, 2007 (*)	June 30, 2007 (unaudited)
ASSETS			
Cash and due from banks	$ 21,777	$ 21,285	$ 15,198
Interest bearing deposits with other banks	98	77	105
Federal funds sold	798	181	1,717
Securities available for sale	284,401	283,015	246,123
Other Investments	22,831	17,051	13,403
Loans held for sale, net	1,077	1,377	2,337
Loans, net	1,130,483	1,052,489	949,175
Property held for sale	2,537	2,058	850
Premises and equipment, net	21,967	22,130	22,133
Accrued interest receivable	7,614	7,191	6,812
Intangible assets	9,880	10,055	3,121
Other assets	22,515	18,413	19,118
Assets related to discontinued operations	-	214	336
Total assets	$ 1,525,978	$ 1,435,536	$ 1,280,428
LIABILITIES AND SHAREHOLDERS' EQUITY			
Liabilities			
Deposits			
Non interest bearing	$ 68,912	$ 65,727	$ 64,373
Interest bearing	788,837	762,960	786,016
Total deposits	857,749	828,687	850,389
Short-term borrowings	147,900	172,055	100,901
Long-term borrowings	400,186	315,738	216,758
Subordinated debentures owed to unconsolidated subsidiary trusts	19,589	19,589	19,589
Other liabilities	9,088	9,241	10,359
Liabilities realted to discontinued operations	-	806	522
Total liabilities	1,434,512	1,346,116	1,198,518
Commitments and Contingencies			
Shareholders' Equity			
Common stock and related surplus, $2.50 par value; authorized 20,000,000 shares, issued and outstanding 2008 - 7,410,791; issued December 2007 - 7,408,941 shares; issued June 2007 - 7,084,980 shares	24,406	24,391	18,037
Retained earnings	70,161	65,077	65,479
Accumulated other comprehensive income	(3,101)	(48)	(1,606)
Total shareholders' equity	91,466	89,420	81,910
Total liabilities and shareholders' equity	$ 1,525,978	$ 1,435,536	$ 1,280,428

(*) - December 31, 2007 financial information has been extracted from audited consolidated financial statements

See Notes to Consolidated Financial Statements

Summit Financial Group, Inc. and Subsidiaries
Consolidated Statements of Income (unaudited)

	Three Months Ended		Six Months Ended	
Dollars in thousands, except per share amounts	June 30, 2008	June 30, 2007	June 30, 2008	June 30, 2007
Interest income				
Interest and fees on loans				
Taxable	$ 19,461	$ 18,958	$ 39,410	$ 37,555
Tax-exempt	115	121	235	237
Interest and dividends on securities				
Taxable	3,161	2,739	6,358	5,318
Tax-exempt	600	524	1,190	1,068
Interest on interest bearing deposits with other banks	2	6	3	9
Interest on Federal funds sold	1	21	3	24
Total interest income	23,340	22,369	47,199	44,211
Interest expense				
Interest on deposits	6,435	8,882	13,559	17,910
Interest on short-term borrowings	571	960	1,490	1,918
Interest on long-term borrowings and subordinated debentures	4,959	3,000	9,837	5,653
Total interest expense	11,965	12,842	24,886	25,481
Net interest income	11,375	9,527	22,313	18,730
Provision for loan losses	1,750	390	2,750	780
Net interest income after provision for loan losses	9,625	9,137	19,563	17,950
Other income				
Insurance commissions	1,275	209	2,602	415
Service fees	824	736	1,567	1,353
Unrealized securities (losses)	(1,541)	-	(1,541)	-
Net cash settlement on interest rate swaps	-	(179)	(171)	(363)
Change in fair value of interest rate swap	-	(273)	705	(47)
Gain (loss) on sale of assets	236	(33)	236	(32)
Other	334	236	578	426
Total other income	1,128	696	3,976	1,752
Other expense				
Salaries and employee benefits	4,187	3,238	8,581	6,463
Net occupancy expense	443	408	919	826
Equipment expense	533	493	1,068	940
Supplies	241	197	435	370
Professional fees	182	193	300	367
Amortization of intangibles	88	38	176	76
Other	1,475	1,151	2,758	2,326
Total other expense	7,149	5,718	14,237	11,368
Income before income taxes	3,604	4,115	9,302	8,334
Income tax expense	1,010	1,135	2,884	2,421
Income from continuing operations	$ 2,594	$ 2,980	$ 6,418	$ 5,913

Discontinued Operations								
Exit costs		-		43		-		123
Operating income(loss)		-		(227)		-		(598)
Income from discontinued operations before income tax expense(benefit)		-		(184)		-		(475)
Income tax expense(benefit)		-		(66)		-		(163)
Income from discontinued operations		-		(118)		-		(312)
Net Income	$	2,594	$	2,862	$	6,418	$	5,601
Basic earnings from continuing operations per common share	$	0.35	$	0.42	$	0.87	$	0.83
Basic earnings per common share	$	0.35	$	0.40	$	0.87	$	0.79
Diluted earnings from continuing operations per common share	$	0.35	$	0.42	$	0.86	$	0.83
Diluted earnings per common share	$	0.35	$	0.40	$	0.86	$	0.78
Dividends per common share	$	0.18	$	0.17	$	0.18	$	0.17

See Notes to Consolidated Financial Statements

Summit Financial Group, Inc. and Subsidiaries
Consolidated Statements of Shareholders' Equity (unaudited)

Dollars in thousands, except per share amounts	Common Stock and Related Surplus	Retained Earnings	Accumulated Other Compre-hensive Income	Total Share-holders' Equity
Balance, December 31, 2007	$ 24,391	$ 65,077	$ (48)	$ 89,420
Six Months Ended June 30, 2008				
Comprehensive income:				
Net income	-	6,418	-	6,418
Other comprehensive income, net of deferred tax benefit of ($1,871):				
Net unrealized loss on securities of ($3,053)	-	-	(3,053)	(3,053)
Total comprehensive income				3,365
Exercise of stock options	9			9
Stock compensation expense	6	-	-	6
Cash dividends declared ($0.18 per share)	-	(1,334)	-	(1,334)
Balance, June 30, 2008	$ 24,406	$ 70,161	$ (3,101)	$ 91,466
Balance, December 31, 2006	$ 18,021	$ 61,083	$ (352)	$ 78,752
Six Months Ended June 30, 2007				
Comprehensive income:				
Net income	-	5,601	-	5,601
Other comprehensive income, net of deferred tax benefit of ($769):				
Net unrealized (loss) on securities of ($1,254)	-	-	(1,254)	(1,254)
Total comprehensive income				4,347
Exercise of stock options	-	-	-	-
Stock compensation expense	16			16
Cash dividends declared ($0.17 per share)	-	(1,205)	-	(1,205)
Balance, June 30, 2007	$ 18,037	$ 65,479	$ (1,606)	$ 81,910

See Notes to Consolidated Financial Statements

6

Summit Financial Group, Inc. and Subsidiaries
Consolidated Statements of Cash Flows (unaudited)

Dollars in thousands	Six Months Ended June 30, 2008	June 30, 2007
Cash Flows from Operating Activities		
Net income	$ 6,418	$ 5,601
Adjustments to reconcile net earnings to net cash		
provided by operating activities:		
Depreciation	795	763
Provision for loan losses	2,750	1,030
Stock compensation expense	6	16
Deferred income tax (benefit)	(824)	210
Loans originated for sale	(3,718)	(12,695)
Proceeds from loans sold	4,055	19,348
(Gain) on sales of loans held for sale	(37)	(562)
Writedown of preferred stock	1,541	
Change in fair value of derivative instruments	(705)	47
Exit costs related to discontinued operations	-	(123)
Loss (gain) on disposal of other assets	(236)	32
Amortization of securities premiums, net	(220)	(37)
Amortization of goodwill and purchase accounting		
adjustments, net	182	81
(Decrease) in accrued interest receivable	(424)	(465)
(Increase) in other assets	(4,710)	(810)
Increase(decrease) in other liabilities	3,078	(947)
Net cash provided by (used in) operating activities	7,951	11,489
Cash Flows from Investing Activities		
Net (increase) decrease in interest bearing deposits		
with other banks	(21)	166
Proceeds from maturities and calls of securities available for sale	16,663	12,404
Principal payments received on securities available for sale	15,772	14,098
Purchases of securities available for sale	(43,055)	(39,484)
Purchases of other investments	(9,429)	(7,781)
Redemption of Federal Home Loan Bank Stock	6,638	7,141
Net (increase) in Federal funds sold	(617)	(1,200)
Net loans made to customers	(82,035)	(34,832)
Purchases of premises and equipment	(632)	(488)
Proceeds from sales of other assets	1,123	86
Proceeds from early termination of interest rate swap	212	-
Net cash provided by (used in) investing activities	(95,381)	(49,890)
Cash Flows from Financing Activities		
Net increase in demand deposit, NOW and		
savings accounts	(5,986)	6,047
Net increase(decrease) in time deposits	35,045	(44,395)

Net increase(decrease) in short-term borrowings	(24,154)	40,473
Proceeds from long-term borrowings	109,894	50,000
Repayment of long-term borrowings	(25,552)	(9,352)
Exercise of stock options	9	-
Dividends paid	(1,334)	(1,205)
Net cash provided by financing activities	87,922	41,568
Increase (decrease) in cash and due from banks	492	3,167
Cash and due from banks:		
Beginning	21,285	12,031
Ending	$ 21,777	$ 15,198

(Continued)

See Notes to Consolidated Financial Statements

Summit Financial Group, Inc. and Subsidiaries
Consolidated Statements of Cash Flows (unaudited)

	Six Months Ended	
Dollars in thousands	June 30, 2008	June 30, 2007
Supplemental Disclosures of Cash Flow Information		
Cash payments for:		
Interest	$ 24,928	$ 25,414
Income taxes	$ 3,690	$ 2,190
Supplemental Schedule of Noncash Investing and Financing Activities		
Other assets acquired in settlement of loans	$ 1,291	$ 852

See Notes to Consolidated Financial Statements

Summit Financial Group, Inc. and Subsidiaries
Notes to Consolidated Financial Statements(unaudited)

Note 1. Basis of Presentation

We, Summit Financial Group, Inc. and subsidiaries, prepare our consolidated financial statements in accordance with accounting principles generally accepted in the United States of America for interim financial information and with instructions to Form 10-Q and Regulation S-X. Accordingly, they do not include all the information and footnotes required by accounting principles generally accepted in the United States of America for annual year end financial statements. In our opinion, all adjustments considered necessary for a fair presentation have been included and are of a normal recurring nature.

The presentation of financial statements in conformity with accounting principles generally accepted in the United States of America requires us to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the reporting period. Actual results could differ materially from these estimates.

The results of operations for the six months ended June 30, 2008 are not necessarily indicative of the results to be expected for the full year. The consolidated financial statements and notes included herein should be read in conjunction with our 2007 audited financial statements and Annual Report on Form 10-K. Certain accounts in the consolidated financial statements for December 31, 2007 and June 30, 2007, as previously presented, have been reclassified to conform to current year classifications.

Note 2. Significant New Accounting Pronouncements

In September 2006, the FASB issued Statement 157, Fair Value Measurements (SFAS 157). SFAS 157 replaces various definitions of fair value in existing accounting literature with a single definition, establishes a framework for measuring fair value in generally accepted accounting principles, and requires additional disclosures about fair value measurements. SFAS 157 does not expand the use of fair value to any new circumstances. SFAS 157 is effective for fiscal years beginning after November 15, 2007. In February 2008, the FASB issued FASB Staff Position (FSP) FAS 157-2, "Effective Date of FASB Statement No. 157." This FSP delays the effective date of FAS 157 for all nonfinancial assets and nonfinancial liabilities, except those that are recognized or disclosed at fair value on a recurring basis (at least annually) to fiscal years beginning after November 15, 2008, and interim periods within those fiscal years. We adopted SFAS 157 on January 1, 2008 and the adoption of this statement did not have a material effect on our financial statements. See Note 3 for a discussion of our fair value measurements.

In February 2007, the FASB issued Statement of Financial Accounting Standard 159 (SFAS 159), The Fair Value Option for Financial Assets and Financial Liabilities-Including an amendment of FASB Statement No. 115. SFAS 159 permits entities to choose to measure many financial instruments and certain other items at fair value at specified election dates. Unrealized gains and losses on items for which the fair value option has been elected are reported in earnings at each subsequent reporting date. The fair value option (i) is applicable on an instrument by instrument basis, with certain exceptions, (ii) is irrevocable (unless a new election date occurs), and (iii) is applied only to entire instruments and not to portions of instruments. We adopted SFAS 159 on January 1, 2008 and the adoption of this statement did not have a material effect on our financial statements.

In December 2007, the FASB issued Statement 141 (revised 2007) (SFAS 141R), Business Combinations. SFAS 141R will significantly change how the acquisition method will be applied to business combinations. SFAS 141R requires an acquirer, upon initially obtaining control of another entity, to recognize the assets, liabilities and any non-controlling interest in the acquiree at fair value as of the acquisition date. Contingent consideration is required to be recognized and measured at fair value on the date of acquisition rather than at a later date when the amount of that consideration may be determinable beyond a reasonable doubt. This fair value approach replaces the cost-allocation process required under SFAS 141 whereby the cost of an acquisition was allocated to the individual assets acquired

Summit Financial Group, Inc. and Subsidiaries
Notes to Consolidated Financial Statements(unaudited)

and liabilities assumed based on their estimated fair value. SFAS 141R requires acquirers to expense acquisition-related costs as incurred rather than allocating such costs to the assets acquired and liabilities assumed, as was previously the case under SFAS 141. Under SFAS 141R, the requirements of SFAS 146, Accounting for Costs Associated with Exit or Disposal Activities, would have to be met in order to accrue for a restructuring plan in purchase accounting. Pre-acquisition contingencies are to be recognized at fair value, unless it is a non-contractual contingency that is not likely to materialize, in which case, nothing should be recognized in purchase accounting and, instead, that contingency would be subject to the probable and estimable recognition criteria of SFAS 5, Accounting for Contingencies. Reversals of deferred income tax valuation allowances and income tax contingencies will be recognized in earnings subsequent to the measurement period. The allowance for loan losses of an acquiree will not be permitted to be recognized by the acquirer. Additionally, SFAS 141(R) will require new and modified disclosures surrounding subsequent changes to acquisition-related contingencies, contingent consideration, noncontrolling interests, acquisition-related transaction costs, fair values and cash flows not expected to be collected for acquired loans, and an enhanced goodwill rollforward. We will be required to prospectively apply SFAS 141(R) to all business combinations completed on or after January 1, 2009. Early adoption is not permitted. We are currently evaluating SFAS 141(R) and have not determined the impact it will have on our financial statements.

Note 3. Fair Value Measurements

SFAS 157 defines fair value as the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. SFAS 157 also establishes a fair value hierarchy which requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. The standard describes three levels of inputs that may be used to measure fair value.

Level 1: Quoted prices (unadjusted) or identical assets or liabilities in active markets that the entity has the ability to access as of the measurement date.

Level 2: Significant other observable inputs other than Level 1 prices, such as quoted prices for similar assets or liabilities, quoted prices in markets that are not active, and other inputs that are observable or can be corroborated by observable market data.

Level 3: Significant unobservable inputs that reflect a company's own assumptions about the assumptions that market participants would use in pricing an asset or liability.

Accordingly, securities available-for-sale and derivatives are recorded at fair value on a recurring basis. Additionally, from time to time, we may be required to record other assets at fair value on a nonrecurring basis, such as loans held for sale, and impaired loans held for investment. These nonrecurring fair value adjustments typically involve application of lower of cost or market accounting or write-downs of individual assets.

Following is a description of valuation methodologies used for assets and liabilities recorded at fair value.

Available-for-Sale Securities: Investment securities available-for-sale are recorded at fair value on a recurring basis. Fair value measurement is based upon quoted prices, if available. If quoted prices are not available, fair values are measured using independent pricing models or other model-based valuation techniques such as the present value of future cash flows, adjusted for the security's credit rating, prepayment assumptions and other factors such as credit loss assumptions. Level 1 securities include those traded on an active exchange, such as the New York Stock Exchange, U.S. Treasury securities that are traded by dealers or brokers in active over-the-counter markets and money market funds. Level 2 securities include mortgage-backed securities issued by government sponsored entities, municipal bonds and corporate debt securities.

Summit Financial Group, Inc. and Subsidiaries
Notes to Consolidated Financial Statements(unaudited)

Loans Held for Sale: Loans held for sale are carried at the lower of cost or market value. The fair value of loans held for sale is based on what secondary markets are currently offering for portfolios with similar characteristics. As such, we classify loans subject to nonrecurring fair value adjustments as Level 2.

Loans: We do not record loans at fair value on a recurring basis. However, from time to time, a loan is considered impaired and an allowance for loan losses is established. Loans for which it is probable that payment of interest and principal will not be made in accordance with the contractual terms of the loan agreement are considered impaired. Once a loan is identified as individually impaired, management measures impairment in accordance with SFAS 114, “Accounting by Creditors for Impairment of a Loan,” (SFAS 114). The fair value of impaired loans is estimated using one of several methods, including collateral value, liquidation value and discounted cash flows. Those impaired loans not requiring an allowance represent loans for which the fair value of the expected repayments or collateral exceed the recorded investments in such loans. At June 30, 2008, substantially all of the total impaired loans were evaluated based on the fair value of the collateral. In accordance with SFAS 157, impaired loans where an allowance is established based on the fair value of collateral require classification in the fair value hierarchy. When the fair value of the collateral is based on an observable market price or a current appraised value, we record the impaired loan as nonrecurring Level 2. When an appraised value is not available or management determines the fair value of the collateral is further impaired below the appraised value and there is no observable market price, we record the impaired loan as nonrecurring Level 3.

Derivative Assets and Liabilities: Substantially all derivative instruments held or issued by us for risk management or customer-initiated activities are traded in over-the-counter markets where quoted market prices are not readily available. For those derivatives, we measure fair value using models that use primarily market observable inputs, such as yield curves and option volatilities, and include the value associated with counterparty credit risk. We classify derivative instruments held or issued for risk management or customer-initiated activities as Level 2. Examples of Level 2 derivatives are interest rate swaps.

Assets and Liabilities Recorded at Fair Value on a Recurring Basis

The table below presents the recorded amount of assets and liabilities measured at fair value on a recurring basis.

Dollars in thousands	Total at June 30, 2008	Fair Value Measurements Using: Level 1	Level 2	Level 3
Assets:				
Available for sale securities	$ 284,401	$ -	$ 284,401	$ -
Derivatives	110	-	110	-
Liabilities:				
Derivatives	$ 63	$ -	$ 63	$ -

Assets and Liabilities Recorded at Fair Value on a Nonrecurring Basis

We may be required, from time to time, to measure certain assets at fair value on a nonrecurring basis in accordance with U.S. generally accepted accounting principles. These include assets that are measured at the lower of cost or market that were recognized at fair value below cost at the end of the period. Assets measured at fair value on a nonrecurring basis are included in the table below.

Summit Financial Group, Inc. and Subsidiaries
Notes to Consolidated Financial Statements(unaudited)

Dollars in thousands	Total at June 30, 2008	Fair Value Measurements Using: Level 1	Level 2	Level 3
Loans held for sale	$ 1,077	$ -	$ 1,077	$ -
Impaired loans	9,947	-	-	9,947

Impaired loans, which are measured for impairment using the fair value of the collateral for collateral-dependent loans, had a carrying amount of $11,542,000, with a valuation allowance of $1,595,000, resulting in an additional provision for loan losses of $1,060,000 for six months ended June 30, 2008.

Note 4. Discontinued Operations

As of January 1, 2008 we no longer have activity related to discontinued operations. The following table lists the assets and liabilities of Summit Mortgage included in the balance sheet as assets and liabilities related to discontinued operations.

Dollars in thousands	December 31, 2007	June 30, 2007
Assets:		
Loans held for sale, net	$ -	$ -
Loans, net	-	-
Premises and equipment, net	-	-
Property held for sale	-	-
Other assets	214	336
Total assets	$ 214	$ 336
Liabilities:		
Accrued expenses and other liabilities	$ 806	$ 522
Total liabilities	$ 806	$ 522

The results of Summit Mortgage are presented as discontinued operations in a separate category on the income statements following the results from continuing operations. The income (loss) from discontinued operations for the three and six months ended June 30, 2007 is presented below.

Summit Financial Group, Inc. and Subsidiaries
Notes to Consolidated Financial Statements(unaudited)

Statements of Income from Discontinued Operations

Dollars in thousands	Three Months Ended June 30, 2007	Six Months Ended June 30, 2007
Interest income	$ 22	$ 134
Interest expense	-	45
Net interest income	22	89
Provision for loan losses	-	250
Net interest income after provision for loan losses	22	(161)
Noninterest income		
Mortgage origination revenue	13	816
(Loss) on sale of assets	-	(51)
Total noninterest income	13	765
Noninterest expense		
Salaries and employee benefits	100	542
Net occupancy expense	13	9
Equipment expense	1	23
Professional fees	100	197
Postage	-	-
Advertising	-	98
Impairment of long-lived assets	-	-
Exit costs	(43)	(123)
Other	48	334
Total noninterest expense	219	1,080
Income (loss) before income tax expense	(184)	(476)
Income tax expense (benefit)	(66)	(163)
Income (loss) from discontinued operations	$ (118)	$ (313)

Included in liabilities related to discontinued operations in the accompanying consolidated financial statements is an accrual for exit costs related to the discontinuance of the mortgage banking segment. During fourth quarter 2006, we accrued $1,859,000 for exit costs, which was comprised of costs related to operating lease terminations, vendor contract terminations, and severance payments. The changes in that accrual are as follows:

Dollars in thousands	Operating Lease Terminations	Vendor Contract Terminations	Severance Payments	Total
Balance, December 31, 2007	$ 586	$ -	$ -	$ 586
Less:				
Payments from the accrual	(398)	-	-	(398)
Reversal of over accrual	-	-	-	-
Balance, June 30, 2008	$ 188	$ -	$ -	$ 188

13

Summit Financial Group, Inc. and Subsidiaries
Notes to Consolidated Financial Statements(unaudited)

Note 5. Earnings per Share

The computations of basic and diluted earnings per share follow:

	Three Months Ended June 30,		Six Months Ended June 30,	
Dollars in thousands , except per share amounts	2008	2007	2008	2007
Numerator for both basic and diluted earnings per share:				
Income from continuing operations	$ 2,594	$ 2,980	$ 6,418	$ 5,914
Income (loss) from discontinued operations	-	(118)	-	(313)
Net Income	$ 2,594	$ 2,862	$ 6,418	$ 5,601
Denominator				
Denominator for basic earnings per share -				
weighted average common shares outstanding	7,410,217	7,084,980	7,409,579	7,084,980
Effect of dilutive securities:				
Stock options	37,953	63,261	39,395	62,804
	37,953	63,261	39,395	62,804
Denominator for diluted earnings per share -				
weighted average common shares outstanding and				
assumed conversions	7,448,170	7,148,241	7,448,974	7,147,784
Basic earnings per share from continuing operations	$ 0.35	$ 0.42	$ 0.87	$ 0.83
Basic earnings per share from discontinued operations	-	(0.02)	-	(0.04)
Basic earnings per share	$ 0.35	$ 0.40	$ 0.87	$ 0.79
Diluted earnings per share from continuing operations	$ 0.35	$ 0.42	$ 0.86	$ 0.83
Diluted earnings per share from discontinued operations	-	(0.02)	-	(0.04)
Diluted earnings per share	$ 0.35	$ 0.40	$ 0.86	$ 0.78

Summit Financial Group, Inc. and Subsidiaries
Notes to Consolidated Financial Statements(unaudited)

Note 6. Securities

The amortized cost, unrealized gains, unrealized losses and estimated fair values of securities at June 30, 2008, December 31, 2007, and June 30, 2007 are summarized as follows:

	June 30, 2008			
	Amortized	Unrealized		Estimated
Dollars in thousands	Cost	Gains	Losses	Fair Value
Available for Sale				
Taxable:				
U. S. Government agencies				
and corporations	$ 39,058	$ 361	$ 234	$ 39,185
Mortgage-backed securities	194,136	1,070	6,303	188,903
State and political subdivisions	3,759	20	-	3,779
Corporate debt securities	1,349	14	15	1,348
Other equity securities	986	-	-	986
Total taxable	239,288	1,465	6,552	234,201
Tax-exempt:				
State and political subdivisions	45,185	608	520	45,273
Other equity securities	4,927	-	-	4,927
Total tax-exempt	50,112	608	520	50,200
Total	$ 289,400	$ 2,073	$ 7,072	$ 284,401

	December 31, 2007			
	Amortized	Unrealized		Estimated
Dollars in thousands	Cost	Gains	Losses	Fair Value
Available for Sale				
Taxable:				
U. S. Government agencies				
and corporations	$ 45,871	$ 420	$ 77	$ 46,214
Mortgage-backed securities	180,838	1,294	1,351	180,781
State and political subdivisions	3,759	26	-	3,785
Corporate debt securities	1,348	18	30	1,336
Other equity securities	844	-	-	844
Total taxable	232,660	1,758	1,458	232,960

Tax-exempt:				
State and political subdivisions	43,960	880	335	44,505
Other equity securities	6,470	-	920	5,550
Total tax-exempt	50,430	880	1,255	50,055
Total	$ 283,090	$ 2,638	$ 2,713	$ 283,015

Summit Financial Group, Inc. and Subsidiaries
Notes to Consolidated Financial Statements(unaudited)

	June 30, 2007			
	Amortized	Unrealized		Estimated
Dollars in thousands	Cost	Gains	Losses	Fair Value
Available for Sale				
Taxable:				
U. S. Government agencies and corporations	$ 35,662	$ 1	$ 408	35,255
Mortgage-backed securities	161,547	191	3,381	158,357
State and political subdivisions	3,759	18	-	3,777
Corporate debt securities	1,677	12	16	1,673
Other equity securities	677	-	-	677
Total taxable	203,322	222	3,805	199,739
Tax-exempt:				
State and political subdivisions	40,900	685	256	41,329
Other equity securities	4,473	594	12	5,055
Total tax-exempt	45,373	1,279	268	46,384
Total	$ 248,695	$ 1,501	$ 4,073	$ 246,123

The maturities, amortized cost and estimated fair values of securities at June 30, 2008, are summarized as follows:

	Available for Sale	
	Amortized	Estimated
Dollars in thousands	Cost	Fair Value
Due in one year or less	$ 55,163	$ 54,315
Due from one to five years	115,110	113,456
Due from five to ten years	66,100	64,587
Due after ten years	47,114	46,130
Equity securities	5,913	5,913
	$ 289,400	$ 284,401

During second quarter 2008, we recognized an other-than-temporary non-cash impairment charge of $1.5 million pre-tax, equivalent to $971,000 after-tax related to certain preferred stock issuances of the Fannie Mae and Freddie Mac which we continue to own.

Summit Financial Group, Inc. and Subsidiaries
Notes to Consolidated Financial Statements(unaudited)

Note 7. Loans

Loans are summarized as follows:

Dollars in thousands	June 30, 2008	December 31, 2007	June 30, 2007
Commercial	$ 112,793	$ 92,599	$ 81,292
Commercial real estate	422,393	384,478	354,833
Construction and development	210,417	225,270	198,721
Residential real estate	361,009	322,640	283,821
Consumer	30,361	31,956	33,937
Other	6,206	6,641	7,111
Total loans	1,143,179	1,063,584	959,715
Less unearned income	2,347	1,903	1,772
Total loans net of unearned income	1,140,832	1,061,681	957,943
Less allowance for loan losses	10,349	9,192	8,768
Loans, net	$ 1,130,483	$ 1,052,489	$ 949,175

Note 8. Allowance for Loan Losses

An analysis of the allowance for loan losses for the six month periods ended June 30, 2008 and 2007, and for the year ended December 31, 2007 is as follows:

	Six Months Ended June 30,		Year Ended December 31,
Dollars in thousands	2008	2007	2007