

SUMMIT FINANCIAL GROUP INC  
Form 10-Q  
May 10, 2007

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

**FORM 10 - Q**

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

For the quarterly period ended **March 31, 2007**.

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**

(State or other jurisdiction of  
incorporation or organization)

**55-0672148**

(IRS Employer  
Identification No.)

**300 North Main Street**

**Moorefield, West Virginia**

(Address of principal executive  
offices)

**26836**

(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  No

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  Accelerated filer  Non-accelerated filer

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes  No

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**  
**7,084,980 shares outstanding as of May 4, 2007**

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Summit Financial Group, Inc. and Subsidiaries**Table of Contents**

	Page	
<b>PART FINANCIAL INFORMATION</b>		
<b>I.</b>		
Item 1.	Financial Statements	
	Consolidated balance sheets March 31, 2007 (unaudited), December 31, 2006, and March 31, 2006 (unaudited)	4
	Consolidated statements of income for the three months ended March 31, 2007 and 2006 (unaudited)	5
	Consolidated statements of shareholders' equity for the three months ended March 31, 2007 and 2006 (unaudited)	6
	Consolidated statements of cash flows for the three months ended March 31, 2007 and 2006 (unaudited)	7-8
	Notes to consolidated financial statements (unaudited)	9-22
Item 2.	Management's Discussion and Analysis of Financial Condition and Results of Operations	23-35
Item 3.	Quantitative and Qualitative Disclosures about Market Risk	32
Item 4.	Controls and Procedures	33

Summit Financial Group, Inc. and Subsidiaries**Table of Contents****P A R T O T H E R I N F O R M A T I O N****II.**

Item 1.	Legal Proceedings	34
Item 1A.	Risk Factors	35
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	None
Item 5.	Other Information	None
Item 6.	Exhibits	
	Exhibits	
	Exhibit 3.1 By-Laws of Summit Financial Group, Inc. as last amended and restated on April 27, 2007	
	Exhibit 10.1 Chief Banking Officer Incentive Plan	
Exhibit 11	Statement re: Computation of Earnings per Share - Information contained in Note 4 to the Consolidated Financial Statements on page 11 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		36



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

	March 31, 2007 (unaudited)	December 31, 2006 (*)	March 31, 2006 (unaudited)
<b>ASSETS</b>			
Cash and due from banks	\$ 12,232,258	\$ 12,030,969	\$ 14,780,214
Interest bearing deposits with other banks	105,752	270,589	1,658,080
Federal funds sold	1,412,000	517,000	607,000
Securities available for sale	258,172,895	247,874,120	233,804,893
Loans, net	930,768,989	916,045,185	824,359,382
Property held for sale	42,000	41,000	268,287
Premises and equipment, net	22,178,553	22,445,635	22,782,107
Accrued interest receivable	6,656,344	6,351,575	4,845,037
Intangible assets	3,158,732	3,196,520	3,309,885
Other assets	17,027,641	16,343,431	16,699,264
Assets related to discontinued operations	2,169,610	9,714,749	14,577,381
<b>Total assets</b>	<b>\$ 1,253,924,774</b>	<b>\$ 1,234,830,773</b>	<b>\$ 1,137,691,530</b>

**LIABILITIES AND SHAREHOLDERS'  
EQUITY**

<b>Liabilities</b>			
<b>Deposits</b>			
Non interest bearing	\$ 60,644,647	\$ 62,591,493	\$ 62,860,714
Interest bearing	816,580,699	826,096,142	667,876,124
<b>Total deposits</b>	<b>877,225,346</b>	<b>888,687,635</b>	<b>730,736,838</b>
Short-term borrowings	79,886,486	60,427,675	136,482,684
Long-term borrowings	182,225,213	174,292,074	163,547,368
Subordinated debentures owed to unconsolidated subsidiary trusts	19,589,000	19,589,000	19,589,000
Other liabilities	10,959,819	9,849,834	10,763,518
Liabilities related to discontinued operations	1,104,319	2,109,320	755,962
<b>Total liabilities</b>	<b>1,170,990,183</b>	<b>1,154,955,538</b>	<b>1,061,875,370</b>

**Commitments and Contingencies**

**Shareholders' Equity**

Common stock and related surplus, \$2.50  
par value;

authorized 20,000,000 shares, issued and  
outstanding

2007 - 7,084,980 shares; issued December

2006 - 7,084,980

18,028,656	18,020,591	18,905,744
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shares; issued March 2006 - 7,134,920			
shares			
Retained earnings	64,807,164	62,206,325	59,186,406
Accumulated other comprehensive income	98,771	(351,681)	(2,275,990)
<b>Total shareholders' equity</b>	<b>82,934,591</b>	<b>79,875,235</b>	<b>75,816,160</b>
<b>Total liabilities and shareholders' equity</b>	<b>\$ 1,253,924,774</b>	<b>\$ 1,234,830,773</b>	<b>\$ 1,137,691,530</b>

(\*) - December 31, 2006 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)**

	<b>Three Months Ended</b>	
	<b>March 31, 2007</b>	<b>March 31, 2006</b>
<b>Interest income</b>		
Interest and fees on loans		
Taxable	\$ 18,597,172	\$ 15,140,378
Tax-exempt	115,189	99,745
Interest and dividends on securities		
Taxable	2,579,027	2,134,877
Tax-exempt	544,882	511,765
Interest on interest bearing deposits with other banks	2,692	16,457
Interest on Federal funds sold	3,185	7,768
<b>Total interest income</b>	<b>21,842,147</b>	<b>17,910,990</b>
<b>Interest expense</b>		
Interest on deposits	9,028,100	5,153,192
Interest on short-term borrowings	958,063	1,963,989
Interest on long-term borrowings and subordinated debentures	2,831,973	2,414,469
<b>Total interest expense</b>	<b>12,818,136</b>	<b>9,531,650</b>
<b>Net interest income</b>	<b>9,024,011</b>	<b>8,379,340</b>
Provision for loan losses	390,000	325,000
<b>Net interest income after provision for loan losses</b>	<b>8,634,011</b>	<b>8,054,340</b>
<b>Other income</b>		
Insurance commissions	206,083	230,066
Service fees	616,914	630,890
Gain (loss) on sale of assets	1,828	(3,875)
Other	187,623	146,279
<b>Total other income</b>	<b>1,012,448</b>	<b>1,003,360</b>
<b>Other expense</b>		
Salaries and employee benefits	3,225,616	3,055,157
Net occupancy expense	418,298	401,119
Equipment expense	446,111	449,568
Supplies	172,118	165,879
Professional fees	174,334	207,534
Postage	67,224	55,700
Advertising	24,551	48,886
Amortization of intangibles	37,788	37,788
Other	1,083,306	939,498
<b>Total other expense</b>	<b>5,649,346</b>	<b>5,361,129</b>
<b>Income before income taxes</b>	<b>3,997,113</b>	<b>3,696,571</b>
Income tax expense	1,201,050	1,107,850
<b>Income from continuing operations</b>	<b>\$ 2,796,063</b>	<b>\$ 2,588,721</b>
<b>Discontinued Operations</b>		
Reversal of severance in exit costs	80,011	-
Operating income(loss)	(371,736)	608,878



<b>Income from discontinued operations before income tax expense(benefit)</b>	(291,725)	608,878
Income tax expense(benefit)	(96,500)	226,000
<b>Income from discontinued operations</b>	(195,225)	382,878
<b>Net Income</b>	\$ 2,600,838	\$ 2,971,599
<b>Basic earnings from continuing operations per common share</b>		
	\$ 0.40	\$ 0.36
<b>Basic earnings per common share</b>	\$ 0.37	\$ 0.42
<b>Diluted earnings from continuing operations per common share</b>		
	\$ 0.39	\$ 0.36
<b>Diluted earnings per common share</b>	\$ 0.36	\$ 0.41

See Notes to Consolidated Financial Statements

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

	<b>Common Stock and Related Surplus</b>	<b>Retained Earnings</b>	<b>Accumulated Other Compre- hensive Income</b>	<b>Total Share- holders' Equity</b>
<b>Balance, December 31, 2006</b>	\$ 18,020,591	\$ 62,206,325	\$ (351,681)	\$ 79,875,235
<b>Three Months Ended March 31, 2007</b>				
Comprehensive income:				
Net income	-	2,600,838	-	2,600,838
Other comprehensive income, net of deferred tax expense of \$276,083:				
Net unrealized gain on securities of \$450,452, net of reclassification adjustment for gains included in net income of \$0	-	-	450,452	450,452
Total comprehensive income				3,051,290
Exercise of stock options	8,065	-	-	8,065
<b>Balance, March 31, 2007</b>	\$ 18,028,656	\$ 64,807,163	\$ 98,771	\$ 82,934,590
<b>Balance, December 31, 2005</b>	\$ 18,856,774	\$ 56,214,807	\$ (1,268,356)	\$ 73,803,225
<b>Three Months Ended March 31, 2006</b>				
Comprehensive income:				
Net income	-	2,971,599	-	2,971,599
Other comprehensive income, net of deferred tax benefit of (\$617,582):				
Net unrealized (loss) on securities of (\$1,007,634)	-	-	(1,007,634)	(1,007,634)
Total comprehensive income				1,963,965
Exercise of stock options	48,970	-	-	48,970
<b>Balance, March 31, 2006</b>	\$ 18,905,744	\$ 59,186,406	\$ (2,275,990)	\$ 75,816,160

See Notes to Consolidated Financial Statements

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

	<b>Three Months Ended</b>	
	<b>March 31,</b>	<b>March 31,</b>
	<b>2007</b>	<b>2006</b>
<b>Cash Flows from Operating Activities</b>		
Net income	\$ 2,600,838	\$ 2,971,599
Adjustments to reconcile net earnings to net cash provided by operating activities:		
Depreciation	385,779	411,139
Provision for loan losses	640,000	395,000
Stock compensation expense	8,065	6,617
Deferred income tax (benefit)	28,200	(127,450)
Loans originated for sale	(8,149,409)	(73,051,790)
Proceeds from loans sold	15,674,280	80,031,236
(Gain) on sales of loans held for sale	(286,302)	(2,737,342)
Securities (gains)	-	-
Reversal of exit costs accrual of discontinued operations	(80,192)	
Loss on disposal of other assets	(1,828)	3,875
Amortization of securities premiums, net	(14,781)	66,874
Amortization of goodwill and purchase accounting adjustments, net	40,671	40,670
(Decrease) in accrued interest receivable	(304,957)	(21,454)
(Increase) in other assets	(818,316)	(281,102)
Increase in other liabilities	526,873	1,695,198
<b>Net cash provided by (used in) operating activities</b>	<b>10,248,921</b>	<b>9,403,070</b>
<b>Cash Flows from Investing Activities</b>		
Net (increase) decrease in interest bearing deposits with other banks	164,837	(121,574)
Proceeds from maturities and calls of securities available for sale	4,484,392	955,937
Proceeds from sales of securities available for sale	1,623,800	2,905,400
Principal payments received on securities available for sale	6,817,338	5,585,097
Purchases of securities available for sale	(22,498,098)	(21,145,507)
Net (increase) decrease in Federal funds sold	(895,000)	3,043,000
Net loans made to customers	(15,361,000)	(31,652,753)
Purchases of premises and equipment	(122,839)	(798,637)
Proceeds from sales of other assets	85,675	16,695
Purchase of life insurance contracts	-	(440,000)
	(25,700,895)	(41,652,342)

<b>Net cash provided by (used in) investing activities</b>			
<b>Cash Flows from Financing Activities</b>			
Net increase in demand deposit, NOW and savings accounts	5,238,895		8,955,789
Net increase(decrease) in time deposits	(16,754,207)		47,937,426
Net increase(decrease) in short-term borrowings	19,458,811		(45,545,429)
Proceeds from long-term borrowings	10,000,000		15,000,000
Repayment of long-term borrowings	(2,290,236)		(1,896,415)
Exercise of stock options	-		42,354
<b>Net cash provided by financing activities</b>	<b>15,653,263</b>		<b>24,493,725</b>
Increase (decrease) in cash and due from banks	201,289		(7,755,547)
<b>Cash and due from banks:</b>			
Beginning	12,030,969		22,535,761
Ending	\$ 12,232,258	\$	14,780,214

(Continued)

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 three months ended March 31, 2007 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 2006 audited financial statements and Annual Report on Form 10-K. Certain accounts in the consolidated financial statements for December 31, 2006 and March 31, 2006, as previously presented, have been reclassified to conform to current year classifications.

**Note 2. Significant New Accounting Pronouncements**

In July 2006, the FASB issued FASB Interpretation No. 48, "Accounting for Uncertainty in Income Taxes--an interpretation of FASB Statement No. 109" (FIN 48), which clarifies the accounting and disclosure for uncertain tax positions, as defined. FIN 48 requires that a tax position meet a "probable recognition threshold" for the benefit of the uncertain tax position to be recognized in the financial statements. A tax position that fails to meet the probable recognition threshold will result in either reduction of a current or deferred tax asset or receivable, or recording a current or deferred tax liability. FIN 48 also provides guidance on measurement, derecognition of tax benefits, classification, interim period accounting disclosure, and transition requirements in accounting for uncertain tax positions. This interpretation is effective for fiscal years beginning after December 15, 2006. The Company will be required to apply the provisions of FIN 48 to all tax positions upon initial adoption with any cumulative effect adjustment to be recognized as an adjustment to retained earnings. We adopted the provisions of this statement January 1, 2007, which has not had a material effect on our financial statements.

**Note 3. 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.

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

	<b>March 31,</b>	<b>December</b>	<b>March 31,</b>
	<b>2007</b>	<b>31,</b>	<b>2006</b>
		<b>2006</b>	
<b>Assets:</b>			
Loans held for sale, net	\$ <b>1,189,966</b>	\$ 8,428,535	\$ 12,342,886
Loans, net	<b>133,838</b>	179,642	662,208
Premises and equipment, net	-	-	694,803
Property held for sale	-	75,000	75,000
Other assets	<b>845,806</b>	1,031,572	802,483
Total assets	<b>\$ 2,169,610</b>	\$ 9,714,749	\$ 14,577,380
<b>Liabilities:</b>			
Accrued expenses and other liabilities	<b>\$ 1,104,319</b>	\$ 2,109,320	\$ 755,962
Total liabilities	<b>\$ 1,104,319</b>	\$ 2,109,320	\$ 755,962

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 periods ended March 31, 2007 and 2006 is presented below.

**Statements of Income from Discontinued Operations**

	<b>For the Quarter Ended March</b>	
	<b>31,</b>	
	<b>2007</b>	<b>2006</b>
Interest income	\$ <b>112,721</b>	\$ 562,351
Interest expense	<b>45,411</b>	310,548
Net interest income	<b>67,310</b>	251,803
Provision for loan losses	<b>250,000</b>	70,000
Net interest income after provision for loan losses	<b>(182,690)</b>	181,803
<b>Noninterest income</b>		
Mortgage origination revenue	<b>803,056</b>	6,583,913
(Loss) on sale of assets	<b>(50,814)</b>	-
Total noninterest income	<b>752,242</b>	6,583,913
<b>Noninterest expense</b>		
Salaries and employee benefits	<b>442,368</b>	2,102,875

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Net occupancy expense	<b>(3,880)</b>	169,608
Equipment expense	<b>21,892</b>	70,291
Professional fees	<b>97,422</b>	77,507
Postage	<b>33</b>	1,735,774
Advertising	<b>97,674</b>	1,290,429
Impairment of long-lived assets	-	-
Exit costs	<b>(80,011)</b>	-
Other	<b>285,780</b>	710,354
Total noninterest expense	<b>861,278</b>	6,156,838
Income (loss) before income tax expense	<b>(291,726)</b>	608,878
Income tax expense (benefit)	<b>(96,500)</b>	226,000
Income (loss) from discontinued operations	<b>\$ (195,226)</b>	<b>\$ 382,878</b>

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:



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

	<b>Operating Lease Terminations</b>	<b>Vendor Contract Termination</b>	<b>Severance Payments</b>	<b>Total</b>
Balance, December 31, 2006	\$ 734,000	\$ 740,000	\$ 385,000	\$ 1,859,000
Less:				
Payments from the accrual	(184,863)	-	(287,889)	(472,752)
Reversal of over accrual	-	-	(80,011)	(80,011)
<b>Balance, March 31, 2007</b>	<b>\$ 549,137</b>	<b>\$ 740,000</b>	<b>\$ 17,100</b>	<b>\$ 1,306,237</b>

**Note 4. Earnings per Share**

The computations of basic and diluted earnings per share follow:

	<b>For the Three Months Ended March 31,</b>	
	<b>2007</b>	<b>2006</b>
Numerator for both basic and diluted earnings per share:		
Income from continuing operations	\$ 2,796,063	\$ 2,588,721
Income (loss) from discontinued operations	(195,225)	382,878
Net Income	\$ 2,600,838	\$ 2,971,599
Denominator		
Denominator for basic earnings per share - weighted average common shares outstanding	7,084,980	7,128,076
Effect of dilutive securities:		
Stock options	62,190	60,987
	<b>62,190</b>	<b>60,987</b>
Denominator for diluted earnings per share - weighted average common shares outstanding and assumed conversions	7,147,170	7,189,063
Basic earnings per share from continuing operations	\$ 0.40	\$ 0.36
Basic earnings per share from discontinued operations	(0.03)	0.06
Basic earnings per share	\$ 0.37	\$ 0.42
Diluted earnings per share from continuing operations	\$ 0.39	\$ 0.36
Diluted earnings per share from discontinued operations	(0.03)	0.05

Diluted earnings per share	\$	<b>0.36</b>	\$	<b>0.41</b>
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**Note 5. Securities**

The amortized cost, unrealized gains, unrealized losses and estimated fair values of securities at March 31, 2007, December 31, 2006, and March 31, 2006 are summarized as follows:

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

	Amortized Cost	March 31, 2007		Estimated Fair Value
		Unrealized Gains	Losses	
<b>Available for Sale</b>				
<b>Taxable:</b>				
U. S. Government agencies and corporations	\$ 36,774,275	\$ 7,704	\$ 263,509	\$ 36,518,470
Mortgage-backed securities	153,538,946	649,600	1,876,262	152,312,284
State and political subdivisions	3,758,987	25,684	-	3,784,671
Corporate debt securities	1,679,740	17,968	1,551	1,696,157
Federal Reserve Bank stock	729,000	-	-	729,000
Federal Home Loan Bank stock	13,735,100	-	-	13,735,100
Other equity securities	150,410	-	-	150,410
<b>Total taxable</b>	<b>210,366,458</b>	<b>700,956</b>	<b>2,141,322</b>	<b>208,926,092</b>
<b>Tax-exempt:</b>				
State and political subdivisions	41,685,349	1,046,096	60,783	42,670,662
Other equity securities	5,973,746	614,134	11,739	6,576,141
<b>Total tax-exempt</b>	<b>47,659,095</b>	<b>1,660,230</b>	<b>72,522</b>	<b>49,246,803</b>
<b>Total</b>	<b>\$ 258,025,553</b>	<b>\$ 2,361,186</b>	<b>\$ 2,213,844</b>	<b>\$ 258,172,895</b>

	Amortized Cost	December 31, 2006		Estimated Fair Value
		Unrealized Gains	Losses	
<b>Available for Sale</b>				
<b>Taxable:</b>				
U. S. Government agencies and corporations	\$ 37,671,345	\$ 2,727	\$ 333,799	\$ 37,340,273
Mortgage-backed securities	146,108,268	470,268	2,262,050	144,316,486
State and political subdivisions	3,758,978	25,225	-	3,784,203
Corporate debt securities	1,682,275	18,908	2,274	1,698,909
Federal Reserve Bank stock	669,000	-	-	669,000
Federal Home Loan Bank stock	12,093,900	-	-	12,093,900
Other equity securities	150,410	-	-	150,410
<b>Total taxable</b>	<b>202,134,176</b>	<b>517,128</b>	<b>2,598,123</b>	<b>200,053,181</b>
<b>Tax-exempt:</b>				
State and political subdivisions	40,329,315	1,026,437	67,709	41,288,043
Other equity securities	5,974,719	572,752	14,575	6,532,896
<b>Total tax-exempt</b>	<b>46,304,034</b>	<b>1,599,189</b>	<b>82,284</b>	<b>47,820,939</b>
<b>Total</b>	<b>\$ 248,438,210</b>	<b>\$ 2,116,317</b>	<b>\$ 2,680,407</b>	<b>\$ 247,874,120</b>



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

	Amortized Cost	March 31, 2006 Unrealized		Estimated Fair Value
		Gains	Losses	
<b>Available for Sale</b>				
<b>Taxable:</b>				
U. S. Government agencies and corporations	\$ 42,089,023	\$ 13,026	\$ 671,421	\$ 41,430,628
Mortgage-backed securities	127,013,475	87,964	4,000,383	123,101,056
State and political subdivisions	3,889,504	-	15,969	3,873,535
Corporate debt securities	3,290,502	24,114	3,893	3,310,723
Federal Reserve Bank stock	639,000	-	-	639,000
Federal Home Loan Bank stock	16,384,900	-	-	16,384,900
Other equity securities	150,410	-	-	150,410
<b>Total taxable</b>	<b>193,456,814</b>	<b>125,104</b>	<b>4,691,666</b>	<b>188,890,252</b>
<b>Tax-exempt:</b>				
State and political subdivisions	37,981,230	832,995	127,911	38,686,314
Other equity securities	5,977,638	269,909	19,220	6,228,327
<b>Total tax-exempt</b>	<b>43,958,868</b>	<b>1,102,904</b>	<b>147,131</b>	<b>44,914,641</b>
<b>Total</b>	<b>\$ 237,415,682</b>	<b>\$ 1,228,008</b>	<b>\$ 4,838,797</b>	<b>\$ 233,804,893</b>

The maturities, amortized cost and estimated fair values of securities at March 31, 2007, are summarized as follows:

	Available for Sale	
	Amortized Cost	Estimated Fair Value
Due in one year or less	\$ 57,430,744	\$ 56,497,112
Due from one to five years	106,222,649	105,669,469
Due from five to ten years	38,674,141	38,946,187
Due after ten years	35,109,763	35,869,476
Equity securities	20,588,256	21,190,651
	<b>\$ 258,025,553</b>	<b>\$ 258,172,895</b>



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

**Note 6. Loans**

Loans are summarized as follows:

	<b>March 31, 2007</b>	December 31, 2006	March 31, 2006
Commercial	\$ 69,700,489	\$ 69,469,550	\$ 66,563,444
Commercial real estate	329,561,244	314,198,436	275,896,117
Construction and development	220,429,701	215,820,164	165,026,192
Residential real estate	279,563,537	282,512,334	281,300,798
Consumer	33,845,269	36,455,257	37,356,618
Other	7,208,600	6,968,465	6,381,884
Total loans	940,308,840	925,424,206	832,525,053
Less unearned income	1,757,328	1,867,613	1,730,728
Total loans net of unearned income	938,551,512	923,556,593	830,794,325
Less allowance for loan losses	7,782,523	7,511,408	6,434,943
<b>Loans, net</b>	<b>\$ 930,768,989</b>	<b>\$ 916,045,185</b>	<b>\$ 824,359,382</b>

**Note 7. Allowance for Loan Losses**

An analysis of the allowance for loan losses for the three month periods ended March 31, 2007 and 2006, and for the year ended December 31, 2006 is as follows:

	<b>Three Months Ended</b>		<b>Year Ended</b>
	<b>March 31,</b>		<b>December</b>
	<b>2007</b>	<b>2006</b>	<b>31, 2006</b>
<b>Balance, beginning of period</b>	\$ 7,511,408	\$ 6,111,713	\$ 6,111,713
<b>Losses:</b>			
Commercial	50,000	-	31,744
Commercial real estate	40,000	-	185,436
Real estate - mortgage	-	-	35,011
Consumer	49,416	72,724	199,505
Other	67,028	47,410	289,159
<b>Total</b>	206,444	120,134	740,855
<b>Recoveries:</b>			
Commercial	20,737	1,025	1,269
Commercial real estate	4,400	19,447	45,918
Real estate - mortgage	123	82	6,518
Consumer	14,240	15,970	62,535

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Other	48,059	81,840	179,310
<b>Total</b>	<b>87,559</b>	<b>118,364</b>	<b>295,550</b>
Net losses	118,885	1,770	445,305
Provision for loan losses	390,000	325,000	1,845,000
<b>Balance, end of period</b>	<b>\$ 7,782,523</b>	<b>\$ 6,434,943</b>	<b>\$ 7,511,408</b>



Summit Financial Group, Inc. and Subsidiaries**Notes to Consolidated Financial Statements (unaudited)****Note 8. Goodwill and Other Intangible Assets**

The following tables present our goodwill at March 31, 2007 and other intangible assets at March 31, 2007, December 31, 2006, and March 31, 2006.

	<b>Goodwill Activity</b>
Balance, January 1, 2007	\$ 2,088,030
Acquired goodwill, net	-
Balance, March 31, 2007	\$ 2,088,030

	<b>Unidentifiable Intangible Assets</b>		
	<b>December</b>		
	<b>March 31, 2007</b>	<b>31, 2006</b>	<b>March 31, 2006</b>
Unidentifiable intangible assets			
Gross carrying amount	\$ 2,267,323	\$ 2,267,323	\$ 2,267,323
Less: accumulated amortization	1,196,621	1,158,833	1,045,468
Net carrying amount	\$ 1,070,702	\$ 1,108,490	\$ 1,221,855

We recorded amortization expense of approximately \$38,000 for the three months ended March 31, 2007 relative to our unidentifiable intangible assets. Annual amortization is expected to be approximately \$151,000 for each of the years ending 2007 through 2011.

**Note 9. Deposits**

The following is a summary of interest bearing deposits by type as of March 31, 2007 and 2006 and December 31, 2006:

	<b>March 31, 2007</b>	<b>December 31, 2006</b>	<b>March 31, 2006</b>
Interest bearing demand deposits	\$ 230,634,293	\$ 220,166,660	\$ 214,571,646
Savings deposits	44,712,689	47,983,961	39,474,064
Retail time deposits	287,439,479	278,321,917	243,645,391
Brokered time deposits	253,794,238	279,623,604	170,185,023
Total	\$ 816,580,699	\$ 826,096,142	\$ 667,876,124

Brokered deposits represent certificates of deposit acquired through a third party. The following is a summary of the maturity distribution of certificates of deposit in denominations of \$100,000 or more as of March 31, 2007:

	<b>Amount</b>	<b>Percent</b>
Three months or less	\$ 67,885,301	23.3%
Three through six months	58,151,193	20.0%
Six through twelve months	53,407,632	18.4%
Over twelve months	111,555,130	38.3%
Total	\$ 290,999,256	100.0%

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

A summary of the scheduled maturities for all time deposits as of March 31, 2007 is as follows:

Nine month period ending	
December 31, 2007	\$ 375,116,669
Year Ending December 31, 2008	97,064,945
Year Ending December 31, 2009	42,130,644
Year Ending December 31, 2010	23,265,877
Year Ending December 31, 2011	2,118,020
Thereafter	1,537,562
	\$ 541,233,717

**Note 10. Borrowed Funds**

**Short-term borrowings:** A summary of short-term borrowings is presented below:

	<b>Quarter Ended March 31, 2007</b>		
	<b>Short-term FHLB Advances</b>	<b>Repurchase Agreements</b>	<b>Federal Funds Purchased and Lines of Credit</b>
Balance at March 31	\$ 71,132,900	\$ 7,358,186	\$ 1,395,400
Average balance outstanding for the period	64,449,678	6,507,188	1,458,241
Maximum balance outstanding at any month end during period	71,132,900	7,358,185	1,625,900
Weighted average interest rate for the period	5.36%	4.09%	7.51%
Weighted average interest rate for balances outstanding at March 31	5.35%	4.13%	7.75%

	<b>Year Ended December 31, 2006</b>		
	<b>Short-term FHLB Advances</b>	<b>Repurchase Agreements</b>	<b>Federal Funds Purchased and Lines of Credit</b>
Balance at December 31	\$ 54,765,000	\$ 4,730,575	\$ 932,100

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Average balance outstanding for the period	123,952,970	5,792,863	1,025,717
Maximum balance outstanding at any month end during period	175,407,800	7,036,562	1,171,200
Weighted average interest rate for the period	5.08%	4.03%	7.49%
Weighted average interest rate for balances outstanding at December 31	5.39%	4.08%	7.75%

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

	<b>Quarter Ended March 31, 2006</b>		
	<b>Short-term FHLB Advances</b>	<b>Repurchase Agreements</b>	<b>Federal Funds Purchased and Lines of Credit</b>
Balance at March 31	\$ 128,538,400	\$ 7,036,562	\$ 907,722
Average balance outstanding for the period	165,480,730	6,594,377	305,069
Maximum balance outstanding at any month end during period	175,407,800	7,036,562	907,722
Weighted average interest rate for the period	4.56%	3.72%	6.40%
Weighted average interest rate for balances outstanding at March 31	4.79%	4.00%	7.25%

**Long-term borrowings:** Our long-term borrowings of \$182,225,213, \$174,292,074 and \$163,547,368 at March 31, 2007, December 31, 2006, and March 31, 2006 respectively, consisted primarily of advances from the Federal Home Loan Bank (“FHLB”).

These borrowings bear both fixed and variable rates and mature in varying amounts through the year 2016.

The average interest rate paid on long-term borrowings for the three month period ended March 31, 2007 was 5.54% compared to 5.03% for the first three months of 2006.

**Subordinated Debentures:** We have three statutory business trusts that were formed for the purpose of issuing mandatorily redeemable securities (the “capital securities”) for which we are obligated to third party investors and investing the proceeds from the sale of the capital securities in our junior subordinated debentures (the “debentures”). The debentures held by the trusts are their sole assets. Our subordinated debentures totaled \$19,589,000 at March 31, 2007, December 31, 2006, and March 31, 2006.

In October 2002, we sponsored SFG Capital Trust I, in March 2004, we sponsored SFG Capital Trust II, and in December 2005, we sponsored SFG Capital Trust III, of which 100% of the common equity of each trust is owned by us. SFG Capital Trust I issued \$3,500,000 in capital securities and \$109,000 in common securities and invested the proceeds in \$3,609,000 of debentures. SFG Capital Trust II issued \$7,500,000 in capital securities and \$232,000 in common securities and invested the proceeds in \$7,732,000 of debentures. SFG Capital Trust III issued \$8,000,000 in capital securities and \$248,000 in common securities and invested the proceeds in \$8,248,000 of debentures. Distributions on the capital securities issued by the trusts are payable quarterly at a variable interest rate equal to 3 month LIBOR plus 345 basis points for SFG Capital Trust I, 3 month LIBOR plus 280 basis points for SFG Capital

Trust II, and 3 month LIBOR plus 145 basis points for SFG Capital Trust III, and equals the interest rate earned on the debentures held by the trusts, and is recorded as interest expense by us. The capital securities are subject to mandatory redemption in whole or in part, upon repayment of the debentures. We have entered into agreements which, taken collectively, fully and unconditionally guarantee the capital securities subject to the terms of the guarantee. The debentures of SFG Capital Trust I, SFG Capital Trust II, and SFG Capital Trust III are first redeemable by us in November 2007, March 2009, and March 2011, respectively.

The capital securities held by SFG Capital Trust I, SFG Capital Trust II, and SFG Capital Trust III qualify as Tier 1 capital under Federal Reserve Board guidelines. In accordance with these Guidelines, trust preferred securities generally are limited to 25% of Tier 1 capital elements, net of goodwill. The amount of trust preferred securities and certain other elements in excess of the limit can be included in Tier 2 capital.

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

A summary of the maturities of all long-term borrowings and subordinated debentures for the next five years and thereafter is as follows:

<b>Year Ending December 31,</b>	<b>Amount</b>
2007	\$ 21,029,707
2008	52,376,851
2009	28,911,094
2010	52,939,159
2011	2,465,409
Thereafter	44,091,993
	\$ 201,814,213

**Note 11. Stock Option Plan**

On January 1, 2006, we adopted SFAS No. 123R, *Share-Based Payment (Revised 2004)*, which is a revision of SFAS No. 123, *Accounting for Stock Issued for Employees*. SFAS No. 123R establishes accounting requirements for share-based compensation to employees and carries forward prior guidance on accounting for awards to non-employees. Prior to the adoption of SFAS No. 123R, we reported employee compensation expense under stock option plans only if options were granted below market prices at grant date in accordance with the intrinsic value method of Accounting Principles Board Opinion (“APB”) No. 25, *Accounting for Stock Issued to Employees*, and related interpretations. In accordance with APB No. 25, we reported no compensation expense on options granted as the exercise price of the options granted always equaled the market price of the underlying stock on the date of grant. SFAS No. 123R eliminates the ability to account for stock-based compensation using APB No. 25 and requires that such transactions be recognized as compensation cost in the income statement based on their fair values on the measurement date, which is generally the date of the grant.

We transitioned to SFAS No. 123R using the modified prospective application method (“modified prospective application”). As permitted under modified prospective application, SFAS No. 123R applies to new awards and to awards modified, repurchased, or cancelled after January 1, 2006. Additionally, compensation cost for non-vested awards that were outstanding as of January 1, 2006 will be recognized as the remaining requisite service is rendered during the period of and/or the periods after the adoption of SFAS No. 123R, adjusted for estimated forfeitures. The recognition of compensation cost for those earlier awards is based on the same method and on the same grant-date fair values previously determined for the pro forma disclosures reported by us for periods prior to January 1, 2006.

The Officer Stock Option Plan, which provides for the granting of stock options for up to 960,000 shares of common stock to our key officers, was adopted in 1998 and expires in 2008. Each option granted under the plan vests according to a schedule designated at the grant date and shall have a term of no more than 10 years following the vesting date. Also, the option price per share shall not be less than the fair market value of our common stock on the date of grant.

The fair value of our employee stock options granted is estimated at the date of grant using the Black-Scholes option-pricing model. This model requires the input of highly subjective assumptions, changes to which can materially

affect the fair value estimate. Additionally, there may be other factors that would otherwise have a significant effect on the value of employee stock options granted but are not considered by the model. Because our employee stock options have characteristics significantly different from those of traded options and because changes in the subjective input assumptions can materially affect the fair value estimate, in management's opinion, the existing models do not necessarily provide a reliable single measure of the fair value of its employee stock options at the time of grant. There were no option grants during the first three months of 2007 or 2006.



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

During first quarter 2007, we recognized \$8,000 of compensation expense for share-based payment arrangements in our income statement, with a deferred tax asset of \$3,000, compared to \$6,600 compensation expense for first quarter 2006 with a deferred tax asset of \$2,250. At March 31, 2007, we had approximately \$36,000 total compensation cost related to nonvested awards not yet recognized and we expect to recognize it over the next two years.

A summary of activity in our Officer Stock Option Plan during the first quarters of 2007 and 2006 is as follows:

	March 31, 2007		March 31, 2006	
	Options	Weighted-Average Exercise Price	Options	Weighted-Average Exercise Price
<b>Outstanding, January 1</b>	349,080	\$ 17.83	361,740	\$ 17.41
Granted	-	-	-	-
Exercised	-	-	(8,700)	4.87
Forfeited	-	-	-	-
<b>Outstanding, March 31</b>	349,080	\$ 17.83	353,040	\$ 17.72

Other information regarding options outstanding and exercisable at March 31, 2007 is as follows:

Range of exercise price	# of shares	Options Outstanding			Options Exercisable		
		Wted. Avg. Remaining Contractual Life	Wted. Avg. Intrinsic Value (in thousands)	# of shares	Wted. Avg. Intrinsic Value (in thousands)		
\$4.63 - \$6.00	83,600	\$ 5.34	5.60	1297	83,600	\$ 5.34	1,297
6.01 - 10.00	31,680	9.49	8.76	360	24,480	9.49	278
10.01 - 17.50	3,500	17.43	6.92	12	3,500	17.43	12
17.51 - 20.00	51,800	17.79	9.72	159	31,000	17.79	95
20.01 - 25.93	178,500	25.19	8.32	-	178,500	25.19	-
	349,080	17.83		1,828	321,080	18.02	1,682

**Note 12. Commitments and Contingencies**

*Off-Balance Sheet Arrangements*

We are a party to certain financial instruments with off-balance-sheet risk in the normal course of business to meet the financing needs of our customers. These instruments involve, to varying degrees, elements of credit and interest rate risk in excess of the amount recognized in the statement of financial position. The contract amounts of these instruments reflect the extent of involvement that we have in this class of financial instruments.

Many of our lending relationships contain both funded and unfunded elements. The funded portion is reflected on our balance sheet. The unfunded portion of these commitments is not recorded on our balance sheet until a draw is made under the loan facility. Since many of the commitments to extend credit may expire without being drawn upon, the total commitment amounts do not necessarily represent future cash flow requirements.

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

A summary of the total unfunded, or off-balance sheet, credit extension commitments follows:

<b>March 31, 2007</b>	
<b>Commitments to extend credit:</b>	
Revolving home equity and credit card lines	<b>\$ 34,023,333</b>
Construction loans	<b>88,947,000</b>
Other loans	<b>32,560,000</b>
<b>Standby letters of credit</b>	<b>13,928,392</b>
<b>Total</b>	<b>\$ 169,458,725</b>

Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. We evaluate each customer's credit worthiness on a case-by-case basis. The amount of collateral obtained, if we deem necessary upon extension of credit, is based on our credit evaluation. Collateral held varies but may include accounts receivable, inventory, equipment or real estate.

Standby letters of credit are conditional commitments issued to guarantee the performance of a customer to a third party. Standby letters of credit generally are contingent upon the failure of the customer to perform according to the terms of the underlying contract with the third party.

Our exposure to credit loss in the event of nonperformance by the other party to the financial instrument for commitments to extend credit is represented by the contractual amount of those instruments. We use the same credit policies in making commitments and conditional obligations as we do for on-balance sheet instruments.

**Note 13. Restrictions on Capital**

We and our subsidiaries are subject to various regulatory capital requirements administered by the banking regulatory agencies. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, we and each of our subsidiaries must meet specific capital guidelines that involve quantitative measures of our and our subsidiaries' assets, liabilities and certain off-balance sheet items as calculated under regulatory accounting practices. We and each of our subsidiaries' capital amounts and classifications are also subject to qualitative judgments by the regulators about components, risk weightings and other factors.

Quantitative measures established by regulation to ensure capital adequacy require us and each of our subsidiaries to maintain minimum amounts and ratios of total and Tier I capital (as defined in the regulations) to risk-weighted assets (as defined), and of Tier I capital (as defined) to average assets (as defined). We believe, as of March 31, 2007, that we and each of our subsidiaries met all capital adequacy requirements to which they were subject.

The most recent notifications from the banking regulatory agencies categorized us and each of our subsidiaries as well capitalized under the regulatory framework for prompt corrective action. To be categorized as well capitalized, we and each of our subsidiaries must maintain minimum total risk-based, Tier I risk-based, and Tier I leverage ratios as set

forth in the table below.

Our actual capital amounts and ratios as well as our subsidiaries', Summit Community Bank's ("Summit Community"), and Shenandoah Valley National Bank's ("Shenandoah") are presented in the following table.

20

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Summit Financial Group, Inc. and Subsidiaries**Notes to Consolidated Financial Statements (unaudited)****(Dollars in thousands)**

	<b>Actual</b>		<b>Minimum Required Regulatory Capital</b>		<b>To be Well Capitalized under Prompt Corrective Action Provisions</b>	
	<b>Amount</b>	<b>Ratio</b>	<b>Amount</b>	<b>Ratio</b>	<b>Amount</b>	<b>Ratio</b>
<b>As of March 31, 2007</b>						
Total Capital (to risk weighted assets)						
Summit	\$ 107,421	11.0%	\$ 78,105	8.0%	\$ 97,631	10.0%
Summit Community	63,062	10.9%	46,107	8.0%	57,634	10.0%
Shenandoah	42,518	10.9%	31,335	8.0%	39,168	10.0%
Tier I Capital (to risk weighted assets)						
Summit	98,676	10.1%	39,052	4.0%	58,579	6.0%
Summit Community	58,381	10.1%	23,053	4.0%	34,580	6.0%
Shenandoah	38,454	9.8%	15,667	4.0%	23,501	6.0%
Tier I Capital (to average assets)						
Summit	98,676	8.0%	37,101	3.0%	61,835	5.0%
Summit Community	58,381	7.7%	22,745	3.0%	37,908	5.0%
Shenandoah	38,454	8.0%	14,345	3.0%	23,909	5.0%
<b>As of December 31, 2006</b>						
Total Capital (to risk weighted assets)						
Summit	\$ 104,231	10.8%	76,991	8.0%	96,239	10.0%
Summit Community	60,813	10.6%	46,032	8.0%	57,540	10.0%
Shenandoah	41,243	10.9%	30,355	8.0%	37,944	10.0%
Tier I Capital (to risk weighted assets)						
Summit	96,028	10.0%	38,495	4.0%	57,743	6.0%
Summit Community	56,170	9.8%	23,016	4.0%	34,524	6.0%
Shenandoah	37,683	9.9%	15,178	4.0%	22,766	6.0%
Tier I Capital (to average assets)						
Summit	96,028	7.9%	36,492	3.0%	60,820	5.0%
Summit Community	56,170	7.5%	22,383	3.0%	37,305	5.0%
Shenandoah	37,683	8.0%	14,097	3.0%	23,495	5.0%

**Note 14. Subsequent Events**

As announced on April 12, 2007, we entered into an Agreement and Plan of Reorganization (the "Agreement") with Greater Atlantic Financial Corporation, Inc. ("Greater Atlantic"), headquartered in Reston, Virginia.

Under the terms of the Agreement, we will pay \$4.60 per share in cash and stock for the outstanding common stock of Great Atlantic, subject to adjustment based on Greater Atlantic's shareholders' equity at the end of the month in which the sale of the Pasadena branch office is completed. If, at that month-end, Greater Atlantic's shareholders' equity, as adjusted in accordance with the terms of the Agreement, is less than \$6.7 million, then the total aggregate value of the transaction consideration will be decreased dollar-for-dollar. If Greater Atlantic's month end adjusted shareholders' equity exceeds \$6.7 million, then the aggregate value of the transaction consideration will be increased dollar-for-dollar, but only to the extent that the amount in excess of \$6.7 million is attributable to the sale of the Pasadena branch office, net of all taxes, if any, Greater Atlantic would be required to pay. Greater Atlantic has entered into a definitive agreement with another financial institution to sell its Pasadena, Maryland branch office for a deposit premium of 8.5%, prior to the close to of its transaction with Summit. At March 31, 2007, the deposits at the Pasadena branch office approximated \$50.9 million, resulting in a present deposit premium of \$4.3 million. The aggregate value of the final transaction consideration will be determined before proxy solicitation materials are sent to Greater Atlantic's shareholders for purposes of soliciting their vote on the transaction.

Summit Financial Group, Inc. and Subsidiaries

**Notes to Consolidated Financial Statements (unaudited)**

The final transaction consideration will be paid 70% in the form of Summit common stock and 30% in cash. The exchange ratio for determining the number of shares of Summit common stock to be issued for each share of Greater Atlantic's common stock will be based on the average closing price of Summit's common stock for the twenty trading days before the closing date of the transaction ("Summit's Average Closing Stock Price"), subject to a "collar". The collar ranges from \$17.82 per share to \$24.10 per share. If Summit's Average Closing Stock Price falls within this range, then Greater Atlantic shareholders will receive shares of Summit's common stock based on an exchange ratio equal to 70% of the final per share transaction consideration divided by Summit's Average Closing Stock Price. However, if Summit's Average Closing Stock Price is less than \$17.82 per share, the exchange ratio will equal 70% of the final per share transaction consideration divided by \$17.82; and if Summit's Average Closing Stock Price is more than \$24.10 per share, then the exchange ratio will equal 70% of the final per share transaction consideration divided by \$24.10.

Consummation of the Merger is subject to approval of the shareholders of Greater Atlantic and the receipt of all required regulatory approvals, as well as other customary conditions. This acquisition is expected to close during fourth quarter of this year.

Also, as previously announced on April 27, 2007, we entered into an Agreement and Plan of Reorganization (the "Agreement") with Kelly Insurance Agency, Inc. and Kelly Property and Casualty Inc. (collectively, the "Kelly Agencies") headquartered in Leesburg, Virginia.

Under the terms of the Agreement, we will pay \$6.2 million for the outstanding common stock of the Kelly Agencies, subject to adjustment based on the Kelly Agencies' working capital as of the closing date. If, at closing, the Kelly Agencies' working capital, determined in accordance with the terms of the Agreement, is less than \$135,000, then the deal's aggregate consideration will be decreased dollar-for-dollar. If the Kelly Agencies' working capital at closing exceeds \$135,000, then the deal's aggregate consideration will be increased dollar-for-dollar.

The final transaction consideration will be paid 100% in the form of Summit common stock. The exchange ratio for determining the number of shares of Summit common stock to be issued for each share of Kelly Agencies' common stock will be based on the average closing price of Summit's common stock for the five trading days before the closing date of the transaction ("Summit's Average Closing Stock Price"). The Kelly Insurance Agencies' shareholders will receive shares of Summit's common stock based on an exchange ratio equal to the final per share transaction consideration divided by Summit's Average Closing Stock Price.

Consummation of the Agreement is subject to approval of the shareholders of the Kelly Agencies and the receipt of all required regulatory approvals, as well as other customary conditions. This acquisition is expected to close during third quarter of this year.

Summit Financial Group, Inc. and Subsidiaries

**Management's Discussion and Analysis of Financial Condition and Results of Operations**

**INTRODUCTION**

The following discussion and analysis focuses on significant changes in our financial condition and results of operations of Summit Financial Group, Inc. ("Company" or "Summit") and our operating units, Summit Community Bank ("Summit Community"), Shenandoah Valley National Bank ("Shenandoah"), and Summit Insurance Services, LLC for the periods indicated. This discussion and analysis should be read in conjunction with our 2006 audited financial statements and Annual Report on Form 10-K.

The Private Securities Litigation Act of 1995 indicates that the disclosure of forward-looking information is desirable for investors and encourages such disclosure by providing a safe harbor for forward-looking statements by us. Our following discussion and analysis of financial condition and results of operations contains certain forward-looking statements that involve risk and uncertainty. In order to comply with the terms of the safe harbor, we note that a variety of factors could cause our actual results and experience to differ materially from the anticipated results or other expectations expressed in those forward-looking statements.

**OVERVIEW**

Our primary source of income is net interest income from loans and deposits. Business volumes tend to be influenced by the overall economic factors including market interest rates, business spending, and consumer confidence, as well as competitive conditions within the marketplace.

Growth in our interest earning assets resulted in an increase of 5.37%, or \$480,000, in our net interest earnings on a tax equivalent basis for the first three months in 2007 compared to the same period of 2006.

**CRITICAL ACCOUNTING POLICIES**

Our consolidated financial statements are prepared in accordance with accounting principles generally accepted in the United States of America and follow general practices within the financial services industry. Application of these principles requires us to make estimates, assumptions, and judgments that affect the amounts reported in our financial statements and accompanying notes. These estimates, assumptions, and judgments are based on information available as of the date of the financial statements; accordingly, as this information changes, the financial statements could reflect different estimates, assumptions, and judgments. Certain policies inherently have a greater reliance on the use of estimates, assumptions, and judgments and as such have a greater possibility of producing results that could be materially different than originally reported.

Our most significant accounting policies are presented in Note 1 to the consolidated financial statements of our 2006 Annual Report on Form 10-K. These policies, along with the disclosures presented in the other financial statement notes and in this financial review, provide information on how significant assets and liabilities are valued in the financial statements and how those values are determined.

Based on the valuation techniques used and the sensitivity of financial statement amounts to the methods, assumptions, and estimates underlying those amounts, we have identified the determination of the allowance for loan losses and the valuation of goodwill to be the accounting areas that require the most subjective or complex judgments, and as such could be most subject to revision as new information becomes available.



The allowance for loan losses represents our estimate of probable credit losses inherent in the loan portfolio. Determining the amount of the allowance for loan losses is considered a critical accounting estimate because it requires significant judgment and the use of estimates related to the amount and timing of expected future cash flows on impaired loans, estimated losses on pools of homogeneous loans based on historical loss experience, and consideration of current economic trends and conditions, all of which may be susceptible to significant change. The loan portfolio also represents the largest asset type on our consolidated balance sheet. To the extent actual outcomes differ from our estimates, additional provisions for loan losses may be required that would negatively impact earnings in future periods. Note 1 to the consolidated financial statements of our 2006 Annual Report on Form 10-K describes the methodology used to determine the allowance for loan losses and a discussion of the factors driving changes in the amount of the allowance for loan losses is included in the Asset Quality section of the financial review of the 2006 Annual Report on Form 10-K.

Summit Financial Group, Inc. and Subsidiaries

**Management's Discussion and Analysis of Financial Condition and Results of Operations**

Goodwill is subject to impairment testing at least annually to determine whether write-downs of the recorded balances are necessary. A fair value is determined based on at least one of three various market valuation methodologies. If the fair value equals or exceeds the book value, no write-down of recorded goodwill is necessary. If the fair value is less than the book value, an expense may be required on our books to write down the goodwill to the proper carrying value. During the third quarter, we will complete the required annual impairment test for 2007. We cannot assure you that future goodwill impairment tests will not result in a charge to earnings. See Notes 1 and 9 of the consolidated financial statements of our Annual Report on Form 10-K for further discussion of our intangible assets, which include goodwill.

Summit Financial Group, Inc. and Subsidiaries

**Management's Discussion and Analysis of Financial Condition and Results of Operations**

**RESULTS OF OPERATIONS**

**Earnings Summary**

Income from continuing operations for the quarter ended March 31, 2007 grew 8.00% to \$2,796,000, or \$0.39 per diluted share as compared to \$2,589,000, or \$0.36 per diluted share for the quarter ended March 31, 2006.

Consolidated net income, which includes the results of discontinued operations, for the periods ended March 31, 2007 and 2006 was \$2,601,000 and 2,972,000, respectively. Returns on average equity and assets for the first three months of 2007 were 12.72% and 0.83%, respectively, compared with 15.60% and 1.05% for the same period of 2006.

**Net Interest Income**

Net interest income is the principal component of our earnings and represents the difference between interest and fee income generated from earning assets and the interest expense paid on deposits and borrowed funds. Fluctuations in interest rates as well as changes in the volume and mix of earning assets and interest bearing liabilities can materially impact net interest income.

Our consolidated net interest income on a fully tax-equivalent basis totaled \$9,416,000 for the three month period ended March 31, 2007 compared to \$8,936,000 for the same period of 2006, representing an increase of \$480,000 or 5.37%. This increase resulted from growth in interest earning assets, primarily loans, which served to more than offset the 80 basis points increase in the cost of interest bearing liabilities during the same period. Average interest earning assets grew 11.52% from \$1,070,582,000 during the first three months of 2006 to \$1,193,946,000 for the first three months of 2007. Average interest bearing liabilities grew 11.81% from \$977,829,000 at March 31, 2006 to \$1,093,276,000 at March 31, 2007, at an average yield for the first three months of 2007 of 4.75% compared to 3.95% for the same period of 2006.

Our consolidated net interest margin decreased to 3.20% for the three month period ended March 31, 2007, compared to 3.39% for the same period in 2006. Our net interest margin decreased 5 basis points compared to the linked quarter. Our margin continues to be affected by our loan growth in an extremely competitive environment. The current competitive pressures are causing loan rates to be lower. Also, our loan growth is at a faster pace than we have been able to grow lower cost retail funds, causing us to rely more on higher cost, non-retail deposit funding vehicles. The current competitive and market conditions are also causing deposit rates to be higher. For the three months ended March 31, 2007 compared to March 31, 2006, the yields on earning assets increased 55 basis points, while the cost of our interest bearing funds increased by 80 basis points.

We anticipate modest growth in our net interest income to continue over the near term as the growth in the volume of interest earning assets will more than offset the expected continued decline in our net interest margin. However, if market interest rates remain significantly unchanged, or go lower over the next 12 to 18 months, the spread between interest earning assets and interest bearing liabilities could narrow such that its impact could not be offset by growth in earning assets. See the "Market Risk Management" section for further discussion of the impact changes in market interest rates could have on us. Further analysis of our yields on interest earning assets and interest bearing liabilities are presented in Tables I and II below.

Summit Financial Group, Inc. and Subsidiaries**Management's Discussion and Analysis of Financial Condition and Results of Operations****Table I - Average Balance Sheet and Net Interest Income Analysis**  
(Dollars in thousands)

	For the Three Months Ended					
	March 31, 2007			March 31, 2006		
	Average Balance	Earnings/ Expense	Yield/ Rate	Average Balance	Earnings/ Expense	Yield/ Rate
<b>Interest earning assets</b>						
Loans, net of unearned income						
Taxable	\$ 928,979	\$ 18,665	8.15%	\$ 829,381	\$ 15,392	7.53%
Tax-exempt (1)	8,917	173	7.87%	8,244	150	7.38%
Securities						
Taxable	208,315	2,577	5.02%	186,586	2,135	4.64%
Tax-exempt (1)	47,289	814	6.98%	44,077	767	7.06%
Federal funds sold and interest bearing deposits with other banks	446	5	4.55%	2,294	24	4.24%
<b>Total interest earning assets</b>	<b>1,193,946</b>	<b>22,234</b>	<b>7.55%</b>	<b>1,070,582</b>	<b>18,468</b>	<b>7.00%</b>
<b>Noninterest earning assets</b>						
Cash & due from banks	13,099			14,449		
Premises and equipment	22,332			23,361		
Other assets	26,993			24,659		
Allowance for loan losses	(8,135)			(6,338)		
<b>Total assets</b>	<b>\$ 1,248,235</b>			<b>\$ 1,126,713</b>		
<b>Interest bearing liabilities</b>						
Interest bearing demand deposits	\$ 221,924	\$ 2,066	3.78%	\$ 204,161	\$ 1,543	3.07%
Savings deposits	46,407	217	1.90%	43,067	73	0.69%
Time deposits	556,525	6,745	4.92%	374,170	3,537	3.83%
Short-term borrowings	72,415	958	5.37%	172,380	1,964	4.62%
Long-term borrowings and capital trust securities	196,005	2,832	5.86%	184,051	2,415	5.32%
<b>Total interest bearing liabilities</b>	<b>1,093,276</b>	<b>12,818</b>	<b>4.75%</b>	<b>977,829</b>	<b>9,532</b>	<b>3.95%</b>

<b>Noninterest bearing liabilities and shareholders' equity</b>			
Demand deposits	61,288		63,308
Other liabilities	11,881		9,395
Shareholders' equity	81,790		76,181
<b>Total liabilities and shareholders' equity</b>	<b>\$ 1,248,235</b>		<b>\$ 1,126,713</b>
<b>Net interest earnings</b>		<b>\$ 9,416</b>	<b>\$ 8,936</b>
<b>Net yield on interest earning assets</b>		<b>3.20%</b>	<b>3.39%</b>

(1) - Interest income on tax-exempt securities has been adjusted assuming an effective tax rate of 34% for all periods presented.

The tax equivalent adjustment resulted in an increase in interest income of \$319,000 and \$305,000 for the periods ended

March 31, 2007 and March 31, 2006, respectively.

Summit Financial Group, Inc. and Subsidiaries**Management's Discussion and Analysis of Financial Condition and Results of Operations****Table II - Changes in Interest Margin Attributable to Rate and Volume**

(Dollars in thousands)

	<b>For the Quarter Ended March 31, 2007 versus March 31, 2006</b>		
	<b>Increase (Decrease) Due to Change in:</b>		
	<b>Volume</b>	<b>Rate</b>	<b>Net</b>
<b>Interest earned on:</b>			
Loans			
Taxable	\$ 1,938	\$ 1,335	\$ 3,273
Tax-exempt	12	11	23
Securities			
Taxable	261	181	442
Tax-exempt	55	(8)	47
Federal funds sold and interest bearing deposits with other banks			
	(20)	1	(19)
Total interest earned on interest earning assets	2,246	1,520	3,766
<b>Interest paid on:</b>			
Interest bearing demand deposits			
	142	381	523
Savings deposits	6	138	144
Time deposits	2,032	1,176	3,208
Short-term borrowings	(1,283)	277	(1,006)
Long-term borrowings and capital trust securities			
	163	254	417
Total interest paid on interest bearing liabilities	1,060	2,226	3,286
<b>Net interest income</b>	<b>\$ 1,186</b>	<b>\$ (706)</b>	<b>\$ 480</b>

**Noninterest Income**

Total noninterest income from continuing operations increased to \$1,012,000 for the first quarter of 2007, compared to \$1,003,000 for the same period of 2006. Other income increased \$41,000 for the first quarter 2007 due to increases in financial services revenue and debit card income due to increased customer activity. Further detail regarding

noninterest income is reflected in the following table.

27

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Summit Financial Group, Inc. and Subsidiaries**Management's Discussion and Analysis of Financial Condition and Results of Operations****Noninterest Income**

<i>Dollars in thousands</i>	<b>For the Quarter Ended March 31,</b>	
	<b>2007</b>	<b>2006</b>
Insurance commissions	\$ 206	\$ 230
Service fees	617	631
(Loss) on sale of assets	2	(4)
Other	187	146
<b>Total</b>	<b>\$ 1,012</b>	<b>\$ 1,003</b>

**Noninterest Expense**

Total noninterest expense for continuing operations increased approximately \$288,000, or 5.4% to \$5,649,000 during the first three months of 2007 as compared to the same period in 2006. Salaries and employee benefits expense represented the largest category of expense growth. Table III below shows the breakdown of these increases.

**Table III -  
Noninterest  
Expense**  
*Dollars in thousands*

	<b>For the Quarter Ended March 31,</b>			
	<b>2007</b>	<b>Change</b>		<b>2006</b>
		<b>\$</b>	<b>%</b>	
Salaries and employee benefits	\$ 3,226	\$ 171	5.6%	\$ 3,055
Net occupancy expense	418	17	4.2%	401
Equipment expense	446	(4)	-0.9%	450
Supplies	172	6	3.6%	166
Professional fees	174	(33)	-15.9%	207
Amortization of intangibles	38	-	0.0%	38
Other	1,175	131	12.5%	1,044
<b>Total</b>	<b>\$ 5,649</b>	<b>\$ 288</b>	<b>5.4%</b>	<b>\$ 5,361</b>

*Salaries and employee benefits:* The 5.6% growth in salaries and employee benefits was primarily due to general merit raises.

*Other:* Other expenses increased 12.5% for first quarter 2007 compared to first quarter 2006. This increase includes \$30,000 of merger expenses related to the upcoming merger of our two subsidiary banks, an increase of \$60,000 in



FDIC insurance premiums, and an increase of \$30,000 in ATM expense.

### **Credit Experience**

The provision for loan losses represents charges to earnings necessary to maintain an adequate allowance for potential future loan losses. Our determination of the appropriate level of the allowance is based on an ongoing analysis of credit quality and loss potential in the loan portfolio, change in the composition and risk characteristics of the loan portfolio, and the anticipated influence of national and local economic conditions. The adequacy of the allowance for loan losses is reviewed quarterly and adjustments are made as considered necessary.

We recorded a \$390,000 provision for loan losses for the first three months of 2007, compared to \$325,000 for the same period in 2006. Net loan charge offs for the first three months of 2007 were \$119,000, as compared to \$2,000 over the same period of 2006. At March 31, 2007, the allowance for loan losses totaled \$7,783,000 or 0.83% of loans, net of unearned income, compared to \$7,511,000 or 0.81% of loans, net of unearned income at December 31, 2006.

Summit Financial Group, Inc. and Subsidiaries**Management's Discussion and Analysis of Financial Condition and Results of Operations**

Overall, our asset quality remains sound. As illustrated in Table IV below, our non-performing assets and loans past due 90 days or more and still accruing interest have increased during the past 12 months, but have shown a slight decrease between December 31, 2006 and March 31, 2007, and still remain at a historically moderate level.

**Table IV - Summary of Past Due Loans and Non-Performing Assets**  
(Dollars in thousands)

	<b>March 31,</b>		<b>December</b>
	<b>2007</b>	<b>2006</b>	<b>31,</b>
			<b>2006</b>
Accruing loans past due 90 days or more	\$ 4,233	\$ 1,046	\$ 4,638
Nonperforming assets:			
Nonaccrual loans	241	401	638
Foreclosed properties	42	268	77
Repossessed assets	1	3	-
Total	\$ 4,517	\$ 1,718	\$ 5,353
Total nonperforming loans as a			
percentage of total loans	0.48%	0.17%	0.57%
Total nonperforming assets as a			
percentage of total assets	0.36%	0.15%	0.43%

However, we have experienced an upward trend in our internally classified assets. This trend has primarily been in residential real estate development loans due to the recent slowdown in the sales of newly constructed homes. The ratio of internally classified loans to total loans increased from 4.13% at December 31, 2006 to 6.45% at March 31, 2007. This increase is primarily due to two customer relationships. Management downgraded these two relationships, as they fell outside of our internal lending policy guidelines but does not expect any material future losses related to these two relationships. Refer to the Asset Quality section of the financial review of the 2006 Annual Report on Form 10-K for further discussion of the processes related to internally classified loans

**FINANCIAL CONDITION**

Our total assets were \$1,253,925,000 at March 31, 2007, compared to \$1,234,831,000 at December 31, 2006, representing a 1.5% increase. Table V below serves to illustrate significant changes in our financial position between December 31, 2006 and March 31, 2007.

Summit Financial Group, Inc. and Subsidiaries**Management's Discussion and Analysis of Financial Condition and Results of Operations****Table V - Summary of Significant Changes in Financial Position  
(Dollars in thousands)**

	<b>Balance December 31, 2006</b>	<b>Increase (Decrease) Amount      Percentage</b>		<b>Balance March 31, 2007</b>
<b>Assets</b>				
Securities available for sale	\$ 247,874	10,299	4.2%	\$ 258,173
Loans, net of unearned income	916,045	14,724	1.6%	930,769
<b>Liabilities</b>				
Deposits	\$ 888,688	\$ (11,463)	-1.3%	\$ 877,225
Short-term borrowings	60,428	19,458	32.2%	79,886
Long-term borrowings and subordinated debentures	193,881	7,933	4.1%	201,814

Loan growth during the first three months of 2007, occurring principally in the commercial and real estate portfolios, was funded both by borrowings from the FHLB and deposits, including brokered certificates of deposit.

Deposits decreased approximately \$11 million during the first quarter of 2007. This decrease was primarily in brokered deposits, which were replaced with FHLB short-term borrowings, which is reflected in their \$19 million increase.

Refer to Notes 6, 7, 9, and 10 of the notes to the accompanying consolidated financial statements for additional information with regard to changes in the composition of our securities, loans, deposits and borrowings between March 31, 2007 and December 31, 2006.

**LIQUIDITY**

Liquidity reflects our ability to ensure the availability of adequate funds to meet loan commitments and deposit withdrawals, as well as provide for other transactional requirements. Liquidity is provided primarily by funds invested in cash and due from banks, Federal funds sold, non-pledged securities, and available lines of credit with the FHLB, the total of which approximated \$215 million, or 17.2% of total assets at March 31, 2007 versus \$275 million, or 22.3% of total assets at December 31, 2006.

Our liquidity position is monitored continuously to ensure that day-to-day as well as anticipated funding needs are met. We are not aware of any trends, commitments, events or uncertainties that have resulted in or are reasonably likely to result in a material change to our liquidity.



Summit Financial Group, Inc. and Subsidiaries**Management's Discussion and Analysis of Financial Condition and Results of Operations****CAPITAL RESOURCES**

One of our continuous goals is maintenance of a strong capital position. Through management of our capital resources, we seek to provide an attractive financial return to our shareholders while retaining sufficient capital to support future growth. Shareholders' equity at March 31, 2007 totaled \$82,935,000 compared to \$79,875,000 at December 31, 2006.

Refer to Note 11 of the notes to the accompanying consolidated financial statements for information regarding regulatory restrictions on our capital as well as our subsidiaries' capital.

**CONTRACTUAL CASH OBLIGATIONS**

During our normal course of business, we incur contractual cash obligations. The following table summarizes our contractual cash obligations at March 31, 2007.

	<b>Long Term Debt</b>	<b>Capital Trust Securities</b>	<b>Operating Leases</b>
2007	\$ 21,029,707	\$ -	\$ 836,447
2008	52,376,851	-	997,070
2009	28,911,094	-	431,349
2010	52,939,159	-	123,389
2011	2,465,409	-	88,620
Thereafter	24,502,993	19,589,000	199,395
<b>Total</b>	<b>\$ 182,225,213</b>	<b>\$ 19,589,000</b>	<b>\$ 2,676,270</b>

**OFF-BALANCE SHEET ARRANGEMENTS**

We are involved with some off-balance sheet arrangements that have or are reasonably likely to have an effect on our financial condition, liquidity, or capital. These arrangements at March 31, 2007 are presented in the following table.

	<b>March 31, 2007</b>
<b>Commitments to extend credit:</b>	
Revolving home equity and credit card lines	\$ 34,023,333
Construction loans	88,947,000
Other loans	32,560,000
<b>Standby letters of credit</b>	13,928,392
<b>Total</b>	<b>\$ 169,458,725</b>



Summit Financial Group, Inc. and Subsidiaries**Management's Discussion and Analysis of Financial Condition and Results of Operations****MARKET RISK MANAGEMENT**

Market risk is the risk of loss arising from adverse changes in the fair value of financial instruments due to changes in interest rates, exchange rates and equity prices. Interest rate risk is our primary market risk and results from timing differences in the repricing of assets, liabilities and off-balance sheet instruments, changes in relationships between rate indices and the potential exercise of imbedded options. The principal objective of asset/liability management is to minimize interest rate risk and our actions in this regard are taken under the guidance of our Asset/Liability Management Committee ("ALCO"), which is comprised of members of senior management and members of the Board of Directors. The ALCO actively formulates the economic assumptions that we use in our financial planning and budgeting process and establishes policies which control and monitor our sources, uses and prices of funds.

Some amount of interest rate risk is inherent and appropriate to the banking business. Our net income is affected by changes in the absolute level of interest rates. Our interest rate risk position is liability sensitive. That is, absent any changes in the volumes of our interest earning assets or interest bearing liabilities, liabilities are likely to reprice faster than assets, resulting in a decrease in net income in a rising rate environment. Net income would increase in a falling interest rate environment. Net income is also subject to changes in the shape of the yield curve. In general, a flattening yield curve would result in a decline in our earnings due to the compression of earning asset yields and funding rates, while a steepening would result in increased earnings as margins widen.

Several techniques are available to monitor and control the level of interest rate risk. We primarily use earnings simulations modeling to monitor interest rate risk. The earnings simulation model forecasts the effects on net interest income under a variety of interest rate scenarios that incorporate changes in the absolute level of interest rates and changes in the shape of the yield curve. Each increase or decrease in interest rates is assumed to gradually take place over the next 12 months, and then remain stable. Assumptions used to project yields and rates for new loans and deposits are derived from historical analysis. Securities portfolio maturities and prepayments are reinvested in like instruments. Mortgage loan prepayment assumptions are developed from industry estimates of prepayment speeds. Noncontractual deposit repricings are modeled on historical patterns.

The following table shows our projected earnings sensitivity as of March 31, 2007 which is well within our ALCO policy limit of +/- 10%:

<b>Change in Interest Rates</b>	<b>Estimated % Change in Net</b>	
	<b>Interest Income Over:</b>	
<b>(basis points)</b>	<b>0 - 12 Months</b>	<b>13 - 24 Months</b>
Down 200 (1)	1.60%	4.70%
Down 200, steepening yield curve (2)	2.59%	9.23%
Up 100 (1)	-0.80%	-0.82%
Up 200 (1)	-2.03%	-7.09%

(1) assumes  
a parallel  
shift in the  
yield curve  
(2) assumes  
steepening curve  
whereby short term  
rates decline by  
200 basis points,  
while long term  
rates decline by 50  
basis points



Summit Financial Group, Inc. and Subsidiaries

**Management's Discussion and Analysis of Financial Condition and Results of Operations**

**CONTROLS AND PROCEDURES**

Our management, including the Chief Executive Officer and Chief Financial Officer, has conducted as of March 31, 2007, an evaluation of the effectiveness of disclosure controls and procedures as defined in Exchange Act Rule 13a-15(e). Based on that evaluation, the Chief Executive Officer and Chief Financial Officer concluded that the disclosure controls and procedures as of March 31, 2007 were effective. There were no changes in our internal control over financial reporting that occurred during the quarter ended March 31, 2007 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

Summit Financial Group, Inc. and Subsidiaries

**Management's Discussion and Analysis of Financial Condition and Results of Operations**

**Item 1. Legal Proceedings**

We are involved in various legal actions arising in the ordinary course of business. In the opinion of counsel, the outcome of these matters will not have a significant adverse effect on the consolidated financial statements.

On December 26, 2003, two of our subsidiaries, Summit Financial, LLC and Shenandoah Valley National Bank, and various employees of Summit Financial, LLC were served with a Petition for Temporary Injunction and a Bill of Complaint filed in the Circuit Court of Fairfax County, Virginia by Corinthian Mortgage Corporation. The filings allege various claims against Summit Financial, LLC and Shenandoah Valley National Bank arising out of the hiring of former employees of Corinthian Mortgage Corporation ("Corinthian") and the alleged use of its proprietary information. The individual defendants have also been sued based on allegations arising out of their former employment relationship with Corinthian and their employment with Summit Financial, LLC. In an 8-K filed on November 15, 2006, Summit announced it would close its mortgage operations which at the time operated as Summit Mortgage, a division of Shenandoah Valley National Bank .

The plaintiff seeks damages in the amount proven at trial on each claim and punitive damages in the amount of \$350,000.. Plaintiff also seeks permanent and temporary injunctive relief prohibiting the alleged use of proprietary information by Summit Financial and the alleged solicitation of Corinthian's employees. On January 22, 2004, the Circuit Court of Fairfax County, Virginia denied Corinthian's petition for a temporary injunction

On November 20, 2006, Corinthian filed an Amended Complaint. Among other things, Corinthian sought to add Summit Financial Group, Inc as a defendant in the case and requested damages in the amount of \$20 million dollars. After consultation with legal counsel, we believe that significant and meritorious defenses exist as to all the claims including with respect to plaintiff's claim for damages. We will continue to evaluate the claims in the Corinthian lawsuit and intend to vigorously defend against them. Management, at the present time, is unable to estimate the impact, if any, an adverse decision may have on our results of operations or financial condition. However, an adverse decision resulting in a large damage award could have a significant negative impact on Summit's regulatory capital thereby limiting Summit's near term growth and its ability to pay dividends to its shareholders.

We are involved in various legal actions arising in the ordinary course of business. In the opinion of counsel, the outcome of these matters will not have a significant adverse effect on the consolidated financial statements.

On January 4, 2006, Mary Forrest, an individual, filed suit in the United States District Court for the Eastern District of Wisconsin, Milwaukee Division, against our subsidiary, Shenandoah Valley National Bank ("Shenandoah"). Further, on May 19, 2006, Marti L. Klutho, an individual, filed suit in the United States District Court for the Eastern District of Missouri, Eastern Division, also against Shenandoah. The plaintiffs in each case claim that Shenandoah violated the Federal Fair Credit Reporting Act ("FCRA") alleging that Shenandoah used information contained in their consumer reports, without extending a "firm offer of credit" within the meaning of the FCRA. Plaintiffs request statutory damages.

In the Forrest case, responsive pleadings have been filed, written discovery has been exchanged by the parties, and plaintiff's deposition has been taken. Plaintiff moved for to certify the case as a class action. Her motion was denied on the ground that plaintiff is not an adequate class representative. Plaintiff thereafter requested permission to appeal to the United States Court of Appeals for the Seventh Circuit, and her request was denied. Although the denial does not dispose of the certification issue with finality, this is currently a single plaintiff case. This case and certain other similar cases pending in the Eastern District of Wisconsin have been stayed awaiting a ruling from the United States Supreme Court on the issue of what constitutes a "willful" violation under the FCRA. The prosecution and defense of

these cases will resume when the Supreme Court case is decided. The Company intends to vigorously defend this case. However, because the Company's investigation and discovery are not complete and the Supreme Court case has not been decided, management is unable to estimate the impact, in any, of an adverse decision.

Summit Financial Group, Inc. and Subsidiaries

**Management's Discussion and Analysis of Financial Condition and Results of Operations**

In the Klutho case, responsive pleadings have been filed. No discovery has been undertaken. Plaintiff has not moved for class certification. The Company moved for judgment on the pleadings, claiming that plaintiff has no legally viable claim. The Company's motion has been taken under advisement and awaits ruling. The Company intends to vigorously defend this case. However, because the Company's motion has not yet been decided and investigation and discovery, if necessary, are not complete, management is unable to estimate the impact, if any, of an adverse decision.

**Item 1A. Risk Factors**

In addition to the other information set forth in this report, you should carefully consider the factors discussed in Part I, "Item 1A. Risk Factors" in our Annual Report on Form 10-K for the year ended December 31, 2006, which could materially affect our business, financial condition or future results. The risks described in our Annual Report on Form 10-K are not the only risks facing our Company. Additional risks and uncertainties not currently known to us or that we currently deem to be immaterial also may materially adversely affect our business, financial condition and/or operating results.

**SIGNATURES**

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

**SUMMIT FINANCIAL GROUP, INC.**  
(registrant)

By: /s/ H. Charles Maddy, III  
H. Charles Maddy, III,  
President and Chief Executive Officer

By: /s/ Robert S. Tissue  
Robert S. Tissue,  
Senior Vice President and Chief Financial Officer

By: /s/ Julie R. Cook  
Julie R. Cook,  
Vice President and Chief Accounting Officer

Date: May 9, 2007

