

SUMMIT FINANCIAL GROUP INC  
Form 10-Q  
May 01, 2013

---

---

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, 2013.

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      (IRS Employer  
of  
incorporation or                  Identification No.)  
organization)

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

(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 has submitted electronically and posted on its corporate Web site, if

Edgar Filing: SUMMIT FINANCIAL GROUP INC - Form 10-Q

any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes  No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See definition of “large accelerated filer”, “accelerated filer” and “smaller reporting company” in Rule 12b-2 of the Exchange Act.

Large accelerated filer  Accelerated filer   
Non-accelerated filer  Smaller reporting company

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  
7,437,472 shares outstanding as of April 30, 2013

---

Summit Financial Group, Inc. and Subsidiaries  
Table of Contents

	Page
<b>PART I. FINANCIAL INFORMATION</b>	
<b>Item 1.</b>	<b>Financial Statements</b>
	Consolidated balance sheets March 31, 2013 (unaudited), December 31, 2012, and March 31, 2012 (unaudited) 4
	Consolidated statements of income for the three months ended March 31, 2013 and 2012 (unaudited) 5
	Consolidated statements of comprehensive income for the three months ended March 31, 2013 and 2012 (unaudited) 6
	Consolidated statements of shareholders' equity for the three months ended March 31, 2013 and 2012 (unaudited) 7
	Consolidated statements of cash flows for the three months ended March 31, 2013 and 2012 (unaudited) 8-9
	Notes to consolidated financial statements (unaudited) 10-41
<b>Item 2.</b>	<b>Management's Discussion and Analysis of Financial Condition and Results of Operations 42-60</b>
<b>Item 3.</b>	<b>Quantitative and Qualitative Disclosures about Market Risk 59</b>
<b>Item 4.</b>	<b>Controls and Procedures 61</b>

Summit Financial Group, Inc. and Subsidiaries  
Table of Contents

PART II. OTHER INFORMATION		
Item 1.	Legal Proceedings	62
Item 1A.	Risk Factors	62
Item 2.	Unregistered Sales of Equity Securities and Use of Proceeds	None
Item 3.	Defaults upon Senior Securities	None
Item 4.	Mine Safety Disclosures	None
Item 5.	Other Information	None
Item 6.	Exhibits	62
SIGNATURES		63
EXHIBIT INDEX		64

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

Dollars in thousands	March 31, 2013 (unaudited)	December 31, 2012 (*)	March 31, 2012 (unaudited)
<b>ASSETS</b>			
Cash and due from banks	\$ 3,906	\$ 3,833	\$ 4,059
Interest bearing deposits with other banks	7,915	10,969	26,855
Cash and cash equivalents	11,821	14,802	30,914
Securities available for sale	283,054	281,539	292,002
Other investments	12,977	14,658	18,342
Loans held for sale, net	148	226	1,126
Loans, net	945,741	937,168	957,797
Property held for sale	54,625	56,172	61,584
Premises and equipment, net	21,024	21,129	21,756
Accrued interest receivable	5,543	5,621	5,269
Intangible assets	8,211	8,300	8,563
Cash surrender value of life insurance policies	29,791	29,553	29,559
Other assets	17,263	17,936	17,453
<b>Total assets</b>	<b>\$ 1,390,198</b>	<b>\$ 1,387,104</b>	<b>\$ 1,444,365</b>
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>			
<b>Liabilities</b>			
Deposits			
Non interest bearing	\$ 93,125	\$ 100,592	\$ 87,916
Interest bearing	973,192	926,533	923,223
<b>Total deposits</b>	<b>1,066,317</b>	<b>1,027,125</b>	<b>1,011,139</b>
Short-term borrowings	5,960	3,958	15,956
Long-term borrowings	163,588	203,268	267,121
Subordinated debentures	16,800	16,800	16,800
Subordinated debentures owed to unconsolidated subsidiary trusts	19,589	19,589	19,589
Other liabilities	7,928	7,809	9,361
<b>Total liabilities</b>	<b>1,280,182</b>	<b>1,278,549</b>	<b>1,339,966</b>
<b>Commitments and Contingencies</b>			
<b>Shareholders' Equity</b>			
Preferred stock and related surplus - authorized			

Edgar Filing: SUMMIT FINANCIAL GROUP INC - Form 10-Q

250,000 shares; Series 2009, 8% Non-cumulative convertible preferred stock, par value \$1.00; issued 3,710 shares	3,519	3,519	3,519
Series 2011, 8% Non-cumulative convertible preferred stock, par value \$1.00; issued 12,000 shares	5,807	5,807	5,807
Common stock and related surplus - authorized 20,000,000 shares; \$2.50 par value; issued and outstanding 2013 - 7,437,472 and 2012 - 7,425,472 shares	24,582	24,520	24,519
Retained earnings	71,440	69,841	66,408
Accumulated other comprehensive income	4,668	4,868	4,146
Total shareholders' equity	110,016	108,555	104,399
Total liabilities and shareholders' equity	\$ 1,390,198	\$ 1,387,104	\$ 1,444,365

(\*) - December 31, 2012 financial information has been extracted from audited consolidated financial statements

See Notes to Consolidated  
Financial Statements

Edgar Filing: SUMMIT FINANCIAL GROUP INC - Form 10-Q

	Three Months Ended	
	March 31,	March 31,
Dollars in thousands, except per share amounts	2013	2012
Interest income		
Interest and fees on loans		
Taxable	\$ 12,834	\$ 14,280
Tax-exempt	70	86
Interest and dividends on securities		
Taxable	1,030	1,699
Tax-exempt	634	721
Interest on interest bearing deposits with other banks	1	11
Total interest income	14,569	16,797
Interest expense		
Interest on deposits	2,768	3,714
Interest on short-term borrowings	17	6
Interest on long-term borrowings and subordinated debentures	2,026	3,059
Total interest expense	4,811	6,779
Net interest income	9,758	10,018
Provision for loan losses	1,500	2,001
Net interest income after provision for loan losses	8,258	8,017
Other income		
Insurance commissions	1,184	1,158
Service fees related to deposit accounts	1,012	1,014
Realized securities gains	42	1,165
(Loss) on sale of assets	(40 )	(77)
Writedown of foreclosed properties	(929 )	(1,912)
Bank owned life insurance income	238	275
Other	326	309
Total		
other-than-temporary impairment loss on securities	(91 )	(511)
Portion of loss recognized in other comprehensive income	37	282

Edgar Filing: SUMMIT FINANCIAL GROUP INC - Form 10-Q

Net impairment loss recognized in earnings	(54 )	(229)
Total other income	1,779	1,703
Other expense		
Salaries, commissions, and employee benefits	4,117	3,901
Net occupancy expense	456	479
Equipment expense	598	594
Professional fees	251	316
Amortization of intangibles	88	88
FDIC premiums	540	522
Foreclosed properties expense	279	362
Other	1,264	1,277
Total other expense	7,593	7,539
Income before income taxes	2,444	2,181
Income tax expense	651	483
Net Income	1,793	1,698
Dividends on preferred shares	194	194
Net Income applicable to common shares	\$ 1,599	\$ 1,504
Basic earnings per common share	\$ 0.22	\$ 0.20
Diluted earnings per common share	\$ 0.19	\$ 0.18

See Notes to  
Consolidated Financial  
Statements



	For the Three Months Ended	
	March 31,	
Dollars in thousands	2013	2012
Net income	\$ 1,793	\$ 1,698
Other comprehensive income (loss):		
Non-credit related other-than-temporary impairment on		
available for sale debt securities - 2013		
- \$37, net of deferred taxes of \$14; 2012		
- \$282, net of deferred taxes of \$107	(23 )	(175)
Net unrealized gain (loss) on available for sale debt securities of:		
2013 - (\$285) net of deferred taxes of \$108 and reclassification adjustment for net realized gains included in net income of \$42; 2012 - \$811, net of deferred taxes of \$308 and reclassification adjustment for net realized gains included in net income of \$1,165	(177 )	503
Total		
comprehensive income\$	1,593	\$ 2,026

See Notes to Consolidated Financial Statements

6

---

Edgar Filing: SUMMIT FINANCIAL GROUP INC - Form 10-Q

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

Dollars in thousands, except per share amounts	Series 2009 Preferred Stock and Related Surplus	Series 2011 Preferred Stock and Related Surplus	Common Stock and Related Surplus	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total Shareholders' Equity
Balance, December 31, 2012	\$3,519	\$5,807	\$24,520	\$69,841	\$ 4,868	\$108,555
Three Months Ended March 31, 2013						
Comprehensive income:						
Net income	-	-	-	1,793	-	1,793
Other comprehensive income					(200)	(200)
Total comprehensive income						1,593
Exercise of stock options	-	-	61	-	-	61
Stock compensation expense	-	-	1	-	-	1
Series 2009 Preferred Stock cash dividends declared (\$20.00 per share)	-	-	-	(74)	-	(74)
Series 2011 Preferred Stock cash dividends declared (\$10.00 per share)	-	-	-	(120)	-	(120)
Balance, March 31, 2013	\$3,519	\$5,807	\$24,582	\$71,440	\$ 4,668	\$110,016
Balance, December 31, 2011	\$3,519	\$5,807	\$24,518	\$64,904	\$ 3,818	\$102,566
Three Months Ended March 31, 2012						
Comprehensive income:						
Net income	-	-	-	1,698	-	1,698
Other comprehensive income					328	328
Total comprehensive income						2,026
Exercise of stock options	-	-	-	-	-	-
Stock compensation expense	-	-	1	-	-	1
Series 2009 Preferred Stock cash dividends declared (\$20.00 per share)	-	-	-	(74)	-	(74)
Series 2011 Preferred Stock cash dividends declared (\$10.00 per share)	-	-	-	(120)	-	(120)
Balance, March 31, 2012	\$3,519	\$5,807	\$24,519	\$66,408	\$ 4,146	\$104,399

See Notes to Consolidated  
Financial Statements

7

---

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

Dollars in thousands	Three Months Ended	
	March 31, 2013	March 31, 2012
Cash Flows from Operating Activities		
Net income	\$ 1,793	\$ 1,698
Adjustments to reconcile net earnings to net cash		
provided by operating activities:		
Depreciation	298	339
Provision for loan losses	1,500	2,001
Stock compensation expense	1	1
Deferred income tax (benefit)	(160 )	(688)
Loans originated for sale	(1,224 )	(2,884)
Proceeds from loans sold	1,302	1,758
(Gain) on loans sold	-	-
Securities (gains)	(42 )	(1,165)
Other-than-temporary impairment of securities	54	229
Loss on disposal of assets	40	77
Write down of foreclosed properties	929	1,912
Amortization of securities premiums (accretion of discounts), net	1,368	858
Amortization of goodwill and purchase accounting adjustments, net	91	91
Decrease in accrued interest receivable	78	516
(Increase) in cash surrender value of bank owned life insurance	(237 )	(275)
(Increase) decrease in other assets	937	(815)

Edgar Filing: SUMMIT FINANCIAL GROUP INC - Form 10-Q

Increase in other liabilities	119	922
Net cash provided by operating activities	6,847	4,575
<b>Cash Flows from Investing Activities</b>		
Proceeds from (purchase of) interest bearing deposits with other banks	-	-
Proceeds from maturities and calls of securities available for sale	808	803
Proceeds from sales of securities available for sale	11,893	25,632
Principal payments received on securities available for sale	15,712	14,501
Purchases of securities available for sale	(31,623)	(45,733)
Redemption of Federal Home Loan Bank Stock	1,674	805
Net principal payments received on loans	(11,417)	5,051
Purchases of premises and equipment	(192 )	(12)
Proceeds from sales of other repossessed assets & property held for sale	1,981	1,243
Net cash provided by (used in) investing activities	(11,164)	2,290
<b>Cash Flows from Financing Activities</b>		
Net increase in demand deposit, NOW and savings accounts	2,702	16,877
Net increase (decrease) in time deposits	36,490	(22,238)
Net increase in short-term borrowings	2,002	1
Proceeds from long-term borrowings	3,454	-
Repayment of long-term borrowings	(43,179)	(3,133)
Exercise of stock options	61	-
Dividends paid on preferred stock	(194 )	(149)
Net cash provided by (used in) financing	1,336	(8,642)

activities				
(Decrease) in cash and cash equivalents		(2,981 )		(1,777)
Cash and cash equivalents:				
Beginning		14,802		32,691
Ending	\$	11,821	\$	30,914

(Continued)

See Notes to Consolidated Financial Statements

8

---

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

Dollars in thousands	Three Months Ended	
	March 31, 2013	March 31, 2012

Supplemental  
Disclosures of Cash  
Flow Information

Cash payments for:		
Interest	\$ 5,047	\$ 6,944
Income taxes	\$ -	\$ 159

Supplemental Schedule of Noncash  
Investing and Financing Activities

Other assets acquired in settlement of loans	\$ 1,343	\$ 1,087
--	----------	----------

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 quarter ended March 31, 2013 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 2012 audited financial statements and Annual Report on Form 10-K. Certain accounts in the consolidated financial statements for December 31, 2012 and March 31, 2012, as previously presented, have been reclassified to conform to current year classifications.

NOTE 2. SIGNIFICANT NEW AUTHORITATIVE ACCOUNTING GUIDANCE

ASU No. 2013-02, Comprehensive Income (Topic 220) – Reporting Amounts Reclassified Out of Accumulated Other Comprehensive Income amended authoritative guidance related to the reporting of reclassifications out of other comprehensive earnings. The new guidance sets requirements for presentation for significant items reclassified to net earnings during the period presented. The new guidance was effective for annual and interim periods beginning on January 1, 2013 and did not have an effect on our financial statements.

NOTE 3. FAIR VALUE MEASUREMENTS

ASC Topic 820 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. ASC Topic 820 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.

10

---

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

Accordingly, securities available-for-sale 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.

**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 original contractual terms of the loan agreement are considered impaired. Once a loan is identified as individually impaired, management measures impairment in accordance with ASC Topic 310, Accounting by Creditors for Impairment of a Loan. 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 March 31, 2013, substantially all of the total impaired loans were evaluated based on the fair value of the collateral. In accordance with ASC Topic 310, impaired loans where an allowance is established based on the fair value of collateral requires 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 a current appraised value is not available and there is no observable market price, we record the impaired loan as nonrecurring Level 3.

When a collateral-dependent loan is identified as impaired, management immediately begins the process of evaluating the estimated fair value of the underlying collateral to determine if a related specific allowance for loan losses or charge-off is necessary. Current appraisals are ordered once a loan is deemed impaired if the existing appraisal is more than twelve months old, or more frequently if there is known deterioration in value. For recently identified impaired loans, a current appraisal may not be available at the financial statement date. Until the current appraisal is obtained, the original appraised value is discounted, as appropriate, to compensate for the estimated depreciation in the value of the loan's underlying collateral since the date of the original appraisal. Such discounts are generally estimated based upon management's knowledge of sales of similar collateral within the applicable market area and its knowledge of other real estate market-related data as well as general economic trends. When a new appraisal is received (which generally are received within 3 months of a loan being identified as impaired), management then re-evaluates the fair value of the collateral and adjusts any specific allocated allowance for loan losses, as appropriate. In addition, management also assigns a discount of 7–10% for the estimated costs to sell the collateral.

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

Other Real Estate Owned (“OREO”): OREO consists of real estate acquired in foreclosure or other settlement of loans. Such assets are carried on the balance sheet at the lower of the investment in the real estate or its fair value less estimated selling costs. The fair value of OREO is determined on a nonrecurring basis generally utilizing current appraisals performed by an independent, licensed appraiser applying an income or market value approach using observable market data (Level 2). Updated appraisals of OREO are generally obtained if the existing appraisal is more than 18 months old or more frequently if there is a known deterioration in value. However, if a current appraisal is not available, the original appraised value is discounted, as appropriate, to compensate for the estimated depreciation in the value of the real estate since the date of its original appraisal. Such discounts are generally estimated based upon management’s knowledge of sales of similar property within the applicable market area and its knowledge of other real estate market-related data as well as general economic trends (Level 3). Upon foreclosure, any fair value adjustment is charged against the allowance for loan losses. Subsequent fair value adjustments are recorded in the period incurred and included in other noninterest income in the consolidated statements of income.

Assets and Liabilities Recorded at Fair Value on a Recurring Basis

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

Dollars in thousands	Balance at March 31, 2013	Fair Value Measurements Using:		
		Level 1	Level 2	Level 3
Available for sale securities				
U.S. Government sponsored agencies	\$ 31,817	\$ -	\$ 31,817	\$ -
Mortgage backed securities:				
Government sponsored agencies	145,331	-	145,331	-
Nongovernment sponsored agencies	14,091	-	14,091	-
State and political subdivisions	13,918	-	13,918	-
Corporate debt securities	2,977	-	2,977	-
Other equity securities	77	-	77	-
Tax-exempt state and political subdivisions	72,201	-	72,201	-
Tax-exempt mortgage-backed securities	2,642	-	2,642	-
Total available for sale securities	\$ 283,054	\$ -	\$ 283,054	\$ -

Dollars in thousands	Balance at December 31, 2012	Fair Value Measurements Using:		
		Level 1	Level 2	Level 3

## Available for sale securities

U.S. Government sponsored agencies	\$ 29,020	\$ -	\$ 29,020	\$ -
Mortgage backed securities:				
Government sponsored agencies	136,570	-	136,570	-
Nongovernment sponsored agencies	15,745	-	15,745	-
State and political subdivisions	12,169	-	12,169	-
Corporate debt securities	1,950	-	1,950	-
Other equity securities	77	-	77	-
Tax-exempt state and political subdivisions	83,270	-	83,270	-
Tax-exempt mortgage backed securities	2,738	-	2,738	-
Total available for sale securities	\$ 281,539	\$ -	\$ 281,539	\$ -

12

---

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

There were no assets measured at fair value on a recurring basis using significant unobservable inputs (Level 3) for the period ended March 31, 2013.

#### 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.

Dollars in thousands	Total at March 31, 2013	Fair Value Measurements Using:		
		Level 1	Level 2	Level 3
Residential mortgage loans held for sale	\$ 148	\$ -	\$ 148	\$ -
<b>Impaired loans</b>				
Commercial	\$ 10,082	\$ -	\$ 4,900	\$ 5,182
Commercial real estate	22,276	-	15,606	6,670
Construction and development	26,631	-	25,133	1,498
Residential real estate	23,644	-	20,959	2,685
Consumer	48	-	-	48
Total impaired loans	\$ 82,681	\$ -	\$ 66,598	\$ 16,083
<b>OREO</b>				
Commercial	\$ -	\$ -	\$ -	\$ -
Commercial real estate	11,779	-	10,991	788
Construction and development	38,599	-	38,581	18
Residential real estate	4,247	-	4,247	-
Consumer	-	-	-	-
Total OREO	\$ 54,625	\$ -	\$ 53,819	\$ 806

Dollars in thousands	Total at	Fair Value Measurements Using:		
	December 31, 2012	Level 1	Level 2	Level 3
Residential mortgage loans held for sale	\$ 226	\$ -	\$ 226	\$ -
<b>Impaired loans</b>				
Commercial	\$ 10,856	\$ -	\$ 5,013	\$ 5,843
Commercial real estate	25,435	-	16,331	9,104
Construction and development	27,352	-	24,578	2,774
Residential real estate	24,442	-	21,625	2,817
Consumer	50	-	-	50
Total impaired loans	\$ 88,135	\$ -	\$ 67,547	\$ 20,588
<b>OREO</b>				
Commercial	\$ -	\$ -	\$ -	\$ -
Commercial real estate	11,835	-	11,047	788
Construction and development	40,671	-	35,978	4,693
Residential real estate	3,666	-	3,666	-
Consumer	-	-	-	-
Total OREO	\$ 56,172	\$ -	\$ 50,691	\$ 5,481

ASC Topic 825, Financial Instruments, requires disclosure of the fair value of financial assets and financial liabilities, including those financial assets and financial liabilities that are not measured and reported at fair value on a recurring basis or non-recurring basis. The following summarizes the methods and significant assumptions we used in estimating our fair value disclosures for financial instruments.

Cash and cash equivalents: The carrying values of cash and cash equivalents approximate their estimated fair value.

Interest bearing deposits with other banks: The carrying values of interest bearing deposits with other banks approximate their estimated fair values.

Federal funds sold: The carrying values of Federal funds sold approximate their estimated fair values.

Securities: Estimated fair values of securities are based on quoted market prices, where available. If quoted market prices are not available, estimated fair values are based on quoted market prices of comparable securities.

Loans held for sale: The carrying values of loans held for sale approximate their estimated fair values.

Loans: The estimated fair values for loans are computed based on scheduled future cash flows of principal and interest, discounted at interest rates currently offered for loans with similar terms to borrowers of similar credit quality. No prepayments of principal are assumed.

Accrued interest receivable and payable: The carrying values of accrued interest receivable and payable approximate their estimated fair values.



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

Deposits: The estimated fair values of demand deposits (i.e. non-interest bearing checking, NOW, money market and savings accounts) and other variable rate deposits approximate their carrying values. Fair values of fixed maturity deposits are estimated using a discounted cash flow methodology at rates currently offered for deposits with similar remaining maturities. Any intangible value of long-term relationships with depositors is not considered in estimating the fair values disclosed.

Short-term borrowings: The carrying values of short-term borrowings approximate their estimated fair values.

Long-term borrowings: The fair values of long-term borrowings are estimated by discounting scheduled future payments of principal and interest at current rates available on borrowings with similar terms.

Subordinated debentures: The carrying values of subordinated debentures approximate their estimated fair values.

Subordinated debentures owed to unconsolidated subsidiary trusts: The carrying values of subordinated debentures owed to unconsolidated subsidiary trusts approximate their estimated fair values.

Off-balance sheet instruments: The fair values of commitments to extend credit and standby letters of credit are estimated using the fees currently charged to enter into similar agreements, taking into account the remaining terms of the agreements and the present credit standing of the counter parties. The amounts of fees currently charged on commitments and standby letters of credit are deemed insignificant, and therefore, the estimated fair values and carrying values are not shown below.

The carrying values and estimated fair values of our financial instruments are summarized below:

Dollars in thousands	March 31, 2013		December 31, 2012	
	Carrying Value	Estimated Fair Value	Carrying Value	Estimated Fair Value
<b>Financial assets</b>				
Cash and due from banks	\$ 11,821	\$ 11,821	\$ 14,802	\$ 14,802
Interest bearing deposits with other banks	-	-	-	-
Securities available for sale	283,054	283,054	281,539	281,539
Other investments	12,977	12,977	14,658	14,658
Loans held for sale, net	148	148	226	226
Loans, net	945,741	971,638	937,168	965,454
Accrued interest receivable	5,543	5,543	5,621	5,621
	\$ 1,259,284	\$ 1,285,181	\$ 1,254,014	\$ 1,282,300
<b>Financial liabilities</b>				
Deposits	\$ 1,066,317	\$ 1,100,213	\$ 1,027,125	\$ 1,064,957
Short-term borrowings	5,960	5,960	3,958	3,958
	163,588	178,776	203,268	220,175

Long-term borrowings				
Subordinated debentures	16,800	16,800	16,800	16,800
Subordinated debentures owed to unconsolidated subsidiary trusts	19,589	19,589	19,589	19,589
Accrued interest payable	1,641	1,641	1,877	1,877
	\$ 1,273,895	\$ 1,322,979	\$ 1,272,617	\$ 1,327,356

15

---

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

## NOTE 4. EARNINGS PER SHARE

The computations of basic and diluted earnings per share follow:

Dollars in thousands, except per share amounts	For the Three Months Ended March 31,					
	2013			2012		
	Income	Common Shares	Per Share	Income	Common Shares	Per Share
(Numerator)	(Denominator)	(Share)	(Numerator)	(Denominator)	(Share)	
Net income	\$ 1,793			\$ 1,698		
Less preferred stock dividends	(194 )			(194 )		
Basic EPS	\$ 1,599	7,432,254	\$ 0.22	\$ 1,504	7,425,472	\$ 0.20
Effect of dilutive securities:						
Stock options		7,087		-		
Series 2009 convertible preferred stock	74	674,545		74	674,545	
Series 2011 convertible preferred stock	120	1,500,000		120	1,500,000	
Diluted EPS	\$ 1,793	9,613,886	\$ 0.19	\$ 1,698	9,600,017	\$ 0.18

Stock option grants and the conversion of preferred stock are disregarded in this computation if they are determined to be anti-dilutive. Our anti-dilutive stock options at March 31, 2013 and 2012 totaled 170,500 shares and 289,380 shares, respectively.

## NOTE 5. SECURITIES

The amortized cost, unrealized gains, unrealized losses and estimated fair values of securities at March 31, 2013, December 31, 2012, and March 31, 2012 are summarized as follows:

Dollars in thousands Available for Sale	Amortized Cost	March 31, 2013		Estimated Fair Value
		Unrealized Gains	Unrealized Losses	

Edgar Filing: SUMMIT FINANCIAL GROUP INC - Form 10-Q

Taxable debt securities:

U. S. Government agencies and corporations	\$ 30,782	\$ 1,035	\$ -	\$ 31,817
Residential mortgage-backed securities:				
Government-sponsored agencies	142,534	3,444	647	145,331
Nongovernment-sponsored agencies	13,691	483	83	14,091
State and political subdivisions	13,889	122	93	13,918
Corporate debt securities	2,962	33	18	2,977
Total taxable debt securities	203,858	5,117	841	208,134
Tax-exempt debt securities:				
State and political subdivisions	68,945	3,527	271	72,201
Residential mortgage-backed securities:				
Government-sponsored agencies	2,642	-	-	2,642
Total tax-exempt debt securities	71,587	3,527	271	74,843
Equity securities	77	-	-	77
Total available for sale securities	\$ 275,522	\$ 8,644	\$ 1,112	\$ 283,054

Dollars in thousands	December 31, 2012			Estimated Fair Value
	Amortized Cost	Unrealized Gains	Unrealized Losses	
Available for Sale				
Taxable debt securities				
U. S. Government agencies				
and corporations	\$ 28,128	\$ 892	\$ -	\$ 29,020
Residential mortgage-backed securities:				
Government-sponsored				
agencies	133,812	3,250	492	136,570
Nongovernment-sponsored				
entities	15,380	509	144	15,745
State and political				
subdivisions	12,187	71	89	12,169
Corporate debt securities	1,959	29	38	1,950
Total taxable debt securities	191,466	4,751	763	195,454
Tax-exempt debt securities				
State and political				
subdivisions	79,403	4,104	237	83,270
Residential mortgage-backed				
securities	2,738	-	-	2,738
Total tax-exempt debt securities	82,141	4,104	237	86,008
Equity securities	77	-	-	77
Total available for sale securities	\$ 273,684	\$ 8,855	\$ 1,000	\$ 281,539

Dollars in thousands	March 31, 2012			Estimated Fair Value
	Amortized Cost	Unrealized Gains	Unrealized Losses	
Available for Sale				
Taxable debt securities:				
U. S. Government agencies				
and corporations	\$ 9,721	\$ 475	\$ 16	\$ 10,180
Residential mortgage-backed				
securities:				
Government-sponsored				
agencies	161,928	3,435	525	164,838
Nongovernment-sponsored				
agencies	32,028	627	715	31,940
State and political				
subdivisions	5,661	-	37	5,624
Corporate debt securities	1,947	12	97	1,862
Total taxable debt securities	211,285	4,549	1,390	214,444
Tax-exempt debt securities:				

Edgar Filing: SUMMIT FINANCIAL GROUP INC - Form 10-Q

State and political subdivisions	70,913	3,837	306	74,444
Residential mortgage-backed securities:				
Government-sponsored agencies	3,037	-	-	3,037
Total tax-exempt debt securities	73,950	3,837	306	77,481
Equity securities	77	-	-	77
Total available for sale securities	\$ 285,312	\$ 8,386	\$ 1,696	\$ 292,002

The maturities, amortized cost and estimated fair values of securities at March 31, 2013, are summarized as follows:

17

---

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

Dollars in thousands	Available for Sale	
	Amortized Cost	Estimated Fair Value
Due in one year or less	\$ 68,134	\$ 69,092
Due from one to five years	85,865	87,851
Due from five to ten years	15,870	16,339
Due after ten years	105,576	109,695
Equity securities	77	77
	\$ 275,522	\$ 283,054

The proceeds from sales, calls and maturities of available for sale securities, including principal payments received on mortgage-backed obligations, and the related gross gains and losses realized, for the three months ended March 31, 2013 are as follows:

Dollars in thousands	Sales	Proceeds from		Gross realized	
		Calls and Maturities	Principal Payments	Gains	Losses
Securities available for sale	\$ 11,893	\$ 808	\$ 15,712	\$ 141	\$ 99

During the three months ended March 31, 2013 and 2012, we recorded other-than-temporary impairment losses on residential mortgage-backed nongovernment sponsored entity securities as follows:

Dollars in thousands	Three Months Ended March 31,	
	2013	2012
Total other-than-temporary impairment losses	\$ (91 )	\$ (511)
Portion of loss recognized in other comprehensive	37	282



income	
Net impairment losses recognized in earnings	\$ (54 ) \$ (229)

Activity related to the credit component recognized on debt securities available for sale for which a portion of other-than-temporary impairment was recognized in other comprehensive income for the three months ended March 31, 2013 is as follows:

	Three Months Ended March 31, 2013
Dollars in thousands	Total
Beginning Balance	\$ (2,903)
Additions for the credit component on debt securities in which other-than-temporary impairment was not previously recognized	(54)
Securities sold during the period	-
Ending Balance	\$ (2,957)

At March 31, 2013, our debt securities with other-than-temporary impairment in which only the amount of loss related to credit was recognized in earnings consisted solely of residential mortgage-backed securities issued by nongovernment-sponsored entities. We utilize third party vendors to estimate the portion of loss attributable to credit using a discounted cash flow models. The vendors estimate cash flows of the underlying collateral of each mortgage-backed security using models that incorporate their best estimates of current key assumptions, such as default rates, loss severity and prepayment rates. Assumptions utilized could vary widely from security to security, and are influenced by such factors as underlying loan interest rates, geographical location of underlying borrowers, collateral type and other borrower characteristics. Specific such assumptions utilized by our vendors in their valuation of our other-than-temporarily impaired residential mortgage-backed securities issued by nongovernment-sponsored entities were as follows at March 31, 2013:

	Weighted Average	Minimum	Range Maximum
Constant voluntary prepayment rates	14.0 %	14.0	% 14.0%
Constant default rates	5.6 %	5.6	% 5.6%
Loss severities	40.0 %	40.0	% 40.0%

Our vendors performing these valuations also analyze the structure of each mortgage-backed instrument in order to determine how the estimated cash flows of the underlying collateral will be distributed to each security issued from the structure. Expected principal and interest cash flows on the impaired debt securities are discounted predominantly using unobservable discount rates which the vendors assume that market participants would utilize in pricing the specific security. Based on the discounted expected cash flows derived from our vendor's models, we expect to recover the remaining unrealized losses on residential mortgage-backed securities issued by nongovernment sponsored entities.

Provided below is a summary of securities available for sale which were in an unrealized loss position at March 31, 2013 and December 31, 2012, including debt securities for which a portion of other-than-temporary impairment has been recognized in other comprehensive income.

	Less than 12 months		March 31, 2013 12 months or more		Total	
	Estimated Fair Value	Unrealized Loss	Estimated Fair Value	Unrealized Loss	Estimated Fair Value	Unrealized Loss
Dollars in thousands						
Temporarily impaired securities						
Taxable debt securities						
U. S. Government agencies						
and corporations	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
Residential mortgage-backed securities:						
Government-sponsored agencies	39,272	(579 )	4,228	(68 )	43,500	(647)
Nongovernment-sponsored entities	1	(5 )	1,287	(10 )	1,288	(15)
State and political subdivisions	4,317	(89 )	387	(4 )	4,704	(93)
Corporate debt securities	-	-	981	(18 )	981	(18)
Tax-exempt debt securities						
State and political subdivisions	17,231	(271 )	-	-	17,231	(271)
Total temporarily impaired securities	60,821	(944 )	6,883	(100 )	67,704	(1,044)

Other-than-temporarily  
impaired securities

Taxable debt securities						
Residential mortgage-backed securities:						
Nongovernment-sponsored entities	-	-	305	(68 )	305	(68)
Total other-than-temporarily impaired securities	-	-	305	(68 )	305	(68)
Total	\$ 60,821	\$ (944 )	\$ 7,188	\$ (168 )	\$ 68,009	\$ (1,112)

19

---

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

	December 31, 2012					
	Less than 12 months		12 months or more		Total	
	Estimated Fair Value	Unrealized Loss	Estimated Fair Value	Unrealized Loss	Estimated Fair Value	Unrealized Loss
Dollars in thousands						
Temporarily impaired securities						
Taxable debt securities						
U. S. Government agencies						
and corporations	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
Residential mortgage-backed securities:						
Government-sponsored agencies	36,498	(414)	8,997	(78)	45,495	(492)
Nongovernment-sponsored entities	-	(4)	1,478	(14)	1,478	(18)
State and political subdivisions	3,766	(85)	387	(4)	4,153	(89)
Corporate debt securities	-	-	962	(38)	962	(38)
Tax-exempt debt securities						
State and political subdivisions	19,934	(237)	-	-	19,934	(237)
Total temporarily impaired securities	60,198	(740)	11,824	(134)	72,022	(874)
Other-than-temporarily impaired securities						
Taxable debt securities						
Residential mortgage-backed securities:						
Nongovernment-sponsored entities	265	(6)	593	(120)	858	(126)
Total other-than-temporarily impaired securities	265	(6)	593	(120)	858	(126)
Total	\$ 60,463	\$ (746)	\$ 12,417	\$ (254)	\$ 72,880	\$ (1,000)

We held 61 available for sale securities, including debt securities with other-than-temporary impairment in which a portion of the impairment remains in other comprehensive income, having an unrealized loss at March 31, 2013. We do not intend to sell these securities, and it is more likely than not that we will not be required to sell these securities before recovery of their amortized cost bases. We believe that this decline in value is primarily attributable to the lack of market liquidity and to changes in market interest rates and not due to credit quality. Accordingly, no additional other-than-temporary impairment charge to earnings is warranted at this time.

#### NOTE 6. LOANS

Loans are generally stated at the amount of unpaid principal, reduced by unearned discount and allowance for loan losses. Interest on loans is accrued daily on the outstanding balances. Loan origination fees and certain direct loan origination costs are deferred and amortized as adjustments of the related loan yield over its contractual life. We categorize residential real estate loans in excess of \$600,000 as jumbo loans.

Generally, loans are placed on nonaccrual status when principal or interest is greater than 90 days past due based upon the loan's contractual terms. Interest is accrued daily on impaired loans unless the loan is placed on nonaccrual status. Impaired loans are placed on nonaccrual status when the payments of principal and interest are in default for a period of 90 days, unless the loan is both well-secured and in the process of collection. Interest on nonaccrual loans is recognized primarily using the cost-recovery method. Loans may be returned to accrual status when repayment is reasonably assured and there has been demonstrated performance under the terms of the loan or, if applicable, the terms of the restructured loans.

Commercial-related loans or portions thereof (which are risk-rated) are charged off to the allowance for loan losses when the loss has been confirmed. This determination is made on a case by case basis considering many factors, including the prioritization of our claim in bankruptcy, expectations of the workout/restructuring of the loan and valuation of the borrower's equity. We deem a loss confirmed when a loan or a portion of a loan is classified "loss" in accordance with bank regulatory classification guidelines, which state, "Assets classified loss are considered uncollectible and of such little value that their continuance as bankable assets is not warranted".

20

---

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

Consumer-related loans are generally charged off to the allowance for loan losses upon reaching specified stages of delinquency, in accordance with the Federal Financial Institutions Examination Council policy. For example, credit card loans are charged off by the end of the month in which the account becomes 180 days past due or within 60 days from receiving notification about a specified event (e.g., bankruptcy of the borrower), which ever is earlier. Residential mortgage loans are generally charged off to net realizable value no later than when the account becomes 180 days past due. Other consumer loans, if collateralized, are generally charged off to net realizable value at 120 days past due.

Loans are summarized as follows:

	December		
Dollars in thousands	March 31,	31,	March 31,
	2013	2012	2012
Commercial	\$ 86,877	\$ 85,829	\$ 99,386
Commercial real estate			
Owner-occupied	151,942	154,252	153,528
Non-owner occupied	288,475	276,082	275,727
Construction and development			
Land and land development	76,277	79,335	88,212
Construction	5,782	3,772	2,148
Residential real estate			
Non-jumbo	213,965	216,714	219,485
Jumbo	62,849	61,567	62,836
Home equity	53,765	53,263	50,884
Consumer	19,638	20,586	21,574
Other	3,191	3,701	2,540
Total loans, net of unearned fees	962,761	955,101	976,320
Less allowance for loan losses	17,020	17,933	18,523
Loans, net	\$ 945,741	\$ 937,168	\$ 957,797

The following table presents the contractual aging of the recorded investment in past due loans by class as of March 31, 2013 and 2012 and December 31, 2012.

Edgar Filing: SUMMIT FINANCIAL GROUP INC - Form 10-Q

At March 31, 2013

Dollars in thousands	30-59 days	Past Due		Total	Current	Recorded Investment > 90 days and Accruing
		60-89 days	> 90 days			
Commercial	\$ 148	\$ 44	\$ 1,921	\$ 2,113	\$ 84,764	\$ -
Commercial real estate						
Owner-occupied	1,075	310	-	1,385	150,557	-
Non-owner occupied	222	708	909	1,839	286,636	-
Construction and development						
Land and land development	65	794	10,538	11,397	64,880	-
Construction	-	-	153	153	5,629	-
Residential mortgage						
Non-jumbo	4,910	1,052	2,362	8,324	205,641	-
Jumbo	-	-	12,565	12,565	50,284	-
Home equity	247	48	-	295	53,470	-
Consumer	244	34	44	322	19,316	-
Other	-	-	-	-	3,191	-
Total	\$ 6,911	\$ 2,990	\$ 28,492	\$ 38,393	\$ 924,368	\$ -

At December 31, 2012

Dollars in thousands	30-59 days	Past Due		Total	Current	Recorded Investment > 90 days and Accruing
		60-89 days	> 90 days			
Commercial	\$ 225	\$ 5	\$ 2,294	\$ 2,524	\$ 83,305	\$ -
Commercial real estate						
Owner-occupied	57	-	1,023	1,080	153,172	-
Non-owner occupied	182	193	908	1,283	274,799	-
Construction and development						
Land and land development	-	-	11,795	11,795	67,540	-
Construction	-	-	153	153	3,619	-
Residential mortgage						
Non-jumbo	3,344	2,616	2,797	8,757	207,957	-

Edgar Filing: SUMMIT FINANCIAL GROUP INC - Form 10-Q

Jumbo	-	-	12,564	12,565	49,002	-
Home equity	337	448	179	964	52,299	-
Consumer	255	79	48	382	20,204	-
Other	-	-	-	-	3,701	-
Total	\$ 4,400	\$ 3,341	\$ 31,761	\$ 39,503	\$ 915,598	\$ -

22

---

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



At March 31, 2012

Dollars in thousands	Past Due			Total	Current	Recorded Investment > 90 days and Accruing
	30-59 days	60-89 days	> 90 days			
Commercial	\$ 893	\$ 37	\$ 2,234	\$ 3,164	\$ 96,222	\$ -
Commercial real estate						
Owner-occupied	1,007	412	955	2,374	151,154	-
Non-owner occupied	1,411	-	1,928	3,339	272,388	-
Construction and development						
Land and land development	375	1,960	13,906	16,241	71,971	-
Construction	-	-	887	887	1,261	-
Residential mortgage						
Non-jumbo	2,679	2,409	2,863	7,951	211,534	-
Jumbo	1,337	-	12,621	13,958	48,878	-
Home equity	-	335	55	390	50,494	-
Consumer	156	103	26	285	21,289	-
Other	-	-	-	-	2,540	-
Total	\$ 7,858	\$ 5,256	\$ 35,475	\$ 48,589	\$ 927,731	\$ -

Nonaccrual loans: The following table presents the nonaccrual loans included in the net balance of loans at March 31, 2013, December 31, 2012, and March 31, 2012.

Dollars in thousands	3/31/2013	12/31/2012	3/31/2012
Commercial	\$ 4,763	\$ 5,002	\$ 2,477
Commercial real estate			
Owner-occupied	495	1,524	1,989
Non-owner occupied	1,030	1,032	2,293
Construction and development			
Land & land development	12,923	13,487	21,287
Construction	153	154	887
Residential mortgage			

Non-jumbo	4,001	3,518	4,583
Jumbo	12,565	12,564	12,621
Home equity	303	440	550
Consumer	72	55	81
Total	\$ 36,305	\$ 37,776	\$ 46,768

Impaired loans: Impaired loans include the following:

§ Loans which we risk-rate (consisting of loan relationships having aggregate balances in excess of \$2.0 million, or loans exceeding \$500,000 and exhibiting credit weakness) through our normal loan review procedures and which, based on current information and events, it is probable that we will be unable to collect all amounts due in accordance with the original contractual terms of the loan agreement. Risk-rated loans with insignificant delays or insignificant short falls in the amount of payments expected to be collected are not considered to be impaired.

§ Loans that have been modified in a troubled debt restructuring.

23

---

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

Both commercial and consumer loans are deemed impaired upon being contractually modified in a troubled debt restructuring. Troubled debt restructurings typically result from our loss mitigation activities and occur when we grant a concession to a borrower who is experiencing financial difficulty in order to minimize our economic loss and to avoid foreclosure or repossession of collateral. Once restructured in a troubled debt restructuring, a loan is generally considered impaired until its maturity, regardless of whether the borrower performs under the modified terms. Although such a loan may be returned to accrual status if the criteria set forth in our accounting policy are met, the loan would continue to be evaluated for an asset-specific allowance for loan losses and we would continue to report the loan in the impaired loan table below.

The table below sets forth information about our impaired loans.

Method Used to Measure Impairment of Impaired  
Loans  
Dollars in  
thousands

Loan Category	03/31/2012	12/31/2012	03/31/2012	Method used to measure impairment
Commerical	\$ 10,322	\$ 10,776	\$ 2,998	Fair value of collateral
	164	165	-	Discounted cash flow
Commerical real estate				
Owner-occupied	13,334	14,028	11,263	Fair value of collateral
	2,673	2,686	2,724	Discounted cash flow
Non-owner occupied	6,858	9,468	10,375	Fair value of collateral
Construction and development				
Land & land development	27,395	29,307	35,746	Fair value of collateral
	656	656	656	Discounted cash flow
Construction	-	-	735	Fair value of collateral
Residential mortgage				
Non-jumbo	5,190	5,626	4,692	Fair value of collateral
	829	692	1,252	Discounted cash flow
Jumbo	21,450	21,543	19,899	Fair value of collateral
Home equity	213	219	353	Fair value of collateral

Consumer		62		66		329	Fair value of collateral
Total	\$	89,146	\$	95,232	\$	91,022	

24

---

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

Edgar Filing: SUMMIT FINANCIAL GROUP INC - Form 10-Q

The following tables present loans individually evaluated for impairment at March 31, 2013, December 31, 2012 and March 31, 2012.

Dollars in thousands	March 31, 2013				
	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Impaired Balance	Interest Income Recognized while impaired
Without a related allowance					
Commercial	\$ 9,442	\$ 9,446	\$ -	\$ 9,446	\$ 439
Commercial real estate					
Owner-occupied	9,882	9,886	-	9,886	455
Non-owner occupied	5,430	5,432	-	5,432	271
Construction and development					
Land & land development	15,623	15,622	-	14,883	575
Construction	-	-	-	-	-
Residential real estate					
Non-jumbo	3,523	3,531	-	3,531	153
Jumbo	7,264	7,265	-	7,265	360
Home equity	185	186	-	186	11
Consumer	35	35	-	35	1
Total without a related allowance	\$ 51,384	\$ 51,403	\$ -	\$ 50,664	\$ 2,265
With a related allowance					
Commercial	\$ 1,031	\$ 1,040	\$ 403	\$ 1,040	\$ 8
Commercial real estate					
Owner-occupied	6,121	6,121	437	6,120	282
Non-owner occupied	1,426	1,426	152	1,427	29
Construction and development					
Land & land development	12,429	12,429	1,421	12,429	157
Construction	-	-	-	-	-
Residential real estate					
Non-jumbo	2,487	2,488	303	2,487	87

Edgar Filing: SUMMIT FINANCIAL GROUP INC - Form 10-Q

Jumbo	14,180	14,185	3,707	14,185	94
Home equity	28	27	28	28	-
Consumer	26	27	14	26	2
Total with a related allowance	\$ 37,728	\$ 37,743	\$ 6,465	\$ 37,742	\$ 659
Total					
Commercial	\$ 61,384	\$ 61,402	\$ 2,413	\$ 60,663	\$ 2,216
Residential real estate	27,667	27,682	4,038	27,682	705
Consumer	61	62	14	61	3
Total	\$ 89,112	\$ 89,146	\$ 6,465	\$ 88,406	\$ 2,924

25

---

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

December 31, 2012					
Dollars in thousands	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Impaired Balance	Interest Income Recognized while impaired
<b>Without a related allowance</b>					
Commercial	\$ 10,518	\$ 10,537	\$ -	\$ 3,131	\$ 134
<b>Commercial real estate</b>					
Owner-occupied	9,992	9,996	-	8,528	368
Non-owner occupied	6,143	6,145	-	6,056	304
<b>Construction and development</b>					
Land & land development	11,596	11,596	-	11,093	367
Construction	-	-	-	-	-
<b>Residential real estate</b>					
Non-jumbo	3,497	3,505	-	3,040	125
Jumbo	7,347	7,349	-	5,399	272
Home equity	191	191	-	191	11
Consumer	38	38	-	32	1
<b>Total without a related allowance</b>	<b>\$ 49,322</b>	<b>\$ 49,357</b>	<b>\$ -</b>	<b>\$ 37,470</b>	<b>\$ 1,582</b>
<b>With a related allowance</b>					
Commercial	\$ 404	\$ 404	\$ 85	\$ 515	\$ 6
<b>Commercial real estate</b>					
Owner-occupied	6,719	6,718	461	4,442	187
Non-owner occupied	3,321	3,323	286	3,341	115
<b>Construction and development</b>					
Land & land development	18,367	18,367	2,611	17,633	344
Construction	-	-	-	-	-
<b>Residential real estate</b>					
Non-jumbo	2,812	2,813	394	2,378	77
Jumbo	14,189	14,194	3,216	13,585	59
Home equity	28	28	28	29	-
Consumer	28	28	16	2	-

Edgar Filing: SUMMIT FINANCIAL GROUP INC - Form 10-Q

Total with a related allowance	\$ 45,868	\$ 45,875	\$ 7,097	\$ 41,925	\$ 788
<hr/>					
Total					
Commercial	\$ 67,060	\$ 67,086	\$ 3,443	\$ 54,739	\$ 1,825
Residential real estate	28,064	28,080	3,638	24,622	544
Consumer	66	66	16	34	1
Total	\$ 95,190	\$ 95,232	\$ 7,097	\$ 79,395	\$ 2,370

26

---

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



Edgar Filing: SUMMIT FINANCIAL GROUP INC - Form 10-Q

March 31, 2012					
Dollars in thousands	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Impaired Balance	Interest Income Recognized while impaired
<b>Without a related allowance</b>					
Commercial	\$ 2,307	\$ 2,306	\$ -	\$ 1,697	\$ 30
<b>Commercial real estate</b>					
Owner-occupied	11,036	11,045	-	9,004	335
Non-owner occupied	6,307	6,308	-	6,046	305
<b>Construction and development</b>					
Land & land development	18,732	18,732	-	10,920	334
Construction	-	-	-	-	-
<b>Residential real estate</b>					
Non-jumbo	3,876	3,886	-	3,139	99
Jumbo	15,661	15,662	-	14,621	200
Home equity	191	191	-	191	11
Consumer	293	293	-	11	1
<b>Total without a related allowance</b>	<b>\$ 58,403</b>	<b>\$ 58,423</b>	<b>\$ -</b>	<b>\$ 45,629</b>	<b>\$ 1,315</b>
<b>With a related allowance</b>					
Commercial	\$ 692	\$ 692	\$ 203	\$ 692	\$ 4
<b>Commercial real estate</b>					
Owner-occupied	2,941	2,942	140	2,942	141
Non-owner occupied	4,065	4,067	439	3,366	116
<b>Construction and development</b>					
Land & land development	17,667	17,670	3,070	16,148	65
Construction	735	735	419	-	-
<b>Residential real estate</b>					
Non-jumbo	2,056	2,058	574	892	34
Jumbo	4,227	4,237	753	2,243	1
Home equity	162	162	111	162	-

Edgar Filing: SUMMIT FINANCIAL GROUP INC - Form 10-Q

Consumer	36	36	1	-	-
Total with a related allowance	\$ 32,581	\$ 32,599	\$ 5,710	\$ 26,445	\$ 361
Total					
Commercial	\$ 64,482	\$ 64,497	\$ 4,271	\$ 50,815	\$ 1,330
Residential real estate	26,173	26,196	1,438	21,248	345
Consumer	329	329	1	11	1
Total	\$ 90,984	\$ 91,022	\$ 5,710	\$ 72,074	\$ 1,676

A modification of a loan is considered a troubled debt restructuring (“TDR”) when a borrower is experiencing financial difficulty and the modification constitutes a concession that we would not otherwise consider. This may include a transfer of real estate or other assets from the borrower, a modification of loan terms, or a combination of both. A loan continues to qualify as a TDR until a consistent payment history or a significant change in the borrower’s financial condition and loan terms has occurred. Included in impaired loans are TDRs of \$52.5 million and \$56.7 million at March 31, 2013 and December 31, 2012, respectively, with no commitments to lend additional funds under these restructurings at either balance sheet date.

The following table presents by class the TDRs that were restructured during the three months ended March 31, 2013 and 2012. Generally, the modifications were extensions of term, modifying the payment terms from principal and interest to interest only for an extended period, or reduction in interest rate. All TDRs are evaluated individually for allowance for loan loss purposes.

	For the Three Months Ended				For the Three Months Ended	
	March 31, 2013				March 31, 2012	
	Pre-modification	Post-modification	Recorded	Pre-modification	Post-modification	Recorded
dollars in thousands	Number of Modifications	Investment	Investment	Number of Modifications	Investment	Investment
Commercial	-	\$-	\$-	2	\$1,031	\$1,039
Commercial real estate						
Owner-occupied	-	-	-	-	-	-
Non-owner occupied	-	-	-	1	336	350
Construction and development						
Land & land development	1	49	50	-	-	-
Construction	-	-	-	-	-	-
Residential real estate						
Non-jumbo	-	-	-	1	60	62
Jumbo	-	-	-	-	-	-
Home equity	-	-	-	-	-	-
Consumer	-	-	-	1	38	38
Total	1	\$49	\$50	5	\$1,465	\$1,489

The following table presents defaults during the stated period of TDRs that were restructured during the past twelve months. For purposes of these tables, a default is considered as either the loan was past due 30 days or more at any time during the period, or the loan was fully or partially charged off during the period.

	For the Three Months Ended	
	March 31, 2013	
	Number of Defaults	Recorded Investment at Default Date
dollars in thousands		
Commercial	-	\$ -
Commercial real estate		
Owner-occupied	-	-
Non-owner occupied	-	-
Construction and development		
Land & land development	2	1,676
Construction	-	-

Residential real estate		
Non-jumbo	2	292
Jumbo	1	130
Home equity	-	-
Consumer	3	28
Total	8	\$ 2,126

We categorize loans into risk categories based on relevant information about the ability of borrowers to service their debt such as current financial information, historical payment experience, credit documentation, public information, and current economic trends, among other factors. We analyze loans individually by classifying the loans as to credit risk. We internally grade all commercial loans at the time of loan origination. In addition, we perform an annual loan review on all non-homogenous commercial loan relationships with an aggregate exposure of \$2 million, at which time these loans are re-graded. We use the following definitions for our risk grades:

Pass: Loans graded as Pass are loans to borrowers of acceptable credit quality and risk. They are higher quality loans that do not fit any of the other categories described below.

28

---

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

OLEM (Special Mention): Commercial loans categorized as OLEM are potentially weak. The credit risk may be relatively minor yet represent a risk given certain specific circumstances. If the potential weaknesses are not monitored or mitigated, the asset may weaken or inadequately protect our position in the future.

Substandard: Commercial loans categorized as Substandard are inadequately protected by the borrower's ability to repay, equity, and/or the collateral pledged to secure the loan. These loans have identified weaknesses that could hinder normal repayment or collection of the debt. These loans are characterized by the distinct possibility that we will sustain some loss if the identified weaknesses are not mitigated.

Doubtful: Commercial loans categorized as Doubtful have all the weaknesses inherent in those loans classified as Substandard, with the added elements that the full collection of the loan is improbable and the possibility of loss is high.

Loss: Loans classified as loss are considered to be non-collectible and of such little value that their continuance as a bankable asset is not warranted. This does not mean that the loan has absolutely no recovery value, but rather it is neither practical nor desirable to defer writing off the loan, even though partial recovery may be obtained in the future.

The following table presents the recorded investment in construction and development, commercial, and commercial real estate loans which are generally evaluated based upon the internal risk ratings defined above.

Loan Risk Profile by Internal Risk Rating

	Construction and Development				Commercial Real Estate					
	Land and land development		Construction	Commercial	Owner Occupied		Non-Owner Occupied			
Dollars in thousands	3/31/2013	12/31/2012	3/31/2012	12/31/2011	3/31/2013	12/31/2012	3/31/2013	12/31/2012	3/31/2013	12/31/2012
Pass	\$ 42,192	\$ 43,572	\$ 5,629	\$ 3,619	\$ 74,790	\$ 73,425	\$ 137,001	\$ 139,176	\$ 276,878	\$ 262,132
OLEM (Special Mention)	7,294	7,349	-	-	1,418	1,260	5,945	1,034	10,143	11,477
Substandard	26,791	28,414	153	153	10,669	11,144	8,996	14,042	1,454	2,473
Doubtful	-	-	-	-	-	-	-	-	-	-
Loss	-	-	-	-	-	-	-	-	-	-
Total	\$ 76,277	\$ 79,335	\$ 5,782	\$ 3,772	\$ 86,877	\$ 85,829	\$ 151,942	\$ 154,252	\$ 288,475	\$ 276,082

The following table presents the recorded investment in consumer, residential real estate, and home equity loans, which are generally evaluated based on the aging status of the loans, which was previously presented, and payment activity.

Dollars in thousands	Performing				Nonperforming		
	3/31/2013	12/31/2012	3/31/2012	3/31/2013	12/31/2012	3/31/2012	
Residential real estate							
Non-jumbo	\$ 209,964	\$ 213,196	\$ 214,902	\$ 4,001	\$ 3,518	\$ 4,583	

Edgar Filing: SUMMIT FINANCIAL GROUP INC - Form 10-Q

Jumbo	50,284	49,003	50,215	12,565	12,564	12,621
Home Equity	53,462	52,823	50,334	303	440	550
Consumer	19,566	20,531	21,493	72	55	81
Other	3,191	3,701	2,540	-	-	-
Total	\$ 336,467	\$ 339,254	\$ 339,484	\$ 16,941	\$ 16,577	\$ 17,835

29

---

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

Loan commitments: ASC Topic 815, Derivatives and Hedging, requires that commitments to make mortgage loans should be accounted for as derivatives if the loans are to be held for sale, because the commitment represents a written option and accordingly is recorded at the fair value of the option liability.

#### NOTE 7. ALLOWANCE FOR LOAN LOSSES

An analysis of the allowance for loan losses for the three month periods ended March 30, 2013 and 2012, and for the year ended December 31, 2012 is as follows:

Dollars in thousands	2013	Three Months Ended March 31, 2012	Year Ended December 31, 2012
Balance, beginning of year	\$ 17,933	\$ 17,712	\$ 17,712
Losses:			
Commercial	17	31	1,273
Commercial real estate			
Owner occupied	63	283	636
Non-owner occupied	3	395	806
Construction and development			
Land and land development	2,062	365	3,390
Construction	-	-	367
Residential real estate			
Non-jumbo	228	126	1,372
Jumbo	60	87	737
Home equity	20	-	5
Consumer	22	32	136
Other	22	20	95
Total	2,497	1,339	8,817
Recoveries:			
Commercial	2	2	13
Commercial real estate			
Owner occupied	2	3	33
Non-owner occupied	-	8	31
Construction and development			
	5	5	61

Land and land development			
Construction	-	-	-
Real estate - mortgage			
Non-jumbo	19	19	81
Jumbo	1	9	86
Home equity	-	60	61
Consumer	21	14	95
Other	34	29	77
Total	84	149	538
Net losses	2,413	1,190	8,279
Provision for loan losses	1,500	2,001	8,500
Balance, end of year	\$ 17,020	\$ 18,523	\$ 17,933



Edgar Filing: SUMMIT FINANCIAL GROUP INC - Form 10-Q

Activity in the allowance for loan losses by loan class during the first three months of 2013 is as follows:

Dollars in thousands	Construction & Land Development		Commercial Real Estate			Residential Real Estate			Other	Total	
	Land & Land Development	Construction	Commercial	Owner Occupied	Non-Owner Occupied	Non-jumbo	Jumbo	Home Equity			Consumer
Allowance for loan losses											
Beginning balance	\$5,220	\$138	\$782	\$1,387	\$3,269	\$2,617	\$3,942	\$425	\$132	\$21	\$17,933
Charge-offs	2,062	-	17	63	3	228	60	20	22	22	2,497
Recoveries	5	-	2	2	-	19	1	-	21	34	84
Provision	742	140	256	53	(18)	(76)	632	(179)	(26)	(24)	1,500
Ending balance	\$3,905	\$278	\$1,023	\$1,379	\$3,248	\$2,332	\$4,515	\$226	\$105	\$9	\$17,020
Allowance related to:											
Loans individually evaluated for impairment	\$1,421	\$-	\$403	\$437	\$152	\$303	\$3,707	\$28	\$14	\$-	\$6,465
Loans collectively evaluated for impairment	2,484	278	620	942	3,096	2,029	808	198	91	9	10,555
Loans acquired with deteriorated credit quality	-	-	-	-	-	-	-	-	-	-	-
Total	\$3,905	\$278	\$1,023	\$1,379	\$3,248	\$2,332	\$4,515	\$226	\$105	\$9	\$17,020
Loans individually evaluated for impairment	\$28,051	\$-	\$10,486	\$16,007	\$6,858	\$6,019	\$21,450	\$213	\$62	\$-	\$89,146
Loans collectively											

evaluated												
for												
impairment	48,226	5,782	76,391	135,935	281,617	207,946	41,399	53,552	19,576	3,191	\$873,615	
Loans												
acquired with												
deteriorated												
credit quality	-	-	-	-	-	-	-	-	-	-	-	-
Total	\$76,277	\$5,782	\$86,877	\$151,942	\$288,475	\$213,965	\$62,849	\$53,765	\$19,638	\$3,191	\$962,761	

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 by reporting unit at March 31, 2013 and other intangible assets by reporting unit at March 31, 2013 and December 31, 2012.

Goodwill Activity						
Community Insurance						
Dollars in thousands	Banking	Services	Total			
Balance, January 1, 2013	\$ 1,488	\$ 4,710	\$ 6,198			
Acquired goodwill, net	-	-	-			
Balance, March 31, 2013	\$ 1,488	\$ 4,710	\$ 6,198			
Other Intangible Assets						
Dollars in thousands						
Unidentifiable intangible assets	March 31, 2013			December 31, 2012		
	Community Insurance Banking	Services	Total	Community Insurance Banking	Services	Total
Gross carrying amount	\$ 2,267	\$ -	\$ 2,267	\$ 2,267	\$ -	\$ 2,267
Less: accumulated amortization	2,104	-	2,104	2,065	-	2,065
Net carrying amount	\$ 163	\$ -	\$ 163	\$ 202	\$ -	\$ 202
Identifiable intangible assets	Gross carrying amount					
	\$ -	\$ 3,000	\$ 3,000	\$ -	\$ 3,000	\$ 3,000
	Less: accumulated amortization					
	-	1,150	1,150	-	1,100	1,100
Net carrying amount	\$ -	\$ 1,850	\$ 1,850	\$ -	\$ 1,900	\$ 1,900

We recorded amortization expense of approximately \$88,000 for the three months ended March 31, 2013 relative to our other intangible assets. Annual amortization is expected to be approximately \$351,000 in 2013, \$251,000 in 2014,

and \$200,000 for each of the years ending 2015 through 2017.

#### NOTE 9. DEPOSITS

The following is a summary of interest bearing deposits by type as of March 31, 2013 and 2012 and December 31, 2012:

	March 31,	December 31,	March 31,
Dollars in thousands	2013	2012	2012
Demand deposits, interest bearing	\$ 181,326	\$ 175,706	\$ 172,506
Savings deposits	197,587	193,039	212,402
Time deposits	594,279	557,788	538,315
Total	\$ 973,192	\$ 926,533	\$ 923,223

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

Included in time deposits are deposits acquired through a third party (“brokered deposits”) totaling \$213.6 million, \$190.4 million and \$184.4 million at March 31, 2013, December 31, 2012, and March 31, 2012, respectively.

A summary of the scheduled maturities for all time deposits as of March 31, 2013 is as follows:

Dollars in thousands	
Nine month period ending December 31, 2013	\$ 192,481
Year ending December 31, 2014	120,908
Year ending December 31, 2015	60,050
Year ending December 31, 2016	86,619
Year ending December 31, 2017	34,561
Thereafter	99,660
	\$ 594,279

The following is a summary of the maturity distribution of all certificates of deposit in denominations of \$100,000 or more as of March 31, 2013:

Dollars in thousands	Amount	Percent
Three months or less	\$ 34,012	7.8%
	42,875	9.8%

Three through six months		
Six through twelve months	62,289	14.3%
Over twelve months	297,771	68.1%
Total	\$ 436,947	100.0%

## NOTE 10. BORROWED FUNDS

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

	Three Months Ended March 31, 2013	
	Short-term FHLB Advances	Federal Funds Purchased and Lines of Credit
Dollars in thousands		
Balance at March 31	\$ -	\$ 5,960
Average balance outstanding for the period	24,321	3,514
Maximum balance outstanding at any month end during period	45,000	5,960
Weighted average interest rate for the period	0.25 %	0.25%
Weighted average interest rate for balances outstanding at March 31	0.25 %	0.25%

---

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

	Year Ended December 31, 2012	
	Short-term FHLB	Federal Funds Purchased and Lines
Dollars in thousands	Advances	of Credit
Balance at December 31	\$ 3,000	\$ 958
Average balance outstanding for the year	12,291	957
Maximum balance outstanding at any month end	20,000	958
Weighted average interest rate for the year	0.24 %	0.25%
Weighted average interest rate for balances outstanding at December 31	0.25 %	0.25%

	Three Months Ended March 31, 2012	
	Short-term FHLB	Federal Funds Purchased and Lines
Dollars in thousands	Advances	of Credit
Balance at March 31	\$ 15,000	\$ 956
Average balance outstanding for the period	13,379	956



Maximum balance outstanding at any month end during period	15,000	956	
Weighted average interest rate for the period	0.17	%	0.25%
Weighted average interest rate for balances outstanding at March 31	0.23	%	0.25%

Long-term borrowings: Our long-term borrowings of \$163.6 million, \$203.3 million and \$267.1 million at March 31, 2013, December 31, 2012, and March 31, 2012 respectively, consisted primarily of advances from the Federal Home Loan Bank (“FHLB”) and structured reverse repurchase agreements with two unaffiliated institutions. All FHLB advances are collateralized primarily by similar amounts of residential mortgage loans, certain commercial loans, mortgage backed securities and securities of U. S. Government agencies and corporations.

	Balance at March 31,		Balance at December 31,
Dollars in thousands	2013	2012	2012
Long-term FHLB advances	\$ 82,672	\$ 157,643	\$ 122,693
Long-term reverse repurchase agreements	72,000	100,000	72,000
Term loans	8,916	9,478	8,575
Total	\$ 163,588	\$ 267,121	\$ 203,268

The term loans are secured by the common stock of our subsidiary bank. \$5.4 million bears a variable interest rate of prime minus 50 basis points with a final maturity of 2017, and \$3.5 million bears a fixed rate of 8% with a final maturity of 2023.

Our long term FHLB borrowings and reverse repurchase agreements bear both fixed and variable rates and mature in varying amounts through the year 2019.

The average interest rate paid on long-term borrowings for the three month period ended March 31, 2013 was 3.82% compared to 3.97% for the first three months of 2012.

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

Subordinated debentures: We have subordinated debt totaling \$16.8 million at March 31, 2013, December 31, 2012, and March 31, 2012. The subordinated debt qualifies as Tier 2 capital under Federal Reserve Board guidelines until the debt is within 5 years of its maturity; thereafter the amount qualifying as Tier 2 capital is reduced by 20 percent each year until maturity. During 2009, we issued \$6.8 million in subordinated debt, of which \$5 million was issued to an affiliate of a director of Summit. We also issued \$1.0 million and \$0.8 million to two unrelated parties. These three issuances bear an interest rate of 10 percent per annum, a term of 10 years, and are not prepayable by us within the first five years. During 2008, we issued \$10 million of subordinated debt to an unrelated institution, which bears a variable interest rate of 1 month LIBOR plus 275 basis points and a term of 7.5 years.

Subordinated debentures owed to unconsolidated subsidiary trusts: 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 \$19.6 million at March 31, 2013, December 31, 2012, and March 31, 2012.

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 \$3.5 million in capital securities and \$109,000 in common securities and invested the proceeds in \$3.61 million of debentures. SFG Capital Trust II issued \$7.5 million in capital securities and \$232,000 in common securities and invested the proceeds in \$7.73 million of debentures. SFG Capital Trust III issued \$8.0 million in capital securities and \$248,000 in common securities and invested the proceeds in \$8.25 million 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 each Capital Trust are redeemable by us quarterly.

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.

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

Dollars in thousands	Long-term borrowings	Subordinated debentures owed to unconsolidated subsidiary trusts	
		Subordinated debentures	unconsolidated subsidiary trusts
Year Ending December 31,	2013	\$ 72	\$ -

2014	82,527	-	-
2015	1,909	10,000	-
2016	28,911	-	-
2017	918	-	-
Thereafter	49,251	6,800	19,589
	\$ 163,588	\$ 16,800	\$ 19,589

35

---

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

## NOTE 11. STOCK OPTION PLAN

The 2009 Officer Stock Option Plan was adopted by our shareholders in May 2009 and provides for the granting of stock options for up to 350,000 shares of common stock to our key officers. Each option granted under the Plan vests according to a schedule designated at the grant date and has a term of no more than 10 years following the vesting date. Also, the option price per share was not to be less than the fair market value of our common stock on the date of grant. The 2009 Officer Stock Option Plan, which expires in May 2019, replaces the 1998 Officer Stock Option Plan (collectively the “Plans”) that expired in May 2008.

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 options granted during the first three months of 2013 or 2012.

We recognize compensation expense based on the estimated number of stock awards expected to actually vest, exclusive of the awards expected to be forfeited. During the first three months of 2013 and 2012, our stock compensation expense and related deferred taxes were insignificant.

A summary of activity in our Plans during the first three months of 2013 and 2012 is as follows:

	For the Three Months Ended March 31,			
	2013		2012	
	Options	Weighted-Average Exercise Price	Options	Weighted-Average Exercise Price
Outstanding, January 1	249,700	\$ 18.98	317,180	\$ 18.17
Granted	-	-	-	-
Exercised (12,000 )		5.09	-	-
Forfeited (1,750 )		19.69	-	-
Expired (38,900 )		23.79	(22,800 )	5.12
Outstanding, March 31	197,050	\$ 18.87	294,380	\$ 18.17

Other information regarding options outstanding and exercisable at March 31, 2013 is as follows:

Range of exercise price	# of shares	Options Outstanding			Options Exercisable		
		WAEP	Wted. Avg. Remaining Contractual Life (yrs)	Aggregate Intrinsic Value (in thousands)	# of shares	WAEP	Aggregate Intrinsic Value (in thousands)
2.54 - \$6.00	23,550	\$ 5.00	3.61	\$ 49	20,500	\$ 5.36	\$ 35
6.01 - 10.00	28,200	9.14	3.39	3	27,000	9.27	-
10.01 - 17.50	2,300	17.43	0.92	-	2,300	17.43	-
17.51 - 20.00	38,500	17.80	3.75	-	38,500	17.80	-
20.01 - 25.93	104,500	25.04	3.49	-	104,500	25.04	-
	197,050	18.87		\$ 52	192,800	19.20	\$ 35

## 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.

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

March  
31,  
Dollars in  
thousands      2013

Commitments to extend credit:	
Revolving home equity and credit card lines	\$ 47,857
Construction loans	17,339
Other loans	29,274
Standby letters of credit	1,830
Total	\$ 96,300

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. REGULATORY MATTERS

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, 2013, 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 subsidiary, Summit Community Bank's ("Summit Community") are presented in the following table.



Dollars in thousands	Actual		Minimum Required Regulatory Capital			To be Well Capitalized under Prompt Corrective Action Provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio	
As of March 31, 2013							
Total Capital (to risk weighted assets)							
Summit	\$ 140,323	14.1 %	\$ 79,576	8.0 %	\$ 99,470	10.0%	
Summit Community	151,015	15.2 %	79,640	8.0 %	99,550	10.0%	
Tier I Capital (to risk weighted assets)							
Summit	116,954	11.8 %	39,788	4.0 %	59,682	6.0%	
Summit Community	138,446	13.9 %	39,820	4.0 %	59,730	6.0%	
Tier I Capital (to average assets)							
Summit	116,954	8.4 %	55,381	4.0 %	69,226	5.0%	
Summit Community	138,446	10.0 %	55,378	4.0 %	69,223	5.0%	
As of December 31, 2012							
Total Capital (to risk weighted assets)							
Summit	138,593	14.0 %	79,391	8.0 %	99,238	10.0%	
Summit Community	148,803	15.0 %	79,484	8.0 %	99,354	10.0%	
Tier I Capital (to risk weighted assets)							
Summit	115,221	11.6 %	39,695	4.0 %	59,543	6.0%	
Summit Community	136,231	13.7 %	39,742	4.0 %	59,613	6.0%	
Tier I Capital (to average assets)							
Summit	115,221	8.3 %	55,591	4.0 %	69,489	5.0%	
Summit Community	136,231	9.8 %	55,581	4.0 %	69,476	5.0%	

Summit Financial Group, Inc. (“Summit”) and its bank subsidiary, Summit Community Bank, Inc. (the “Bank”), have entered into informal Memoranda of Understanding (“MOU’s”) with their respective regulatory authorities. A memorandum of understanding is characterized by the regulatory authorities as an informal action that is not published or publicly available and that is used when circumstances warrant a milder form of action than a formal supervisory action, such as a formal written agreement or order.

Under the Summit MOU, Summit has agreed among other things to:

- § Summit suspending all cash dividends on its common stock until further notice. Dividends on all preferred stock, as well as interest payments on subordinated notes underlying Summit’s trust preferred securities, continue to be permissible; and,
- § Summit not incurring any additional debt, other than trade payables, without the prior written consent of the principal banking regulators.

Additional information regarding Summit’s MOU is included in Part I. Item 1A – Risk Factors on our Form 10-K for the year ended December 31, 2012.

On October 25, 2012, the Bank entered into a revised MOU (“Bank MOU”) which replaced the Bank MOU effective September 24, 2009 and subsequently amended on February 1, 2011. In general, the Bank MOU includes provisions substantially similar to those in the prior Bank MOU with the exception that several provisions deemed no longer applicable by the regulatory authorities were removed and a provision relative to reducing the Bank’s levels of classified assets was added.

In summary, we have agreed, among other things, to address the following matters relative to the Bank:

- § maintaining a Board committee which monitors and promotes compliance with the provisions of the Bank MOU;
- § providing the Bank's regulatory authorities with updated reports of criticized assets and/or formal workout plans for all nonperforming borrower relationships with an aggregate outstanding balance exceeding \$1 million;
- § developing and submitting to regulatory authorities a written plan to reduce the Bank's risk exposure in each adversely classified credit relationship in excess of \$1 million and all OREO;
- § establishing procedures to report all loans with balances exceeding \$500,000 that have credit weaknesses or that fall outside of the Bank's policy;
  - § annually reviewing the organizational structure and operations of the Bank's loan department;
  - § maintaining an adequate allowance for loan and lease losses through charges to current operating income;
- § reviewing overall liquidity objectives and developing and submitting to regulatory authorities plans and procedures aimed to improve liquidity and reduce reliance on volatile liabilities;
- § preparing comprehensive budgets and earnings forecasts for the Bank and submitting reports comparing actual performance to the budget plan;
- § maintaining a minimum Tier 1 Leverage Capital ratio of at least 8% and a Total Risk-based Capital ratio of at least 11%;
  - § not paying any cash dividends without the prior written consent of the banking regulators; and,
- § providing quarterly progress reports to the Bank's regulatory authorities detailing steps taken to comply with the Bank MOU.

#### NOTE 14. SEGMENT INFORMATION

We operate two business segments: community banking and insurance services. These segments are primarily identified by the products or services offered. The community banking segment consists of our full service banks which offer customers traditional banking products and services through various delivery channels. The insurance services segment consists of three insurance agency offices that sell insurance products. The accounting policies discussed throughout the notes to the consolidated financial statements apply to each of our business segments.

Intersegment revenue and expense consists of management fees allocated to the bank and Summit Insurance Services, LLC for all centralized functions that are performed by the parent, including overall direction in the areas of strategic planning, investment portfolio management, asset/liability management, financial reporting and other financial and administrative services. Information for each of our segments is included below:

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

Edgar Filing: SUMMIT FINANCIAL GROUP INC - Form 10-Q

In thousands	Three Months Ended March 31, 2013				
	Community Banking	Insurance Services	Parent	Eliminations	Total
Net interest income	\$ 10,226	\$ -	\$ (468 )	\$ -	\$ 9,758
Provision for loan losses	1,500	-	-	-	1,500
Net interest income after provision for loan losses	8,726	-	(468 )	-	8,258
Other income	576	1,203	272	(272 )	1,779
Other expenses	6,300	1,121	444	(272 )	7,593
Income (loss) before income taxes	3,002	82	(640 )	-	2,444
Income tax expense (benefit)	825	36	(210 )	-	651
Net income (loss)	2,177	46	(430 )	-	1,793
Dividends on preferred shares	-	-	194	-	194
Net income (loss) applicable to common shares	\$ 2,177	\$ 46	\$ (624 )	\$ -	\$ 1,599
Intersegment revenue (expense)	\$ (245 )	\$ (27 )	\$ 272	\$ -	\$ -
Average assets	\$ 1,446,533	\$ 6,264	\$ 155,808	\$ (216,698 )	\$ 1,391,907

In thousands	Three Months Ended March 31, 2012				
	Community Banking	Insurance Services	Parent	Eliminations	Total
Net interest income	\$ 10,467	\$ -	\$ (449 )	\$ -	\$ 10,018
Provision for loan losses	2,001	-	-	-	2,001
Net interest income after provision for loan losses	8,466	-	(449 )	-	8,017
Other income	528	1,175	261	(261 )	1,703
Other expenses	6,361	1,004	435	(261 )	7,539
Income (loss) before income taxes	2,633	171	(623 )	-	2,181

Edgar Filing: SUMMIT FINANCIAL GROUP INC - Form 10-Q

taxes

Income tax					
expense (benefit)	625	69	(211 )	-	483
Net income (loss)	2,008	102	(412 )	-	1,698
Dividends on					
preferred shares	-	-	194	-	194
Net income (loss)					
applicable to					
common shares	\$ 2,008	\$ 102	\$ (606 )	\$ -	\$ 1,504
Intersegment					
revenue (expense)	\$ (236 )	\$ (25 )	\$ 261	\$ -	\$ -
Average assets	\$ 1,500,416	\$ 6,367	\$ 152,954	\$ (217,225)	\$ 1,442,512

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 segments, Summit Community Bank ("Summit Community"), and Summit Insurance Services, LLC for the periods indicated. See Note 14 of the accompanying consolidated financial statements for our segment information. This discussion and analysis should be read in conjunction with our 2012 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.

Interest earning assets declined by 3.28% for the first three months in 2013 compared to the same period of 2012 while our net interest earnings on a tax equivalent basis decreased 2.99%. Our tax equivalent net interest margin increased 3 basis points. Historically high levels of nonaccrual loans continue to negatively impact our net interest earnings while our reduced cost of interest bearing funds continues to positively impact our net interest earnings.

## BUSINESS SEGMENT RESULTS

We are organized and managed along two major business segments, as described in Note 14 of the accompanying consolidated financial statements. The results of each business segment are intended to reflect each segment as if it were a stand alone business. Net income by segment follows:

	Three Months Ended March 31,	
Dollars in thousands	2013	2012
Community banking	\$ 2,177	\$ 2,008
Insurance	46	102
Parent and other	(624 )	(606)
Consolidated net income (loss)	\$ 1,599	\$ 1,504

## 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.

42

---

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



Our most significant accounting policies are presented in the notes to the consolidated financial statements of our 2012 Annual Report on Form 10-K. These policies, along with the other disclosures presented in the 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, the valuation of goodwill, fair value measurements and deferred tax assets 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.

**Allowance for Loan Losses:** 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 8 to the consolidated financial statements of our 2012 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 2012 Annual Report on Form 10-K.

**Goodwill:** Goodwill is subject to an analysis by reporting unit at least annually to determine whether write-downs of the recorded balances are necessary. Initially, an assessment of qualitative factors (Step 0) is performed to determine whether the existence of events or circumstances leads to a determination that it is more likely than not that the fair value of a reporting unit is less than its carrying amount. If, after assessing the totality of events or circumstances, we determine it is not more likely than not that the fair value of a reporting unit is less than its carrying value, then performing the two-step impairment test is unnecessary. However, if we conclude otherwise, then we are required to perform the first step (Step 1) of the two-step impairment test by calculating the fair value of the reporting unit and comparing the fair value with the carrying amount of the reporting unit. If the fair value is less than the carrying value, an expense may be required on our books to write down the goodwill to the proper carrying value. Step 2 of impairment testing, which is necessary only if the reporting unit does not pass Step 1, compares the implied fair value of the reporting unit goodwill with the carrying amount of the goodwill for the reporting unit. The implied fair value of goodwill is determined in the same manner as goodwill that is recognized in a business combination.

Community Banking – During third quarter 2012, we performed the Step 0 assessment of our goodwill of our community banking reporting unit and determined that it was not more likely than not that the fair value was less than its carrying value. Because we did not experience any significant adverse changes in our banking business or its reporting structure since our last 2-step impairment test at September 30, 2011, we performed the qualitative Step 0 assessments. In performing the qualitative Step 0 assessments, we considered certain events and circumstances such as macroeconomic conditions, industry and market considerations, overall financial performance and cost factors when evaluating whether it is more likely than not that the fair value is less than its carrying amount. No indicators of impairment were noted as of September 30, 2012.

Insurance Services – During third quarter 2012, we performed the Step 0 assessment of our goodwill of our insurance services reporting unit. We considered certain events and circumstances specific to the reporting unit, such as macroeconomic conditions, industry and market considerations, overall financial performance and cost factors when evaluating whether it is more likely than not that the fair value of our insurance services reporting unit is less than its carrying value and deemed it necessary to perform the further 2-step impairment test. We performed an internal valuation utilizing the income approach to determine the fair value of our insurance services reporting unit. This methodology consisted of discounting the expected future cash flows of this unit based upon a forecast of its operations considering long-term key business drivers such as anticipated commission revenue growth. The long term growth rate used in determining the terminal value was estimated at 2%, and a discount rate of 10.5% was applied to the insurance services unit's estimated future cash flows. We did not fail this Step 1 test as of September 30, 2012, therefore Step 2 testing was not necessary.

We cannot assure you that future goodwill impairment tests will not result in a charge to earnings. See Note 11 of the consolidated financial statements of our 2012 Annual Report on Form 10-K for further discussion of our intangible assets, which include goodwill.

Fair Value Measurements: ASC Topic 820 Fair Value Measurements and Disclosures provides a definition of fair value, establishes a framework for measuring fair value, and requires expanded disclosures about fair value measurements. Fair value is the price that could be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants. Based on the observability of the inputs used in the valuation techniques, we classify our financial assets and liabilities measured and disclosed at fair value in accordance with the three-level hierarchy (e.g., Level 1, Level 2 and Level 3) established under ASC Topic 820. Fair value determination in accordance with this guidance requires that we make a number of significant judgments. In determining the fair value of financial instruments, we use market prices of the same or similar instruments whenever such prices are available. We do not use prices involving distressed sellers in determining fair value. If observable market prices are unavailable or impracticable to obtain, then fair value is estimated using modeling techniques such as discounted cash flow analyses. These modeling techniques incorporate our assessments regarding assumptions that market participants would use in pricing the asset or the liability, including assumptions about the risks inherent in a particular valuation technique and the risk of nonperformance.

Fair value is used on a recurring basis for certain assets and liabilities in which fair value is the primary basis of accounting. Additionally, fair value is used on a non-recurring basis to evaluate assets or liabilities for impairment or for disclosure purposes in accordance with ASC Topic 825 Financial Instruments.

Results of Operations

Deferred Income Tax Assets: At March 31, 2013, we had net deferred tax assets of \$11.7 million. Based on our ability to offset the net deferred tax asset against taxable income in carryback years and expected future taxable income in carryforward years, there was no impairment of the deferred tax asset at March 31, 2013. All available evidence, both positive and negative, was considered to determine whether, based on the weight of that evidence, impairment should be recognized. However, our forecast process includes judgmental and quantitative elements that may be subject to significant change. If our forecast of taxable income within the carryback/carryforward periods available under applicable law is not sufficient to cover the amount of net deferred tax assets, such assets may become impaired.

## RESULTS OF OPERATIONS

### Earnings Summary

Net income applicable to common shares for the three months ended March 31, 2013 increased to \$1.60 million, or \$0.19 per diluted share as compared to \$1.50 million or \$0.18 per diluted share for the same period of 2012. Earnings for the three months ended March 31, 2013 were positively impacted by lower provisions for loan losses and lower other-than-temporary impairment of securities, and negatively impacted by continued write-downs of foreclosed properties to their estimated fair values. The provision for loan losses was \$1.5 million and \$2.0 million for the three months ended March 31, 2013 and 2012, respectively. Included in earnings for the three months ended March 31, 2013 was \$42,000 in realized securities gains, \$929,000 of charges resulting from the write down of a portion of our foreclosed properties to fair value and \$54,000 in other than temporary impairment charges on securities. Returns on average equity and assets for the first three months of 2013 were 6.55% and 0.52%, respectively, compared with 6.49% and 0.47% for the same period of 2012.

### 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 net interest income on a fully tax-equivalent basis totaled \$10.1 million for the three months ended March 31, 2013 compared to \$10.4 million for the same period of 2012, representing a decrease of \$312,000 or 2.99%. While our tax-equivalent earnings on interest earning assets decreased, this decrease was partially offset by a reduction in the volume of interest bearing liabilities and a reduction in the cost of interest bearing liabilities (see Table II). Average interest earning assets decreased 3.28% from \$1.31 billion during the first three months of 2012 to \$1.27 billion for the first three months of 2013. Average interest bearing liabilities declined 4.84% from \$1.24 billion at March 31, 2012 to \$1.18 billion at March 31, 2013, at an average yield for the first three months of 2013 of 1.65% compared to 2.20% for the same period of 2012.

Our consolidated net interest margin increased to 3.23% for the three months ended March 31 2013, compared to 3.20% for the same period in 2012. The margin continues to be affected by elevated levels of nonaccruing loans. The present continued low interest rate environment has served to positively impact our net interest margin due to our liability sensitive balance sheet. For the three months ended

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

March 31, 2013 compared to March 31, 2012, the yields on earning assets decreased 50 basis points, while the cost of our interest bearing funds decreased by 55 basis points.

Assuming no significant change in market interest rates, we anticipate a relatively stable net interest margin in the near term as we do not expect interest rates to rise in the near future, we do not expect significant growth in our interest earning assets, nor do we expect our nonperforming asset balances to decline significantly in the near future. We continue to monitor the net interest margin through net interest income simulation to minimize the potential for any significant negative impact. 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.

46

---

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, 2013			March 31, 2012			
	Average Balance	Earnings/ Expense	Yield/ Rate		Average Balance	Earnings/ Expense	Yield/ Rate
<b>Interest earning assets</b>							
Loans, net of unearned income (1)							
Taxable	\$ 960,509	\$ 12,833	5.42 %		\$ 973,862	\$ 14,279	5.90%
Tax-exempt (2)	5,965	106	7.21 %		7,248	130	7.21%
<b>Securities</b>							
Taxable	216,306	1,030	1.93 %		234,973	1,699	2.91%
Tax-exempt (2)	79,147	961	4.92 %		71,559	1,092	6.14%
<b>Federal funds sold and interest bearing deposits with other banks</b>							
Total interest earning assets	1,269,437	14,931	4.77 %		1,312,524	17,211	5.27%
<b>Noninterest earning assets</b>							
Cash & due from banks	4,240				4,073		
Premises and equipment	21,101				21,978		
Other assets	114,701				122,188		
Allowance for loan losses	(17,572 )				(18,251 )		
Total assets	\$ 1,391,907				\$ 1,442,512		
<b>Interest bearing liabilities</b>							
Interest bearing demand deposits	\$ 174,724	\$ 70	0.16 %		\$ 160,147	\$ 82	0.21%
Savings deposits	195,556	309	0.64 %		211,783	381	0.72%
Time deposits	574,545	2,388	1.69 %		550,689	3,250	2.37%
Short-term borrowings	27,834	17	0.25 %		14,390	7	0.20%
Long-term borrowings and capital trust securities	209,255	2,027	3.93 %		305,027	3,059	4.03%
Total interest bearing liabilities	1,181,914	4,811	1.65 %		1,242,036	6,779	2.20%

Noninterest bearing liabilities				
and shareholders' equity				
Demand deposits	92,926		87,000	
Other liabilities	7,653		8,850	
Total liabilities	1,282,493		1,337,886	
Shareholders' equity - preferred	9,325		9,326	
Shareholders' equity - common	100,089		95,300	
Total liabilities and shareholders' equity	\$ 1,391,907		\$ 1,442,512	
Net interest earnings		\$ 10,120		\$ 10,432
Net yield on interest earning assets		3.23	%	3.20%

(1) - For purposes of this table, nonaccrual loans are included in average loan balances.

(2) - Interest income on tax-exempt securities and loans 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 \$362,000 and \$414,000 for the periods ended

March 31, 2013  
and March 31 2012,  
respectively.



Table II - Changes in Interest Margin Attributable to Rate and Volume

In thousands	For the Three Months Ended		
	March 31, 2013 versus March 31, 2012		
	Increase (Decrease) Due to		
	Change in:		
	Volume	Rate	Net
Interest earned on:			
Loans			
Taxable	\$ (209 )	\$ (1,236 )	\$ (1,445)
Tax-exempt	(24 )	-	(24)
Securities			
Taxable	(128 )	(541 )	(669)
Tax-exempt	104	(235 )	(131)
Federal funds sold and interest bearing deposits with other banks	(5 )	(6 )	(11)
Total interest earned on interest earning assets	(262 )	(2,018 )	(2,280)
Interest paid on:			
Interest bearing demand deposits	6	(18 )	(12)
Savings deposits	(29 )	(43 )	(72)
Time deposits	131	(993 )	(862)
Short-term borrowings	7	3	10
Long-term borrowings and capital trust securities	(953 )	(79 )	(1,032)

Total interest paid on interest bearing liabilities	(838 )	(1,130)	(1,968)
Net interest income	\$ 576	\$ (888 )	\$ (312)

### Noninterest Income

Total noninterest income increased to \$1.78 million for the first three months of 2013, compared to \$1.70 million for the same period of 2012, with writedowns of foreclosed properties to their estimated fair value being the primary negative component. Further detail regarding noninterest income is reflected in the following table.

Table III -  
Noninterest Income

Dollars in thousands	For the Quarter Ended March 31,	
	2013	2012
Insurance commissions	\$ 1,184	\$ 1,158
Service fees related to deposit accounts	1,012	1,014
Realized securities gains (losses)	42	1,165
Other-than-temporary impairment of securities	(54 )	(229)
Gain (loss) on sale of assets	(40 )	(77)
Bank owned life insurance income	238	275
Writedown of foreclosed properties	(929 )	(1,912)
Other	326	309
Total	\$ 1,779	\$ 1,703

Other-than-temporary impairment of securities: During the first three months of 2013, we recorded non-cash other-than temporary impairment charges of \$54,000 related to certain residential mortgage-backed securities which we continue to own.

Writedown of foreclosed properties: During the first three months of 2013, we recorded \$929,000 in charges to writedown certain OREO properties to fair value less estimated costs to sell as part of our normal, ongoing re-appraisal process. Continued volatility in the real estate markets could result in further writedowns of these properties in the foreseeable future.

#### Noninterest Expense

Total noninterest expense increased less than 1% for the three months ended March 31, 2013, as compared to the same period in 2012. Salaries, commissions, and employee benefits increased during the first three months of 2013 compared to the first three months of 2012 primarily as a result of general merit raises. Professional fees, including legal expenses related to complex collection issues relative to our problem assets, and foreclosed properties expense have both decreased due to our lower volume of problem assets and foreclosed properties. Table IV below shows the breakdown of the changes.

Table IV -  
Noninterest  
Expense

Dollars in thousands	For the Quarter Ended March 31,				2012
	2013	\$	%	Change	
Salaries, commissions, and employee benefits	\$ 4,117	\$ 216	5.5 %		\$ 3,901
Net occupancy expense	456	(23 )	-4.8 %		479
Equipment expense	598	4	0.7 %		594
Professional fees	251	(65 )	-20.6 %		316
Amortization of intangibles	88	-	0.0 %		88
FDIC premiums	540	18	3.4 %		522
Foreclosed properties expense	279	(83 )	-22.9 %		362
Other	1,264	(13 )	-1.0 %		1,277
Total	\$ 7,593	\$ 54	0.7 %		\$ 7,539

#### Credit Experience

While recent economic data points to a stabilizing real estate market, general economic conditions remain weak when compared to pre-2008 levels. As a result, we continue to experience elevated levels of loan delinquencies and nonperforming assets. Although Management anticipates loan delinquencies and nonperforming assets will remain higher than pre-recession levels, we do expect recent trends of improvement to continue.

The provision for loan losses represents charges to earnings necessary to maintain an adequate allowance for probable credit losses inherent in the loan portfolio. 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

49

---

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

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 \$1.5 million and \$2.0 million provisions for loan losses for the first three months of 2013 and 2012, respectively. This decline is a result of lower levels of specific reserves, based upon the fair value of collateral method in measuring impairment, necessary on newly identified impaired loans at March 31, 2013 compared to March 31, 2012.

As illustrated in Table V below, our non-performing assets have decreased during the past 12 months.

Table V -  
Summary of  
Non-Performing  
Assets

Dollars in thousands	2013	March 31, 2012	December 31, 2012
Accruing loans past due 90 days or more	\$ -	\$ -	\$ -
Nonaccrual loans			
Commercial	4,763	2,477	5,002
Commercial real estate	1,525	4,282	2,556
Commercial construction and development	-	799	-
Residential construction and development	13,076	21,375	13,641
Residential real estate	16,869	17,754	16,522
Consumer	72	81	55
Total nonaccrual loans	36,305	46,768	37,776
Foreclosed properties			
Commercial	-	-	-
Commercial real estate	11,779	14,703	11,835
Commercial construction and development	16,670	17,377	17,597
Residential construction and development	21,929	25,724	23,074

Residential real estate	4,247	3,780	3,666
Consumer	-	-	-
Total foreclosed properties	54,625	61,584	56,172
Repossessed assets	19	266	6
Total nonperforming assets	\$ 90,949	\$ 108,618	\$ 93,954
Total nonperforming loans as a percentage of total loans	3.77%	4.79%	3.96%
Total nonperforming assets as a percentage of total assets	6.54%	7.52%	6.77%

The following table details the activity regarding our foreclosed properties for the three months ended March 31, 2013 and 2012.

	For the Three Months Ended March 31,	
Dollars in thousands	2013	2012
Balance January 1	\$ 56,172	\$ 63,938
Acquisitions	1,331	1,084
Improvements	73	211
Disposals	(2,022 )	(1,316)
Writedowns to fair value	(929 )	(1,912)
Reclassification of covered loans	-	(421)
Balance March 31	\$ 54,625	\$ 61,584

The following table details our most significant nonperforming loan relationships at March 31, 2013.

Table IX - Significant Nonperforming Loan Relationships  
March 31,  
2013  
Dollars in thousands

Location	Underlying Collateral	Loan Origination Date	Loan Nonaccrual Date	Loan Balance	Method Used to Measure Impairment	Most Recent Appraised Value	Amount Allocated to Allowance for Loan Losses	Amount Previously Charged-off
Southwestern WV	Accounts Receivable, Inventory, Equipment, & Commercial Real Estate	Oct. 2007	Jun. 2012	\$2,239	Collateral Value	\$3,254	(2) \$309	\$565
Shenandoah Valley VA	Residential Building Lots	Aug. 2004, July 2005, & July 2007	Jun. 2011	\$1,461	Collateral value	\$1,780	(1) \$-	\$405
Northern VA	Single family residence & Business Investment	Aug. 2007, Oct. 2007 & Sept. 2008	Dec. 2011	\$12,565	Collateral value	\$10,000	(1) \$3,565	\$-
Eastern Panhandle	Residential development	Mar. 2008 & June	Jun. 2011	\$7,279	Collateral value	\$8,158	(1) \$879	\$1,134

WV	& undeveloped acreage	2008							
Shenandoah Valley VA	Residential Subdivision & 2 single family residential building lots	Jun. 2008	Sept. 2011	\$1,403	Collateral value	\$1,552	(1)	\$6	\$552
Southcentral WV	UCC Business Assets & Residential Subdivision	Feb. 2003, Mar. 2008 & Apr. 2008	May 2011 & Jul. 2011	\$1,220	Collateral value	\$1,594	(2)	\$36	\$-

(1) - Values are based upon recent external appraisal.

(2) - Value is based upon current appraisal on the real estate and most recent estimate on business assets.

Refer to Note 6 of the accompanying consolidated financial statements for information regarding our past due loans, impaired loans, nonaccrual loans, and troubled debt restructurings.

We maintain the allowance for loan losses at a level considered adequate to provide for estimated probable credit losses inherent in the loan portfolio. The allowance is comprised of three distinct reserve components: (1) specific reserves related to loans individually evaluated, (2) quantitative reserves related to loans collectively evaluated, and (3) qualitative reserves related to loans collectively evaluated. A summary of the methodology we employ on a quarterly basis with respect to each of these components in order to evaluate the overall adequacy of our allowance for loan losses is as follows:

51

---

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



#### Specific Reserve for Loans Individually Evaluated

First, we identify loan relationships having aggregate balances in excess of \$500,000 and that may also have credit weaknesses. Such loan relationships are identified primarily through our analysis of internal loan evaluations, past due loan reports, and loans adversely classified by regulatory authorities. Each loan so identified is then individually evaluated to determine whether it is impaired – that is, based on current information and events, it is probable that we will be unable to collect all amounts due in accordance with the contractual terms of the underlying loan agreement. Substantially all of our impaired loans are and historically have been collateral dependent, meaning repayment of the loan is expected to be provided solely from the sale of the loan's underlying collateral. For such loans, we measure impairment based on the fair value of the loan's collateral, which is generally determined utilizing current appraisals. A specific reserve is established in an amount equal to the excess, if any, of the recorded investment in each impaired loan over the fair value of its underlying collateral, less estimated costs to sell. Our policy is to re-evaluate the fair value of collateral dependent loans at least every twelve months unless there is a known deterioration in the collateral's value, in which case a new appraisal is obtained.

#### Quantitative Reserve for Loans Collectively Evaluated

Second, we stratify the loan portfolio into the following ten loan pools: land and land development, construction, commercial, commercial real estate -- owner-occupied, commercial real estate -- non-owner occupied, conventional residential mortgage, jumbo residential mortgage, home equity, consumer, and other. Loans within each pool are then further segmented between (1) loans which were individually evaluated for impairment and not deemed to be impaired, (2) larger-balance loan relationships exceeding \$2 million which are assigned an internal risk rating in conjunction with our normal ongoing loan review procedures and (3) smaller-balance homogenous loans.

Quantitative reserves relative to each loan pool are established as follows: for all loan segments detailed above an allocation equaling 100% of the respective pool's average 12 month historical net loan charge-off rate (determined based upon the most recent twelve quarters) is applied to the aggregate recorded investment in the pool of loans.

#### Qualitative Reserve for Loans Collectively Evaluated

Third, we consider the necessity to adjust our average historical net loan charge-off rates relative to each of the above ten loan pools for potential risk factors that could result in actual losses deviating from prior loss experience. For example, if we observe a significant increase in delinquencies within the conventional mortgage loan pool above historical trends, an additional allocation to the average historical loan charge-off rate is applied. Such qualitative risk factors considered are: (1) levels of and trends in delinquencies and impaired loans, (2) levels of and trends in charge-offs and recoveries, (3) trends in volume and term of loans, (4) effects of any changes in risk selection and underwriting standards, and other changes in lending policies, procedures, and practice, (5) experience, ability, and depth of lending management and other relevant staff, (6) national and local economic trends and conditions, (7) industry conditions, and (8) effects of changes in credit concentrations.

### Relationship between Allowance for Loan Losses, Net Charge-offs and Nonperforming Loans

In analyzing the relationship between the allowance for loan losses, net loan charge-offs and nonperforming loans, it is helpful to understand the process of how loans are treated as they deteriorate over time. Reserves for loans are established at origination through the quantitative and qualitative reserve process discussed above.

Charge-offs, if necessary, are typically recognized in a period after the reserves were established. If the previously established reserves exceed that needed to satisfactorily resolve the problem credit, a reduction in the overall level of the reserve could be recognized. In summary, if loan quality deteriorates, the typical credit sequence is periods of reserve building, followed by periods of higher net charge-offs.

Consumer loans are generally charged off to the allowance for loan losses upon reaching specified stages of delinquency, in accordance with the Federal Financial Institutions Examination Council policy. For example, credit card loans are charged off by the end of the month in which the account becomes 180 days past due or within 60 days from receiving notification about a specified event (e.g., bankruptcy of the borrower), whichever is earlier. Residential mortgage loans are generally charged off to net realizable value no later than when the account becomes 180 days past due. Other consumer loans, if collateralized, are generally charged off to net realizable value at 120 days past due.

Commercial-related loans (which are risk-rated) are charged off to the allowance for loan losses when the loss has been confirmed. This determination includes many factors, including the prioritization of our claim in bankruptcy, expectations of the workout/restructuring of the loan and valuation of the borrower's equity.

Substantially all of our nonperforming loans are secured by real estate. The majority of these loans were underwritten in accordance with our loan-to-value policy guidelines which range from 70-85% at the time of origination. The fair values of the underlying collateral value remains in excess of the recorded investment in many of our nonperforming loans, and therefore, no specific reserve allocation is required; as of March 31, 2013, approximately 58% of our impaired loans required no reserves or have been charged down to their fair value.

At March 31, 2013, December 31, 2012, and March 31, 2012, our allowance for loan losses totaled \$17.0 million, or 1.77% of total loans, \$17.9 million, or 1.88% of total loans and \$18.5 million, or 1.89% of total loans, respectively, and is considered adequate to cover our estimate of probable credit losses inherent in our loan portfolio.

At March 31, 2013, December 31, 2012, and March 31, 2012, we had approximately \$54.6 million, \$56.2 million and \$61.6 million, respectively, in other real estate owned which was obtained as the result of foreclosure proceedings. Although foreclosed property is recorded at fair value less estimated costs to sell, the prices ultimately realized upon their sale may or may not result in us recognizing loss.

## FINANCIAL CONDITION

Our total assets were \$1.390 billion at March 31, 2013, compared to \$1.387 billion at December 31, 2012, representing a 0.22% increase. Table VIII below serves to illustrate significant changes in our financial position between December 31, 2012 and March 31, 2013.

Table VIII - Summary of Significant Changes in Financial Position

Dollars in thousands	Balance	Increase (Decrease)		Balance
	December 31, 2012	Amount	Percentage	March 31, 2013
<b>Assets</b>				
Securities available for sale	\$281,539	1,515	0.5	% \$283,054
Loans, net of unearned interest	937,168	8,573	0.9	% 945,741
<b>Liabilities</b>				
Deposits	\$1,027,125	\$39,192	3.8	% \$1,066,317
Short-term borrowings	3,958	2,002	50.6	% 5,960
Long-term borrowings	203,268	(39,680)	-19.5	% 163,588
Subordinated debentures	16,800	-	0.0	% 16,800
Subordinated debentures owed to unconsolidated subsidiary trusts	19,589	-	0.0	% 19,589

Loans and securities increased slightly during the first three months of 2013. We have slowed our loan growth due to the current weakened economic conditions in our market areas and limited availability of new capital resources.

Deposits increased approximately \$39.2 million during the first three months of 2013; brokered deposits increased approximately \$23.2 million.

The decrease in long term borrowings is primarily attributable to maturities and repayments of long-term FHLB advances during the first three months of 2013.

Refer to Notes 5, 6, 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, 2013 and December 31, 2012.

## LIQUIDITY AND CAPITAL RESOURCES

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 (net of float and reserves), Federal funds sold, non-pledged securities, and available lines of credit with the Federal Home Loan Bank of Pittsburgh (“FHLB”) and Federal Reserve Bank of Richmond, which totaled approximately \$488 million or 35.1% of total consolidated assets at March 31, 2013.

Our liquidity strategy is to fund loan growth with deposits and other borrowed funds while maintaining an adequate level of short- and medium-term investments to meet normal daily loan and deposit

54

---

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

activity. As a member of the FHLB, we have access to approximately \$335 million. As of March 31, 2013 and December 31, 2012, these advances totaled approximately \$83 million and \$126 million, respectively. At March 31, 2013, we had additional borrowing capacity of \$252 million through FHLB programs. We have established a line with the Federal Reserve Bank to be used as a contingency liquidity vehicle. The amount available on this line at March 31, 2013 was approximately \$82 million, which is secured by a pledge of our consumer and commercial and industrial loan portfolios. We have a \$6 million unsecured line of credit with a correspondent bank. Also, we classify all of our securities as available for sale to enable us to liquidate them if the need arises.

Liquidity risk represents the risk of loss due to the possibility that funds may not be available to satisfy current or future commitments based on external market issues, customer or creditor perception of financial strength, and events unrelated to Summit such as war, terrorism, or financial institution market specific issues. The Asset/Liability Management Committee (“ALCO”), comprised of members of senior management and certain members of the Board of Directors, oversees our liquidity risk management process. The ALCO develops and recommends policies and limits governing our liquidity to the Board of Directors for approval with the objective of ensuring that we can obtain cost-effective funding to meet current and future obligations, as well as maintain sufficient levels of on-hand liquidity, under both normal and “stressed” circumstances.

One aspect of our liquidity management process is establishing contingency liquidity funding plans under various scenarios in order to prepare for unexpected liquidity shortages or events. The following represents three “stressed” liquidity circumstances and our related contingency plans with respect to each.

Scenario 1 – Summit Community’s capital status becomes less than “well capitalized”. Banks which are less than “well capitalized” in accordance with regulatory capital guidelines are prohibited from issuing new brokered deposits without first obtaining a waiver from the FDIC to do so. In the event Summit Community’s capital status were to fall below well capitalized and was not successful in obtaining the FDIC’s waiver to issue new brokered deposits, Summit Community:

- Would have limited amounts of maturing brokered deposits to replace in the short-term, as we have limited our brokered deposits maturing in any one quarter to no more than \$50 million.
- Presently has \$488 million in available sources of liquid funds which could be drawn upon to fund maturing brokered deposits until Summit Community had restored its capital to well capitalized status.
- Would first seek to restore its capital to well capitalized status through capital contributions from Summit, its parent holding company.
- Would generally have no more than \$100 million in brokered deposits maturing in any one year time frame, which is well within its presently available sources of liquid funds, if in the event Summit does not have the capital resources to restore Summit Community’s capital to well capitalized status. One year would give Summit Community ample time to raise alternative funds either through retail deposits or the sale of assets, and obtain capital resources to restore it to well capitalized status.

Scenario 2 – Summit Community’s credit quality deteriorates such that the FHLB restricts further advances. If in the event that the Bank’s credit quality deteriorated to the point that further advances under its line with the FHLB were restricted, Summit Community:

- Would severely curtail lending and other growth activities until such time as access to this line could be restored, thus eliminating the need for net new advances, and
- Would still have available current liquid funding sources secured by unencumbered loans and securities totaling \$267 million aside from its FHLB line, which would result in a funding source of approximately \$225 million.

Scenario 3 – A competitive financial institution offers a retail deposit program at interest rates significantly above current market rates in the Summit Community’s market areas. If a competitive financial institution offered a retail deposit program at rates well in excess of current market rates in the Summit Community’s market area, the Bank:

- Presently has \$488 million in available sources of liquid funds which could be drawn upon immediately to fund any “net run off” of deposits from this activity.
- Would severely curtail lending and other growth activities so as to preserve the availability of as much contingency funds as possible.
- Would begin offering its own competitive deposit program when deemed prudent so as to restore the retail deposits lost to the competition.

We continuously monitor our liquidity position 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.

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, 2013 totaled \$110.0 million compared to \$108.6 million at December 31, 2012.

Summit and Summit Community have entered into informal Memoranda of Understanding (“MOU’s”) with their respective regulatory authorities. A memorandum of understanding is characterized by the regulatory authorities as an informal action that is not published or publicly available and that is used when circumstances warrant a milder form of action than a formal supervisory action, such as a formal written agreement or order. Among other things, under the MOU’s, Summit’s management team has agreed to:

- The Bank achieving and maintaining a minimum Tier 1 leverage capital ratio of at least 8% and a total risk-based capital ratio of at least 11%;
- The Bank providing 30 days prior notice of any declaration of intent to pay cash dividends to provide the Bank’s regulatory authorities an opportunity to object;
- Summit suspending all cash dividends on its common stock until further notice. Dividends on all preferred stock, as well as interest payments on subordinated notes underlying Summit’s trust preferred securities, continue to be permissible; and,
- Summit not incurring any additional debt, other than trade payables, without the prior written consent of the principal banking regulators.

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

On October 25, 2012, the Bank entered into a revised MOU (“Bank MOU”) which replaced the Bank MOU effective September 24, 2009 and subsequently amended on February 1, 2011. In general, the Bank MOU includes provisions substantially similar to those in the prior Bank MOU with the exception that several provisions deemed no longer applicable by the regulatory authorities were removed and a provision relative to reducing the Bank’s levels of classified assets was added.

In summary, we have agreed, among other things, to address the following matters relative to the Bank:

- maintaining a Board committee which monitors and promotes compliance with the provisions of the Bank MOU;
- providing the Bank’s regulatory authorities with updated reports of criticized assets and/or formal workout plans for all nonperforming borrower relationships with an aggregate outstanding balance exceeding \$1 million;
- developing and submitting to regulatory authorities a written plan to reduce the Bank’s risk exposure in each adversely classified credit relationship in excess of \$1 million and all OREO;
  - establishing procedures to report all loans with balances exceeding \$500,000 that have credit weaknesses or that fall outside of the Bank’s policy;
    - annually reviewing the organizational structure and operations of the Bank’s loan department;
  - maintaining an adequate allowance for loan and lease losses through charges to current operating income;
- reviewing overall liquidity objectives and developing and submitting to regulatory authorities plans and procedures aimed to improve liquidity and reduce reliance on volatile liabilities;
- preparing comprehensive budgets and earnings forecasts for the Bank and submitting reports comparing actual performance to the budget plan;
- maintaining a minimum Tier 1 Leverage Capital ratio of at least 8% and a Total Risk-based Capital ratio of at least 11%;
  - not paying any cash dividends without the prior written consent of the banking regulators; and,
- providing quarterly progress reports to the Bank’s regulatory authorities detailing steps taken to comply with the Bank MOU.

Dividends on Summit’s preferred stock, as well as interest payments on our subordinated debt and junior subordinated debentures underlying our trust preferred securities, continue to be permissible. However, such dividends and interest payments on our preferred stock and trust preferred debt are subject to future review by the regulatory authorities should we continue to experience deterioration in our financial condition.



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

Although dividends from Summit Community are the principal source of funds to pay dividends, interest, and principal payments on Summit's preferred stock, subordinated debentures (including those owed to unconsolidated subsidiary trusts), and term borrowings, we currently have sufficient cash on hand to continue to service our subordinated debentures and term borrowings obligations as well as the expected dividend payments on our preferred stock through early 2015. Nevertheless, we can make no assurances that we will continue to have sufficient funds available for Summit's debt service and for distributions to the holders of our preferred stock.

Refer to Note 13 of the notes to the accompanying consolidated financial statements for additional 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, 2013.

Table IX -  
Contractual  
Cash  
Obligations

	Long Term Debt	Capital Trust Securities	Operating Leases
Dollars in thousands			
2013	\$ 72	\$ -	\$ 190
2014	82,527	-	209
2015	11,909	-	38
2016	28,911	-	-
2017	918	-	-
Thereafter	56,051	19,589	-
Total	\$ 180,388	\$ 19,589	\$ 437

#### 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, 2013 are presented in the following table.

Table X -  
Off-Balance  
Sheet  
Arrangements

	March 31, 2013
Dollars in thousands	
Commitments to extend credit:	

Revolving home equity and	
credit	
card lines	\$ 47,857
Construction	
loans	17,339
Other loans	29,274
Standby letters of credit	1,830
Total	\$ 96,300

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. The nature of our lending and funding activities tends to drive our interest rate risk position to being 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, except for the up 400 scenario, which assumes a gradual increase in rates over 24 months. 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 presents the estimated sensitivity of our net interest income to changes in interest rates, as measured by our earnings simulation model as of March 31, 2013. The sensitivity is measured as a percentage change in net interest income given the stated changes in interest rates (gradual change over 12 months, stable thereafter for the down 100 and the up 200 scenarios, and gradual change over 24 months for the up 400 scenario) compared to net interest income with rates unchanged in the same period. The estimated changes set forth below are dependent on the assumptions discussed above and are well within our ALCO policy limit, which is a 10% reduction in net interest income over the ensuing twelve month period.

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

Change in Interest Rates	Estimated (basis points)	% Change in Net Interest Income Over:	% Change in Net Interest Income Over:
	0-12 Months	13-24 Months	
Down	100 (1) 0.25	7.22%	
Up 200	(1) -2.15	-3.33%	
Up 400	(2) -0.99	-5.29%	

(1) assumes a parallel shift in the yield curve  
 (2) assumes 400 bp increase over 24 months

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, 2013, 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, 2013 were effective. There were no changes in our internal control over financial reporting that occurred during the quarter ended March 31, 2013 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

Summit Financial Group, Inc. and Subsidiaries  
Part II. Other Information

Item 1. Legal Proceedings

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

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, 2012.

Item 6. Exhibits

Exhibit 3.i	Amended and Restated Articles of Incorporation of Summit Financial Group, Inc.
Exhibit 3.ii	Articles of Amendment 2009
Exhibit 3.iii	Articles of Amendment 2011
Exhibit 3.iv	Amended and Restated By-Laws of Summit Financial Group, Inc.
Exhibit 11	Statement re: Computation of Earnings per Share – Information contained in Note 4 to the Consolidated Financial Statements on page 15 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
Exhibit 101	Interactive Data File (XBRL)



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: April 30, 2013

## EXHIBIT INDEX

Exhibit No.	Description	Page Number
(3)	Articles of Incorporation and By-laws:	
	(i) Amended and Restated Articles of Incorporation of Summit Financial Group, Inc.	(a)
	(ii) Articles of Amendment 2009	(b)
	(iii) Articles of Amendment 2011	(c)
	(iv) Amended and Restated By-laws of Summit Financial Group, Inc.	(d)
11	Statement re: Computation of Earnings per Share	15
31.1	Sarbanes-Oxley Act Section 302 Certification of Chief Executive Officer	
31.2	Sarbanes-Oxley Act Section 302 Certification of Chief Financial Officer	
32.1*	Sarbanes-Oxley Act Section 906 Certification of Chief Executive Officer	
32.2*	Sarbanes-Oxley Act Section 906 Certification of Chief Financial Officer	
101**	Interactive data file (XBRL)	

\* Furnished, not filed.

\*\* As provided in Rule 406T of Regulation S-T, this information is furnished and not filed for purposes of Sections 11 and 12 of the Securities Act of 1933 and Section 18 of the Securities Exchange Act of 1934.

- (a) Incorporated by reference to Exhibit 3.i of Summit Financial Group, Inc.'s filing on Form 10-Q dated March 31, 2006.
- (b) Incorporated by reference to Exhibit 3.1 of Summit Financial Group, Inc.'s filing on Form 8-K dated September 30, 2009.
- (c) Incorporated by reference to Exhibit 3.1 of Summit Financial Group, Inc.'s filing on Form 8-K dated November 3, 2011.
- (d) Incorporated by reference to Exhibit 3.2 of Summit Financial Group, Inc.'s filing on Form 10-Q dated June 30, 2006.

