

SUMMIT FINANCIAL GROUP INC  
Form 10-Q  
August 07, 2013

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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 June 30, 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 (IRS  
other Employer  
jurisdiction of  
incorporation Identification  
or No.)  
organization)

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

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

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Sections 13 or 15(d) of the Securities and Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if

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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  
7,443,422 shares outstanding as of August 2, 2013

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Summit Financial Group, Inc. and Subsidiaries  
Table of Contents

|                                      | Page  |       |
|--------------------------------------|---|-------|
| <b>PART I. FINANCIAL INFORMATION</b> |   |       |
| Item 1.                              | Financial Statements  |       |
|                                      | Consolidated balance sheets<br>June 30, 2013 (unaudited), December 31,<br>2012,<br>and June 30, 2012 (unaudited)            | 4     |
|                                      | Consolidated statements of income<br>for the three and six months ended<br>June 30, 2013 and 2012 (unaudited)               | 5     |
|                                      | Consolidated statements of comprehensive<br>income for the three and six months ended<br>June 30, 2013 and 2012 (unaudited) | 6     |
|                                      | Consolidated statements of shareholders'<br>equity<br>for the six months ended<br>June 30, 2013 and 2012 (unaudited)        | 7     |
|                                      | Consolidated statements of cash flows<br>for the six months ended<br>June 30, 2013 and 2012 (unaudited)                     | 8-9   |
|                                      | Notes to consolidated financial statements<br>(unaudited)   | 10-41 |
| Item 2.                              | Management's Discussion and Analysis of<br>Financial Condition<br>and Results of Operations                                 | 42-58 |
| Item 3.                              | Quantitative and Qualitative Disclosures<br>about Market Risk   | 57    |
| Item 4.                              | Controls and Procedures   | 58    |

Summit Financial Group, Inc. and Subsidiaries  
Table of Contents

|                  |  |      |
|------------------|--|------|
| PART II.         | OTHER<br>INFORMATION   |      |
| Item 1.          | Legal Proceedings  | 59   |
| Item 1A.         | Risk Factors   | 59   |
| Item 2.          | Unregistered Sales of Equity Securities and Use<br>of Proceeds | None |
| Item 3.          | Defaults upon Senior Securities                                | None |
| Item 4.          | Mine Safety Disclosures  | None |
| Item 5.          | Other Information  | None |
| Item 6.          | Exhibits   | 59   |
| SIGNATURES       |  | 60   |
| EXHIBIT<br>INDEX |  | 61   |

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

| Dollars in thousands   | June 30,<br>2013<br>(unaudited) | December 31,<br>2012<br>(*) | June 30,<br>2012<br>(unaudited) |
|--|---------------------------------|-----------------------------|---------------------------------|
| <b>ASSETS</b>  |                                 |                             |                                 |
| Cash and due from banks  | \$ 4,336                        | \$ 3,833                    | \$ 4,266                        |
| Interest bearing deposits with<br>other banks                          | 7,971                           | 10,969                      | 14,288                          |
| Cash and cash equivalents  | 12,307                          | 14,802                      | 18,554                          |
| Securities available for sale  | 291,180                         | 281,539                     | 289,151                         |
| Other investments  | 7,411                           | 14,658                      | 17,506                          |
| Loans held for sale, net   | 1,080                           | 226                         | 622                             |
| Loans, net   | 925,979                         | 937,168                     | 948,294                         |
| Property held for sale   | 47,258                          | 56,172                      | 60,069                          |
| Premises and equipment, net  | 20,936                          | 21,129                      | 21,470                          |
| Accrued interest receivable  | 5,718                           | 5,621                       | 5,515                           |
| Intangible assets  | 8,124                           | 8,300                       | 8,475                           |
| Cash surrender value of life<br>insurance policies                     | 30,027                          | 29,553                      | 29,808                          |
| Other assets   | 19,950                          | 17,936                      | 16,977                          |
| <b>Total assets</b>  | <b>\$ 1,369,970</b>             | <b>\$ 1,387,104</b>         | <b>\$ 1,416,441</b>             |
| <b>LIABILITIES AND<br/>SHAREHOLDERS' EQUITY</b>                        |                                 |                             |                                 |
| <b>Liabilities</b>   |                                 |                             |                                 |
| Deposits   |                                 |                             |                                 |
| Non interest bearing   | \$ 92,147                       | \$ 100,592                  | \$ 96,172                       |
| Interest bearing   | 946,016                         | 926,533                     | 905,497                         |
| <b>Total deposits</b>  | <b>1,038,163</b>                | <b>1,027,125</b>            | <b>1,001,669</b>                |
| Short-term borrowings  | 16,762                          | 3,958                       | 10,957                          |
| Long-term borrowings   | 163,565                         | 203,268                     | 253,635                         |
| Subordinated debentures  | 16,800                          | 16,800                      | 16,800                          |
| Subordinated debentures<br>owed to unconsolidated<br>subsidiary trusts | 19,589                          | 19,589                      | 19,589                          |
| Other liabilities  | 7,880                           | 7,809                       | 8,084                           |
| <b>Total liabilities</b>   | <b>1,262,759</b>                | <b>1,278,549</b>            | <b>1,310,734</b>                |
| <b>Commitments and<br/>Contingencies</b>                               |                                 |                             |                                 |
| <b>Shareholders' Equity</b>  |                                 |                             |                                 |
| Preferred stock and related<br>surplus - authorized 250,000<br>shares; |                                 |                             |                                 |
| Series 2009, 8%<br>Non-cumulative convertible                          |                                 |                             |                                 |

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|  |              |              |              |
|--|--------------|--------------|--------------|
| preferred stock,<br>par value \$1.00; issued<br>3,710 shares   | 3,519        | 3,519        | 3,519        |
| Series 2011, 8%<br>Non-cumulative convertible<br>preferred stock,<br>par value \$1.00; issued<br>2013 - 11,978, 2012 - 12,000<br>shares                                  | 5,796        | 5,807        | 5,807        |
| Common stock and related<br>surplus - authorized<br>20,000,000 shares;<br>\$2.50 par value; issued<br>and outstanding 2013 -<br>7,440,222 and<br>2012 - 7,425,472 shares | 24,593       | 24,520       | 24,520       |
| Retained earnings  | 72,462       | 69,841       | 67,126       |
| Accumulated other<br>comprehensive income  | 841          | 4,868        | 4,735        |
| Total shareholders' equity   | 107,211      | 108,555      | 105,707      |
| Total liabilities and<br>shareholders' equity  | \$ 1,369,970 | \$ 1,387,104 | \$ 1,416,441 |

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

See Notes to Consolidated Financial Statements

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| Dollars in thousands, except per share amounts                  | Three Months Ended |               | Six Months Ended |               |
|---|--------------------|---------------|------------------|---------------|
|   | June 30, 2013      | June 30, 2012 | June 30, 2013    | June 30, 2012 |
| <b>Interest income</b>  |                    |               |                  |               |
| Interest and fees on loans                                      |                    |               |                  |               |
| Taxable   | \$ 12,734          | \$ 13,960     | \$ 25,568        | \$ 28,239     |
| Tax-exempt  | 65                 | 81            | 135              | 167           |
| Interest and dividends on securities                            |                    |               |                  |               |
| Taxable   | 926                | 1,554         | 1,956            | 3,252         |
| Tax-exempt  | 581                | 671           | 1,215            | 1,393         |
| Interest on interest bearing deposits with other banks          |                    |               |                  |               |
|   | 2                  | 12            | 3                | 24            |
| <b>Total interest income</b>                                    | <b>14,308</b>      | <b>16,278</b> | <b>28,877</b>    | <b>33,075</b> |
| <b>Interest expense</b>   |                    |               |                  |               |
| Interest on deposits  |                    |               |                  |               |
|   | 2,820              | 3,360         | 5,588            | 7,073         |
| Interest on short-term borrowings                               |                    |               |                  |               |
|   | 9                  | 10            | 26               | 16            |
| Interest on long-term borrowings and subordinated debentures    |                    |               |                  |               |
|   | 1,975              | 2,937         | 4,001            | 5,997         |
| <b>Total interest expense</b>                                   | <b>4,804</b>       | <b>6,307</b>  | <b>9,615</b>     | <b>13,086</b> |
| <b>Net interest income</b>                                      | <b>9,504</b>       | <b>9,971</b>  | <b>19,262</b>    | <b>19,989</b> |
| Provision for loan losses                                       | 1,000              | 2,001         | 2,500            | 4,002         |
| <b>Net interest income after provision for loan losses</b>      | <b>8,504</b>       | <b>7,970</b>  | <b>16,762</b>    | <b>15,987</b> |
| <b>Other income</b>   |                    |               |                  |               |
| Insurance commissions   |                    |               |                  |               |
|   | 1,132              | 1,141         | 2,316            | 2,299         |
| Service fees related to deposit accounts                        |                    |               |                  |               |
|   | 1,085              | 1,075         | 2,096            | 2,089         |
| Realized securities gains (losses)                              |                    |               |                  |               |
|   | (57 )              | 320           | (16 )            | 1,485         |
| Loss on sale of assets  | (512 )             | (523 )        | (552 )           | (599)         |
| Write-down of foreclosed properties                             |                    |               |                  |               |
|   | (1,494 )           | (1,631 )      | (2,423 )         | (3,543)       |
| Other   | 559                | 552           | 1,123            | 1,135         |
| <b>Total other-than-temporary impairment loss on securities</b> | <b>(27 )</b>       | <b>(370 )</b> | <b>(117 )</b>    | <b>(882)</b>  |
| Portion of loss recognized in other comprehensive income        |                    |               |                  |               |
|   | -                  | 264           | 37               | 547           |
| <b>Net impairment loss recognized in earnings</b>               | <b>(27 )</b>       | <b>(106 )</b> | <b>(80 )</b>     | <b>(335)</b>  |
| <b>Total other income</b>                                       | <b>686</b>         | <b>828</b>    | <b>2,464</b>     | <b>2,531</b>  |
| <b>Other expense</b>  |                    |               |                  |               |
| Salaries, commissions, and employee benefits                    |                    |               |                  |               |
|   | 3,987              | 3,892         | 8,104            | 7,793         |

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|  |          |         |          |          |
|--|----------|---------|----------|----------|
| Net occupancy expense                  | 476      | 490     | 932      | 968      |
| Equipment expense                      | 559      | 605     | 1,157    | 1,210    |
| Professional fees                      | 360      | 242     | 611      | 558      |
| Amortization of intangibles            | 88       | 88      | 176      | 176      |
| FDIC premiums                          | 515      | 500     | 1,055    | 1,022    |
| Foreclosed properties expense          | 295      | 233     | 575      | 595      |
| Other                                  | 1,241    | 1,245   | 2,504    | 2,512    |
| Total other expense                    | 7,521    | 7,295   | 15,114   | 14,834   |
| Income before income taxes             | 1,669    | 1,503   | 4,112    | 3,684    |
| Income tax expense                     | 452      | 590     | 1,102    | 1,073    |
| Net Income                             | 1,217    | 913     | 3,010    | 2,611    |
| Dividends on preferred shares          | 194      | 194     | 388      | 388      |
| Net Income applicable to common shares | \$ 1,023 | \$ 719  | \$ 2,622 | \$ 2,223 |
|  |          |         |          |          |
| Basic earnings per common share        | \$ 0.14  | \$ 0.10 | \$ 0.35  | \$ 0.30  |
| Diluted earnings per common share      | \$ 0.13  | \$ 0.09 | \$ 0.31  | \$ 0.27  |

See Notes to Consolidated  
Financial Statements



|   |      |          | For the Three Months Ended<br>June 30, |       |
|---|------|----------|--|-------|
| Dollars in thousands  | 2013 |          | 2012                                   |       |
| Net income  | \$   | 1,217    | \$                                     | 913   |
| Other comprehensive income (loss):  |      |          |  |       |
| Non-credit related other-than-temporary impairment on available for sale debt securities - 2013 - \$0, net of deferred taxes of \$0; 2012 - \$264, net of deferred taxes of \$100   |      | -        |  | (164) |
| Net unrealized gain (loss) on available for sale debt securities of:  |      |          |  |       |
| 2013 - (\$6,174) net of deferred taxes of \$2,346 and reclassification adjustment for net realized (losses) included in net income of (\$57); 2012 - \$1,213, net of deferred taxes of \$461 and reclassification adjustment for net realized gains included in net income of \$320 |      | (3,828 ) |  | 752   |
| Total comprehensive income (loss)   | \$   | (2,611 ) | \$                                     | 1,501 |

|  |      |       | For the Six Months Ended<br>June 30, |       |
|--|------|-------|--------------------------------------|-------|
| Dollars in thousands   | 2013 |       | 2012                                 |       |
| Net income   | \$   | 3,010 | \$                                   | 2,611 |
| Other comprehensive income (loss):   |      |       |                                      |       |
| Non-credit related other-than-temporary impairment on available for sale debt securities - |      |       |                                      |       |

|   |             |    |       |
|---|-------------|----|-------|
| 2013- \$37, net of<br>deferred  |             |    |       |
| taxes of  |             |    |       |
| \$14; 2012 - \$547, net<br>of deferred taxes of                                       |             |    |       |
| \$208   | (23 )       |    | (339) |
| Net unrealized gain<br>(loss) on available for<br>sale debt securities                |             |    |       |
| of:   |             |    |       |
| 2013 - (\$6,460) net of deferred taxes of<br>\$2,455 and reclassification adjustment  |             |    |       |
| for net realized (losses) included in net<br>income of (\$16); 2012 - \$2,027, net of |             |    |       |
| deferred taxes of \$770 and<br>reclassification adjustment for net                    |             |    |       |
| realized  |             |    |       |
| gains included in   |             |    |       |
| net income of \$1,485   | (4,005 )    |    | 1,257 |
| Total   |             |    |       |
| comprehensive   |             |    |       |
| income (loss)   | \$ (1,018 ) | \$ | 3,529 |

See Notes to  
Consolidated  
Financial Statements

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

|   | Series 2009<br>Preferred<br>Stock and<br>Related<br>Surplus | Series 2011<br>Preferred<br>Stock and<br>Related<br>Surplus | Common<br>Stock and<br>Related<br>Surplus | Retained<br>Earnings | Accumulated<br>Other<br>Compre-<br>hensive<br>Income | Total<br>Share-<br>holders'<br>Equity |
|---|---|---|---|----------------------|--|---------------------------------------|
| Dollars in thousands, except per share amounts                          |   |   |   |                      |  |                                       |
| Balance, December 31, 2012  | \$3,519   | \$5,807   | \$24,520                                  | \$69,840             | \$ 4,869   | \$108,555                             |
| Six Months Ended June 30, 2013  |   |   |   |                      |  |                                       |
| Comprehensive income:   |   |   |   |                      |  |                                       |
| Net income  | -   | -   | -   | 3,010                | -  | 3,010                                 |
| Other comprehensive income (loss)                                       |   |   |   |                      | (4,028 )   | (4,028)                               |
| Total comprehensive income (loss)                                       |   |   |   |                      |  | (1,018)                               |
| Exercise of stock options   | -   | -   | 61  | -                    | -  | 61                                    |
| Stock compensation expense  | -   | -   | 1   | -                    | -  | 1                                     |
| Series 2009 Preferred Stock cash dividends declared (\$40.00 per share) | -   | -   | -   | (148 )               | -  | (148)                                 |
| Series 2011 Preferred Stock cash dividends declared (\$20.00 per share) | -   | -   | -   | (240 )               | -  | (240)                                 |
| Conversion of Series 2011 Preferred Stock to Common Stock               | -   | (11 )   | 11  |                      |  |                                       |
| Balance, June 30, 2013  | \$3,519   | \$5,796   | \$24,593                                  | \$72,462             | \$ 841   | \$107,211                             |
| Balance, December 31, 2011  | \$3,519   | \$5,807   | \$24,519                                  | \$64,903             | \$ 3,817   | \$102,565                             |
| Six Months Ended June 30, 2012  |   |   |   |                      |  |                                       |
| Comprehensive income:   |   |   |   |                      |  |                                       |
| Net income  | -   | -   | -   | 2,611                | -  | 2,611                                 |
| Other comprehensive income  |   |   |   |                      | 918  | 918                                   |
| Total comprehensive income  |   |   |   |                      |  | 3,529                                 |
| Stock compensation expense  | -   | -   | 1   | -                    | -  | 1                                     |
| Series 2009 Preferred Stock cash dividends declared (\$40.00 per share) | -   | -   | -   | (148 )               | -  | (148)                                 |
| Series 2011 Preferred Stock cash dividends declared (\$20.00 per share) | -   | -   | -   | (240 )               | -  | (240)                                 |

|                        |         |         |          |          |          |           |
|------------------------|---------|---------|----------|----------|----------|-----------|
| Balance, June 30, 2012 | \$3,519 | \$5,807 | \$24,520 | \$67,126 | \$ 4,735 | \$105,707 |
|------------------------|---------|---------|----------|----------|----------|-----------|

See Notes to Consolidated  
Financial Statements

7

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

| Dollars in thousands  | Six Months Ended |                  |
|---|------------------|------------------|
|   | June 30,<br>2013 | June 30,<br>2012 |
| Cash Flows from Operating Activities  |                  |                  |
| Net income  | \$ 3,010         | \$ 2,611         |
| Adjustments to reconcile net earnings to net cash provided by operating activities: |                  |                  |
| Depreciation  | 587              | 676              |
| Provision for loan losses   | 2,500            | 4,002            |
| Stock compensation expense  | 1                | 1                |
| Deferred income tax expense (benefit)   | 360              | (586)            |
| Loans originated for sale   | (4,624 )         | (4,875)          |
| Proceeds from loans sold  | 3,770            | 4,253            |
| Securities (gains) losses   | 16               | (1,485)          |
| Other-than-temporary impairment of securities                                       | 80               | 335              |
| Loss on disposal of assets  | 552              | 599              |
| Write down of foreclosed properties   | 2,423            | 3,543            |
| Amortization of securities premiums (accretion of discounts), net                   | 3,002            | 1,882            |
| Amortization of goodwill and purchase accounting adjustments, net                   | 181              | 182              |
| (Increase) decrease in accrued interest receivable                                  | (97 )            | 269              |
| (Increase) in cash surrender value of bank owned life insurance                     | (474 )           | (524)            |
| (Increase) decrease in other assets   | 1,009            | (1,244)          |
| (Decrease) in other liabilities   | (929 )           | (494)            |

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|  |          |          |
|--|----------|----------|
| Net cash provided by operating activities                                | 11,367   | 9,145    |
| Cash Flows from Investing Activities                                     |          |          |
| Proceeds from maturities and calls of securities available for sale      | 1,058    | 2,736    |
| Proceeds from sales of securities available for sale                     | 29,389   | 51,798   |
| Principal payments received on securities available for sale             | 32,768   | 29,943   |
| Purchases of securities available for sale                               | (79,177) | (86,284) |
| Proceeds from maturities and calls of other investments                  | (643 )   | -        |
| Redemption of Federal Home Loan Bank Stock                               | 4,618    | 1,641    |
| Net principal payments received on loans                                 | 5,878    | 8,616    |
| Purchases of premises and equipment                                      | (393 )   | (62)     |
| Proceeds from disposal of premises and equipment                         | 11       | -        |
| Proceeds from sales of other repossessed assets & property held for sale | 8,862    | 5,121    |
| Net cash provided by investing activities                                | 2,371    | 13,509   |
| Cash Flows from Financing Activities                                     |          |          |
| Net increase in demand deposit, NOW and savings accounts                 | 6,123    | 9,601    |
| Net increase (decrease) in time deposits                                 | 4,915    | (24,431) |
| Net increase (decrease) in short-term borrowings                         | 12,804   | (4,999)  |
| Proceeds from long-term borrowings                                       | 3,454    | -        |
| Repayment of long-term borrowings  | (43,202) | (16,619) |
| Exercise of stock options  | 61       | -        |
| Dividends paid on preferred stock  | (388 )   | (343)    |
| Net cash (used in) financing activities                                  | (16,233) | (36,791) |
| (Decrease) in cash and cash equivalents                                  | (2,495 ) | (14,137) |
| Cash and cash equivalents:   |          |          |

|           |           |           |
|-----------|-----------|-----------|
| Beginning | 14,802    | 32,691    |
| Ending    | \$ 12,307 | \$ 18,554 |

(Continued)

See Notes to Consolidated  
Financial Statements

8

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

| Dollars in thousands   | Six Months Ended |                  |
|--|------------------|------------------|
|  | June 30,<br>2013 | June 30,<br>2012 |
| Supplemental Disclosures<br>of Cash Flow Information                   |                  |                  |
| Cash payments for:   |                  |                  |
| Interest   | \$ 9,881         | \$ 13,344        |
| Income taxes   | \$ 1,081         | \$ 1,834         |
| Supplemental Schedule of Noncash Investing and<br>Financing Activities |                  |                  |
| Other assets acquired in<br>settlement of loans                        | \$ 2,811         | \$ 5,025         |

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 June 30, 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 June 30, 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.

ASU 2013-10, “Derivatives and Hedging (Topic 815) – Inclusion of the Fed Funds Effective Swap Rate (or Overnight Index Swap Rate) as a Benchmark Interest Rate for Hedge Accounting Purposes” permits the Fed Funds Effective Swap Rate (or Overnight Index Swap Rate) to be used as a U.S. benchmark interest rate for hedge accounting purposes under Topic 815, in addition to interest rates on direct Treasury obligations of the U.S. government and the London Interbank Offered Rate (“LIBOR”). ASU 2013-10 is effective prospectively for qualifying new or redesignated hedging relationships entered into on or after July 17, 2013 and is not expected to have a significant impact 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.

10

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

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

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

Accordingly, securities available-for-sale 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 June 30, 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.

11

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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<br>June 30,<br>2013 | Fair Value Measurements Using: |            |         |
|---|--------------------------------|--------------------------------|------------|---------|
|   |                                | Level 1                        | Level 2    | Level 3 |
| Available for sale securities               |                                |                                |            |         |
| U.S. Government sponsored agencies          | \$ 36,764                      | \$ -                           | \$ 36,764  | \$ -    |
| Mortgage backed securities:                 |                                |                                |            |         |
| Government sponsored agencies               | 148,541                        | -                              | 148,541    | -       |
| Nongovernment sponsored entities            | 12,657                         | -                              | 12,657     | -       |
| State and political subdivisions            | 13,347                         | -                              | 13,347     | -       |
| Corporate debt securities                   | 3,959                          | -                              | 3,959      | -       |
| Other equity securities                     | 77                             | -                              | 77         | -       |
| Tax-exempt state and political subdivisions | 75,835                         | -                              | 75,835     | -       |
| Tax-exempt mortgage-backed securities       | -                              | -                              | -          | -       |
| Total available for sale securities         | \$ 291,180                     | \$ -                           | \$ 291,180 | \$ -    |

| Dollars in thousands                        | Balance at<br>December<br>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 | \$ -    |

There were no assets measured at fair value on a recurring basis using significant unobservable inputs (Level 3) for the period ended June 30, 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<br>June 30, 2013 | Fair Value Measurements Using: |          |          |
|--|---------------------------|--------------------------------|----------|----------|
|  |                           | Level 1                        | Level 2  | Level 3  |
| Residential mortgage loans held for sale | \$ 1,080                  | \$ -                           | \$ 1,080 | \$ -     |
| Impaired loans                           |                           |                                |          |          |
| Commercial                               | \$ 7,600                  | \$ -                           | \$ 3,301 | \$ 4,299 |
| Commercial real estate                   | 20,639                    | -                              | 8,897    | 11,742   |
| Construction and development             | 25,521                    | -                              | 23,210   | 2,311    |
| Residential real estate                  | 22,871                    | -                              | 18,816   | 4,055    |

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|                              |           |      |           |           |
|------------------------------|-----------|------|-----------|-----------|
| Consumer                     | 49        | -    | -         | 49        |
| Total impaired loans         | \$ 76,680 | \$ - | \$ 54,224 | \$ 22,456 |
| <b>OREO</b>                  |           |      |           |           |
| Commercial                   | \$ -      | \$ - | \$ -      | \$ -      |
| Commercial real estate       | 10,310    | -    | 10,228    | 82        |
| Construction and development | 33,083    | -    | 33,083    | -         |
| Residential real estate      | 3,865     | -    | 3,865     | -         |
| Consumer                     | -         | -    | -         | -         |
| Total OREO                   | \$ 47,258 | \$ - | \$ 47,176 | \$ 82     |

13

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



| Dollars in thousands                        | Total at<br>December 31,<br>2012 | Fair Value Measurements Using: |           |           |
|---|----------------------------------|--------------------------------|-----------|-----------|
|   |                                  | Level 1                        | Level 2   | Level 3   |
| Residential mortgage loans held<br>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<br>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<br>development             | 40,671                           | -                              | 35,978    | 4,693     |
| Residential real estate                     | 3,666                            | -                              | 3,666     | -         |
| Consumer                                    | -                                | -                              | -         | -         |
| Total OREO                                  | \$ 56,172                        | \$ -                           | \$ 50,691 | \$ 5,481  |

Our policy with respect to troubled debt restructurings (“TDRs”), included in impaired loans, is to appraise any underlying collateral at the time of restructure, and then only obtain periodic reappraisals if the TDR is not performing in accordance with the terms of the restructure. Substantially all Level 3 fair values of impaired loans in the above tables are performing TDRs.

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.

14

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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           | June 30, 2013  |                      | December 31, 2012 |                      |
|--------------------------------|----------------|----------------------|-------------------|----------------------|
|                                | Carrying Value | Estimated Fair Value | Carrying Value    | Estimated Fair Value |
| <b>Financial assets</b>        |                |                      |                   |                      |
| Cash and due from banks        | \$ 12,307      | \$ 12,307            | \$ 14,802         | \$ 14,802            |
| Interest bearing deposits with |                |                      |                   |                      |
| other banks                    | -              | -                    | -                 | -                    |
| Securities available for sale  | 291,180        | 291,180              | 281,539           | 281,539              |
| Other investments              | 7,411          | 7,411                | 14,658            | 14,658               |
| Loans held for sale, net       | 1,080          | 1,080                | 226               | 226                  |
| Loans, net                     | 925,979        | 945,069              | 937,168           | 965,454              |
| Accrued interest receivable    | 5,718          | 5,718                | 5,621             | 5,621                |
|                                | \$ 1,243,675   | \$ 1,262,765         | \$ 1,254,014      | \$ 1,282,300         |
| <b>Financial liabilities</b>   |                |                      |                   |                      |
| Deposits                       | \$ 1,038,163   | \$ 1,069,878         | \$ 1,027,125      | \$ 1,064,957         |
| Short-term borrowings          | 16,762         | 16,762               | 3,958             | 3,958                |
| Long-term borrowings           | 163,565        | 176,100              | 203,268           | 220,175              |
| 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 | 1,610        | 1,610        | 1,877        | 1,877        |
|                          | \$ 1,256,489 | \$ 1,300,739 | \$ 1,272,617 | \$ 1,327,356 |

15

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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 June 30, |               |         |             |               |         |
|--|-------------------------------------|---------------|---------|-------------|---------------|---------|
|  | 2013                                | Common        |         | 2012        | Common        |         |
|  | Income                              | Shares        | Per     | Income      | Shares        | Per     |
|  | (Numerator)                         | (Denominator) | Share   | (Numerator) | (Denominator) | Share   |
| Net income                                     | \$ 1,217                            |               |         | \$ 913      |               |         |
| Less preferred stock dividends                 | (194 )                              |               |         | (194 )      |               |         |
| Basic EPS                                      | \$ 1,023                            | 7,438,401     | \$ 0.14 | \$ 719      | 7,425,472     | \$ 0.10 |
| Effect of dilutive securities:                 |                                     |               |         |             |               |         |
| Stock options                                  | -                                   | 7,568         |         | -           | 2,330         |         |
| Series 2011 convertible preferred stock        | 120                                 | 1,499,071     |         | 120         | 1,500,000     |         |
| Series 2009 convertible preferred stock        | 74                                  | 674,545       |         | -           | -             |         |
| Diluted EPS                                    | \$ 1,217                            | 9,619,585     | \$ 0.13 | \$ 839      | 8,927,802     | \$ 0.09 |

| Dollars in thousands, except per share amounts | For the Six Months Ended June 30, |               |         |             |               |         |
|--|-----------------------------------|---------------|---------|-------------|---------------|---------|
|  | 2013                              | Common        |         | 2012        | Common        |         |
|  | Income                            | Shares        | Per     | Income      | Shares        | Per     |
|  | (Numerator)                       | (Denominator) | Share   | (Numerator) | (Denominator) | Share   |
| Net income                                     | \$ 3,010                          |               |         | \$ 2,611    |               |         |
| Less preferred stock dividends                 | (388 )                            |               |         | (388 )      |               |         |
| Basic EPS                                      | \$ 2,622                          | 7,435,344     | \$ 0.35 | \$ 2,223    | 7,425,472     | \$ 0.30 |
| Effect of dilutive securities:                 |                                   |               |         |             |               |         |
| Stock options                                  | -                                 | 7,496         |         | -           | 1,023         |         |

|  |          |           |         |          |           |         |
|--|----------|-----------|---------|----------|-----------|---------|
| Series 2011<br>convertible<br>preferred<br>stock | 240      | 1,499,533 |         | 240      | 1,500,000 |         |
| Series 2009<br>convertible<br>preferred<br>stock | 148      | 674,545   |         | 148      | 674,545   |         |
| Diluted EPS                                      | \$ 3,010 | 9,616,918 | \$ 0.31 | \$ 2,611 | 9,601,040 | \$ 0.27 |

Stock option grants and the convertible preferred shares are disregarded in this computation if they are determined to be anti-dilutive. Our anti-dilutive stock options at June 30, 2013 and 2012 totaled 170,500 shares and 282,980 shares, respectively. Our anti-dilutive convertible preferred shares totaled 674,545 for the quarter ended June 30, 2012.

## NOTE 5. SECURITIES

The amortized cost, unrealized gains, unrealized losses and estimated fair values of securities at June 30, 2013, December 31, 2012, and June 30, 2012 are summarized as follows:

| Dollars in thousands                    | Amortized<br>Cost | June 30, 2013       |                      | Estimated<br>Fair Value |
|---|-------------------|---------------------|----------------------|-------------------------|
|   |                   | Unrealized<br>Gains | Unrealized<br>Losses |                         |
| Available for Sale                      |                   |                     |                      |                         |
| Taxable debt securities:                |                   |                     |                      |                         |
| U. S. Government agencies               |                   |                     |                      |                         |
| and corporations                        | \$ 35,605         | \$ 1,186            | \$ 27                | \$ 36,764               |
| Residential mortgage-backed securities: |                   |                     |                      |                         |
| Government-sponsored agencies           |                   |                     |                      |                         |
|   | 147,738           | 2,313               | 1,510                | 148,541                 |
| Nongovernment-sponsored agencies        |                   |                     |                      |                         |
|   | 12,373            | 326                 | 42                   | 12,657                  |
| State and political subdivisions        | 13,838            | 2                   | 493                  | 13,347                  |
| Corporate debt securities               | 3,966             | 27                  | 34                   | 3,959                   |
| Total taxable debt securities           | 213,520           | 3,854               | 2,106                | 215,268                 |
| Tax-exempt debt securities:             |                   |                     |                      |                         |
| State and political subdivisions        |                   |                     |                      |                         |
|   | 76,225            | 1,647               | 2,037                | 75,835                  |
| Residential mortgage-backed securities: |                   |                     |                      |                         |
| Government-sponsored agencies           |                   |                     |                      |                         |
|   | -                 | -                   | -                    | -                       |
| Total tax-exempt debt securities        | 76,225            | 1,647               | 2,037                | 75,835                  |
| Equity securities                       | 77                | -                   | -                    | 77                      |
| Total available for sale securities     | \$ 289,822        | \$ 5,501            | \$ 4,143             | \$ 291,180              |

| Dollars in thousands                    | Amortized<br>Cost | December 31, 2012   |                      | Estimated<br>Fair Value |
|---|-------------------|---------------------|----------------------|-------------------------|
|   |                   | Unrealized<br>Gains | Unrealized<br>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                   |

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|  |            |          |          |            |
|--|------------|----------|----------|------------|
| 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 |

17

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



| Dollars in thousands                          | Amortized<br>Cost | June 30, 2012       |                      | Estimated<br>Fair Value |
|---|-------------------|---------------------|----------------------|-------------------------|
|   |                   | Unrealized<br>Gains | Unrealized<br>Losses |                         |
| Available for Sale                            |                   |                     |                      |                         |
| Taxable debt securities:                      |                   |                     |                      |                         |
| U. S. Government agencies<br>and corporations | \$ 18,000         | \$ 665              | \$ 2                 | \$ 18,663               |
| Residential mortgage-backed<br>securities:    |                   |                     |                      |                         |
| Government-sponsored<br>agencies              | 157,618           | 3,846               | 297                  | 161,167                 |
| Nongovernment-sponsored<br>agencies           | 23,188            | 550                 | 477                  | 23,261                  |
| State and political subdivisions              | 8,672             | 27                  | 43                   | 8,656                   |
| Corporate debt securities                     | 1,951             | 16                  | 127                  | 1,840                   |
| Total taxable debt securities                 | 209,429           | 5,104               | 946                  | 213,587                 |
| Tax-exempt debt securities:                   |                   |                     |                      |                         |
| State and political subdivisions              | 69,036            | 3,733               | 251                  | 72,518                  |
| Residential mortgage-backed<br>securities:    |                   |                     |                      |                         |
| Government-sponsored<br>agencies              | 2,969             | -                   | -                    | 2,969                   |
| Total tax-exempt debt securities              | 72,005            | 3,733               | 251                  | 75,487                  |
| Equity securities                             | 77                | -                   | -                    | 77                      |
| Total available for sale securities           | \$ 281,511        | \$ 8,837            | \$ 1,197             | \$ 289,151              |

The maturities, amortized cost and estimated fair values of securities at June 30, 2013, are summarized as follows:

| Dollars in<br>thousands          | Available for Sale |                         |
|----------------------------------|--------------------|-------------------------|
|                                  | Amortized<br>Cost  | Estimated<br>Fair Value |
| Due in one<br>year or less       | \$ 73,257          | \$ 73,674               |
| Due from<br>one to five<br>years | 84,882             | 85,636                  |
| Due from<br>five to ten<br>years | 20,782             | 20,872                  |
| Due after ten<br>years           | 110,824            | 110,921                 |
| Equity<br>securities             | 77                 | 77                      |

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\$ 289,822    \$ 291,180

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 six months ended June 30, 2013 are as follows:

| Dollars in thousands          | Proceeds from |                      |                    | Gross realized |        |
|-------------------------------|---------------|----------------------|--------------------|----------------|--------|
|                               | Sales         | Calls and Maturities | Principal Payments | Gains          | Losses |
| Securities available for sale | \$ 29,389     | \$ 1,058             | \$ 32,768          | \$ 167         | \$ 183 |

18

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

During the three and six months ended June 30, 2013 and 2012, we recorded other-than-temporary impairment losses on residential mortgage-backed nongovernment sponsored entity securities as follows:

| In thousands   | Three Months Ended |                  | Six Months Ended |          |
|--|--------------------|------------------|------------------|----------|
|  | 2013               | June 30,<br>2012 | 2013             | 2012     |
| Total other-than-temporary impairment losses             | \$ (27 )           | \$ (370 )        | \$ (117 )        | \$ (882) |
| Portion of loss recognized in other comprehensive income | -                  | 264              | 37               | 547      |
| Net impairment losses recognized in earnings             | \$ (27 )           | \$ (106 )        | \$ (80 )         | \$ (335) |

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 and six months ended June 30, 2013 is as follows:

| In thousands   | Three             | Six               |
|--|-------------------|-------------------|
|  | Months            | Months            |
|  | Ended             | Ended             |
|  | June 30,          | June 30,          |
|  | 2013              | 2013              |
| Beginning Balance  | Total<br>\$ 2,957 | Total<br>\$ 2,904 |
| Additions for the credit component on debt securities in which other-than-temporary impairment was not previously recognized | 27                | 80                |
| Securities sold during the period  | -                 | -                 |
| Ending Balance   | \$ 2,984          | \$ 2,984          |

At June 30, 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 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.

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 June 30, 2013 and December 31, 2012, including debt securities for which a portion of other-than-temporary impairment has been recognized in other comprehensive income.

19

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

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| Dollars in thousands            | June 30, 2013       |             |                   |            |            |            |
|---------------------------------|---------------------|-------------|-------------------|------------|------------|------------|
|                                 | Less than 12 months |             | 12 months or more |            | Total      |            |
|                                 | Estimated           | Unrealized  | Estimated         | Unrealized | Estimated  | Unrealized |
|                                 | Fair Value          | Loss        | Fair Value        | Loss       | Fair Value | Loss       |
| Temporarily impaired securities |                     |             |                   |            |            |            |
| Taxable debt securities         |                     |             |                   |            |            |            |
| U. S. Government agencies       |                     |             |                   |            |            |            |
| and corporations                | \$ 3,786            | \$ (27 )    | \$ -              | \$ -       | \$ 3,786   | \$ (27)    |
| Residential                     |                     |             |                   |            |            |            |
| mortgage-backed securities:     |                     |             |                   |            |            |            |
| Government-sponsored            |                     |             |                   |            |            |            |
| agencies                        | 65,600              | (1,352 )    | 8,045             | (158 )     | 73,645     | (1,510)    |
| Nongovernment-sponsored         |                     |             |                   |            |            |            |
| entities                        | 632                 | (6 )        | 1,056             | (5 )       | 1,688      | (11)       |
| State and political             |                     |             |                   |            |            |            |
| subdivisions                    | 9,997               | (489 )      | 386               | (4 )       | 10,383     | (493)      |
| Corporate debt securities       | 2,965               | (34 )       | -                 | -          | 2,965      | (34)       |
| Tax-exempt debt securities      |                     |             |                   |            |            |            |
| State and political             |                     |             |                   |            |            |            |
| subdivisions                    | 38,852              | (2,037 )    | -                 | -          | 38,852     | (2,037)    |
| Total temporarily impaired      |                     |             |                   |            |            |            |
| securities                      | 121,832             | (3,945 )    | 9,487             | (167 )     | 131,319    | (4,112)    |
| Other-than-temporarily          |                     |             |                   |            |            |            |
| impaired securities             |                     |             |                   |            |            |            |
| Taxable debt securities         |                     |             |                   |            |            |            |
| Residential                     |                     |             |                   |            |            |            |
| mortgage-backed securities:     |                     |             |                   |            |            |            |
| Nongovernment-sponsored         |                     |             |                   |            |            |            |
| entities                        | -                   | -           | 29                | (31 )      | 29         | (31)       |
| Total other-than-temporarily    |                     |             |                   |            |            |            |
| impaired securities             | -                   | -           | 29                | (31 )      | 29         | (31)       |
| Total                           | \$ 121,832          | \$ (3,945 ) | \$ 9,516          | \$ (198 )  | \$ 131,348 | \$ (4,143) |

| Dollars in thousands            | December 31, 2012   |            |                   |            |            |            |
|---------------------------------|---------------------|------------|-------------------|------------|------------|------------|
|                                 | Less than 12 months |            | 12 months or more |            | Total      |            |
|                                 | Estimated           | Unrealized | Estimated         | Unrealized | Estimated  | Unrealized |
|                                 | Fair Value          | Loss       | Fair Value        | Loss       | Fair Value | Loss       |
| Temporarily impaired securities |                     |            |                   |            |            |            |
| Taxable debt securities         |                     |            |                   |            |            |            |
| U. S. Government agencies       |                     |            |                   |            |            |            |
| and corporations                | \$ -                | \$ -       | \$ -              | \$ -       | \$ -       | \$ -       |
| Residential                     |                     |            |                   |            |            |            |
| mortgage-backed securities:     |                     |            |                   |            |            |            |
| Nongovernment-sponsored         |                     |            |                   |            |            |            |
| entities                        | 36,498              | (414 )     | 8,997             | (78 )      | 45,495     | (492)      |

|  |           |           |           |           |           |            |
|--|-----------|-----------|-----------|-----------|-----------|------------|
| Government-sponsored agencies                    |           |           |           |           |           |            |
| 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 123 available for sale securities having an unrealized loss at June 30, 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".

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:

|                              | June 30,  | December    | June 30,  |
|------------------------------|-----------|-------------|-----------|
| Dollars in thousands         | 2013      | 31,<br>2012 | 2012      |
| Commercial                   | \$ 78,963 | \$ 85,829   | \$ 92,060 |
| Commercial real estate       |           |             |           |
| Owner-occupied               | 149,660   | 154,252     | 152,347   |
| Non-owner occupied           | 277,773   | 276,082     | 280,891   |
| Construction and development |           |             |           |
| Land and land development    | 73,427    | 79,335      | 84,383    |
| Construction                 | 7,634     | 3,772       | 1,793     |
| Residential real estate      |           |             |           |
| Non-jumbo                    | 216,759   | 216,714     | 217,321   |
| Jumbo                        | 58,567    | 61,567      | 61,961    |

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|                                      |            |            |            |
|--------------------------------------|------------|------------|------------|
| Home equity                          | 53,774     | 53,263     | 51,693     |
| Consumer                             | 20,147     | 20,586     | 21,212     |
| Other                                | 3,397      | 3,701      | 2,523      |
| Total loans, net of<br>unearned fees | 940,101    | 955,101    | 966,184    |
| Less allowance for<br>loan losses    | 14,122     | 17,933     | 17,890     |
| Loans, net                           | \$ 925,979 | \$ 937,168 | \$ 948,294 |

21

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



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The following table presents the contractual aging of the recorded investment in past due loans by class as of June 30, 2013 and 2012 and December 31, 2012.

| At June 30, 2013             |            |            |           |           |            |  |
|------------------------------|------------|------------|-----------|-----------|------------|--|
| Dollars in thousands         | Past Due   |            |           | Total     | Current    | Recorded Investment > 90 days and Accruing |
|                              | 30-59 days | 60-89 days | > 90 days |           |            |  |
| Commercial                   | \$ 144     | \$ 55      | \$ 1,669  | \$ 1,868  | \$ 77,095  | \$ -                                       |
| Commercial real estate       |            |            |           |           |            |  |
| Owner-occupied               | 85         | -          | 314       | 399       | 149,261    | -  |
| Non-owner occupied           | 543        | -          | 899       | 1,442     | 276,331    | -  |
| Construction and development |            |            |           |           |            |  |
| Land and land development    | 698        | -          | 9,929     | 10,627    | 62,800     | -  |
| Construction                 | -          | -          | 60        | 60        | 7,574      | -  |
| Residential mortgage         |            |            |           |           |            |  |
| Non-jumbo                    | 4,086      | 1,171      | 2,494     | 7,751     | 209,008    | -  |
| Jumbo                        | 709        | -          | 9,000     | 9,709     | 48,858     | -  |
| Home equity                  | 101        | 26         | 25        | 152       | 53,622     | -  |
| Consumer                     | 239        | 64         | 63        | 366       | 19,781     | -  |
| Other                        | 53         | -          | -         | 53        | 3,344      | -  |
| Total                        | \$ 6,658   | \$ 1,316   | \$ 24,453 | \$ 32,427 | \$ 907,674 | \$ -                                       |

| At December 31, 2012         |            |            |           |          |           |  |
|------------------------------|------------|------------|-----------|----------|-----------|--|
| Dollars in thousands         | Past Due   |            |           | Total    | Current   | Recorded Investment > 90 days and Accruing |
|                              | 30-59 days | 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         |            |            |           |          |           |  |

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|             |          |          |           |           |            |      |
|-------------|----------|----------|-----------|-----------|------------|------|
| Non-jumbo   | 3,344    | 2,616    | 2,797     | 8,757     | 207,957    | -    |
| 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

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

At June 30, 2012

| Dollars in thousands         | Past Due   |            |           | Total     | Current    | Recorded<br>Investment<br>> 90<br>days<br>and<br>Accruing |
|------------------------------|------------|------------|-----------|-----------|------------|---|
|                              | 30-59 days | 60-89 days | > 90 days |           |            |   |
| Commercial                   | \$ 367     | \$ 20      | \$ 2,334  | \$ 2,721  | \$ 89,339  | \$ -  |
| Commercial real estate       |            |            |           |           |            |   |
| Owner-occupied               | 1,074      | 888        | 590       | 2,552     | 149,795    | -   |
| Non-owner occupied           | 480        | 101        | 1,287     | 1,868     | 279,023    | -   |
| Construction and development |            |            |           |           |            |   |
| Land and land development    |            |            |           |           |            |   |
| Construction                 | 1,756      | 79         | 12,634    | 14,469    | 69,914     | -   |
| Construction                 | -          | -          | 153       | 153       | 1,640      | -   |
| Residential mortgage         |            |            |           |           |            |   |
| Non-jumbo                    | 3,819      | 950        | 3,139     | 7,908     | 209,413    | -   |
| Jumbo                        | 2,160      | 1,050      | 12,592    | 15,802    | 46,159     | -   |
| Home equity                  | 450        | 7          | 69        | 526       | 51,167     | -   |
| Consumer                     | 329        | 88         | 37        | 454       | 20,758     | -   |
| Other                        | -          | -          | -         | -         | 2,523      | -   |
| Total                        | \$ 10,435  | \$ 3,183   | \$ 32,835 | \$ 46,453 | \$ 919,731 | \$ -  |

Nonaccrual loans: The following table presents the nonaccrual loans included in the net balance of loans at June 30, 2013, December 31, 2012 and June 30, 2012.

| Dollars in thousands         | 6/30/2013 | 12/31/2012 | 6/30/2012 |
|------------------------------|-----------|------------|-----------|
| Commercial                   | \$ 3,996  | \$ 5,002   | \$ 6,476  |
| Commercial real estate       |           |            |           |
| Owner-occupied               | 796       | 1,524      | 2,248     |
| Non-owner occupied           | 899       | 1,032      | 1,288     |
| Construction and development |           |            |           |
| Land & land development      |           |            |           |
| Construction                 | 60        | 154        | 153       |
| Residential mortgage         |           |            |           |
| Non-jumbo                    | 4,333     | 3,518      | 3,449     |
| Jumbo                        | 9,000     | 12,564     | 14,752    |
| Home equity                  | 271       | 440        | 349       |
| Consumer                     | 92        | 55         | 78        |

|       |           |           |           |
|-------|-----------|-----------|-----------|
| Other | -         | -         | -         |
| Total | \$ 30,892 | \$ 37,776 | \$ 46,037 |

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

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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                | 6/30/2013 | 12/31/2012 | 6/30/2012 | Method used to measure impairment |
|------------------------------|-----------|------------|-----------|-----------------------------------|
| Commerical                   | \$ 7,825  | \$ 10,776  | \$ 3,031  | Fair value of collateral          |
|                              | 162       | 165        | 3,864     | Discounted cash flow              |
| Commerical real estate       |           |            |           |                                   |
| Owner-occupied               | 12,074    | 14,028     | 13,299    | Fair value of collateral          |
|                              | 2,657     | 2,686      | 2,709     | Discounted cash flow              |
| Non-owner occupied           | 6,814     | 9,468      | 9,987     | Fair value of collateral          |
| Construction and development |           |            |           |                                   |
| Land & land development      | 26,710    | 29,307     | 33,160    | Fair value of collateral          |
|                              | 654       | 656        | 656       | Discounted cash flow              |
| Residential mortgage         |           |            |           |                                   |
| Non-jumbo                    | 5,322     | 5,626      | 5,997     | Fair value of collateral          |
|                              | 891       | 692        | 1,243     | Discounted cash flow              |
| Jumbo                        | 17,824    | 21,543     | 23,653    | Fair value of collateral          |
| Home equity                  | 213       | 219        | 360       | Fair value of collateral          |
| Consumer                     | 62        | 66         | 45        | Fair value of collateral          |
| Total                        | \$ 81,208 | \$ 95,232  | \$ 98,004 |                                   |



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

The following tables present loans individually evaluated for impairment at June 30, 2013, December 31, 2012 and June 30, 2012.

| Dollars in thousands                | June 30, 2013       |                          |                   |                          |   |
|-------------------------------------|---------------------|--------------------------|-------------------|--------------------------|---|
|                                     | Recorded Investment | Unpaid Principal Balance | Related Allowance | Average Impaired Balance | Interest Income Recognized while impaired |
| <b>Without a related allowance</b>  |                     |                          |                   |                          |   |
| Commercial                          | \$ 6,942            | \$ 7,104                 | \$ -              | \$ 8,133                 | \$ 435                                    |
| <b>Commercial real estate</b>       |                     |                          |                   |                          |   |
| Owner-occupied                      | 9,770               | 9,774                    | -                 | 10,638                   | 491                                       |
| Non-owner occupied                  | 5,396               | 5,398                    | -                 | 3,969                    | 199                                       |
| <b>Construction and development</b> |                     |                          |                   |                          |   |
| Land & land development             | 16,904              | 16,904                   | -                 | 16,853                   | 725                                       |
| Construction                        | -                   | -                        | -                 | -                        | -   |
| <b>Residential real estate</b>      |                     |                          |                   |                          |   |
| Non-jumbo                           | 3,250               | 3,258                    | -                 | 3,035                    | 120                                       |
| Jumbo                               | 7,911               | 7,916                    | -                 | 9,352                    | 503                                       |
| Home equity                         | 186                 | 186                      | -                 | 186                      | 11  |
| Consumer                            | 37                  | 38                       | -                 | 37                       | 2   |
| Total without a related allowance   | \$ 50,396           | \$ 50,578                | \$ -              | \$ 52,203                | \$ 2,486                                  |
| <b>With a related allowance</b>     |                     |                          |                   |                          |   |
| Commercial                          | \$ 874              | \$ 883                   | \$ 387            | \$ 565                   | \$ 4                                      |
| <b>Commercial real estate</b>       |                     |                          |                   |                          |   |
| Owner-occupied                      | 4,957               | 4,957                    | 741               | 3,967                    | 186                                       |
| Non-owner occupied                  | 1,415               | 1,416                    | 165               | 1,421                    | 28  |
| <b>Construction and development</b> |                     |                          |                   |                          |   |
| Land & land development             | 10,460              | 10,460                   | 1,844             | 10,483                   | 65  |
| Construction                        | -                   | -                        | -                 | -                        | -   |

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|                                |           |           |          |           |          |  |
|--------------------------------|-----------|-----------|----------|-----------|----------|--|
| Residential real estate        |           |           |          |           |          |  |
| Non-jumbo                      | 2,952     | 2,955     | 307      | 2,963     | 141      |  |
| Jumbo                          | 9,907     | 9,908     | 1,044    | 10,277    | 45       |  |
| Home equity                    | 28        | 27        | 27       | 28        | -        |  |
| Consumer                       | 25        | 24        | 13       | 25        | 2        |  |
| Total with a related allowance | \$ 30,618 | \$ 30,630 | \$ 4,528 | \$ 29,729 | \$ 471   |  |
| Total                          |           |           |          |           |          |  |
| Commercial                     | \$ 56,718 | \$ 56,896 | \$ 3,137 | \$ 56,029 | \$ 2,133 |  |
| Residential real estate        |           |           |          |           |          |  |
|                                | 24,234    | 24,250    | 1,378    | 25,841    | 820      |  |
| Consumer                       | 62        | 62        | 13       | 62        | 4        |  |
| Total                          | \$ 81,014 | \$ 81,208 | \$ 4,528 | \$ 81,932 | \$ 2,957 |  |

25

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



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| December 31, 2012                        |                        |                                |                      |                                |   |
|--|------------------------|--------------------------------|----------------------|--------------------------------|---|
| Dollars in thousands                     | Recorded<br>Investment | Unpaid<br>Principal<br>Balance | Related<br>Allowance | Average<br>Impaired<br>Balance | Interest<br>Income<br>Recognized<br>while<br>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                             | -   |

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|                                |           |           |          |           |          |
|--------------------------------|-----------|-----------|----------|-----------|----------|
| Consumer                       | 28        | 28        | 16       | 2         | -        |
| Total with a related allowance | \$ 45,868 | \$ 45,875 | \$ 7,097 | \$ 41,925 | \$ 788   |
| 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

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

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| June 30, 2012                            |                        |                                |                      |                                |   |
|--|------------------------|--------------------------------|----------------------|--------------------------------|---|
| Dollars in thousands                     | Recorded<br>Investment | Unpaid<br>Principal<br>Balance | Related<br>Allowance | Average<br>Impaired<br>Balance | Interest<br>Income<br>Recognized<br>while<br>impaired |
| <b>Without a related allowance</b>       |                        |                                |                      |                                |   |
| Commercial                               | \$ 5,938               | \$ 5,947                       | \$ -                 | \$ 1,818                       | \$ 47   |
| <b>Commercial real estate</b>            |                        |                                |                      |                                |   |
| Owner-occupied                           | 12,893                 | 12,872                         | -                    | 9,778                          | 359   |
| Non-owner occupied                       | 6,642                  | 6,645                          | -                    | 6,260                          | 304   |
| <b>Construction and development</b>      |                        |                                |                      |                                |   |
| <b>Land &amp; land development</b>       |                        |                                |                      |                                |   |
| Construction                             | 17,981                 | 17,982                         | -                    | 15,696                         | 579   |
| Construction                             | -                      | -                              | -                    | -                              | -   |
| <b>Residential real estate</b>           |                        |                                |                      |                                |   |
| Non-jumbo                                | 3,810                  | 3,819                          | -                    | 3,164                          | 140   |
| Jumbo                                    | 17,665                 | 17,669                         | -                    | 15,504                         | 250   |
| Home equity                              | 191                    | 191                            | -                    | 191                            | 11  |
| Consumer                                 | 41                     | 41                             | -                    | 26                             | 1   |
| <b>Total without a related allowance</b> | <b>\$ 65,161</b>       | <b>\$ 65,166</b>               | <b>\$ -</b>          | <b>\$ 52,437</b>               | <b>\$ 1,691</b>                                       |
| <b>With a related allowance</b>          |                        |                                |                      |                                |   |
| Commercial                               | \$ 948                 | \$ 948                         | \$ 254               | \$ 879                         | \$ 4  |
| <b>Commercial real estate</b>            |                        |                                |                      |                                |   |
| Owner-occupied                           | 3,136                  | 3,136                          | 53                   | 2,854                          | 156   |
| Non-owner occupied                       | 3,341                  | 3,342                          | 306                  | 3,350                          | 115   |
| <b>Construction and development</b>      |                        |                                |                      |                                |   |
| <b>Land &amp; land development</b>       |                        |                                |                      |                                |   |
| Construction                             | 15,834                 | 15,834                         | 3,029                | 13,589                         | 114   |
| Construction                             | -                      | -                              | -                    | -                              | -   |
| <b>Residential real estate</b>           |                        |                                |                      |                                |   |
| Non-jumbo                                | 3,418                  | 3,421                          | 1,095                | 2,019                          | 57  |
| Jumbo                                    | 5,979                  | 5,984                          | 1,634                | 2,583                          | 25  |
| Home equity                              | 169                    | 169                            | 147                  | 165                            | 7   |
| Consumer                                 | 4                      | 4                              | 4                    | -                              | -   |
| <b>Total with a related allowance</b>    | <b>\$ 32,829</b>       | <b>\$ 32,838</b>               | <b>\$ 6,522</b>      | <b>\$ 25,439</b>               | <b>\$ 478</b>   |
| <b>Total</b>                             |                        |                                |                      |                                |   |
| Commercial                               | \$ 66,713              | \$ 66,706                      | \$ 3,642             | \$ 54,224                      | \$ 1,678  |
| Residential real estate                  | 31,232                 | 31,253                         | 2,876                | 23,626                         | 490   |

|          |           |           |          |           |          |
|----------|-----------|-----------|----------|-----------|----------|
| Consumer | 45        | 45        | 4        | 26        | 1        |
| Total    | \$ 97,990 | \$ 98,004 | \$ 6,522 | \$ 77,876 | \$ 2,169 |

A modification of a loan is considered a 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 be classified as a TDR for the life of the loan. Included in impaired loans are TDRs of \$48.1 million, of which \$38.5 million were current with respect to restructured contractual payments at June 30, 2013, and \$56.7 million, of which \$42.3 million were current with respect to restructured contractual payments at December 31, 2012. There were 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 and six months ended June 30, 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.

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| dollars in thousands         | For the Three Months Ended<br>June 30, 2013 |                        |                        | For the Three Months Ended<br>June 30, 2012 |                        |                        |
|------------------------------|---|------------------------|------------------------|---|------------------------|------------------------|
|                              | Pre-modification                            |                        | Modification           | Pre-modification                            |                        | Modification           |
|                              | Number of<br>Modifications                  | Recorded<br>Investment | Recorded<br>Investment | Number of<br>Modifications                  | Recorded<br>Investment | Recorded<br>Investment |
| Commercial                   | 1   | \$ 23                  | \$ 23                  | 1   | \$ 77                  | \$ 78                  |
| Commercial real estate       |   |                        |                        |   |                        |                        |
| Owner-occupied               | -   | -                      | -                      | -   | -                      | -                      |
| Non-owner occupied           | -   | -                      | -                      | -   | -                      | -                      |
| Construction and development |   |                        |                        |   |                        |                        |
| Land & land development      | -   | -                      | -                      | 1   | 1,789                  | 1,000                  |
| Construction                 | -   | -                      | -                      | -   | -                      | -                      |
| Residential real estate      |   |                        |                        |   |                        |                        |
| Non-jumbo                    | 2   | 241                    | 241                    | 3   | 497                    | 506                    |
| Jumbo                        | -   | -                      | -                      | 3   | 2,301                  | 2,701                  |
| Home equity                  | -   | -                      | -                      | -   | -                      | -                      |
| Consumer                     | -   | -                      | -                      | 1   | 4                      | 4                      |
| Total                        | 3   | \$ 264                 | \$ 264                 | 9   | \$ 4,668               | \$ 4,289               |

| dollars in thousands         | For the Six Months Ended<br>June 30, 2013 |                        |                        | For the Six Months Ended<br>June 30, 2012 |                        |                        |
|------------------------------|---|------------------------|------------------------|---|------------------------|------------------------|
|                              | Pre-modification                          |                        | Modification           | Pre-modification                          |                        | Modification           |
|                              | Number of<br>Modifications                | Recorded<br>Investment | Recorded<br>Investment | Number of<br>Modifications                | Recorded<br>Investment | Recorded<br>Investment |
| Commercial                   | 1   | \$ 23                  | \$ 23                  | 3   | \$ 1,109               | \$ 1,117               |
| Commercial real estate       |   |                        |                        |   |                        |                        |
| Owner-occupied               | -   | -                      | -                      | -   | -                      | -                      |
| Non-owner occupied           | -   | -                      | -                      | 2   | 2,134                  | 1,757                  |
| Construction and development |   |                        |                        |   |                        |                        |
| Land & land development      | 1   | 49                     | 50                     | 1   | 1,789                  | 1,000                  |
| Construction                 | -   | -                      | -                      | -   | -                      | -                      |
| Residential real estate      |   |                        |                        |   |                        |                        |
| Non-jumbo                    | 2   | 241                    | 241                    | 5   | 557                    | 567                    |
| Jumbo                        | -   | -                      | -                      | 3   | 2,301                  | 2,701                  |
| Home equity                  | -   | -                      | -                      | -   | -                      | -                      |
| Consumer                     | -   | -                      | -                      | 2   | 42                     | 42                     |
| Total                        | 4   | \$ 313                 | \$ 314                 | 16  | \$ 7,932               | \$ 7,184               |

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.

28

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

|                              | For the Three Months Ended<br>June 30, 2013 |  | For the Six Months<br>Ended<br>June 30, 2013 |  |
|------------------------------|---|--|--|--|
|                              | Number<br>of<br>Defaults                    | Recorded<br>Investment<br>at Default<br>Date | Number<br>of<br>Defaults                     | Recorded<br>Investment<br>at Default<br>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   | 519  | 2  | 521  |
| Jumbo                        | -   | -  | -  | -  |
| Home equity                  | -   | -  | -  | -  |
| Consumer                     | 2   | 23   | 2  | 24   |
| Total                        | 4   | \$ 542                                       | 6  | \$ 2,221                                     |

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.

**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.

29

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



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   | 6/30/2013                    | 12/31/2012 | 6/30/2013    | 12/31/2012 | 6/30/2013              | 12/31/2012 | 6/30/2013      | 12/31/2012 | 6/30/2013          | 12/31/2012 |
| Pass                   | \$ 40,785                    | \$ 43,572  | \$ 7,574     | \$ 3,619   | \$ 69,208              | \$ 73,425  | \$ 136,076     | \$ 139,176 | \$ 264,775         | \$ 262,132 |
| OLEM (Special Mention) | 6,671                        | 7,349      | -            | -          | 1,391                  | 1,260      | 5,508          | 1,034      | 11,551             | 11,477     |
| Substandard            | 25,971                       | 28,414     | 60           | 153        | 8,364                  | 11,144     | 8,076          | 14,042     | 1,447              | 2,473      |
| Doubtful               | -                            | -          | -            | -          | -                      | -          | -              | -          | -                  | -          |
| Loss                   | -                            | -          | -            | -          | -                      | -          | -              | -          | -                  | -          |
| Total                  | \$ 73,427                    | \$ 79,335  | \$ 7,634     | \$ 3,772   | \$ 78,963              | \$ 85,829  | \$ 149,660     | \$ 154,252 | \$ 277,773         | \$ 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    | 6/30/2013  | Performing<br>12/31/2012 | 6/30/2012  | 6/30/2013 | Nonperforming<br>12/31/2012 | 6/30/2012 |
|-------------------------|------------|--------------------------|------------|-----------|-----------------------------|-----------|
| Residential real estate |            |                          |            |           |                             |           |
| Non-jumbo               | \$ 212,426 | \$ 213,196               | \$ 213,872 | \$ 4,333  | \$ 3,518                    | \$ 3,449  |
| Jumbo                   | 49,567     | 49,003                   | 47,209     | 9,000     | 12,564                      | 14,752    |
| Home Equity             | 53,503     | 52,823                   | 51,344     | 271       | 440                         | 349       |
| Consumer                | 20,056     | 20,531                   | 21,134     | 91        | 55                          | 78        |
| Other                   | 3,397      | 3,701                    | 2,523      | -         | -                           | -         |
| Total                   | \$ 338,949 | \$ 339,254               | \$ 336,082 | \$ 13,695 | \$ 16,577                   | \$ 18,628 |

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 six month periods ended June 30, 2013 and 2012, and for the year ended December 31, 2012 is as follows:

| Dollars in<br>thousands         | Six Months Ended |                  | Year                             |
|---------------------------------|------------------|------------------|----------------------------------|
|                                 | 2013             | June 30,<br>2012 | Ended<br>December<br>31,<br>2012 |
| Balance,<br>beginning of year   | \$ 17,933        | \$ 17,712        | \$ 17,712                        |
| Losses:                         |                  |                  |                                  |
| Commercial                      | 54               | 126              | 1,273                            |
| Commercial<br>real estate       |                  |                  |                                  |
| Owner<br>occupied               | 66               | 636              | 636                              |
| Non-owner<br>occupied           | 9                | 457              | 806                              |
| Construction<br>and development |                  |                  |                                  |
| Land and<br>land development    | 2,166            | 1,715            | 3,390                            |
| Construction                    | -                | 368              | 367                              |
| Residential real<br>estate      |                  |                  |                                  |
| Non-jumbo                       | 384              | 480              | 1,372                            |
| Jumbo                           | 3,625            | 237              | 737                              |
| Home equity                     | 76               | 4                | 5                                |
| Consumer                        | 34               | 65               | 136                              |
| Other                           | 51               | 41               | 95                               |
| Total                           | 6,465            | 4,129            | 8,817                            |
| Recoveries:                     |                  |                  |                                  |
| Commercial                      | 4                | 4                | 13                               |
| Commercial<br>real estate       |                  |                  |                                  |
| Owner<br>occupied               | 2                | 24               | 33                               |
| Non-owner<br>occupied           | -                | 13               | 31                               |
| Construction<br>and development |                  |                  |                                  |

|                              |           |           |           |
|------------------------------|-----------|-----------|-----------|
| Land and<br>land development | 9         | 14        | 61        |
| Construction                 | -         | -         | -         |
| Real estate -<br>mortgage    |           |           |           |
| Non-jumbo                    | 43        | 32        | 81        |
| Jumbo                        | 3         | 84        | 86        |
| Home equity                  | 1         | 60        | 61        |
| Consumer                     | 37        | 34        | 95        |
| Other                        | 55        | 40        | 77        |
| Total                        | 154       | 305       | 538       |
| Net losses                   | 6,311     | 3,824     | 8,279     |
| Provision for loan<br>losses | 2,500     | 4,002     | 8,500     |
| Balance, end of<br>year      | \$ 14,122 | \$ 17,890 | \$ 17,933 |

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

| Dollars in thousands      | Construction & Land Development |              | Commercial Real Estate |                    | Residential Real Estate |         | Home Equity | Consumer | Other | Total |          |
|---------------------------|---------------------------------|--------------|------------------------|--------------------|-------------------------|---------|-------------|----------|-------|-------|----------|
|                           | Land & Land Development         | Construction | Commercial-Occupied    | Non-Owner Occupied | Non-jumbo               | Jumbo   |             |          |       |       |          |
| 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               | 2,166                           | -            | 54                     | 66                 | 9                       | 384     | 3,625       | 76       | 34    | 51    | 6,465    |
| Recoveries                | 9                               | -            | 4                      | 2                  | -                       | 43      | 3           | 1        | 37    | 55    | 154      |
| Provision                 | 1,257                           | 22           | 339                    | 334                | (1,727)                 | (95)    | 2,498       | (77)     | (42)  | (9)   | 2,500    |
| Ending balance            | \$4,320                         | \$160        | \$1,071                | \$1,657            | \$1,533                 | \$2,181 | \$2,818     | \$273    | \$93  | \$16  | \$14,122 |

Allowance related to:

|   |         |       |         |         |         |         |         |       |      |      |          |
|---|---------|-------|---------|---------|---------|---------|---------|-------|------|------|----------|
| Loans individually evaluated for impairment     | \$1,843 | \$-   | \$387   | \$741   | \$165   | \$308   | \$1,043 | \$28  | \$13 | \$-  | \$4,528  |
| Loans collectively evaluated for impairment     | 2,477   | 160   | 684     | 916     | 1,368   | 1,873   | 1,775   | 245   | 80   | 16   | 9,594    |
| Loans acquired with deteriorated credit quality | -       | -     | -       | -       | -       | -       | -       | -     | -    | -    | -        |
| Total   | \$4,320 | \$160 | \$1,071 | \$1,657 | \$1,533 | \$2,181 | \$2,818 | \$273 | \$93 | \$16 | \$14,122 |

|   |          |     |         |          |         |         |          |       |      |     |          |
|---|----------|-----|---------|----------|---------|---------|----------|-------|------|-----|----------|
| Loans individually evaluated for impairment | \$27,364 | \$- | \$7,987 | \$14,731 | \$6,814 | \$6,213 | \$17,824 | \$213 | \$62 | \$- | \$81,208 |
|---|----------|-----|---------|----------|---------|---------|----------|-------|------|-----|----------|

|   |          |         |          |           |           |           |          |          |          |         |           |
|---|----------|---------|----------|-----------|-----------|-----------|----------|----------|----------|---------|-----------|
| Loans collectively evaluated for impairment     | 46,063   | 7,634   | 70,976   | 134,929   | 270,959   | 210,546   | 40,743   | 53,561   | 20,085   | 3,397   | \$858,893 |
| Loans acquired with deteriorated credit quality | -        | -       | -        | -         | -         | -         | -        | -        | -        | -       | -         |
| Total   | \$73,427 | \$7,634 | \$78,963 | \$149,660 | \$277,773 | \$216,759 | \$58,567 | \$53,774 | \$20,147 | \$3,397 | \$940,101 |

## NOTE 8. GOODWILL AND OTHER INTANGIBLE ASSETS

The following tables present our goodwill by reporting unit at June 30, 2013 and other intangible assets by reporting unit at June 30, 2013 and December 31, 2012.

| Dollars in thousands     | Goodwill Activity |                    |          |
|--------------------------|-------------------|--------------------|----------|
|                          | Community Banking | Insurance Services | Total    |
| Balance, January 1, 2013 | \$ 1,488          | \$ 4,710           | \$ 6,198 |
| Acquired goodwill, net   | -                 | -                  | -        |
| Balance, June 30, 2013   | \$ 1,488          | \$ 4,710           | \$ 6,198 |

| Dollars in thousands             | Other Intangible Assets        |          |          |                                |          |          |
|----------------------------------|--------------------------------|----------|----------|--------------------------------|----------|----------|
|                                  | June 30, 2013                  |          |          | December 31, 2012              |          |          |
|                                  | Community Insurance<br>Banking | Services | Total    | Community Insurance<br>Banking | Services | Total    |
| Unidentifiable intangible assets |                                |          |          |                                |          |          |
| Gross carrying amount            | \$ 2,267                       | \$ -     | \$ 2,267 | \$ 2,267                       | \$ -     | \$ 2,267 |
| Less: accumulated amortization   | 2,141                          | -        | 2,141    | 2,065                          | -        | 2,065    |
| Net carrying amount              | \$ 126                         | \$ -     | \$ 126   | \$ 202                         | \$ -     | \$ 202   |
| Identifiable intangible assets   |                                |          |          |                                |          |          |
| Gross carrying amount            | \$ -                           | \$ 3,000 | \$ 3,000 | \$ -                           | \$ 3,000 | \$ 3,000 |
| Less: accumulated amortization   | -                              | 1,200    | 1,200    | -                              | 1,100    | 1,100    |
| Net carrying amount              | \$ -                           | \$ 1,800 | \$ 1,800 | \$ -                           | \$ 1,900 | \$ 1,900 |

We recorded amortization expense of approximately \$176,000 for the six months ended June 30, 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 June 30, 2013 and 2012 and December 31, 2012:

| Dollars in thousands              | June 30,   | December   | June 30,   |
|-----------------------------------|------------|------------|------------|
|                                   | 2013       | 31, 2012   | 2012       |
| Demand deposits, interest bearing | \$ 187,244 | \$ 175,706 | \$ 164,868 |
| Savings deposits                  | 196,069    | 193,039    | 204,509    |
| Time deposits                     | 562,703    | 557,788    | 536,121    |
| Total                             | \$ 946,016 | \$ 926,533 | \$ 905,498 |

Included in time deposits are deposits acquired through a third party (“brokered deposits”) totaling \$192.1 million, \$190.4 million and \$181.6 million at June 30, 2013, December 31, 2012, and June 30, 2012, respectively.

A summary of the scheduled maturities for all time deposits as of June 30, 2013 is as follows:

|   |            |
|---|------------|
| Dollars in<br>thousands                               |            |
| Six month<br>period<br>ending<br>December<br>31, 2013 | \$ 143,414 |
| Year<br>ending<br>December<br>31, 2014                | 146,390    |
| Year<br>ending<br>December<br>31, 2015                | 65,071     |
| Year<br>ending<br>December<br>31, 2016                | 81,241     |
| Year<br>ending<br>December<br>31, 2017                | 29,175     |
| Thereafter  | 97,412     |
|   | \$ 562,703 |

The following is a summary of the maturity distribution of all certificates of deposit in denominations of \$100,000 or more as of June 30, 2013:

| Dollars in thousands      | Amount     | Percent |
|---------------------------|------------|---------|
| Three months or less      | \$ 49,489  | 12.0%   |
| Three through six months  | 46,871     | 11.4%   |
| Six through twelve months | 61,195     | 14.9%   |
| Over twelve months        | 253,549    | 61.7%   |
| Total                     | \$ 411,104 | 100.0%  |

NOTE 10. BORROWED FUNDS

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

| Dollars in thousands                                       | Six Months Ended<br>June 30, 2013 |   |
|--|-----------------------------------|---|
|  | Short-term<br>FHLB<br>Advances    | Federal<br>Funds<br>Purchased<br>and Lines<br>of Credit |
| Balance at June 30   | \$ 15,800                         | \$ 962  |
| Average balance outstanding for the period                 | 17,398                            | 3,474   |
| Maximum balance outstanding at any month end during period | 45,000                            | 5,961   |
| Weighted average   | 0.25 %                            | 0.25%   |



|   |      |   |       |
|---|------|---|-------|
| interest rate<br>for the period   |      |   |       |
| Weighted<br>average<br>interest rate<br>for balances<br>outstanding<br>at June 30 | 0.25 | % | 0.25% |

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

|                         | Six Months Ended<br>June 30, 2012 |  |  |
|-------------------------|-----------------------------------|--|--|
|                         | Short-term<br>FHLB                | Federal<br>Funds<br>Purchased<br>and Lines |  |
| Dollars in<br>thousands | Advances                          | of Credit                                  |  |

|   |           |        |
|---|-----------|--------|
| Balance at<br>June 30   | \$ 10,000 | \$ 957 |
| Average<br>balance<br>outstanding<br>for the period                               | 14,162    | 956    |
| Maximum<br>balance<br>outstanding at<br>any month<br>end during<br>period         | 20,000    | 957    |
| Weighted<br>average<br>interest rate<br>for the period                            | 0.22 %    | 0.25%  |
| Weighted<br>average<br>interest rate<br>for balances<br>outstanding<br>at June 30 | 0.23 %    | 0.25%  |

Long-term borrowings: Our long-term borrowings of \$163.6 million, \$203.3 million and \$253.6 million at June 30, 2013, December 31, 2012, and June 30, 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 June 30, |            | Balance at<br>December<br>31, |
|--|---------------------|------------|-------------------------------|
| Dollars in<br>thousands                          | 2013                | 2012       | 2012                          |
| Long-term<br>FHLB<br>advances                    | \$ 82,649           | \$ 157,609 | \$ 122,693                    |
| Long-term<br>reverse<br>repurchase<br>agreements | 72,000              | 87,000     | 72,000                        |
| Term loans                                       | 8,916               | 9,026      | 8,575                         |
| Total  | \$ 163,565          | \$ 253,635 | \$ 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 six month period ended June 30, 2013 was 3.86% compared to 3.95% for the first six months of 2012.

Subordinated debentures: We have subordinated debt totaling \$16.8 million at June 30, 2013, December 31, 2012, and June 30, 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 June 30, 2013, December 31, 2012, and June 30, 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.

35

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

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 | Subordinated debentures owed to unconsolidated subsidiary trusts |
|--------------------------|----------------------|-------------------------|--|
| Year Ending December 31, |                      |                         |  |
| 2013                     | \$ 49                | \$ -                    | \$ -   |
| 2014                     | 82,527               | -                       | -  |
| 2015                     | 1,909                | 10,000                  | -  |
| 2016                     | 28,911               | -                       | -  |
| 2017                     | 919                  | -                       | -  |
| Thereafter               | 49,250               | 6,800                   | 19,589   |
|                          | \$ 163,565           | \$ 16,800               | \$ 19,589  |

#### 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 six 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 six months of 2012 and 2011, our stock compensation expense and related deferred taxes were insignificant.

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

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

|                        | For the Six Months Ended June 30, |                                 |           |                                 |
|------------------------|-----------------------------------|---------------------------------|-----------|---------------------------------|
|                        | 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 (39,700 )      |                                   | 23.41                           | (22,800 ) | 5.12                            |
| Outstanding, June 30   | 196,250                           | \$ 18.92                        | 294,380   | \$ 19.18                        |

Other information regarding options outstanding and exercisable at June 30, 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           | 22,750      | \$5.01              | 3.48  | \$ 74                                    | 19,750              | \$5.36 | \$ 57                                    |
| 6.01 - 10.00            | 28,200      | 9.14                | 3.14  | 6  | 27,000              | 9.27   | 3  |
| 10.01 - 17.50           | 2,300       | 17.43               | 0.67  | -  | 2,300               | 17.43  | -  |
| 17.51 - 20.00           | 38,500      | 17.80               | 3.50  | -  | 38,500              | 17.8   | -  |
| 20.01 - 25.93           | 104,500     | 25.04               | 3.24  | -  | 104,500             | 25.04  | -  |
|                         | 196,250     | 18.92               |   | \$ 80                                    | 192,050             | 19.2   | \$ 60                                    |

## 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.

37

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



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

|   | June 30,   |
|---|------------|
| Dollars in thousands                        | 2013       |
| Commitments to extend credit:               |            |
| Revolving home equity and credit card lines | \$ 47,209  |
| Construction loans                          | 35,286     |
| Other loans                                 | 37,022     |
| Standby letters of credit                   | 2,246      |
| Total                                       | \$ 121,763 |

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 June 30, 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.

38

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

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<br>As of June 30, 2013 | Actual     |        | Minimum Required<br>Regulatory Capital |       |           |       | To be Well Capitalized<br>under Prompt Corrective<br>Action Provisions |  |
|---|------------|--------|--|-------|-----------|-------|--|--|
|   | Amount     | Ratio  | Amount                                 | Ratio | Amount    | Ratio |  |  |
| Total Capital (to risk weighted assets)     |            |        |  |       |           |       |  |  |
| Summit                                      | \$ 141,165 | 14.4 % | \$ 78,195                              | 8.0 % | \$ 97,744 | 10.0% |  |  |
| Summit Community                            | 152,323    | 15.6 % | 78,283                                 | 8.0 % | 97,854    | 10.0% |  |  |
| Tier I Capital (to risk weighted assets)    |            |        |  |       |           |       |  |  |
| Summit                                      | 118,050    | 12.1 % | 39,098                                 | 4.0 % | 58,647    | 6.0%  |  |  |
| Summit Community                            | 140,008    | 14.3 % | 39,142                                 | 4.0 % | 58,713    | 6.0%  |  |  |
| Tier I Capital (to<br>average assets)       |            |        |  |       |           |       |  |  |
| Summit                                      | 118,050    | 8.6 %  | 55,121                                 | 4.0 % | 68,901    | 5.0%  |  |  |
| Summit Community                            | 140,008    | 10.2 % | 55,121                                 | 4.0 % | 68,902    | 5.0%  |  |  |
| As of December 31,<br>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<br>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.

39

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

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.

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

## 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:

| In thousands  | Six Months Ended June 30, 2013 |                    |             |               |              |
|---|--------------------------------|--------------------|-------------|---------------|--------------|
|   | Community Banking              | Insurance Services | Parent      | Eliminations  | Total        |
| Net interest income                                 | \$ 20,212                      | \$ -               | \$ (950 )   | \$ -          | \$ 19,262    |
| Provision for loan losses                           | 2,500                          | -                  | -           | -             | 2,500        |
| Net interest income after provision for loan losses | 17,712                         | -                  | (950 )      | -             | 16,762       |
| Other income  | 112                            | 2,352              | 544         | (544 )        | 2,464        |
| Other expenses                                      | 12,676                         | 2,188              | 794         | (544 )        | 15,114       |
| Income (loss) before income taxes                   | 5,148                          | 164                | (1,200 )    | -             | 4,112        |
| Income tax expense (benefit)                        | 1,447                          | 66                 | (411 )      | -             | 1,102        |
| Net income (loss)                                   | 3,701                          | 98                 | (789 )      | -             | 3,010        |
| Dividends on preferred shares                       | -                              | -                  | 388         | -             | 388          |
| Net income (loss) applicable to common shares       | \$ 3,701                       | \$ 98              | \$ (1,177 ) | \$ -          | \$ 2,622     |
| Intersegment revenue (expense)                      | \$ (490 )                      | \$ (54 )           | \$ 544      | \$ -          | \$ -         |
| Average assets                                      | \$ 1,442,999                   | \$ 6,304           | \$ 156,502  | \$ (217,203 ) | \$ 1,388,602 |

| In thousands        | Six Months Ended June 30, 2012 |                    |           |              |           |
|---------------------|--------------------------------|--------------------|-----------|--------------|-----------|
|                     | Community Banking              | Insurance Services | Parent    | Eliminations | Total     |
| Net interest income | \$ 20,882                      | \$ -               | \$ (893 ) | \$ -         | \$ 19,989 |

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|   |              |          |             |               |              |
|---|--------------|----------|-------------|---------------|--------------|
| Provision for loan losses                           | 4,002        | -        | -           | -             | 4,002        |
| Net interest income after provision for loan losses | 16,880       | -        | (893 )      | -             | 15,987       |
| Other income  | 228          | 2,322    | 503         | (522 )        | 2,531        |
| Other expenses                                      | 12,536       | 1,958    | 862         | (522 )        | 14,834       |
| Income (loss) before income taxes                   | 4,572        | 364      | (1,252 )    | -             | 3,684        |
| Income tax expense (benefit)                        | 1,342        | 146      | (415 )      | -             | 1,073        |
| Net income (loss)                                   | 3,230        | 218      | (837 )      | -             | 2,611        |
| Dividends on preferred shares                       | -            | -        | 388         | -             | 388          |
| Net income (loss) applicable to common shares       | \$ 3,230     | \$ 218   | \$ (1,225 ) | \$ -          | \$ 2,223     |
| Intersegment revenue (expense)                      | \$ (471 )    | \$ (51 ) | \$ 522      | \$ -          | \$ -         |
| Average assets                                      | \$ 1,496,527 | \$ 6,453 | \$ 153,426  | \$ (217,297 ) | \$ 1,439,109 |

41

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

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| In thousands  | Three Months Ended June 30, 2013 |                    |            |               |              |
|---|----------------------------------|--------------------|------------|---------------|--------------|
|   | Community Banking                | Insurance Services | Parent     | Eliminations  | Total        |
| Net interest income                                 | \$ 9,986                         | \$ -               | \$ (482 )  | \$ -          | \$ 9,504     |
| Provision for loan losses                           | 1,000                            | -                  | -          | -             | 1,000        |
| Net interest income after provision for loan losses | 8,986                            | -                  | (482 )     | -             | 8,504        |
| Other income  | (463 )                           | 1,149              | 272        | (272 )        | 686          |
| Other expenses                                      | 6,377                            | 1,067              | 349        | (272 )        | 7,521        |
| Income (loss) before income taxes                   | 2,146                            | 82                 | (559 )     | -             | 1,669        |
| Income tax expense (benefit)                        | 622                              | 31                 | (201 )     | -             | 452          |
| Net income (loss)                                   | 1,524                            | 51                 | (358 )     | -             | 1,217        |
| Dividends on preferred shares                       | -                                | -                  | 194        | -             | 194          |
| Net income (loss) applicable to common shares       | \$ 1,524                         | \$ 51              | \$ (552 )  | \$ -          | \$ 1,023     |
| Intersegment revenue (expense)                      | \$ (245 )                        | \$ (27 )           | \$ 272     | \$ -          | \$ -         |
| Average assets                                      | \$ 1,439,506                     | \$ 6,344           | \$ 157,189 | \$ (217,703 ) | \$ 1,385,336 |

| In thousands  | Three Months Ended June 30, 2012 |                    |           |              |          |
|---|----------------------------------|--------------------|-----------|--------------|----------|
|   | Community Banking                | Insurance Services | Parent    | Eliminations | Total    |
| Net interest income                                 | \$ 10,416                        | \$ -               | \$ (445 ) | \$ -         | \$ 9,971 |
| Provision for loan losses                           | 2,001                            | -                  | -         | -            | 2,001    |
| Net interest income after provision for loan losses | 8,415                            | -                  | (445 )    | -            | 7,970    |
| Other income  | (300 )                           | 1,146              | 243       | (261 )       | 828      |
| Other expenses                                      | 6,176                            | 953                | 427       | (261 )       | 7,295    |
| Income (loss) before income taxes                   | 1,939                            | 193                | (629 )    | -            | 1,503    |
| Income tax expense (benefit)                        | 716                              | 77                 | (203 )    | -            | 590      |
| Net income (loss)                                   | 1,223                            | 116                | (426 )    | -            | 913      |
| Dividends on preferred shares                       | -                                | -                  | 194       | -            | 194      |
| Net income (loss) applicable to common shares       | \$ 1,223                         | \$ 116             | \$ (620 ) | \$ -         | \$ 719   |
| Intersegment revenue (expense)                      | \$ (236 )                        | \$ (25 )           | \$ 261    | \$ -         | \$ -     |



|                |              |          |            |              |              |
|----------------|--------------|----------|------------|--------------|--------------|
| Average assets | \$ 1,490,039 | \$ 6,538 | \$ 153,986 | \$ (217,516) | \$ 1,433,047 |
|----------------|--------------|----------|------------|--------------|--------------|

NOTE 15. SUBSEQUENT EVENT – INTEREST RATE SWAP TRANSACTION

On July 18, 2013, we entered into a \$40 million notional forward-starting, pay-fixed/receive LIBOR interest rate swap with an effective date of July 18, 2016, which was designated as a cash flow hedge of \$40 million of forecasted variable rate Federal Home Loan Bank advances. Under the terms of the swap we will pay a fixed rate of 2.98% for a 3 year period.

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 3.12% for the first six months in 2013 compared to the same period of 2012 while our net interest earnings on a tax equivalent basis decreased 4.03%. Our tax equivalent net interest margin decreased 2 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 |          | Six Months Ended June |          |
|-------------------------|--------------------|----------|-----------------------|----------|
|                         | June 30,           |          | 30,                   |          |
| In thousands            | 2013               | 2012     | 2013                  | 2012     |
| Community banking       | \$ 1,524           | \$ 1,223 | \$ 3,701              | \$ 3,230 |
| Insurance               | 51                 | 116      | 98                    | 218      |
| Parent                  | (552 )             | (620 )   | (1,177)               | (1,225)  |
| Consolidated net income | \$ 1,023           | \$ 719   | \$ 2,622              | \$ 2,223 |

## 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.

43

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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.

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

Deferred Income Tax Assets: At June 30, 2013, we had net deferred tax assets of \$13.5 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 June 30, 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 six months ended June 30, 2013 increased to \$2.6 million, or \$0.31 per diluted share as compared to \$2.2 million or \$0.27 per diluted share for the same period of 2012. Net income applicable to common shares for the quarter ended June 30, 2013 totaled \$1.0 million, or \$0.13 per diluted share as compared to \$719,000, or \$0.09 per diluted share for the quarter ended June 30, 2012. Earnings for both the quarter and six months ended June 30, 2013 were positively impacted by lower provisions for loan losses and negatively impacted by our continued write-downs of foreclosed properties to their estimated fair values. The provision for loan losses was \$2.5 million and \$4.0 million for the six months ended June 30, 2013 and 2012, respectively. Included in earnings for the six months ended June 30, 2013 was \$552,000 in losses on the sales of assets, primarily foreclosed properties, and \$2.4 million of charges resulting from the write down of a portion of our foreclosed properties to fair value. Returns on average equity and assets for the first six months of 2013 were 5.47% and 0.43%, respectively, compared with 4.96% and 0.36% 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 \$20.0 million for the six months ended June 30, 2013 compared to \$20.8 million for the same period of 2012, representing a decrease of \$837,000 or 4.0%. While our earnings on interest earning assets decreased \$4.3 million, 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 3.12% from \$1.31 billion during the first six months of 2012 to \$1.27 billion for the first six months of 2013. Average interest bearing liabilities declined 4.51% from \$1.23 billion at June 30, 2012 to \$1.18 billion at June 30, 2013, at an average yield for the first six months of 2013 of 1.65% compared to 2.14% for the same period of 2012.

Our consolidated net interest margin decreased to 3.18% for the six months ended June 30, 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 six months ended June 30, 2013 compared to June 30, 2012, the yields on earning assets decreased 50 basis points, while the cost of our interest bearing funds decreased by 49 basis points.

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



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.

47

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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 Six Months Ended |                      |                |               |                    |                      |                |
|---|--------------------------|----------------------|----------------|---------------|--------------------|----------------------|----------------|
|   | June 30, 2013            |                      |                | June 30, 2012 |                    |                      |                |
|   | Average<br>Balance       | Earnings/<br>Expense | Yield/<br>Rate |               | Average<br>Balance | Earnings/<br>Expense | Yield/<br>Rate |
| <b>Interest earning assets</b>                                    |                          |                      |                |               |                    |                      |                |
| Loans, net of unearned income (1)                                 |                          |                      |                |               |                    |                      |                |
| Taxable   | \$ 955,425               | \$ 25,569            | 5.40 %         |               | \$ 969,965         | \$ 28,239            | 5.85%          |
| Tax-exempt (2)  | 5,714                    | 203                  | 7.16 %         |               | 7,034              | 253                  | 7.23%          |
| <b>Securities</b>   |                          |                      |                |               |                    |                      |                |
| Taxable   | 221,998                  | 1,955                | 1.78 %         |               | 234,584            | 3,252                | 2.79%          |
| Tax-exempt (2)  | 75,297                   | 1,842                | 4.93 %         |               | 71,318             | 2,111                | 5.95%          |
| Federal funds sold and interest bearing deposits with other banks |                          |                      |                |               |                    |                      |                |
| Total interest earning assets                                     | 1,266,457                | 29,572               | 4.71 %         |               | 1,307,178          | 33,879               | 5.21%          |
| <b>Noninterest earning assets</b>                                 |                          |                      |                |               |                    |                      |                |
| Cash & due from banks   | 4,384                    |                      |                |               | 4,169              |                      |                |
| Premises and equipment  | 21,059                   |                      |                |               | 21,818             |                      |                |
| Other assets  | 113,334                  |                      |                |               | 124,321            |                      |                |
| Allowance for loan losses   | (16,632 )                |                      |                |               | (18,377 )          |                      |                |
| Total assets  | \$ 1,388,602             |                      |                |               | \$ 1,439,109       |                      |                |
| <b>Interest bearing liabilities</b>                               |                          |                      |                |               |                    |                      |                |
| Interest bearing demand deposits                                  |                          |                      |                |               |                    |                      |                |
| Savings deposits  | \$ 176,811               | \$ 132               | 0.15 %         |               | \$ 163,228         | \$ 164               | 0.20%          |
| Time deposits   | 196,464                  | 597                  | 0.61 %         |               | 210,030            | 733                  | 0.70%          |
| Short-term borrowings   | 577,669                  | 4,859                | 1.70 %         |               | 543,169            | 6,176                | 2.29%          |
| Long-term borrowings and capital trust securities                 | 20,872                   | 26                   | 0.25 %         |               | 15,145             | 16                   | 0.21%          |
| Total interest bearing liabilities                                | 204,584                  | 4,001                | 3.94 %         |               | 300,433            | 5,996                | 4.01%          |
| Total interest bearing liabilities                                | 1,176,400                | 9,615                | 1.65 %         |               | 1,232,005          | 13,085               | 2.14%          |

|   |           |           |              |           |
|---|-----------|-----------|--------------|-----------|
| Noninterest bearing liabilities               |           |           |              |           |
| and shareholders' equity                      |           |           |              |           |
| Demand deposits                               | 94,501    |           | 90,498       |           |
| Other liabilities                             | 7,632     |           | 11,323       |           |
| Total liabilities                             | 1,278,533 |           | 1,333,826    |           |
| Shareholders' equity                          |           |           |              |           |
| - preferred                                   | 9,324     |           | 9,326        |           |
| Shareholders' equity - common                 | 100,745   |           | 95,957       |           |
| Total liabilities and shareholders' equity \$ | 1,388,602 |           | \$ 1,439,109 |           |
| Net interest earnings                         |           | \$ 19,957 |              | \$ 20,794 |
| Net yield on interest earning assets          |           | 3.18      | %            | 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 \$695,000 and \$805,000 for the periods ended

June 30, 2013 and  
June 30, 2012,  
respectively.

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

| In thousands  | For the Six Months Ended              |             |            |
|---|---------------------------------------|-------------|------------|
|   | June 30, 2013 versus June 30, 2012    |             |            |
|   | Increase (Decrease) Due to Change in: |             |            |
|   | Volume                                | Rate        | Net        |
| Interest earned on:   |                                       |             |            |
| Loans   |                                       |             |            |
| Taxable   | \$ (429 )                             | \$ (2,241 ) | \$ (2,670) |
| Tax-exempt  | (47 )                                 | (3 )        | (50)       |
| Securities  |                                       |             |            |
| Taxable   | (167 )                                | (1,130)     | (1,297)    |
| Tax-exempt  | 111                                   | (380 )      | (269)      |
| Federal funds sold and interest bearing deposits with other banks | (11 )                                 | (10 )       | (21)       |
| Total interest earned on interest earning assets                  | (543 )                                | (3,764)     | (4,307)    |
| Interest paid on:   |                                       |             |            |
| Interest bearing demand deposits                                  | 13                                    | (45 )       | (32)       |
| Savings deposits  | (46 )                                 | (90 )       | (136)      |
| Time deposits   | 368                                   | (1,685)     | (1,317)    |
| Short-term borrowings   | 7                                     | 3           | 10         |
| Long-term borrowings and capital trust securities                 | (1,892)                               | (103 )      | (1,995)    |
| Total interest paid on interest bearing liabilities               | (1,550)                               | (1,920)     | (3,470)    |
| Net interest income   | \$ 1,007                              | \$ (1,844)  | \$ (837)   |

Noninterest Income

Total noninterest income decreased to \$2.46 million for the first six months of 2013, compared to \$2.53 million for the same period of 2012, with losses on the sales of assets, primarily foreclosed properties, and writedowns of foreclosed properties to their estimated fair value being the primary negative components. Further detail regarding noninterest income is reflected in the following table.

Table III -  
Noninterest Income

| Dollars in thousands                          | For the Quarter Ended |                  | For the Six Months |                        |
|---|-----------------------|------------------|--------------------|------------------------|
|   | 2013                  | June 30,<br>2012 | 2013               | Ended June 30,<br>2012 |
| Insurance commissions                         | \$ 1,132              | \$ 1,141         | \$ 2,316           | \$ 2,299               |
| Service fees related to deposit accounts      | 1,085                 | 1,075            | 2,096              | 2,089                  |
| Realized securities gains (losses)            | (57 )                 | 320              | (16 )              | 1,485                  |
| Other-than-temporary impairment of securities | (27 )                 | (106 )           | (80 )              | (335)                  |
| Gain (loss) on sale of assets                 | (512 )                | (523 )           | (552 )             | (599)                  |
| Bank owned life insurance income              | 236                   | 250              | 474                | 525                    |
| Writedown of foreclosed properties            | (1,494)               | (1,631)          | (2,423)            | (3,543)                |
| Other   | 322                   | 302              | 649                | 610                    |
| Total   | \$ 685                | \$ 828           | \$ 2,464           | \$ 2,531               |

Other-than-temporary impairment of securities: During the first six months of 2013, we recorded non-cash other-than-temporary impairment charges of \$80,000 related to certain residential mortgage-backed securities which we continue to own.

Gain/(loss) on sale of assets: During second quarter 2013, we recognized \$552,000 in losses on sales of assets, principally foreclosed properties.

Writedown of foreclosed properties: During the first six months of 2013, we recorded \$2.42 million 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 1.9% for the six months ended June 30, 2013, as compared to the same period in 2012. Salaries, commissions, and employee benefits increased during the first six months of 2013 compared to the first six 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 remain elevated. Table IV below shows the breakdown of the changes.

Table IV -  
Noninterest  
Expense

| Dollars in<br>thousands                            | For the Quarter Ended June 30,<br>Change |        |        |          | For the Six Months Ended June 30,<br>Change |        |        |           |
|--|--|--------|--------|----------|---|--------|--------|-----------|
|  | 2013                                     | \$     | %      | 2012     | 2013  | \$     | %      | 2012      |
| Salaries,<br>commissions, and<br>employee benefits | \$ 3,987                                 | \$ 95  | 2.4 %  | \$ 3,892 | \$ 8,104                                    | \$ 311 | 4.0 %  | \$ 7,793  |
| Net occupancy<br>expense                           | 476                                      | (14 )  | -2.9 % | 490      | 932   | (36 )  | -3.7 % | 968       |
| Equipment<br>expense                               | 559                                      | (46 )  | -7.6 % | 605      | 1,157                                       | (53 )  | -4.4 % | 1,210     |
| Professional fees                                  | 360                                      | 118    | 48.8 % | 242      | 611   | 53     | 9.5 %  | 558       |
| Amortization of<br>intangibles                     | 88                                       | -      | 0.0 %  | 88       | 176   | -      | 0.0 %  | 176       |
| FDIC premiums                                      | 515                                      | 15     | 3.0 %  | 500      | 1,055                                       | 33     | 3.2 %  | 1,022     |
| Foreclosed<br>properties expense                   | 295                                      | 62     | 26.6 % | 233      | 575   | (20 )  | -3.4 % | 595       |
| Other  | 1,241                                    | (4 )   | -0.3 % | 1,245    | 2,504                                       | (8 )   | -0.3 % | 2,512     |
| Total  | \$ 7,521                                 | \$ 226 | 3.1 %  | \$ 7,295 | \$ 15,114                                   | \$ 280 | 1.9 %  | \$ 14,834 |

#### 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 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.

50

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

We recorded \$2.5 million and \$4.0 million provisions for loan losses for the first six 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 June 30, 2013 compared to June 30, 2012.

As illustrated in Table V below, our non-performing assets have decreased since year end 2012.

Table V - Summary of Non-Performing Assets

| Dollars in thousands                                       | 2013      | June 30,<br>2012 | December 31,<br>2012 |
|--|-----------|------------------|----------------------|
| Accruing loans past due 90 days or more                    | \$ -      | \$ -             | \$ -                 |
| Nonaccrual loans   |           |                  |                      |
| Commercial   | 3,996     | 6,476            | 5,002                |
| Commercial real estate                                     | 1,695     | 3,536            | 2,556                |
| Commercial construction and development                    | -         | 662              | -                    |
| Residential construction and development                   | 11,505    | 16,735           | 13,641               |
| Residential real estate                                    | 13,605    | 18,550           | 16,522               |
| Consumer   | 91        | 78               | 55                   |
| Total nonaccrual loans                                     | 30,892    | 46,037           | 37,776               |
| Foreclosed properties                                      |           |                  |                      |
| Commercial   | -         | -                | -                    |
| Commercial real estate                                     | 10,310    | 12,029           | 11,835               |
| Commercial construction and development                    | 11,492    | 18,632           | 17,597               |
| Residential construction and development                   | 21,591    | 26,014           | 23,074               |
| Residential real estate                                    | 3,865     | 3,393            | 3,666                |
| Consumer   | -         | -                | -                    |
| Total foreclosed properties                                | 47,258    | 60,068           | 56,172               |
| Repossessed assets   | 2         | -                | 6                    |
| Total nonperforming assets                                 | \$ 78,152 | \$ 106,105       | \$ 93,954            |
| Total nonperforming loans as a percentage of total loans   | 3.29%     | 4.76%            | 3.96%                |
| Total nonperforming assets as a percentage of total assets | 5.70%     | 7.49%            | 6.77%                |



The following table details the activity regarding our foreclosed properties for the three months and six months ended June 30, 2013 and 2012.

| Dollars in thousands              | For the Three Months Ended June 30, |           | For the Six Months Ended June 30, |           |
|-----------------------------------|-------------------------------------|-----------|-----------------------------------|-----------|
|                                   | 2013                                | 2012      | 2013                              | 2012      |
| Beginning balance                 | \$ 54,625                           | \$ 61,584 | \$ 56,172                         | \$ 63,938 |
| Acquisitions                      | 1,467                               | 3,937     | 2,798                             | 5,021     |
| Improvements                      | 34                                  | 309       | 107                               | 521       |
| Disposals                         | (7,374)                             | (4,130)   | (9,396)                           | (5,449)   |
| Writedowns to fair value          | (1,494)                             | (1,631)   | (2,423)                           | (3,543)   |
| Reclassification of covered loans | -                                   | (1)       | -                                 | (420)     |
| Balance June 30                   | \$ 47,258                           | \$ 60,068 | \$ 47,258                         | \$ 60,068 |

The following table details our most significant nonperforming loan relationships at June 30, 2013.

Table IX - Significant Nonperforming Loan Relationships

June 30,

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            | \$ 2,075     | Collateral Value                  | \$ 3,081 (2 )               | \$ 233  | \$ 565                        |
| Shenandoah Valley VA | Residential Building Lots & Single family residence & Business Investment | Aug. 2004, July 2007, & Oct. 2007 & Sept. 2008 | Jun. 2011            | \$ 1,435     | Collateral value                  | \$ 1,574 (1 )               | \$ 40   | \$ 405                        |
| Northern VA          | Residential development & undeveloped acreage                             | Mar. 2008 & June 2008                          | Dec. 2011            | \$ 9,000     | Collateral value                  | \$ 10,000 (1 )              | \$ 1,000                                      | \$ 3,565                      |
| Eastern Panhandle 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:

#### 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 June 30, 2013, approximately 62% of our impaired loans required no reserves or have been charged down to their fair value.

At June 30, 2013, December 31, 2012, and June 30, 2012, our allowance for loan losses totaled \$14.1 million, or 1.50% of total loans, \$17.9 million, or 1.88% of total loans and \$17.9 million, or 1.85% of total loans, respectively, and is considered adequate to cover our estimate of probable credit losses inherent in our loan portfolio.

At June 30, 2013, December 31, 2012, and June 30, 2012, we had approximately \$47.3 million, \$56.2 million and \$60.1 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 \$1.370 billion at June 30, 2013, compared to \$1.387 billion at December 31, 2012, representing a 1.24% decrease. Table VIII below serves to illustrate significant changes in our financial position between December 31, 2012 and June 30, 2013.

Table VIII - Summary of Significant Changes in Financial Position

| Dollars in thousands            | Balance           | Increase (Decrease) |            | Balance       |
|---------------------------------|-------------------|---------------------|------------|---------------|
|                                 | December 31, 2012 | Amount              | Percentage | June 30, 2013 |
| <b>Assets</b>                   |                   |                     |            |               |
| Securities available for sale   | \$ 281,539        | 9,641               | 3.4 %      | \$ 291,180    |
| Loans, net of unearned interest | 937,168           | (11,189)            | -1.2 %     | 925,979       |
| <b>Liabilities</b>              |                   |                     |            |               |
| Deposits                        | \$ 1,027,125      | \$ 11,038           | 1.1 %      | \$ 1,038,163  |

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|  |         |          |       |   |         |
|--|---------|----------|-------|---|---------|
| Short-term borrowings  | 3,958   | 12,804   | 323.5 | % | 16,762  |
| Long-term borrowings   | 203,268 | (39,703) | -19.5 | % | 163,565 |
| Subordinated debentures  | 16,800  | -        | 0.0   | % | 16,800  |
| Subordinated debentures owed to unconsolidated subsidiary trusts | 19,589  | -        | 0.0   | % | 19,589  |

54

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

Loans decreased 1.2% and securities increased 3.4% during the first six 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 decreased approximately \$11.0 million during the first six months of 2013; brokered deposits increased approximately \$1.7 million.

The decrease in long term borrowings is primarily attributable to maturities and repayments of long-term FHLB advances during the first six 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 June 30, 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 \$494 million or 36.06% of total consolidated assets at June 30, 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 activity. As a member of the FHLB, we have access to approximately \$329 million. As of June 30, 2013 and December 31, 2012, these advances totaled approximately \$83 million and \$126 million, respectively. At June 30, 2013, we had additional borrowing capacity of \$247 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 June 30, 2013 was approximately \$81 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.

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



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 \$494 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 \$279 million aside from its FHLB line, which would result in a funding source of approximately \$236 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 \$494 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.

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

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 June 30, 2013 totaled \$107.2 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.

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;

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

- 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.

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 borrowing 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 June 30, 2013.

| Dollars in thousands | Long Term Debt | Capital Trust Securities | Operating Leases |
|----------------------|----------------|--------------------------|------------------|
|                      | 2013           | \$ 49                    | \$ -             |
| 2014                 | 82,527         | -                        | 204              |
| 2015                 | 11,909         | -                        | 38               |
| 2016                 | 28,911         | -                        | -                |
| 2017                 | 919            | -                        | -                |

|            |            |           |        |
|------------|------------|-----------|--------|
| Thereafter | 56,050     | 19,589    | -      |
| Total      | \$ 180,365 | \$ 19,589 | \$ 365 |

58

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

## 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 June 30, 2013 are presented in the following table.

| Table X -<br>Off-Balance<br>Sheet<br>Arrangements       |        | June 30,<br>2013 |
|---|--------|------------------|
| Dollars in<br>thousands                                 |        |                  |
| Commitments<br>to extend<br>credit:                     |        |                  |
| Revolving<br>home equity<br>and<br>credit<br>card lines |        | \$ 47,209        |
| Construction<br>loans                                   | 35,286 |                  |
| Other loans   | 37,022 |                  |
| Standby letters<br>of credit                            | 2,246  |                  |
| Total   |        | \$ 121,763       |

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 June 30, 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.



Results of Operations

| Change<br>in<br>Interest<br>Rates<br>(basis<br>points)<br>Down | Estimated %<br>Change in Net<br>Interest Income<br>Over: |                 |
|--|--|-----------------|
|  | 0-12<br>Months   | 13-24<br>Months |
| 100 (1)  | -0.21 %  | 4.70%           |
| Up 200<br>(1)  | -3.01 %  | -2.04%          |
| Up 400<br>(2)  | -2.27 %  | -6.76%          |

(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 June 30, 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 June 30, 2013 were effective. There were no changes in our internal control over financial reporting that occurred during the quarter ended June 30, 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: August 6, 2013

## EXHIBIT INDEX

| Exhibit No. | Description  | Page Number |
|-------------|--|-------------|
| (3)         | Articles of Incorporation and By-laws:   |             |
|             | (i) Amended and Restated Articles of Incorporation of (a) Summit Financial Group, Inc. |             |
|             | (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.

