SUMMIT FINANCIAL GROUP INC
Form 10-Q
August 09, 2007

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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10 Q

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

For the quarterly period ended June 30, 2007.

or

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

For the transition period from __________ to __________.

Commission File Number 0-16587

Summit Financial Group, Inc.

(Exact name of registrant as specified in its charter)

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

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

(304) 530-1000

(Registrant s telephone number, including area code)

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

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

Large accelerated filer o Accelerated filer þ Non-accelerated filer o

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

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

Common Stock, $2.50 par value
7,084,980 shares outstanding as of August 6, 2007

Summit Financial Group, Inc. and Subsidiaries

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

(dollars in thousands)	**June 30, 2007 (unaudited)**	**December 31, 2006 (*)**	**June 30, 2006 (unaudited)**
ASSETS			
Cash and due from banks	$ 15,198	$ 12,031	$ 12,530
Interest bearing deposits with other banks	105	271	123
Federal funds sold	1,717	517	1,590
Securities available for sale	259,526	247,874	238,382
Loans held for sale, net	2,337		
Loans, net	949,175	916,045	866,170
Property held for sale	850	41	283
Premises and equipment, net	22,133	22,446	22,870
Accrued interest receivable	6,812	6,352	5,018
Intangible assets	3,121	3,196	3,272
Other assets	18,410	16,343	17,778
Assets related to discontinued operations	336	9,715	11,632
Total assets	$ 1,279,720	$ 1,234,831	$ 1,179,648
LIABILITIES AND SHAREHOLDERS EQUITY			
Liabilities			
Deposits			
Non interest bearing	$ 64,373	$ 62,592	$ 66,071
Interest bearing	786,016	826,096	695,492
Total deposits	850,389	888,688	761,563
Short-term borrowings	100,901	60,428	164,185
Long-term borrowings	214,887	174,292	147,579
Subordinated debentures owed to unconsolidated subsidiary trusts	19,589	19,589	19,589
Other liabilities	10,365	9,850	9,844
Liabilities realted to discontinued operations	522	2,109	329
Total liabilities	1,196,653	1,154,956	1,103,089
Commitments and Contingencies			
Shareholders Equity			
Common stock and related surplus, $2.50 par value; authorized 20,000,000 shares, issued and outstanding 2007 and December 2006 - 7,084,980 shares; issued June 2006 - 7,135,120 shares	18,037	18,021	18,914

Retained earnings	66,636	62,206	60,678
Accumulated other comprehensive income	(1,606)	(352)	(3,033)
Total shareholders equity	83,067	79,875	76,559
Total liabilities and shareholders equity	$ 1,279,720	$ 1,234,831	$ 1,179,648

(*) - December 31, 2006 financial information has been extracted from audited consolidated financial statements

See Notes to Consolidated Financial Statements

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

(dollars in thousands, except per share amounts)	**Three Months Ended June 30, 2007**	**June 30, 2006**	**Six Months Ended June 30, 2007**	**June 30, 2006**
Interest income				
Interest and fees on loans				
Taxable	$ 18,958	$ 16,508	$ 37,555	$ 31,648
Tax-exempt	121	102	236	202
Interest and dividends on securities				
Taxable	2,739	2,250	5,318	4,385
Tax-exempt	524	537	1,068	1,049
Interest on interest bearing deposits with other banks	6	4	9	20
Interest on Federal funds sold	21	8	25	16
Total interest income	22,369	19,409	44,211	37,320
Interest expense				
Interest on deposits	8,882	6,408	17,910	11,561
Interest on short-term borrowings	960	1,831	1,918	3,795
Interest on long-term borrowings and subordinated debentures	3,181	2,517	6,013	4,932
Total interest expense	13,023	10,756	25,841	20,288
Net interest income	9,346	8,653	18,370	17,032
Provision for loan losses	390	330	780	655
Net interest income after provision for loan losses	8,956	8,323	17,590	16,377
Other income				
Insurance commissions	209	247	416	477
Service fees	736	726	1,353	1,356
Securities gains (losses)				
Gain (loss) on sale of assets	(33)		(32)	(4)
Other	242	136	429	283
Total other income	1,154	1,109	2,166	2,112
Other expense				
Salaries and employee benefits	3,238	3,049	6,463	6,104
Net occupancy expense	408	390	826	791
Equipment expense	493	496	940	946
Supplies	197	222	370	388
Professional fees	193	245	367	452

Amortization of intangibles	38	38	76	76
Other	1,151	1,232	2,326	2,276
Total other expense	5,718	5,672	11,368	11,033
Income before income taxes	4,392	3,760	8,388	7,456
Income tax expense	1,240	1,167	2,441	2,275
Income from continuing operations	3,152	2,593	5,947	5,181
Discontinued Operations				
Exit costs	43		123	
Operating income(loss)	(227)	74	(598)	683
Income from discontinued operations before income tax expense(benefit)	(184)	74	(475)	683
Income tax expense(benefit)	(66)	33	(162)	259
Income from discontinued operations	(118)	41	(313)	424
Net Income	$ 3,034	$ 2,634	$ 5,634	$ 5,605
Basic earnings from continuing operations per common share	$ 0.45	$ 0.36	$ 0.84	$ 0.73
Basic earnings per common share	$ 0.43	$ 0.37	$ 0.80	$ 0.79
Diluted earnings from continuing operations per common share	$ 0.44	$ 0.36	$ 0.83	$ 0.72
Diluted earnings per common share	$ 0.42	$ 0.37	$ 0.79	$ 0.78
Dividends per common share	$ 0.17	$ 0.16	$ 0.17	$ 0.16

See Notes to Consolidated Financial Statements

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

(dollars in thousands, except per share amounts)	Common Stock and Related Surplus	Retained Earnings	Accumulated Other Compre-hensive Income	Total Share-holders Equity
Balance, December 31, 2006	$ 18,021	$ 62,206	$ (352)	$ 79,875
Six Months Ended June 30, 2007				
Comprehensive income:				
Net income		5,634		5,634
Other comprehensive income, net of deferred tax benefit of ($769):				
Net unrealized loss on securities of ($1,254)			(1,254)	(1,254)
Total comprehensive income				4,380
Stock compensation expense	16			16
Cash dividends declared ($0.17 per share)		(1,204)		(1,204)
Balance, June 30, 2007	$ 18,037	$ 66,636	$ (1,606)	$ 83,067
Balance, December 31, 2005	$ 18,857	$ 56,215	$ (1,268)	$ 73,804
Six Months Ended June 30, 2006				
Comprehensive income:				
Net income		5,605		5,605
Other comprehensive income, net of deferred tax benefit of ($909):				
Net unrealized (loss) on securities of ($1,765)			(1,765)	(1,765)
Total comprehensive income				3,840
Exercise of stock options	44			44
Stock compensation expense	13			13
Cash dividends declared ($0.16 per share)		(1,142)		(1,142)
Balance, June 30, 2006	$ 18,914	$ 60,678	$ (3,033)	$ 76,559

See Notes to Consolidated Financial Statements

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

	Six Months Ended	
(dollars in thousands)	**June 30, 2007**	**June 30, 2006**
Cash Flows from Operating Activities		
Net income	$ 5,634	$ 5,605
Adjustments to reconcile net earnings to net cash provided by operating activities:		
Depreciation	763	853
Provision for loan losses	1,030	875
Stock compensation expense	16	13
Deferred income tax (benefit)	230	(192)
Loans originated for sale	(12,695)	(140,305)
Proceeds from loans sold	19,348	152,290
(Gain) on sales of loans held for sale	(562)	(5,102)
Securities (gains)		
Exit costs related to discontinued operations	(123)	
Loss on disposal of other assets	32	4
Amortization of securities premiums, net	(37)	101
Amortization of goodwill and purchase accounting adjustments, net	81	81
(Decrease) in accrued interest receivable	(465)	(189)
(Increase) in other assets	(810)	(271)
Increase(decrease) in other liabilities	(954)	131
Net cash provided by (used in) operating activities	11,488	13,894
Cash Flows from Investing Activities		
Net (increase) decrease in interest bearing deposits with other banks	166	1,414
Proceeds from maturities and calls of securities available for sale	12,404	3,500
Proceeds from sales of securities available for sale	7,141	8,623
Principal payments received on securities available for sale	14,098	11,954
Purchases of securities available for sale	(47,265)	(41,579)
Net (increase) decrease in Federal funds sold	(1,200)	2,060
Net loans made to customers	(34,832)	(73,832)
Purchases of premises and equipment	(488)	(1,317)
Proceeds from sales of other assets	86	26
Purchase of life insurance contracts		(880)
Net cash provided by (used in) investing activities	(49,890)	(90,031)
Cash Flows from Financing Activities		
Net increase in demand deposit, NOW and savings accounts	6,047	11,137
Net increase(decrease) in time deposits	(44,395)	76,599
Net increase(decrease) in short-term borrowings	40,473	(17,843)
Proceeds from long-term borrowings	50,000	17,801
Repayment of long-term borrowings	(9,352)	(20,465)
Exercise of stock options		44
Dividends paid	(1,204)	(1,142)

Net cash provided by financing activities	41,569	66,131
Increase (decrease) in cash and due from banks	3,167	(10,006)
Cash and due from banks:		
Beginning	12,031	22,536
Ending	$ 15,198	$ 12,530

(Continued)

See Notes to Consolidated Financial Statements

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

(dollars in thousands)	**Six Months Ended June 30, 2007**	**June 30, 2006**
Supplemental Disclosures of Cash Flow Information		
Cash payments for:		
Interest	$ 25,414	$ 19,832
Income taxes	$ 2,190	$ 2,641
Supplemental Schedule of Noncash Investing and Financing Activities		
Other assets acquired in settlement of loans	$ 852	$ 44

See Notes to Consolidated Financial Statements

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Summit Financial Group, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (unaudited)

Note 1. Basis of Presentation

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

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

The results of operations for the six months ended June 30, 2007 are not necessarily indicative of the results to be expected for the full year. The consolidated financial statements and notes included herein should be read in conjunction with our 2006 audited financial statements and Annual Report on Form 10-K. Certain accounts in the consolidated financial statements for December 31, 2006 and June 30, 2006, as previously presented, have been reclassified to conform to current year classifications.

Note 2. Significant New Accounting Pronouncements

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

In September 2006, the FASB issued Statement No. 157, *Fair Value Measurements* (SFAS 157). SFAS 157 defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles (GAAP), and expands disclosures about fair value measurements, but does not require any new fair value measurements. This Statement is effective for financial statements issued for fiscal years beginning after November 15, 2007, and early application is encouraged. We are currently evaluating the adoption of this statement and have not determined the impact it will have on our financial statements.

In February 2007, the FASB issued Statement of Financial Accounting Standard No. 159 (SFAS 159), *The Fair Value Option for Financial Assets and Financial Liabilities-Including an amendment of FASB Statement No. 115.* The fair value option established by this Statement permits all entities to choose to measure eligible items at fair value at specified election dates. Unrealized gains and losses on items for which the fair value option has been elected are to be reported in earnings at each subsequent reporting date. The fair value option (i) may be applied instrument by instrument, with a few exceptions, such as investments otherwise accounted for by the equity method, (ii) is irrevocable (unless a new election date occurs), and (iii) is applied only to entire instruments and not to portions

Summit Financial Group, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (unaudited)

of instruments. This statement becomes effective for us January 1, 2008. We are currently evaluating the adoption of this statement and have not determined the impact it will have on our financial statements.

Note 3. Acquisition and Subsequent Event

Effective July 2, 2007, we acquired Kelly Insurance Agency, Inc. and Kelly Property and Casualty, Inc., two Virginia corporations located in Leesburg, Virginia, which were merged into Summit Insurance Services, LLC, our wholly owned subsidiary. We have deemed this transaction to be an immaterial acquisition.

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

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

The final transaction consideration will be paid 70% in the form of Summit common stock and 30% in cash. The exchange ratio for determining the number of shares of Summit common stock to be issued for each share of Greater Atlantic s common stock will be based on the average closing price of Summit s common stock for the twenty trading days before the closing date of the transaction (Summit s Average Closing Stock Price), subject to a collar . The collar ranges from $17.82 per share to $24.10 per share. If Summit s Average Closing Stock Price falls within this range, then Greater Atlantic shareholders will receive shares of Summit s common stock based on an exchange ratio equal to 70% of the final per share transaction consideration divided by Summit s Average Closing Stock Price. However, if Summit s Average Closing Stock Price is less than $17.82 per share, the exchange ratio will equal 70% of the final per share transaction consideration divided by $17.82; and if Summit s Average Closing Stock Price is more than $24.10 per share, then the exchange ratio will equal 70% of the final per share transaction consideration divided by $24.10. Consummation of the Merger is subject to approval of the shareholders of Greater Atlantic and the receipt of all required regulatory approvals, as well as other customary conditions. This acquisition is expected to close during fourth quarter of this year.

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Summit Financial Group, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (unaudited)

Note 4. Discontinued Operations

The following table lists the assets and liabilities of Summit Mortgage included in the balance sheet as assets and liabilities related to discontinued operations.

(dollars in thousands)	**June 30, 2007**	December 31, 2006	June 30, 2006
Assets:			
Loans held for sale, net	**$**	$ 8,428	$ 9,702
Loans, net		180	510
Premises and equipment, net			683
Property held for sale		75	75
Other assets	**336**	1,032	662
Total assets	**$ 336**	$ 9,715	$ 11,632
Liabilities:			
Accrued expenses and other liabilities	**$ 522**	$ 2,109	$ 329
Total liabilities	**$ 522**	$ 2,109	$ 329

The results of Summit Mortgage are presented as discontinued operations in a separate category on the income statements following the results from continuing operations. The income (loss) from discontinued operations for the periods ended June 30, 2007 and 2006 is presented below.

Statements of Income from Discontinued Operations

	Three Months Ended June 30,		**Six Months Ended June 30,**	
(dollars in thousands)	**2007**	2006	**2007**	2006
Interest income	**$ 22**	$ 411	**$ 134**	$ 974
Interest expense		234	**45**	545
Net interest income	**22**	177	**89**	429
Provision for loan losses		150	**250**	220
Net interest income after provision for loan losses	**22**	27	**(161)**	209
Noninterest income				
Mortgage origination revenue	**13**	5,946	**816**	12,529
(Loss) on sale of assets			**(51)**	
Total noninterest income	**13**	5,946	**765**	12,529
Noninterest expense				

Salaries and employee benefits	**100**	1,806	**542**	3,908
Net occupancy expense	**13**	180	**9**	349
Equipment expense	**1**	79	**23**	150
Professional fees	**100**	244	**197**	322
Postage		1,690		3,426
Advertising		1,163	**98**	2,453
Impairment of long-lived assets				
Exit costs	**(43)**		**(123)**	
Other	**48**	737	**334**	1,447
Total noninterest expense	**219**	5,899	**1,080**	12,055
Income (loss) before income tax expense	**(184)**	74	**(476)**	683
Income tax expense (benefit)	**(66)**	33	**(163)**	259
Income (loss) from discontinued operations	**$ (118)**	$ 41	**$ (313)**	$ 424

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Summit Financial Group, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (unaudited)

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

(dollars in thousands)	**Operating Lease Terminations**	**Vendor Contract Terminations**	**Severance Payments**	**Total**
Balance, December 31, 2006	$ **734**	$ **740**	$ **385**	**$ 1,859**
Less:				
Payments from the accrual	(379)	(509)	(305)	**(1,193)**
Addition to the accrual	188			**188**
Reversal of over accrual		(231)	(80)	**(311)**
Balance, June 30, 2007	$ 543	$	$	**$ 543**

Note 5. Earnings per Share

The computations of basic and diluted earnings per share follow:

	Three Months Ended June 30,		**Six Months Ended June 30,**	
(dollars in thousands, except per share amounts)	**2007**	2006	**2007**	2006
Numerator for both basic and diluted earnings per share:				
Income from continuing operations	**$ 3,152**	$ 2,593	**$ 5,947**	$ 5,181
Income (loss) from discontinued operations	**(118)**	41	**(313)**	424
Net Income	**$ 3,034**	$ 2,634	**$ 5,634**	$ 5,605
Denominator				
Denominator for basic earnings per share - weighted average common shares outstanding	**7,084,980**	7,135,107	**7,084,980**	7,131,611
Effect of dilutive securities:				
Stock options	**63,261**	58,300	**62,904**	61,588
	63,261	58,300	**62,904**	61,588
Denominator for diluted earnings per share - weighted average common shares outstanding and assumed conversions	**7,148,241**	7,193,407	**7,147,884**	7,193,199
Basic earnings per share from continuing operations	**$ 0.45**	**$ 0.36**	**$ 0.84**	**$ 0.73**
Basic earnings per share from discontinued operations	**(0.02)**	**0.01**	**(0.04)**	**0.06**
Basic earnings per share	**$ 0.43**	**$ 0.37**	**$ 0.80**	**$ 0.79**

Diluted earnings per share from continuing operations	$	**0.44**	$	**0.36**	$	**0.83**	$	**0.72**
Diluted earnings per share from discontinued operations		**(0.02)**		**0.01**		**(0.04)**		**0.06**
Diluted earnings per share	$	**0.42**	$	**0.37**	$	**0.79**	$	**0.78**

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Summit Financial Group, Inc. and Subsidiaries
Notes to Consolidated Financial Statements (unaudited)
Note 6. Securities
The amortized cost, unrealized gains, unrealized losses and estimated fair values of securities at June 30, 2007, December 31, 2006, and June 30, 2006 are summarized as follows:

		June 30, 2007		
	Amortized	Unrealized		Estimated
(dollars in thousands)	Cost	Gains	Losses	Fair Value
Available for Sale				
Taxable:				
U. S. Government agencies and corporations	$ 35,662	$ 1	$ 408	$ 35,254
Mortgage-backed securities	161,547	190	3,381	158,357
State and political subdivisions	3,759	18		3,777
Corporate debt securities	1,677	12	16	1,674
Federal Home Loan Bank stock	13,403			13,403
Other equity securities	677			677
Total taxable	216,725	221	3,805	213,142
Tax-exempt:				
State and political subdivisions	40,900	685	256	41,329
Other equity securities	4,473	594	12	5,055
Total tax-exempt	45,373	1,279	268	46,384
Total	$ 262,098	$ 1,500	$ 4,073	$ 259,526

		December 31, 2006		
	Amortized	Unrealized		Estimated
(dollars in thousands)	Cost	Gains	Losses	Fair Value
Available for Sale				
Taxable:				
U. S. Government agencies and corporations	$ 37,671	$ 3	$ 334	$ 37,340
Mortgage-backed securities	146,108	470	2,262	144,316
State and political subdivisions	3,759	25		3,784
Corporate debt securities	1,682	19	2	1,699
Federal Reserve Bank stock	669			669
Federal Home Loan Bank stock	12,094			12,094
Other equity securities	151			151
Total taxable	202,134	517	2,598	200,053
Tax-exempt:				
State and political subdivisions	40,329	1,026	68	41,287
Other equity securities	5,975	573	14	6,534

Total tax-exempt	46,304	1,599	82	47,821
Total	$ 248,438	$ 2,116	$ 2,680	$ 247,874

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

	June 30, 2006			
(dollars in thousands)	**Amortized Cost**	**Unrealized Gains**	**Unrealized Losses**	**Estimated Fair Value**
Available for Sale				
Taxable:				
U. S. Government agencies and corporations	$ 40,448	$ 2	$ 830	$ 39,620
Mortgage-backed securities	131,993	35	4,693	127,335
State and political subdivisions	3,759		37	3,722
Corporate debt securities	2,537	15	5	2,547
Federal Reserve Bank stock	639			639
Federal Home Loan Bank stock	15,769			15,769
Other equity securities	151			151
Total taxable	195,296	52	5,565	189,783
Tax-exempt:				
State and political subdivisions	41,911	645	334	42,222
Other equity securities	5,977	430	30	6,377
Total tax-exempt	47,888	1,075	364	48,599
Total	$ 243,184	$ 1,127	$ 5,929	$ 238,382

The maturities, amortized cost and estimated fair values of securities at June 30, 2007, are summarized as follows:

	Available for Sale	
(dollars in thousands)	**Amortized Cost**	**Estimated Fair Value**
Due in one year or less	$ 54,515	$ 53,643
Due from one to five years	113,797	111,492
Due from five to ten years	39,912	39,670
Due after ten years	35,321	35,586
Equity securities	18,553	19,135
	$ 262,098	$ 259,526

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Summit Financial Group, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (unaudited)

Note 7. Loans

Loans are summarized as follows:

(dollars in thousands)	**June 30, 2007**	December 31, 2006	June 30, 2006
Commercial	**$ 81,292**	$ 69,470	$ 64,341
Commercial real estate	**354,833**	314,198	296,681
Construction and development	**198,721**	215,820	182,000
Residential real estate	**283,821**	282,512	288,316
Consumer	**33,937**	36,455	37,040
Other	**7,111**	6,969	6,188
Total loans	**959,715**	925,424	874,566
Less unearned income	**1,772**	1,868	1,767
Total loans net of unearned income	**957,943**	923,556	872,799
Less allowance for loan losses	**8,768**	7,511	6,629
Loans, net	**$ 949,175**	$ 916,045	$ 866,170

Note 8. Allowance for Loan Losses

An analysis of the allowance for loan losses for the six month periods ended June 30, 2007 and 2006, and for the year ended December 31, 2006 is as follows:

	Six Months Ended June 30,		**Year Ended December 31,**
(dollars in thousands)	**2007**	**2006**	**2006**
Balance, beginning of period	$ 7,511	$ 6,112	$ 6,112
Losses:			
Commercial	50	32	32
Commercial real estate	40	19	185
Construction and development			
Real estate mortgage	77		35
Consumer	82	81	200
Other	98	202	289
Total	347	334	741
Recoveries:			
Commercial	21	1	1
Commercial real estate	7	37	46
Construction and development			
Real estate mortgage	5	6	6
Consumer	27	26	63

Other	72	126	179
Total	132	196	295
Net losses	215	138	446
Provision for loan losses	1,030	655	1,845
Reclassification of reserves related to loans previously reflected in discontinued operations	442		
Balance, end of period	$ 8,768	$ 6,629	$ 7,511

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Summit Financial Group, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (unaudited)

Note 9. Goodwill and Other Intangible Assets

The following tables present our goodwill at June 30, 2007 and other intangible assets at June 30, 2007, December 31, 2006, and June 30, 2006.

(dollars in thousands)	**Goodwill Activity**
Balance, January 1, 2007	$ 2,088
Acquired goodwill, net	
Balance, June 30, 2007	$ 2,088

	Unidentifiable Intangible Assets		
(dollars in thousands)	**June 30, 2007**	**December 31, 2006**	**June 30, 2006**
Unidentifiable intangible assets			
Gross carrying amount	$ 2,267	$ 2,267	$ 2,267
Less: accumulated amortization	1,234	1,159	1,083
Net carrying amount	$ 1,033	$ 1,108	$ 1,184

We recorded amortization expense of approximately $76,000 for the six months ended June 30, 2007 relative to our unidentifiable intangible assets. Annual amortization is expected to be approximately $151,000 for each of the years ending 2007 through 2011.

Note 10. Deposits

The following is a summary of interest bearing deposits by type as of June 30, 2007 and 2006 and December 31, 2006:

(dollars in thousands)	**June 30, 2007**	**December 31, 2006**	**June 30, 2006**
Interest bearing demand deposits	**$ 230,509**	$ 220,167	$ 214,279
Savings deposits	**41,910**	47,984	38,737
Retail time deposits	**289,826**	278,322	251,644
Brokered time deposits	**223,771**	279,623	190,832
Total	**$ 786,016**	$ 826,096	$ 695,492

Brokered deposits represent certificates of deposit acquired through a third party. The following is a summary of the maturity distribution of certificates of deposit in denominations of $100,000 or more as of June 30, 2007:

(dollars in thousands)	**Amount**	**Percent**
Three months or less	$ 59,544	20.7%
Three through six months	53,013	18.4%
Six through twelve months	83,012	28.9%

Over twelve months	92,162	32.0%
Total	$ 287,731	100.0%

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A summary of the scheduled maturities for all time deposits as of June 30, 2007 is as follows:

(dollars in thousands)	
Six month period ending December 31, 2007	$ 252,926
Year ending December 31, 2008	189,059
Year ending December 31, 2009	43,695
Year ending December 31, 2010	23,336
Year ending December 31, 2011	2,169
Thereafter	2,412
	$ 513,597

Note 11. Borrowed Funds

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

	Six Months Ended June 30, 2007		
(dollars in thousands)	**Short-term FHLB Advances**	**Repurchase Agreements**	**Federal Funds Purchased and Lines of Credit**
Balance at June 30	$93,659	$5,654	$ 1,588
Average balance outstanding for the period	63,636	6,409	1,886
Maximum balance outstanding at any month end during period	93,659	7,358	2,669
Weighted average interest rate for the period	5.39%	4.10%	7.66%
Weighted average interest rate for balances outstanding at June 30	5.30%	4.11%	7.75%

	Year Ended December 31, 2006		
(dollars in thousands)	**Short-term FHLB Advances**	**Repurchase Agreements**	**Federal Funds Purchased and Lines of Credit**
Balance at December 31	$ 54,765	$4,731	$ 932
Average balance outstanding for the period	123,953	5,793	1,026
Maximum balance outstanding at any month end during period	175,408	7,037	1,171
Weighted average interest rate for the period	5.08%	4.03%	7.49%
Weighted average interest rate for balances outstanding at December 31	5.39%	4.08%	7.75%

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	Six Months Ended June 30, 2006		
(dollars in thousands)	**Short-term FHLB Advances**	**Repurchase Agreements**	**Federal Funds Purchased and Lines of Credit**
Balance at June 30	$157,796	$5,749	$ 640
Average balance outstanding for the period	151,199	6,334	832
Maximum balance outstanding at any month end during period	175,408	7,037	1,164
Weighted average interest rate for the period	4.82%	3.92%	7.03%
Weighted average interest rate for balances outstanding at June 30	5.36%	4.17%	7.75%

Long-term borrowings: Our long-term borrowings of $214,887,000, $174,292,000 and $147,579,000 at June 30, 2007, December 31, 2006, and June 30, 2006 respectively, consisted primarily of advances from the Federal Home Loan Bank (FHLB).

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

The average interest rate paid on long-term borrowings for the six month period ended June 30, 2007 was 5.51% compared to 5.19% for the first six months of 2006.

Subordinated Debentures: We have three statutory business trusts that were formed for the purpose of issuing mandatorily redeemable securities (the capital securities) for which we are obligated to third party investors and investing the proceeds from the sale of the capital securities in our junior subordinated debentures (the debentures). The debentures held by the trusts are their sole assets. Our subordinated debentures totaled $19,589,000 at June 30, 2007, December 31, 2006, and June 30, 2006.

In October 2002, we sponsored SFG Capital Trust I, in March 2004, we sponsored SFG Capital Trust II, and in December 2005, we sponsored SFG Capital Trust III, of which 100% of the common equity of each trust is owned by us. SFG Capital Trust I issued $3,500,000 in capital securities and $109,000 in common securities and invested the proceeds in $3,609,000 of debentures. SFG Capital Trust II issued $7,500,000 in capital securities and $232,000 in common securities and invested the proceeds in $7,732,000 of debentures. SFG Capital Trust III issued $8,000,000 in capital securities and $248,000 in common securities and invested the proceeds in $8,248,000 of debentures.

Distributions on the capital securities issued by the trusts are payable quarterly at a variable interest rate equal to 3 month LIBOR plus 345 basis points for SFG Capital Trust I, 3 month LIBOR plus 280 basis points for SFG Capital Trust II, and 3 month LIBOR plus 145 basis points for SFG Capital Trust III, and equals the interest rate earned on the debentures held by the trusts, and is recorded as interest expense by us. The capital securities are subject to mandatory redemption in whole or in part, upon repayment of the debentures. We have entered into agreements which, taken collectively, fully and unconditionally guarantee the capital securities subject to the terms of the guarantee. The debentures of SFG Capital Trust I, SFG Capital Trust II, and SFG Capital Trust III are first redeemable by us in November 2007, March 2009, and March 2011, respectively.

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

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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)

Year Ending December 31,	**Amount**
2007	$ 13,968
2008	52,377
2009	28,911
2010	52,662
2011	2,466
Thereafter	84,092
	$ 234,476

Note 12. Stock Option Plan

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

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

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

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

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Summit Financial Group, Inc. and Subsidiaries

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During the first six months of 2007, we recognized $16,000 of compensation expense for share-based payment arrangements in our income statement, with a deferred tax asset of $6,000, compared to $13,200 compensation expense for the first six months of 2006 with a deferred tax asset of $5,000. At June 30, 2007, we had approximately $28,000 total compensation cost related to nonvested awards not yet recognized and we expect to recognize it over the next eighteen months.

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

	For the Six Months Ended			
	June 30, 2007		June 30, 2006	
	Options	Weighted-Average Exercise Price	Options	Weighted-Average Exercise Price
Outstanding, January 1	349,080	$ 17.83	361,740	$ 17.41
Granted				
Exercised			(8,900)	4.89
Forfeited				
Outstanding, June 30	349,080	$ 17.83	352,840	$ 17.73

Other information regarding options outstanding and exercisable at June 30, 2007 is as follows:

	Options Outstanding				Options Exercisable		
Range of exercise price	# of shares	WAEP	Wted. Avg. Remaining Contractual Life (yrs)	Aggregate Intrinsic Value (in thousands)	# of shares	WAEP	Aggregate Intrinsic Value (in thousands)
$4.63 - $6.00	83,600	$ 5.34	5.35	$ 1,213	83,600	$ 5.34	$ 1,213
6.01 - 10.00	31,680	9.49	8.51	328	24,480	9.49	254
10.01 - 17.50	3,500	17.43	6.67	8	3,500	17.43	8
17.51 - 20.00	51,800	17.79	9.47	107	31,000	17.79	64
20.01 - 25.93	178,500	25.19	8.07		178,500	25.19	
	349,080	17.83		$ 1,656	321,080	18.02	$ 1,539

Note 13. 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

Summit Financial Group, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (unaudited)

made under the loan facility. Since many of the commitments to extend credit may expire without being drawn upon, the total commitment amounts do not necessarily represent future cash flow requirements. A summary of the total unfunded, or off-balance sheet, credit extension commitments follows:

(dollars in thousands)	**June 30, 2007**
Commitments to extend credit:	
Revolving home equity and credit card lines	**$ 34,713**
Construction loans	**81,354**
Other loans	**39,209**
Standby letters of credit	**11,747**
Total	**$ 167,023**

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 14. Restrictions on Capital

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

Quantitative measures established by regulation to ensure capital adequacy require us and each of our subsidiaries to maintain minimum amounts and ratios of total and Tier I capital (as defined in the regulations) to risk-weighted assets (as defined), and of Tier I capital (as defined) to average assets (as defined). We believe, as of June 30, 2007, that we and each of our subsidiaries met all capital adequacy requirements to which they were subject.

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

Our actual capital amounts and ratios as well as our subsidiary, Summit Community Bank s (Summit Community) are presented in the following table.

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(dollars in thousands)	Actual Amount	Actual Ratio	Minimum Required Regulatory Capital Amount	Minimum Required Regulatory Capital Ratio	To be Well Capitalized under Prompt Corrective Action Provisions Amount	To be Well Capitalized under Prompt Corrective Action Provisions Ratio
As of June 30, 2007						
Total Capital (to risk weighted assets)						
Summit	$109,581	11.1%	$78,982	8.0%	$98,727	10.0%
Summit Community	107,527	11.0%	78,276	8.0%	97,845	10.0%
Tier I Capital (to risk weighted assets)						
Summit	$100,551	10.2%	39,491	4.0%	59,236	6.0%
Summit Community	98,497	10.1%	39,138	4.0%	58,707	6.0%
Tier I Capital (to average assets)						
Summit	$100,551	8.0%	37,600	3.0%	62,667	5.0%
Summit Community	98,497	7.9%	37,588	3.0%	62,647	5.0%
As of December 31, 2006						
Total Capital (to risk weighted assets)						
Summit	$104,231	10.8%	76,991	8.0%	96,239	10.0%
Summit Community	60,813	10.6%	46,032	8.0%	57,540	10.0%
Shenandoah	41,243	10.9%	30,355	8.0%	37,944	10.0%
Tier I Capital (to risk weighted assets)						
Summit	96,028	10.0%	38,495	4.0%	57,743	6.0%
Summit Community	56,170	9.8%	23,016	4.0%	34,524	6.0%
Shenandoah	37,683	9.9%	15,178	4.0%	22,766	6.0%
Tier I Capital (to average assets)						
Summit	96,028	7.9%	36,492	3.0%	60,820	5.0%
Summit Community	56,170	7.5%	22,383	3.0%	37,305	5.0%
Shenandoah	37,683	8.0%	14,097	3.0%	23,495	5.0%

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Summit Financial Group, Inc. and Subsidiaries

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

INTRODUCTION

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

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

OVERVIEW

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

Growth in our interest earning assets resulted in an increase of 5.66%, or $1,024,000 in our net interest earnings on a tax equivalent basis for the first six months in 2007 compared to the same period of 2006.

CRITICAL ACCOUNTING POLICIES

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

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

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

The allowance for loan losses represents our estimate of probable credit losses inherent in the loan portfolio. Determining the amount of the allowance for loan losses is considered a critical accounting estimate because it requires significant judgment and the use of estimates related to the amount and timing of expected future cash flows

Summit Financial Group, Inc. and Subsidiaries

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

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

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

Summit Financial Group, Inc. and Subsidiaries

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

RESULTS OF OPERATIONS

Earnings Summary

Income from continuing operations for the six months ended June 30, 2007 grew 14.78% to $5,947,000, or $0.83 per diluted share as compared to $5,181,000, or $0.72 per diluted share for the six months ended June 30, 2006. For the quarter ended June 30, 2007, income from continuing operations increased 21.56% to $3,152,000, or $0.44 per diluted share as compared to $2,593,000, or $0.36 per diluted share for the same period of 2006. Consolidated net income, which includes the results of discontinued operations, grew to $5,634,000 for the six months ended June 30, 2007 compared to $5,605,000 for the same period of 2006. On a quarterly basis, consolidated net income grew 15.19% to $3,034,000 for second quarter 2007 compared to $2,634,000 for the second quarter 2006. Consolidated returns on average equity and assets for the first six months of 2007 were 13.53% and 0.90%, respectively, compared with 14.53% and 0.98% for the same period of 2006.

Net Interest Income

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

Our consolidated net interest income on a fully tax-equivalent basis totaled $19,108,000 for the six month period ended June 30, 2007 compared to $18,084,000 for the same period of 2006, representing an increase of $1,024,000 or 5.66%. This increase resulted from growth in interest earning assets, primarily loans, which served to more than offset the 62 basis points increase in the cost of interest bearing liabilities during the same period. Average interest earning assets grew 10.50% from $1,087,366,000 during the first six months of 2006 to $1,201,516,000 for the first six months of 2007. Average interest bearing liabilities grew 10.69% from $992,532,000 at June 30, 2006 to $1,098,677,000 at June 30, 2007, at an average yield for the first six months of 2007 of 4.74% compared to 4.12% for the same period of 2006.

Our consolidated net interest margin decreased to 3.21% for the six month period ended June 30, 2007, compared to 3.35% for the same period in 2006. On a quarterly basis, our net interest margin declined to 3.22% at June 30, 2007, from 3.32% for the quarter ended June 30, 2006. Our net interest margin increased 2 basis points compared to the linked quarter. Our margin continues to be affected by our loan growth in an extremely competitive environment. The current competitive pressures are causing loan rates to be lower. Also, our loan growth is at a faster pace than we have been able to grow lower cost retail funds, causing us to rely more on higher cost, non-retail deposit funding vehicles. The current competitive and market conditions are also causing deposit rates to be higher. For the six months ended June 30, 2007 compared to June 30, 2006, the yields on earning assets increased 42 basis points, while the cost of our interest bearing funds increased by 62 basis points.

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

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Table I Average Balance Sheet and Net Interest Income Analysis
(dollars in thousands)

	For the Six Months Ended					
	June 30, 2007			June 30, 2006		
	Average Balance	Earnings/ Expense	Yield/ Rate	Average Balance	Earnings/ Expense	Yield/ Rate
Interest earning assets						
Loans, net of unearned income						
Taxable	$ 934,513	$ 37,645	8.12%	$ 844,093	$ 32,077	7.66%
Tax-exempt (1)	9,147	358	7.89%	8,242	305	7.46%
Securities						
Taxable	209,965	5,316	5.11%	188,414	4,385	4.69%
Tax-exempt (1)	46,433	1,597	6.94%	44,988	1,568	7.03%
Federal funds sold and interest bearing deposits with other banks	1,458	33	4.56%	1,629	37	4.58%
Total interest earning assets	1,201,516	44,949	7.54%	1,087,366	38,372	7.12%
Noninterest earning assets						
Cash & due from banks	13,821			14,259		
Premises and equipment	22,260			23,475		
Other assets	27,452			25,890		
Allowance for loan losses	(8,376)			(6,525)		
Total assets	$ 1,256,673			$ 1,144,465		
Interest bearing liabilities						
Interest bearing demand deposits	$ 225,705	$ 4,150	3.71%	$ 209,565	$ 3,366	3.24%
Savings deposits	44,820	398	1.79%	40,209	147	0.74%
Time deposits	546,634	13,362	4.93%	402,422	8,048	4.03%
Short-term borrowings	71,930	1,918	5.38%	158,365	3,795	4.83%
Long-term borrowings and capital trust securities	209,588	6,013	5.79%	181,971	4,932	5.47%
Total interest bearing liabilities	1,098,677	25,841	4.74%	992,532	20,288	4.12%

Noninterest bearing liabilities and shareholders equity						
Demand deposits	62,986			64,906		
Other liabilities	11,722			9,850		
Shareholders equity	83,288			77,177		
Total liabilities and shareholders equity	$ 1,256,673			$ 1,144,465		
Net interest earnings		$ 19,108			$ 18,084	
Net yield on interest earning assets			3.21%			3.35%

(1) - Interest income on tax-exempt securities has been adjusted assuming an effective tax rate of 34% for all periods presented. The tax equivalent adjustment resulted in an increase in interest income of $649,000 and $623,000 for the periods ended June 30, 2007 and June 30 2006, respectively.

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Table II Changes in Interest Margin Attributable to Rate and Volume
(dollars in thousands)

	For the Six Months Ended June 30, 2007 versus June 30, 2006 Increase (Decrease) Due to Change in:		
	Volume	**Rate**	**Net**
Interest earned on:			
Loans			
Taxable	$ 3,568	$ 2,000	$ 5,568
Tax-exempt	34	19	53
Securities			
Taxable	527	404	931
Tax-exempt	50	(21)	29
Federal funds sold and interest bearing deposits with other banks	(4)		(4)
Total interest earned on interest earning assets	4,175	2,402	6,577
Interest paid on:			
Interest bearing demand deposits	272	512	784
Savings deposits	19	232	251
Time deposits	3,280	2,034	5,314
Short-term borrowings	(2,265)	388	(1,877)
Long-term borrowings and capital trust securities	781	300	1,081
Total interest paid on interest bearing liabilities	2,087	3,466	5,553
Net interest income	$ 2,088	$ (1,064)	$ 1,024

Noninterest Income

Total noninterest income from continuing operations increased to $2,166,000 for the six months ended June 30, 2007, compared to $2,112,000 for the same period of 2006. Other income increased $146,000 for the six months ended June 30, 2007 compared to the same period of 2006 and $106,000 for the second quarter of 2007 compared to second quarter 2006 due to increases in financial services revenue and debit card income due to increased customer activity. Further detail regarding noninterest income is reflected in the following table.

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Noninterest Income

(dollars in thousands)

	For the Quarter Ended June 30,		For the Six Months Ended June 30,	
	2007	2006	2007	2006
Insurance commissions	$ 209	$ 247	$ 416	$ 477
Service fees	736	726	1,353	1,356
(Loss) on sale of assets	(33)		(32)	(4)
Other	242	136	429	283
Total	$1,154	$1,109	$2,166	$2,112

Noninterest Expense

Total noninterest expense for continuing operations was well controlled, increasing approximately $335,000, or 3.0% during the first six months of 2007 as compared to the same period in 2006 and $46,000 or 0.8% for second quarter 2007 compared to second quarter 2006 Salaries and employee benefits expense represented the largest category of expense growth, which resulted primarily from general merit raises. Table III below shows the breakdown of these increases.

Table III Noninterest Expense

(dollars in thousands)

	For the Quarter Ended June 30,				For the Six Months Ended June 30.			
		Change				Change		
	2007	$	%	2006	2007	$	%	2006
Salaries and employee benefits	**$3,238**	**$189**	**6.2%**	$3,049	**$ 6,463**	**$359**	**5.9%**	$ 6,104
Net occupancy expense	**408**	**18**	**4.6%**	390	**826**	**35**	**4.4%**	791
Equipment expense	**493**	**(3)**	**-0.6%**	496	**940**	**(6)**	**-0.6%**	946
Supplies	**197**	**(25)**	**-11.3%**	222	**370**	**(18)**	**-4.6%**	388
Professional fees	**193**	**(52)**	**-21.2%**	245	**367**	**(85)**	**-18.8%**	452
Amortization of intangibles	**38**		**0.0%**	38	**76**		**0.0%**	76
Other	**1,151**	**(81)**	**-6.6%**	1,232	**2,326**	**50**	**2.2%**	2,276
Total	**$5,718**	**$ 46**	**0.8%**	$5,672	**$11,368**	**$335**	**3.0%**	$11,033

Credit Experience

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

We recorded a $780,000 provision for loan losses for the first six months of 2007, compared to $655,000 for the same period in 2006. Net loan charge offs for the first six months of 2007 were $215,000, as compared to $138,000 over the same period of 2006. At June 30, 2007, the allowance for loan losses totaled $8,768,000 or 0.91% of loans, net of unearned income, compared to $7,511,000 or 0.81% of loans, net of unearned income at December 31, 2006.

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As illustrated in Table IV below, our non-performing assets and loans past due 90 days or more and still accruing interest have increased during the past 12 months.

Table IV Summary of Past Due Loans and Non-Performing Assets

(dollars in thousands)

	June 30,		December 31,
	2007	2006	2006
Accruing loans past due 90 days or more	$ 5,631	$ 290	$ 4,638
Nonperforming assets:			
Nonaccrual loans	1,676	697	638
Foreclosed properties	850	283	77
Repossessed assets	1	15	
Total	$ 8,158	$ 1,285	$ 5,353
Total nonperforming loans as a percentage of total loans	0.76%	0.11%	0.57%
Total nonperforming assets as a percentage of total assets	0.64%	0.11%	0.43%

Relationships with three developers comprise in excess of 50 percent of total nonperforming assets. Each of these loans is well-collateralized and adequate reserves are in place. We have experienced an upward trend in our internally classified assets. This trend has primarily been in residential real estate development loans due to the recent slowdown in the sales of newly constructed homes.

In addition, as a result of our internal loan review process, the ratio of internally classified loans to total loans increased from 4.12% at December 31, 2006 to 5.81% at June 30, 2007. Our internal loan review process includes a watch list of loans that have been specifically identified through the use of various sources, including past due loan reports, previous internal and external loan evaluations, classified loans identified as part of regulatory agency loan reviews and reviews of new loans representative of current lending practices. Once this watch list is reviewed to ensure it is complete, we review the specific loans for collectibility, performance and collateral protection. In addition, a grade is assigned to the individual loans utilizing internal grading criteria, which is somewhat similar to the criteria utilized by each subsidiary bank s primary regulatory agency. The increase in internally classified loans at June 30, 2007 is primarily due to two customer relationships. Management downgraded these two relationships, as they fell outside of our internal lending policy guidelines and does not expect any material future losses related to these two relationships. Refer to the Asset Quality section of the financial review of the 2006 Annual Report on Form 10-K for further discussion of the processes related to internally classified loans.

FINANCIAL CONDITION

Our total assets were $1,279,720,000 at June 30, 2007, compared to $1,234,831,000 at December 31, 2006, representing a 3.6% increase. Table V below serves to illustrate significant changes in our financial position between December 31, 2006 and June 30, 2007.

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Table V Summary of Significant Changes in Financial Position
(dollars in thousands)

	Balance December 31, 2006	Increase (Decrease) Amount	Percentage	Balance June 30, 2007
Assets				
Securities available for sale	$247,874	11,652	4.7%	$259,526
Loans, net	916,045	33,130	3.6%	949,175
Liabilities				
Deposits	$888,688	$(38,299)	-4.3%	$850,389
Short-term borrowings	60,428	40,473	67.0%	100,901
Long-term borrowings and subordinated debentures	193,881	40,595	20.9%	234,476

Loan growth during the first six months of 2007, occurring principally in the commercial real estate portfolio, was funded primarily by borrowings from the FHLB.

Deposits decreased approximately $38 million during the first half of 2007. This decrease was primarily in brokered deposits, which were replaced with FHLB short-term borrowings, which is reflected in their $40 million increase.

Refer to Notes 6, 7, 10, and 11 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, 2007 and December 31, 2006.

LIQUIDITY

Liquidity reflects our ability to ensure the availability of adequate funds to meet loan commitments and deposit withdrawals, as well as provide for other transactional requirements. Liquidity is provided primarily by funds invested in cash and due from banks, Federal funds sold, non-pledged securities, and available lines of credit with the FHLB, the total of which approximated $289 million, or 22.6% of total assets at June 30, 2007 versus $275 million, or 22.3% of total assets at December 31, 2006.

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

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CAPITAL RESOURCES

One of our continuous goals is maintenance of a strong capital position. Through management of our capital resources, we seek to provide an attractive financial return to our shareholders while retaining sufficient capital to support future growth. Shareholders equity at June 30, 2007 totaled $83,067,000 compared to $79,875,000 at December 31, 2006.

During second quarter 2007, our Board of Directors declared and paid the first half 2007 cash dividend of $0.17 per share compared to $0.16 paid for the first half of 2006. The first half 2007 dividend totaled $1,204,000, representing a 5.43% increase over the $1,142,000 paid during the first half 2006.

Refer to Note 14 of the notes to the accompanying consolidated financial statements for information regarding regulatory restrictions on our capital as well as our subsidiaries capital.

CONTRACTUAL CASH OBLIGATIONS

During our normal course of business, we incur contractual cash obligations. The following table summarizes our contractual cash obligations at June 30, 2007.

(dollars in thousands)	**Long Term Debt**	**Capital Trust Securities**	**Operating Leases**
2007	$ 13,968	$	$ 185
2008	52,377		259
2009	28,911		227
2010	52,662		123
2011	2,466		89
Thereafter	64,503	19,589	199
Total	$214,887	$19,589	$1,082

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, 2007 are presented in the following table.

(dollars in thousands)	**June 30, 2007**
Commitments to extend credit:	
Revolving home equity and credit card lines	$ 34,023
Construction loans	88,947
Other loans	32,560
Standby letters of credit	13,928
Total	$169,458

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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. The nature of our lending and funding activities tends to drive our interest rate risk position to being liability sensitive in the intermediate term. That is, absent any changes in the volumes of our interest earning assets or interest bearing liabilities, liabilities are likely to reprice faster than assets, resulting in a decrease in net income in a rising rate environment. Net income would increase in a falling interest rate environment. Net income is also subject to changes in the shape of the yield curve. In general, a flattening yield curve would result in a decline in our earnings due to the compression of earning asset yields and funding rates, while a steepening would result in increased earnings as margins widen.

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

The following table shows our projected earnings sensitivity as of June 30, 2007 which is well within our ALCO policy limit of a 10% reduction in net interest income over the ensuing twelve month period.

Change in Interest Rates	**Estimated % Change in Net Interest Income Over:**	
(basis points)	**0 - 12 Months**	**0 - 24 Months**
Down 200 (1)	1.32%	5.79%
Down 200, steepening yield curve (2)	2.24%	10.01%
Up 100 (1)	0.75%	0.18%
Up 200 (1)	0.66%	-4.21%

(1) assumes a parallel shift in the yield curve

(2) assumes steepening curve whereby short term rates decline by 200

basis points, while long term rates decline by 50 basis points

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CONTROLS AND PROCEDURES

Our management, including the Chief Executive Officer and Chief Financial Officer, has conducted as of June 30, 2007, an evaluation of the effectiveness of disclosure controls and procedures as defined in Exchange Act Rule 13a-15(e). Based on that evaluation, the Chief Executive Officer and Chief Financial Officer concluded that the disclosure controls and procedures as of June 30, 2007 were effective. There were no changes in our internal control over financial reporting that occurred during the quarter ended June 30, 2007 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 counsel, the outcome of these matters will not have a significant adverse effect on the consolidated financial statements. The Company is also involved in other legal proceedings described more fully below.

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

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

On November 20, 2006, Corinthian filed an Amended Complaint which joined Summit Financial Group as a defendant and requested damages in the amount of 20 million dollars. Trial of this matter is currently scheduled to begin on January 14, 2008.

After consultation with legal counsel, we believe that significant and meritorious defenses exist as to all the claims including with respect to plaintiff s claim for damages. We will continue to evaluate the claims in the Corinthian lawsuit and intend to vigorously defend against them. Management, at the present time, is unable to estimate the impact, if any, an adverse decision may have on our results of operations or financial condition. However, an adverse decision resulting in a large damage award could have a significant negative impact on Summit s regulatory capital thereby limiting Summit s near term growth and its ability to pay dividends to its shareholders.

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

In the Forrest case, responsive pleadings have been filed, written discovery has been exchanged by the parties, and plaintiff s deposition has been taken. Plaintiff moved to certify the case as a class action. Her motion was denied on the ground that plaintiff is not an adequate class representative. Plaintiff thereafter requested permission to appeal to the United States Court of Appeals for the Seventh Circuit, and her request was denied. Although the denial does not dispose of the certification issue with finality, this is currently a single plaintiff case. This case and certain other similar cases pending in the Eastern District of Wisconsin were stayed awaiting a ruling from the United States Supreme Court on the standard for determining what constitutes a willful violation under the FCRA. On June 4, 2007, the United States Supreme Court determined that willfulness under the FCRA covers both knowing and reckless violations of the Act. On June 19, 2007, the District Court lifted the stay and set a scheduling conference to take place on August 14, 2007. The Company intends to vigorously defend this case. However, because the Company s investigation and discovery are not complete, management is unable to estimate the impact, in any, of an adverse decision.

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In the Klutho case the Company moved for judgment on the pleadings, claiming that plaintiff has no legally viable claim. The Court granted the Company s motion and dismissed the plaintiff s claims in their entirety with prejudice on May 22, 2007. Plaintiff has not attempted to challenge the court s ruling, and the time for plaintiff to file any post-judgment motions and/or a notice of appeal have expired; therefore, the Klutho case is concluded.

Summit Financial Group, Inc. and Subsidiaries

Part II. Other Information

Item 1A. Risk Factors

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

Item 4. Submission of Matters to a Vote of Security Holders

On May 17, 2007, we held our Annual Meeting of Shareholders, and the shareholders took the following actions:

1. Elected as directors the following individuals to three year terms:

	For	Withheld
Oscar M. Bean	5,597,219	42,793
Dewey F. Bensenhaver	5,609,833	30,179
John W. Crites	5,602,071	37,941
James P. Geary II	5,568,257	71,755
Phoebe F. Heishman	5,536,356	103,656
Charles S. Piccirillo	5,538,602	101,410

The following directors terms of office continued after the 2007 annual shareholders meeting: Frank A. Baer, III, James M. Cookman, Patrick N. Frye, Thomas J. Hawse, III, Gary L. Hinkle, Gerald W. Huffman, H. Charles Maddy, III, Duke A. McDaniel, Ronald F. Miller, and G. R. Ours, Jr.

2. Ratified Arnett & Foster, PLLC, to serve as our independent registered public accounting firm for the year ending December 31, 2007.

For	Against	Abstentions
5,523,335	8,091	42,712

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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 8, 2007