SUMMIT FINANCIAL GROUP INC
Form 10-Q
May 11, 2009

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

FORM 10 – Q

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

For the quarterly period ended March 31, 2009.
or

[ ] TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(D) OF THE SECURITIES EXCHANGE ACT OF 1934 For the transition period from ___________ to __________.

Commission File Number 0-16587

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

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

300 North Main Street
Moorefield, West Virginia 26836
(Address of principal executive offices) (Zip Code)
(304) 530-1000
(Registrant's telephone number, including area code)

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if 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 o No o

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 o Accelerated filerþ Non-accelerated filer o Smaller reporting companyo

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
7,415,310 shares outstanding as of May 7, 2009

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PART II. OTHER INFORMATION

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

Dollars in thousands	March 31, 2009 (unaudited)	December 31, 2008 (*)	March 31, 2008 (unaudited)
ASSETS			
Cash and due from banks	$ 15,358	$ 11,356	$ 21,912
Interest bearing deposits with other banks	114	108	103
Federal funds sold	-	2	1,514
Securities available for sale	295,706	327,606	284,082
Other investments	24,000	23,016	17,947
Loan held for sale, net	1,327	978	489
Loans, net	1,186,042	1,192,157	1,079,223
Property held for sale	7,807	8,110	2,183
Premises and equipment, net	23,407	22,434	22,055
Accrued interest receivable	6,991	7,217	6,851
Intangible assets	9,617	9,704	9,968
Other assets	28,599	24,428	18,783
Total assets	$ 1,598,968	$ 1,627,116	$ 1,465,110
LIABILITIES AND SHAREHOLDERS' EQUITY			
Liabilities			
Deposits			
Non interest bearing	$ 70,483	$ 69,808	$ 64,111
Interest bearing	884,875	896,042	772,833
Total deposits	955,358	965,850	836,944
Short-term borrowings	120,480	153,100	93,950
Long-term borrowings	411,098	392,748	412,329
Subordinated debentures owed to unconsolidated subsidiary trusts	19,589	19,589	19,589
Other liabilities	8,839	8,585	10,343
Total liabilities	1,515,364	1,539,872	1,373,155
Commitments and Contingencies			
Shareholders' Equity			
Preferred stock and related surplus, $1.00 par value;			
authorized 250,000 shares, no shares issued	-	-	-
Common stock and related surplus, $2.50 par value;			
authorized 20,000,000 shares, issued and outstanding			
2009 - 7,415,310 shares; issued December 2008 - 7,415,310			
shares; issued March 2008 - 7,408,941 shares	24,453	24,453	24,394
Retained earnings	66,475	64,709	68,901
Accumulated other comprehensive income	(7,324)	(1,918)	(1,340)
Total shareholders' equity	83,604	87,244	91,955
Total liabilities and shareholders' equity	$ 1,598,968	$ 1,627,116	$ 1,465,110

(*) - December 31, 2008 financial information has been extracted from audited consolidated financial statements

See Notes to Consolidated Financial Statements

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

Dollars in thousands	Three Months Ended March 31, 2009	March 31, 2008
Interest income		
Interest and fees on loans		
Taxable	$ 18,147	$ 19,948
Tax-exempt	107	121
Interest and dividends on securities		
Taxable	4,224	3,196
Tax-exempt	513	590
Interest on interest bearing deposits with other banks	-	2
Interest on Federal funds sold	-	2
Total interest income	22,991	23,859
Interest expense		
Interest on deposits	6,620	7,124
Interest on short-term borrowings	213	919
Interest on long-term borrowings and subordinated debentures	4,822	4,877
Total interest expense	11,655	12,920
Net interest income	11,336	10,939
Provision for loan losses	4,000	1,000
Net interest income after provision for loan losses	7,336	9,939
Other income		
Insurance commissions	1,344	1,327
Service fees	735	743
Realized securities gains (losses)	256	-
Unrealized securities gains (losses)	(215)	-
Gain (loss) on sale of assets	(9)	-
Net cash settlement on derivative instruments	-	(170)
Change in fair value of derivative instruments	-	705
Other	329	243
Total other income	2,440	2,848
Other expense		
Salaries and employee benefits	4,279	4,395
Net occupancy expense	597	476
Equipment expense	568	534
Supplies	194	194
Professional fees	334	118
Amortization of intangibles	88	88
FDIC premiums	383	174
Other	1,308	1,110

Total other expense		7,751		7,089
Income before income taxes		2,025		5,698
Income tax expense		260		1,874
Net Income	$	1,765	$	3,824
Basic earnings per common share	$	0.24	$	0.52
Diluted earnings per common share	$	0.24	$	0.51

See Notes to Consolidated Financial Statements

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

Dollars in thousands	Common Stock and Related Surplus	Retained Earnings	Accumulated Other Comprehensive Income	Total Shareholders' Equity
Balance, December 31, 2008	$ 24,453	$ 64,709	$ (1,918)	$ 87,244
Three Months Ended March 31, 2009				
Comprehensive income:				
Net income	-	1,765	-	1,765
Other comprehensive income, net of deferred tax benefit of $3,175:				
Net unrealized loss on securities of ($5,662), net of reclassification adjustment for gains included in net income of $256	-	-	(5,406)	(5,406)
Stock compensation expense	-	-	-	-
Total comprehensive income				(3,641)
Exercise of stock options	-	-	-	-
Balance, March 31, 2009	$ 24,453	$ 66,474	$ (7,324)	$ 83,603
Balance, December 31, 2007	$ 24,391	$ 65,077	$ (48)	$ 89,420
Three Months Ended March 31, 2008				
Comprehensive income:				
Net income	-	3,824	-	3,824
Other comprehensive income, net of deferred tax expense of $792:				
Net unrealized gain on securities of $(1,292), net of reclassification adjustment for gains included in net income of $0	-	-	(1,292)	(1,292)
Stock compensation expense	3	-	-	3
Total comprehensive income				2,535
Exercise of stock options	-	-	-	-
Balance, March 31, 2008	$ 24,394	$ 68,901	$ (1,340)	$ 91,955

See Notes to Consolidated Financial Statements

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

	Three Months Ended	
	March 31,	March 31,
Dollars in thousands	2009	2008
Cash Flows from Operating Activities		
Net income	$ 1,765	$ 3,824
Adjustments to reconcile net earnings to net cash provided by operating activities:		
Depreciation	406	398
Provision for loan losses	4,000	1,000
Stock compensation expense	-	3
Deferred income tax (benefit)	(537)	(26)
Loans originated for sale	(4,821)	(1,608)
Proceeds from loans sold	4,485	2,523
(Gain) on sales of loans held for sale	(13)	(28)
Change in fair value of derivative instruments	-	(705)
Securities (gains)	(256)	-
Writedown of an equity investment	215	-
Loss on disposal of other assets	9	-
Amortization of securities premiums, net	(586)	(104)
Amortization of goodwill and purchase accounting adjustments, net	91	91
Decrease in accrued interest receivable	225	340
(Increase) decrease in other assets	193	(945)
Increase in other liabilities	254	2,430
Net cash provided by (used in) operating activities	5,430	7,193
Cash Flows from Investing Activities		
Net (increase) in interest bearing deposits with other banks	(6)	(26)
Proceeds from maturities and calls of securities available for sale	3,367	13,814
Proceeds from sales of securities available for sale	9,730	-
Principal payments received on securities available for sale	16,729	7,169
Purchases of securities available for sale	(6,020)	(24,029)
Purchases of other investments	(982)	(3,935)
Redemption of Federal Home Loan Bank stock	-	3,039
Net (increase) decrease in federal funds sold	2	(1,333)
Net loans made to customers	1,885	(27,881)
Purchases of premises and equipment	(1,379)	(324)
Proceeds from sales of other assets	45	-
Proceeds from early termination of interest rate swap	-	212
Net cash provided by (used in) investing activities	23,371	(33,294)
Cash Flows from Financing Activities		
Net increase (decrease) in demand deposit, NOW and savings accounts	31,448	(10,040)
Net increase(decrease) in time deposits	(41,940)	18,293
Net (decrease) in short-term borrowings	(32,620)	(78,105)

Proceeds from long-term borrowings	40,000	100,000
Repayment of long-term borrowings	(26,649)	(13,408)
Proceeds from issuance of subordinated debentures	4,962	9,988
Net cash provided by financing activities	(24,799)	26,728
Increase (decrease) in cash and due from banks	4,002	627
Cash and due from banks:		
Beginning	11,356	21,285
Ending	$ 15,358	$ 21,912

(Continued)

See Notes to Consolidated Financial Statements

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

	Three Months Ended			
Dollars in thousands		March 31, 2009		March 31, 2008
Supplemental Disclosures of Cash Flow Information				
Cash payments for:				
Interest	$	11,832	$	12,561
Income taxes	$	-	$	-
Supplemental Schedule of Noncash Investing and Financing Activities				
Other assets acquired in settlement of loans	$	230	$	147

See Notes to Consolidated Financial Statements

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

Note 1. Basis of Presentation

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

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

The results of operations for the three months ended March 31, 2009 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 2008 audited financial statements and Annual Report on Form 10-K and Form 10-K/A. Certain accounts in the consolidated financial statements for December 31, 2008 and March 31, 2008, as previously presented, have been reclassified to conform to current year classifications.

Note 2. Significant New Accounting Pronouncements

In April 2009, FASB issued FASB Staff Position ("FSP") No. FAS 157-4, Determining Fair Value When the Volume and Level of Activity for the Asset or Liability Have Significantly Decreased and Identifying Transactions That Are Not Orderly. Effective for interim and annual reporting periods ending after June 15, 2009, with early adoption permitted for periods ending after March 15, 2009, FSP FAS 157-4 provides guidelines for making fair value measurements more consistent with the principles presented in SFAS 157, "Fair Value Measurements," when the volume and level of activity for assets or liabilities have significantly decreased. FSP FAS 157-4 relates to determining fair values when there is no active market or where the price inputs being used represent distressed sales. It reaffirms what SFAS 157 states is the objective of fair value measurement – to reflect how much an asset would be sold for in an orderly transaction (as opposed to a distressed or forced transaction) at the date of the financial statements under current market conditions. Specifically, it reaffirms the need to use judgment to ascertain if a formerly active market has become inactive and in determining fair values when markets have become inactive. We will adopt FSP FAS 157-4 at June 30, 2009, and do not anticipate the adoption will have material impact on our financial condition or results of operations.

In April 2009, FASB issued FASB Staff Position ("FSP") No. FAS 115-2 and FAS 124-2, Recognition and Presentation of Other-Than-Temporary Impairments. Effective for interim and annual reporting periods ending after June 15, 2009, with early adoption permitted for periods ending after March 15, 2009, FSP FAS 115-2 and FAS 124-2 amended Other-Than-Temporary Impairment guidance in U.S. GAAP to make the guidance more operational and to improve the presentation and disclosure of other-than-temporary impairment on debt and equity securities in the financial statements. FSP FAS 115-2 and FAS 124-2 is intended to bring greater consistency to the timing of impairment recognition, and provide greater clarity to investors about the credit and noncredit components of impaired debt securities that are not expected to be sold. The measure of impairment in comprehensive income remains fair value. The FSP also requires increased and more timely disclosures sought by investors regarding expected cash flows, credit losses, and an aging of securities with unrealized losses. We will adopt FSP FAS 115-2 and FAS 124-2 on June 30, 2009 and do not expect that the adoption will have a material effect on our financial statements.

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

In April 2009, FASB issued FASB Staff Position ("FSP") No. FAS 107-1 and APB 28-1, Interim Disclosures about Fair Value of Financial Instruments. Effective for interim and annual reporting periods ending after June 15, 2009, with early adoption permitted for periods ending after March 15, 2009, FSP FAS 107-1 and APB 28-1 amends SFAS 107, Disclosures about Fair Value of Financial Instruments, to require disclosures about fair value of financial instruments for interim reporting periods of publicly traded companies as well as in annual financial statements. This FSP also amends APB Opinion No. 28, Interim Financial Reporting, to require those disclosures in summarized financial information at interim reporting periods. FSP FAS 107-1 and APB 28-1 only relates to disclosures and therefore will not have an impact on our financial condition or results of operations. We will adopt FSP FAS 107-1 and APB 28-1 on June 30, 2009.

In March 2008, FASB issued Statement of Financial Accounting Standards No. 161 ("SFAS 161"), Disclosures about Derivative Instruments and Hedging Activities-an amendment of FASB Statement No. 133. Effective for fiscal years and interim periods beginning after November 15, 2008, SFAS 161 amends and expands the disclosure requirements of Statement No. 133 by requiring enhanced disclosures for how and why an entity uses derivative instruments; how derivative instruments and related hedged items are accounted for under Statement No. 133 and its related interpretations; and how derivative instruments and related items affect an entity's financial position, financial performance and cash flows. The adoption of SFAS 161 did not have a material impact on our financial condition or results of operations as it only relates to disclosures.

In December 2007, the FASB issued Statement 141 (revised 2007) (SFAS 141R), Business Combinations. SFAS 141R will significantly change how the acquisition method will be applied to business combinations. SFAS 141R requires an acquirer, upon initially obtaining control of another entity, to recognize the assets, liabilities and any non-controlling interest in the acquiree at fair value as of the acquisition date. Contingent consideration is required to be recognized and measured at fair value on the date of acquisition rather than at a later date when the amount of that consideration may be determinable beyond a reasonable doubt. This fair value approach replaces the cost-allocation process required under SFAS 141 whereby the cost of an acquisition was allocated to the individual assets acquired and liabilities assumed based on their estimated fair value. SFAS 141R requires acquirers to expense acquisition-related costs as incurred rather than allocating such costs to the assets acquired and liabilities assumed, as was previously the case under SFAS 141. Under SFAS 141R, the requirements of SFAS 146, Accounting for Costs Associated with Exit or Disposal Activities, would have to be met in order to accrue for a restructuring plan in purchase accounting. Pre-acquisition contingencies are to be recognized at fair value, unless it is a non-contractual contingency that is not likely to materialize, in which case, nothing should be recognized in purchase accounting and, instead, that contingency would be subject to the probable and estimable recognition criteria of SFAS 5, Accounting for Contingencies. Reversals of deferred income tax valuation allowances and income tax contingencies will be recognized in earnings subsequent to the measurement period. The allowance for loan losses of an acquiree will not be permitted to be recognized by the acquirer. Additionally, SFAS 141(R) will require new and modified disclosures surrounding subsequent changes to acquisition-related contingencies, contingent consideration, noncontrolling interests, acquisition-related transaction costs, fair values and cash flows not expected to be collected for acquired loans, and an enhanced goodwill rollforward. We will be required to prospectively apply SFAS 141(R) to all business combinations completed on or after January 1, 2009. Early adoption is not permitted. We are currently evaluating SFAS 141(R) and have not determined the impact it will have on our financial statements.

Note 3. Fair Value Measurements

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

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

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

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

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

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

Available-for-Sale Securities: Investment securities available-for-sale are recorded at fair value on a recurring basis. Fair value measurement is based upon quoted prices, if available. If quoted prices are not available, fair values are measured using independent pricing models or other model-based valuation techniques such as the present value of future cash flows, adjusted for the security's credit rating, prepayment assumptions and other factors such as credit loss assumptions. Level 1 securities include those traded on an active exchange, such as the New York Stock Exchange, U.S. Treasury securities that are traded by dealers or brokers in active over-the-counter markets and money market funds. Level 2 securities include mortgage-backed securities issued by government sponsored entities, municipal bonds and corporate debt securities. Certain residential mortgage-backed securities issued by nongovernment entities are Level 3, due to the unobservable inputs used in pricing those 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 contractual terms of the loan agreement are considered impaired. Once a loan is identified as individually impaired, management measures impairment in accordance with SFAS 114, "Accounting by Creditors for Impairment of a Loan," (SFAS 114). The fair value of impaired loans is estimated using one of several methods, including collateral value, liquidation value and discounted cash flows. Those impaired loans not requiring an allowance represent loans for which the fair value of the expected repayments or collateral exceed the recorded investments in such loans. At March 31, 2009, substantially all of the total impaired loans were evaluated based on the fair value of the collateral. In accordance with SFAS 157, impaired loans where an allowance is established based on the fair value of collateral require classification in the fair value hierarchy. When the fair value of the collateral is based on an observable market price or a current appraised value, we record the impaired loan as nonrecurring Level 2. When an appraised value is not available or management

determines the fair value of the collateral is further impaired below the appraised value and there is no observable market price, we record the impaired loan as nonrecurring Level 3.

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

Assets and Liabilities Recorded at Fair Value on a Recurring Basis

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

	Total at	Fair Value Measurements Using:		
Dollars in thousands	March 31, 2009	Level 1	Level 2	Level 3
Assets:				
Available for sale securities	$ 295,706	$ -	$ 287,965	$ 7,741
Derivatives	13	-	13	-
Liabilities:				
Derivatives	$ 14	$ -	$ 14	$ -

The table below presents a reconciliation of all assets measured at fair value on a recurring basis using significant unobservable inputs (Level 3) for the period ended March 31, 2009. There were no gains or losses recorded in earnings attributable to unrealized gains or losses relating to those securities still held at March 31, 2009.

Dollars in thousands	Securities
Balance Jan. 1, 2009	$ 11,711
Unrealized gains/(losses) recorded in other comprehensive income	(1,315)
Purchases, issuances, and settlements	(900)