SUMMIT FINANCIAL GROUP INC
Form 10-Q/A
September 26, 2007

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

**FORM 10 – Q/A**
**Amendment No. 1**

[X] 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
[ ] 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 filerþ 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**

**EXPLANATORY NOTE**

Summit Financial Group, Inc. ("Company" or "Summit") is filing this amendment to its Quarterly Report on From 10-Q for the quarter ended June 30, 2007 to amend and restate financial statements and other financial information filed with the Securities and Exchange Commission ("SEC"). This amendment is being filed to correct errors in the originally filed Quarterly Report on Form 10-Q related to the Company's derivative accounting under Statement of Financial Standards No. 133, *Accounting for Derivative Instruments and Hedging Activities* ("SFAS No. 133").

In 2003, we entered into four interest rate swap agreements on certain convertible rate advances from the Federal Home Loan Bank("FHLB") that were designated as fair value hedges. The terms of the FHLB convertible rate advances include an option of the FHLB to convert the debt's fixed interest rate to a variable rate on a quarterly basis. We evaluated these hedging relationships and concluded that the short-cut method of hedge accounting could be applied and the assumption of no ineffectiveness was valid based upon: (a) the criteria in paragraph 68 of SFAS 133 were met, and (b) the conversion options in the FHLB advances were mirrored in the interest rate swaps.

Based on comments received from the Securities and Exchange Commission, we learned that the above interpretation of paragraph 68 is incorrect. The conversion is not specifically listed in paragraph 68, and the presence of that term prohibits the application of the short-cut method of hedge accounting, even if the terms are mirrored between the interest rate swap and the hedged item. Eliminating the application of fair value hedge accounting reverses the fair value adjustments that have been made to the advances and results in all fair value changes for the interest rate swaps being recognized in noninterest income. Additionally, the net cash settlement payments received/paid during each period for these interest rate swaps were reclassified from interest expense on long-term borrowings to noninterest income.

See Note 1, Restatement, in the Notes to Consolidated Financial Statements for a summary of the effects of this restatement.

We have also updated information relative to material subsequent events and legal matters in Note 4 of the Notes to Consolidated Financial Statements and Part II Other Information Item 1. Legal Proceedings to reflect the current status of such items through the filing date of this Form 10-Q/A.

Summit Financial Group, Inc. and Subsidiaries

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Summit Financial Group, Inc. and Subsidiaries

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**PART II. OTHER INFORMATION**

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

| *(dollars in thousands)* | | **June 30, 2007 (unaudited) (Restated)** | | **December 31, 2006 (*) (Restated)** | | **June 30, 2006 (unaudited) (Restated)** |
|---|---|---|---|---|---|---|
| **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 | | 19,118 | | 17,031 | | 18,720 |
| Assets related to discontinued operations | | 336 | | 9,715 | | 11,632 |
| **Total assets** | $ | 1,280,428 | $ | 1,235,519 | $ | 1,180,590 |
| | | | | | | |
| **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 | | 216,758 | | 176,109 | | 150,057 |
| Subordinated debentures owed to unconsolidated subsidiary trusts | | 19,589 | | 19,589 | | 19,589 |
| Other liabilities | | 10,359 | | 9,844 | | 9,844 |
| Liabilities realted to discontinued operations | | 522 | | 2,109 | | 329 |
| **Total liabilities** | | 1,198,518 | | 1,156,767 | | 1,105,567 |
| | | | | | | |
| **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 | | 65,479 | | 61,083 | 59,142 |
| Accumulated other comprehensive income | | (1,606) | | (352) | (3,033) |
| **Total shareholders' equity** | | 81,910 | | 78,752 | 75,023 |
| | | | | | |
| **Total liabilities and shareholders' equity** | $ | 1,280,428 | $ | 1,235,519 | $ 1,180,590 |

(*) - 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 (Restated) | Three Months Ended June 30, 2006 (Restated) | Six Months Ended June 30, 2007 (Restated) | Six Months Ended June 30, 2006 (Restated) |
|---|---|---|---|---|
| **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 | 3,000 | 2,370 | 5,653 | 4,705 |
| **Total interest expense** | 12,842 | 10,609 | 25,481 | 20,061 |
| **Net interest income** | 9,527 | 8,800 | 18,730 | 17,259 |
| Provision for loan losses | 390 | 330 | 780 | 655 |
| **Net interest income after provision for loan losses** | 9,137 | 8,470 | 17,950 | 16,604 |
| **Other income** | | | | |
| Insurance commissions | 209 | 247 | 416 | 477 |
| Service fees | 736 | 726 | 1,353 | 1,356 |
| Securities gains (losses) | - | - | - | - |
| Net cash settlement on interest rate swaps | (179) | (111) | (363) | (182) |
| Change in fair value of interest rate swap | (273) | (246) | (47) | (719) |
| Gain (loss) on sale of assets | (33) | - | (32) | (4) |
| Other | 236 | 133 | 426 | 273 |
| **Total other income** | 696 | 749 | 1,753 | 1,201 |
| **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** | 4,115 | 3,547 | 8,335 | 6,772 |
| Income tax expense | 1,135 | 1,086 | 2,421 | 2,015 |
| **Income from continuing operations** | $ 2,980 | $ 2,461 | $ 5,914 | $ 4,757 |

| | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| **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 | $ | 2,862 | $ | 2,502 | $ | 5,601 | $ | 5,181 |
| | | | | | | | | |
| Basic earnings from continuing operations per common share | $ | 0.42 | $ | 0.34 | $ | 0.83 | $ | 0.67 |
| Basic earnings per common share | $ | 0.40 | $ | 0.35 | $ | 0.79 | $ | 0.73 |
| Diluted earnings from continuing operations per common share | $ | 0.42 | $ | 0.34 | $ | 0.83 | $ | 0.66 |
| Diluted earnings per common share | $ | 0.40 | $ | 0.35 | $ | 0.78 | $ | 0.72 |
| 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

**Statement of Shareholders' Equity (unaudited)**

| *(dollars in thousands, except per share amounts)* | Common Stock and Related Surplus | Retained Earnings (Restated) | Accumulated Other Comprehensive Income | Total Shareholders' Equity (Restated) |
|---|---|---|---|---|
| **Balance, December 31, 2006** | $ 18,021 | $ 61,083 | $ (352) | $ 78,752 |
| **Six Months Ended June 30, 2007** | | | | |
| Comprehensive income: | | | | |
| Net income | - | 5,601 | - | 5,601 |
| 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 | | | | 4,347 |
| Stock compensation expense | 16 | - | - | 16 |
| Cash dividends declared ($0.17 per share) | - | (1,205) | - | (1,205) |
| | | | | |
| **Balance, June 30, 2007** | $ 18,037 | $ 65,479 | $ (1,606) | $ 81,910 |
| | | | | |
| **Balance, December 31, 2005** | $ 18,857 | $ 55,102 | $ (1,268) | $ 72,691 |
| **Six Months Ended June 30, 2006** | | | | |
| Comprehensive income: | | | | |
| Net income | - | 5,181 | - | 5,181 |
| 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 | | | | 3,416 |
| Exercise of stock options | 44 | - | - | 44 |
| Stock compensation expense | 13 | | | 13 |
| Cash dividends declared ($0.16 per share) | - | (1,141) | - | (1,141) |
| | | | | |
| **Balance, June 30, 2006** | $ 18,914 | $ 59,142 | $ (3,033) | $ 75,023 |

See Notes to Consolidated Financial Statements

Summit Financial Group, Inc. and Subsidiaries

**Consolidated Statements of Cash Flows (unaudited)**

| | Six Months Ended | |
|---|---|---|
| *(dollars in thousands)* | **June 30, 2007 (Restated)** | **June 30, 2006 (Restated)** |
| **Cash Flows from Operating Activities** | | |
| Net income | $ 5,601 | $ 5,181 |
| 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) | 210 | (452) |
| 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) | - | - |
| Change in fair value of derivative instruments | 47 | 719 |
| 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 | (947) | 95 |
| **Net cash provided by (used in) operating activities** | 11,489 | 13,893 |
| **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 | (1,205) | (1,141) |
| **Net cash provided by financing activities** | 41,568 | 66,132 |
| 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 (Restated) | Six Months Ended June 30, 2006 (Restated) |
|---|---|---|
| **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

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

**Note 1. Restatement**

Summit Financial Group, Inc. ("We", "Company", or "Summit") is restating its consolidated financial statements and other financial information to correct errors related to our derivative accounting under Statement of Financial Accounting Standards No. 133, *Accounting for Derivative Instruments and Hedging Activities* ("SFAS. No. 133").

In 2003, we entered into four interest rate swap agreements on certain convertible rate advances from the Federal Home Loan Bank("FHLB") that were designated as fair value hedges. The terms of the FHLB convertible rate advances include an option of the FHLB to convert the debt's fixed interest rate to a variable rate on a quarterly basis. We evaluated these hedging relationships and concluded that the short-cut method of hedge accounting could be applied and the assumption of no ineffectiveness was valid based upon: (a) the criteria in paragraph 68 of SFAS 133 were met, and (b) the conversion options in the FHLB advances were mirrored in the interest rate swaps.

Recently, we learned that the above interpretation of paragraph 68 is incorrect. The conversion is not specifically listed in paragraph 68, and the presence of that term prohibits the application of the short-cut method of hedge accounting, even if the terms are mirrored between the interest rate swap and the hedged item. Eliminating the application of fair value hedge accounting reverses the fair value adjustments that have been made to the advances and results in all fair value changes for the interest rate swaps being recognized in noninterest income. Additionally, the net cash settlement payments received/paid during each period for these interest rate swaps were reclassified from interest expense on long-term borrowings to noninterest income.

The following tables reflect a summary of both the originally reported and restated amounts:

**Consolidated Balance Sheets**
*(dollars in thousands)*

| | June 30, 2007 | | December 31, 2006 | | June 30, 2006 | |
|---|---|---|---|---|---|---|
| | As Previously Reported | As Restated | As Previously Reported | As Restated | As Previously Reported | As Restated |
| Other assets | $ 18,410 | $ 19,118 | $ 16,343 | $ 17,031 | $ 17,778 | $ 18,720 |
| Total assets | 1,279,720 | 1,280,428 | 1,234,831 | 1,235,519 | 1,179,648 | 1,180,590 |
| Long-term borrowings | 214,887 | 216,758 | 174,292 | 176,109 | 147,579 | 150,057 |
| Total liabilities | 1,196,653 | 1,198,518 | 1,154,956 | 1,156,767 | 1,103,089 | 1,105,567 |
| Retained earnings | 66,636 | 65,479 | 62,206 | 6,183 | 60,678 | 59,142 |
| Total shareholders' equity | 83,067 | 81,910 | 79,875 | 78,752 | 76,559 | 75,023 |
| Total liabilities and shareholders' equity | 1,279,720 | 1,280,428 | 1,234,831 | 1,235,519 | 1,179,648 | 1,180,590 |

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

**Consolidated Statements of Income**
*(dollars in thousands)*

| | Three Months Ended June 30, | | | | Six Months Ended March 31, | | | |
|---|---|---|---|---|---|---|---|---|
| | 2007 | | 2006 | | 2007 | | 2006 | |
| | As Previously Reported | As Restated | As Previously Reported | As Restated | As Previously Reported | As Restated | As Previously Reported | As Restated |
| Interest income | $ 22,369 | $ 22,369 | $ 19,409 | $ 19,409 | $ 44,211 | $ 44,211 | $ 37,320 | $ 37,320 |
| Interest expense | 13,023 | 12,842 | 10,756 | 10,609 | 25,841 | 25,481 | 20,288 | 20,061 |
| Net interest income | 9,346 | 9,527 | 8,653 | 8,800 | 18,370 | 18,730 | 17,032 | 17,259 |
| Provision for loan losses | 390 | 390 | 330 | 330 | 780 | 780 | 655 | 655 |
| Noninterest income: | | | | | | | | |
| Net cash settlement on derivative instruments | - | (179) | - | (111) | - | (363) | - | (182) |
| Change in fair value of | | - | | | | | | |
| derivative instruments | - | (273) | - | (246) | - | (47) | - | (719) |
| Other noninterest income | 1,154 | 1,148 | 1,109 | 1,106 | 2,166 | 2,163 | 2,112 | 2,102 |
| Noninterest expense | 5,718 | 5,718 | 5,672 | 5,672 | 11,368 | 11,368 | 11,033 | 11,033 |
| Income from continuing operations before income taxes | 4,392 | 4,115 | 3,760 | 3,547 | 8,388 | 8,335 | 7,456 | 6,772 |
| Income tax expense | 1,240 | 1,135 | 1,167 | 1,086 | 2,441 | 2,421 | 2,275 | 2,015 |
| Income from continuing operations | | | | | | | | |

| | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| Income (loss) from discontinued | 3,152 | 2,980 | 2,593 | 2,461 | 5,947 | 5,914 | 5,181 | 4,757 |
| operations, net of income taxes | (118) | (118) | 41 | 41 | (313) | (313) | 424 | 424 |
| Net income | $ 3,034 | $ 2,862 | $ 2,634 | $ 2,502 | $ 5,634 | $ 5,601 | $ 5,605 | $ 5,181 |
| | | | | | | | | |
| **Diluted earnings per share:** | | | | | | | | |
| Income from continuing operations | $ 0.44 | $ 0.42 | $ 0.36 | $ 0.34 | $ 0.83 | $ 0.83 | $ 0.72 | $ 0.66 |
| Net income | $ 0.42 | $ 0.40 | $ 0.37 | $ 0.35 | $ 0.79 | $ 0.78 | $ 0.78 | $ 0.72 |
| Average diluted shares outstanding | 7,148,241 | 7,148,241 | 7,189,644 | 7,189,644 | 7,148,241 | 7,148,241 | 7,189,644 | 7,187,644 |

**Consolidated Statements of Shareholders' Equity**
*(dollars in thousands)*

| | June 30, | | | |
|---|---|---|---|---|
| | 2007 | | 2006 | |
| | As Previously Reported | As Restated | As Previously Reported | As Restated |
| Balance, beginning of period | $ 79,875 | $ 78,752 | $ 73,804 | $ 72,691 |
| Increase attributable to net income | 5,634 | 5,601 | 5,605 | 5,181 |
| Balance, end of period | 83,067 | 81,910 | 76,559 | 75,023 |

In addition, the following Notes to Consolidated Financial Statements have been restated: 6, 12 and 15.

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

**Note 2. 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/A 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/A. 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 3. 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 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.

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

**Note 4. 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. This branch sale closed on August 24, 2007, at which time the deposits at the Pasadena branch office approximated $51.5 million, resulting in a 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.

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

**Note 5. 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 6. Earnings per Share**

The computations of basic and diluted earnings per share follow:

| | **Three Months Ended June 30, (Restated)** | | **Six Months Ended June 30, (Restated)** | |
|---|---|---|---|---|
| *(dollars in thousands , except per share amounts)* | **2007** | 2006 | **2007** | 2006 |
| Numerator for both basic and diluted earnings per share: | | | | |
| Income from continuing operations | **$ 2,980** | $ 2,461 | **$ 5,914** | $ 4,757 |
| Income (loss) from discontinued operations | **(118)** | 41 | **(313)** | 424 |
| Net Income | **$ 2,862** | $ 2,502 | **$ 5,601** | $ 5,181 |
| | | | | |
| 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 | **$** | **0.42** | **$** | **0.34** | **$** | **0.83** | **$** | **0.67** |
| Basic earnings per share from discontinued operations | | **(0.02)** | | **0.01** | | **(0.04)** | | **0.06** |
| Basic earnings per share | **$** | **0.40** | **$** | **0.35** | **$** | **0.79** | **$** | **0.73** |
| | | | | | | | | |
| Diluted earnings per share from continuing operations | **$** | **0.42** | **$** | **0.34** | **$** | **0.83** | **$** | **0.66** |
| Diluted earnings per share from discontinued operations | | **(0.02)** | | **0.01** | | **(0.04)** | | **0.06** |
| Diluted earnings per share | **$** | **0.40** | **$** | **0.35** | **$** | **0.78** | **$** | **0.72** |

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

**Note 7. 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 Fair |
| *(dollars in thousands)* | Cost | Gains | Losses | 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 Fair |
| *(dollars in thousands)* | Cost | Gains | Losses | 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 |

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

| | June 30, 2006 | | | |
|---|---|---|---|---|
| | Amortized | Unrealized | | Estimated Fair |
| *(dollars in thousands)* | Cost | Gains | Losses | 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 |

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

**Note 8. 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 9. 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 10. 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 11. 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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Summit Financial Group, Inc. and Subsidiaries

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

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

| | 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 $216,758,000, $176,109,000 and $150,057,000 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 Restated** |
|---|---|
| 2007 | $ 13,968 |
| 2008 | 52,377 |
| 2009 | 28,911 |
| 2010 | 54,533 |
| 2011 | 2,466 |
| Thereafter | 84,092 |
| | $ 236,347 |

**Note 13. 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.

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

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 14. Commitments and Contingencies**

*Off-Balance Sheet Arrangements*

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

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

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

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 15. 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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Summit Financial Group, Inc. and Subsidiaries

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

| (dollars in thousands) | Actual Amount (Restated) | Actual Ratio (Restated) | Minimum Required Regulatory Capital Amount (Restated) | Minimum Required Regulatory Capital Ratio | To be Well Capitalized under Prompt Corrective Action Provisions Amount (Restated) | To be Well Capitalized under Prompt Corrective Action Provisions Ratio |
|---|---|---|---|---|---|---|
| **As of June 30, 2007** | | | | | | |
| Total Capital (to risk weighted assets) | | | | | | |
| Summit | $ 108,424 | 11.0% | $ 79,038 | 8.0% | $ 98,798 | 10.0% |
| Summit Community | 106,370 | 10.9% | 78,333 | 8.0% | 97,916 | 10.0% |
| Tier I Capital (to risk weighted assets) | | | | | | |
| Summit | $ 99,394 | 10.1% | 39,519 | 4.0% | 59,279 | 6.0% |
| Summit Community | 97,340 | 9.9% | 39,166 | 4.0% | 58,750 | 6.0% |
| Tier I Capital (to average assets) | | | | | | |
| Summit | $ 99,394 | 7.9% | 37,600 | 3.0% | 62,667 | 5.0% |
| Summit Community | 97,340 | 7.8% | 37,588 | 3.0% | 62,647 | 5.0% |
| | | | | | | |
| **As of December 31, 2006** | | | | | | |
| Total Capital (to risk weighted assets) | | | | | | |
| Summit | $ 103,102 | 10.7% | 77,086 | 8.0% | 96,357 | 10.0% |
| Summit Community | 59,684 | 10.4% | 45,911 | 8.0% | 57,388 | 10.0% |
| Shenandoah | 41,243 | 10.9% | 30,355 | 8.0% | 37,944 | 10.0% |
| Tier I Capital (to risk weighted assets) | | | | | | |
| Summit | 94,899 | 9.9% | 38,343 | 4.0% | 57,515 | 6.0% |
| Summit Community | 55,041 | 9.6% | 22,934 | 4.0% | 34,401 | 6.0% |
| Shenandoah | 37,683 | 9.9% | 15,178 | 4.0% | 22,766 | 6.0% |
| Tier I Capital (to average assets) | | | | | | |
| Summit | 94,899 | 7.8% | 36,496 | 3.0% | 60,826 | 5.0% |
| Summit Community | 55,041 | 7.4% | 22,314 | 3.0% | 37,190 | 5.0% |
| Shenandoah | 37,683 | 8.0% | 14,097 | 3.0% | 23,495 | 5.0% |

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/A.

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.

## RESTATEMENT

As discussed in Note 1, Restatement, in the Notes to Consolidated Financial Statements, we are restating financial statements and other financial information for the quarter ended and six months ended June 30, 2007 and all comparative financial information included herein.

In 2003, we entered into four interest rate swap agreements on certain convertible rate advances from the Federal Home Loan Bank("FHLB") that were designated as fair value hedges. The terms of the FHLB convertible rate advances include an option of the FHLB to convert the debt's fixed interest rate to a variable rate on a quarterly basis. We evaluated these hedging relationships and concluded that the short-cut method of hedge accounting could be applied and the assumption of no ineffectiveness was valid based upon: (a) the criteria in paragraph 68 of SFAS 133 were met, and (b) the conversion options in the FHLB advances were mirrored in the interest rate swaps.

Based on comments received from the Securities and Exchange Commission, we learned that the above interpretation of paragraph 68 is incorrect. The conversion is not specifically listed in paragraph 68, and the presence of that term prohibits the application of the short-cut method of hedge accounting, even if the terms are mirrored between the interest rate swap and the hedged item. Eliminating the application of fair value hedge accounting reverses the fair value adjustments that have been made to the advances and results in all fair value changes for the interest rate swaps being recognized in noninterest income. Additionally, the net cash settlement payments received/paid during each period for these interest rate swaps were reclassified from interest expense on long-term borrowings to noninterest income.

## 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 6.32%, or $1,157,000 in our net interest earnings on a tax equivalent basis for the first six months in 2007 compared to the same period of 2006.

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

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

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

on impaired loans, estimated losses on pools of homogeneous loans based on historical loss experience, and consideration of current economic trends and conditions, all of which may be susceptible to significant change. The loan portfolio also represents the largest asset type on our consolidated balance sheet. To the extent actual outcomes differ from our estimates, additional provisions for loan losses may be required that would negatively impact earnings in future periods. Note 2 to the consolidated financial statements of our 2006 Annual Report on Form 10-K/A 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/A.

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 2 and 10of the consolidated financial statements of our Annual Report on Form 10-K/A for further discussion of our intangible assets, which include goodwill.

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## RESULTS OF OPERATIONS

### Earnings Summary

Income from continuing operations for the six months ended June 30, 2007 grew 24.32% to $5,914,000, or $0.83 per diluted share as compared to $4,757,000, or $0.66per 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 $2,980,000, or $0.42 per diluted share as compared to $2,461,000, or $0.34 per diluted share for the same period of 2006. Consolidated net income, which includes the results of discontinued operations, grew to $5,601,000 for the six months ended June 30, 2007 compared to $5,181,000 for the same period of 2006. On a quarterly basis, consolidated net income grew 14.39% to $2,862,000 for second quarter 2007 compared to $2,502,000 for the second quarter 2006. Consolidated returns on average equity and assets for the first six months of 2007 were 13.45% and 0.89%, respectively, compared with 12.33% and 0.83% 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 $19,468,000 for the six month period ended June 30, 2007 compared to $18,311,000 for the same period of 2006, representing an increase of $1,157,000 or 6.32%. This increase resulted from growth in interest earning assets, primarily loans, which served to more than offset the 60 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 4.68% compared to 4.08% for the same period of 2006.

Our consolidated net interest margin decreased to 3.27% for the six month period ended June 30, 2007, compared to 3.40% for the same period in 2006. On a quarterly basis, our net interest margin declined to 3.28% at June 30, 2007, from 3.38% for the quarter ended June 30, 2006. Our net interest margin remained stable 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 60 basis points.

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

Summit Financial Group, Inc. and Subsidiaries

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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 (Restated) | Yield/ Rate (Restated) | Average Balance | Earnings/ Expense (Restated) | Yield/ Rate (Restated) |
| **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 | 5,653 | 5.44% | 181,971 | 4,705 | 5.21% |
| **Total interest bearing liabilities** | 1,098,677 | 25,481 | 4.68% | 992,532 | 20,061 | 4.08% |
| | | | | | | |
| **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** | | $ 19,468 | | | $ 18,311 | |
| **Net yield on interest earning assets** | | | 3.27% | | | 3.40% |

(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 (Restated) 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 | 738 | 210 | 948 |
| Total interest paid on interest bearing liabilities | 2,044 | 3,376 | 5,420 |
| **Net interest income** | $ 2,131 | $ (974) | $ 1,157 |

**Noninterest Income**

Total noninterest income from continuing operations increased to $1,753,000 for the six months ended June 30, 2007, compared to $1,201,000 for the same period of 2006. Other income increased $153,000 for the six months ended June 30, 2007 compared to the same period of 2006 and increased $103,000 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, 2007 (Restated) | For the Quarter Ended June 30, 2006 (Restated) | For the Six Months Ended June 30, 2007 (Restated) | For the Six Months Ended June 30, 2006 (Restated) |
|---|---|---|---|---|
| Insurance commissions | $ 209 | $ 247 | $ 416 | $ 477 |
| Service fees | 736 | 726 | 1,353 | 1,356 |
| Net cash settlement on derivative instruments | (179) | (111) | (363) | (182) |
| Change in fair value of derivative instruments | (273) | (246) | (47) | (719) |
| (Loss) on sale of assets | (33) | - | (32) | (4) |
| Other | 236 | 133 | 426 | 273 |
| Total | $ 696 | $ 749 | $ 1,753 | $ 1,201 |

**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, | Change | | | For the Six Months Ended June 30. | 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, 2007 | June 30, 2006 | December 31, 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/A for further discussion of the processes related to internally classified loans.

**FINANCIAL CONDITION**

Our total assets were $1,280,428,000 at June 30, 2007, compared to $1,235,519,000 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 (restated) | Increase (Decrease) Amount (restated) | Increase (Decrease) Percentage (restated) | Balance June 30, 2007 (restated) |
|---|---|---|---|---|
| **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 | 195,698 | 40,649 | 20.8% | 236,347 |

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 7, 8, 11, and 12 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.

Summit Financial Group, Inc. and Subsidiaries

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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 $81,910,000 compared to $78,752,000 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 15 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 (restated)** | **Capital Trust Securities** | **Operating Leases** |
|---|---|---|---|
| 2007 | $ 13,968 | $ - | $ 185 |
| 2008 | 52,377 | - | 259 |
| 2009 | 28,911 | - | 227 |
| 2010 | 54,533 | - | 123 |
| 2011 | 2,466 | - | 89 |
| Thereafter | 64,503 | 19,589 | 199 |
| **Total** | $ 216,758 | $ 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 | $ 34,713 |
| Construction loans | 81,354 |
| Other loans | 39,209 |
| **Standby letters of credit** | 11,747 |
| **Total** | $ 167,023 |

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Summit Financial Group, Inc. and Subsidiaries
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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

(a) Restatement

As a result of a review by the Staff of the Securities and Exchange Commission (the "Staff") of Summit's Form 10-K filed for the year ended December 31, 2006, the Company determined that its interpretation with respect to applying the short-cut method of hedge accounting under paragraph 68 of SFAS 133 to certain of its interest rate swaps was incorrect.

In August 2003, Summit entered into four interest rate swaps with notional values totaling $36 million that were designated as fair value hedges of certain convertible rate advances from the Federal Home Loan Bank ("FHLB"). The terms of the FHLB convertible rate advances include an option of the FHLB to convert the debt's fixed interest rate to a variable rate on a quarterly basis. Summit evaluated these hedging relationships and concluded that the short-cut method of hedge accounting could be applied and the assumption of no ineffectiveness was valid based upon: (a) the criteria in paragraph 68 of SFAS 133 were met, and (b) the conversion options in the FHLB advances were mirrored in the interest rate swaps.

Based on comments received from the Staff, Summit learned that the above interpretation of paragraph 68 is incorrect. The conversion is not specifically listed in paragraph 68, and the presence of that term prohibits the application of the short-cut method of hedge accounting, even if the terms are mirrored between the interest rate swap and the hedged item. Although these hedging relationships would have qualified for hedge accounting if the "long haul" method had been applied, SFAS 133 does not permit the use of the "long haul" method retroactively. Consequently, the restatement assumes hedge accounting was not applied to these derivatives and the related hedged item during the periods under review.

On August 16, 2007, Management, the Audit Committee of the Board of Directors and the Executive Committee of the Board of Directors of Summit Financial Group, Inc. ("Summit" or the "Company") concluded that a restatement of its financial statements and other financial information for the year ended December 31, 2006 and for the quarters ended March 31 and June 30 of 2007 (including the financial statements and other financial information for all comparative periods contained therein) with respect to the accounting for certain derivatives transactions under Statement of Financial Accounting Standards No. 133, Accounting for Derivative Instruments and Hedging Activities, as amended ("SFAS 133") was necessary.

(b) Evaluation of Disclosure Controls and Procedures

In connection with the restatement, under the direction of our Chief Executive Officer and Chief Financial Officer, we reevaluated our disclosure controls and procedures. As a result we determined that a deficiency in processes and procedures over financial reporting of derivatives and hedging originally classified as effective at June 30, 2007 should have been classified as ineffective at March 31, 2007. Solely as a result of this condition, we concluded that our disclosure controls and procedures were not effective as of December 31, 2006, March 31, 2007 and June 30, 2007.

(c) Remediation of Material Weakness in Internal Control

We believe that we will have fully remediated the material weakness in our internal control over financial reporting with respect to accounting for derivative transactions used as hedges as of September 30, 2007. The remedial actions planned include:

- implementing additional management and oversight controls to review and approve hedging strategies and related documentation to ensure hedge accounting is appropriately applied with respect to SFAS 133 and related guidance;

- retesting our internal financial controls with respect to the deficiencies related to the material weakness to ensure they are operating effectively to ensure compliance with SFAS 133; and

- improving training, education and accounting reviews to ensure that all relevant personnel involved in derivatives transactions understand and apply hedge accounting in compliance with generally accepted accounting principles, including SFAS 133 and its related interpretations.

*Changes in Internal Control Over Financial Reporting:* As previously reported, there were no changes in our internal control over financial reporting during the quarter ended June 30, 2007 that 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 claimed 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 Klutho case the Company moved for judgment on the pleadings, claiming that plaintiff has no legally viable claim. On May 22, 2007, Shenandoah's motion for judgment in the Klutho case was granted, and the case was dismissed. Plaintiff did not appeal, and the case has been concluded.

On March 28, 2007, plaintiff's motion for class certification in the Forrest case was denied. Her subsequent petition for appeal to the Federal Seventh Circuit Court of Appeals was also denied. The parties have since settled on a one plaintiff basis for an insignificant amount, and this case has also been 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/A 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/A 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 |

**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: September 25, 2007