

SUMMIT FINANCIAL GROUP INC  
Form 10-Q  
August 10, 2009

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

FORM 10 – Q

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

For the quarterly period ended June 30, 2009.

or

SECURITIES  TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(D) OF THE  
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  
(State or other jurisdiction of  
incorporation or organization)

55-0672148  
(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  No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required

to submit and post such files).

Yes  No

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

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

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes  No

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

Common Stock, \$2.50 par value  
7,425,472 shares outstanding as of August 7, 2009

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	Exhibits	
	Exhibit 11	Statement re: Computation of Earnings per Share – Information contained in Note 4 to the Consolidated Financial Statements on page 14 of this Quarterly Report is incorporated herein by reference.
	Exhibit 10.1	Summit Financial Group, Inc. 2009 Officer Stock Option Plan Form of Non-Qualified Stock Option Grant Agreement
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Sarbanes-Oxley Act Section 302 Certification  
of Chief Financial Officer

Exhibit 32.1

Sarbanes-Oxley Act Section 906 Certification  
of Chief Executive Officer

Exhibit 32.2

Sarbanes-Oxley Act Section 906 Certification  
of Chief Financial Officer

SIGNATURES

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

Dollars in thousands	June 30, 2009 (unaudited)	December 31, 2008 (*)	June 30, 2008 (unaudited)
<b>ASSETS</b>			
Cash and due from banks	\$ 4,281	\$ 11,356	\$ 21,777
Interest bearing deposits with other banks	10,505	108	98
Federal funds sold	-	2	798
Securities available for sale	289,267	327,606	284,401
Other Investments	24,000	23,016	22,831
Loans held for sale, net	841	978	1,077
Loans, net	1,165,653	1,192,157	1,130,483
Property held for sale	20,435	8,110	2,537
Premises and equipment, net	23,776	22,434	21,967
Accrued interest receivable	6,760	7,217	7,614
Intangible assets	9,529	9,704	9,880
Other assets	28,863	24,428	22,515
Total assets	\$ 1,583,910	\$ 1,627,116	\$ 1,525,978

**LIABILITIES AND SHAREHOLDERS'**

**EQUITY**

Liabilities

<b>Deposits</b>			
Non interest bearing	\$ 69,878	\$ 69,808	\$ 68,912
Interest bearing	884,346	896,042	788,837
Total deposits	954,224	965,850	857,749
Short-term borrowings	104,718	153,100	147,900
Long-term borrowings	412,802	392,748	400,186
Subordinated debentures owed to unconsolidated subsidiary trusts	19,589	19,589	19,589
Other liabilities	8,824	8,585	9,088
Total liabilities	1,500,157	1,539,872	1,434,512

**Commitments and Contingencies**

**Shareholders' Equity**

Preferred stock and related surplus,  
\$1.00 par value;

authorized 250,000 shares, no shares issued	-	-	-
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Common stock and related surplus, \$2.50  
par value;

authorized 20,000,000 shares, issued and outstanding			
2009 - 7,425,472; issued December 2008 - 7,415,310 shares;			

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issued June 2008 - 7,410,791 shares	24,508	24,453	24,406
Retained earnings	62,579	64,709	70,161
Accumulated other comprehensive income	(3,334)	(1,918)	(3,101)
Total shareholders' equity	83,753	87,244	91,466
Total liabilities and shareholders' equity	\$ 1,583,910	\$ 1,627,116	\$ 1,525,978

(\*) - December 31, 2008 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)

	Three Months Ended		Six Months Ended	
	June 30,	June 30,	June 30,	June 30,
Dollars in thousands, except per share amounts	2009	2008	2009	2008
<b>Interest income</b>				
Interest and fees on loans				
Taxable	\$ 17,937	\$ 19,461	\$ 36,083	\$ 39,410
Tax-exempt	113	115	220	235
Interest and dividends on securities				
Taxable	4,194	3,161	8,418	6,358
Tax-exempt	516	600	1,029	1,190
Interest on interest bearing deposits with other banks				
Interest on Federal funds sold	1	2	1	3
	-	1	-	3
Total interest income	22,761	23,340	45,751	47,199
<b>Interest expense</b>				
Interest on deposits	6,358	6,435	12,979	13,559
Interest on short-term borrowings	145	571	358	1,490
Interest on long-term borrowings and subordinated debentures				
	5,151	4,959	9,972	9,837
Total interest expense	11,654	11,965	23,309	24,886
Net interest income	11,107	11,375	22,442	22,313
Provision for loan losses	5,500	1,750	9,500	2,750
Net interest income after provision for loan losses	5,607	9,625	12,942	19,563
<b>Other income</b>				
Insurance commissions	1,283	1,275	2,627	2,602
Service fees	857	824	1,593	1,567
Realized securities gains	39	-	295	-
Gain (loss) on sale of assets	(115)	236	(124)	236
Net cash settlement on derivative instruments				
	-	-	-	(171)
Change in fair value of derivative instruments				
	-	-	-	705
Other	362	334	691	578
Total other-than-temporary impairment loss on securities	(5,219)	(1,541)	(5,434)	(1,541)
Portion of loss recognized in other comprehensive income				
	451	-	451	-
Net impairment loss recognized in earnings	(4,768)	(1,541)	(4,983)	(1,541)
Total other income	(2,342)	1,128	99	3,976
<b>Other expense</b>				
Salaries and employee benefits	4,308	4,187	8,587	8,581
Net occupancy expense	466	443	1,063	919
Equipment expense	527	533	1,095	1,068



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Supplies	248	241	442	435
Professional fees	403	182	737	300
Amortization of intangibles	88	88	176	176
FDIC premiums	1,245	180	1,628	354
Other	1,424	1,295	2,732	2,404
Total other expense	8,709	7,149	16,460	14,237
Income (loss) before income taxes	(5,444)	3,604	(3,419)	9,302
Income tax expense (benefit)	(1,994)	1,010	(1,734)	2,884
Net income (loss)	\$ (3,450)	\$ 2,594	\$ (1,685)	\$ 6,418
Basic earnings per common share	\$ (0.47)	\$ 0.35	\$ (0.23)	\$ 0.87
Diluted earnings per common share	\$ (0.46)	\$ 0.35	\$ (0.23)	\$ 0.86

See Notes to Consolidated Financial Statements

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

Dollars in thousands, except per share amounts	Common Stock and Related Surplus	Retained Earnings	Accumulated Other Compre- hensive Income	Total Share- holders' Equity
Balance, December 31, 2008	\$ 24,453	\$ 64,709	\$ (1,918)	\$ 87,244
Six Months Ended June 30, 2009				
Comprehensive income:				
Net income	-	(1,685)	-	(1,685)
Other comprehensive income, net of deferred tax (benefit) of (\$868):				
Net unrealized loss on securities available for sale of (\$1,711), net of reclassification adjustment for gains included in net income of \$295	-	-	(1,416)	(1,416)
Total comprehensive income				(3,101)
Exercise of stock options	55	-	-	55
Stock compensation expense	-	-	-	-
Cash dividends declared (\$0.06 per share)	-	(445)	-	(445)
Balance, June 30, 2009	\$ 24,508	\$ 62,579	\$ (3,334)	\$ 83,753
Balance, December 31, 2007				
Balance, December 31, 2007	\$ 24,391	\$ 65,077	\$ (48)	\$ 89,420
Six Months Ended June 30, 2008				
Comprehensive income:				
Net income	-	6,418	-	6,418
Other comprehensive income, net of deferred tax benefit of (\$1,871):				
Net unrealized loss on securities available for sale of (\$3,053)	-	-	(3,053)	(3,053)
Total comprehensive income				3,365
Exercise of stock options	9	-	-	9
Stock compensation expense	6	-	-	6
Cash dividends declared (\$0.18 per share)	-	(1,334)	-	(1,334)
Balance, June 30, 2008	\$ 24,406	\$ 70,161	\$ (3,101)	\$ 91,466

See Notes to Consolidated Financial Statements



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

Dollars in thousands	June 30, 2009	Six Months Ended June 30, 2008
<b>Cash Flows from Operating Activities</b>		
Net income	\$ (1,685)	\$ 6,418
Adjustments to reconcile net earnings to net cash provided by operating activities:		
Depreciation	803	795
Provision for loan losses	9,500	2,750
Stock compensation expense	-	6
Deferred income tax (benefit)	(2,477)	(824)
Loans originated for sale	(13,390)	(3,718)
Proceeds from loans sold	13,553	4,055
(Gain) on sales of loans held for sale	(26)	(37)
Securities (gains)	(295)	-
Writedown of equity investment	215	1,541
Writedown of debt securities	4,768	-
Change in fair value of derivative instruments	-	(705)
Loss (gain) on disposal of other repossessed assets & property held for sale	120	(236)
Amortization of securities premiums, net	(1,436)	(220)
Amortization of goodwill and purchase accounting adjustments, net	181	182
Increase (decrease) in accrued interest receivable	457	(424)
(Increase) in other assets	(1,061)	(4,710)
Increase in other liabilities	239	3,078
Net cash provided by (used in) operating activities	9,466	7,951
<b>Cash Flows from Investing Activities</b>		
Net (increase) decrease in interest bearing deposits with other banks	(10,398)	(21)
Proceeds from maturities and calls of securities available for sale	12,540	16,663
Proceeds from sales of securities available for sale	9,696	-
Principal payments received on securities available for sale	40,063	15,772
Purchases of securities available for sale	(29,496)	(43,055)
Purchases of other investments	(982)	(9,429)
Redemption of Federal Home Loan Bank Stock	-	6,638
Net (increase) decrease in Federal funds sold	2	(617)
Net loans made to customers	3,772	(82,035)
Purchases of premises and equipment	(2,145)	(632)
Proceeds from sales of other repossessed assets & property held for sale	789	1,123

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Proceeds from early termination of interest rate swap	-	212
Net cash provided by (used in) investing activities	23,841	(95,381)
Cash Flows from Financing Activities		
Net increase(decrease) in demand deposit, NOW and savings accounts	39,718	(5,986)
Net increase(decrease) in time deposits	(51,344)	35,045
Net (decrease) in short-term borrowings	(48,382)	(24,154)
Proceeds from long-term borrowings	42,656	109,894
Repayment of long-term borrowings	(28,602)	(25,552)
Proceeds from issuance of subordinated debentures	5,962	-
Exercise of stock options	43	9
Dividends paid	(433)	(1,334)
Net cash provided by financing activities	(40,382)	87,922
Increase (decrease) in cash and due from banks	(7,075)	492
Cash and due from banks:		
Beginning	11,356	21,285
Ending	\$ 4,281	\$ 21,777

(Continued)

See Notes to Consolidated Financial Statements

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

Dollars in thousands	Six Months Ended	
	June 30, 2009	June 30, 2008
<b>Supplemental Disclosures of Cash Flow Information</b>		
Cash payments for:		
Interest	\$ 23,556	\$ 24,928
Income taxes	\$ 1,395	\$ 3,690
<b>Supplemental Schedule of Noncash Investing and Financing Activities</b>		
Other assets acquired in settlement of loans	\$ 13,232	\$ 1,291

See Notes to Consolidated Financial Statements

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

Note 1. Basis of Presentation

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

The presentation of financial statements in conformity with accounting principles generally accepted in the United States of America requires us to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the reporting period. Actual results could differ materially from these estimates. For the second quarter of 2009, we evaluated subsequent events through August 7, 2009.

The results of operations for the six months ended June 30, 2009 are not necessarily indicative of the results to be expected for the full year. The consolidated financial statements and notes included herein should be read in conjunction with our 2008 audited financial statements and Annual Report on Form 10-K and Form 10-K/A. Certain accounts in the consolidated financial statements for December 31, 2008 and June 30, 2008, as previously presented, have been reclassified to conform to current year classifications.

Note 2. Significant New Accounting Pronouncements

On June 29, 2009, the FASB issued Statement of Financial Accounting Standards No. 168 (“SFAS 168”). SFAS 168 replaces SFAS 162, The Hierarchy of Generally Accepted Accounting Principles and establishes the FASB Accounting Standards Codification (the “Codification”) as the source of authoritative accounting principles recognized by the FASB to be applied by non-governmental entities in the preparation of financial statements in conformity with generally accepted accounting principles. Rules and interpretive releases of the SEC under authority of federal securities laws are also sources of authoritative guidance for SEC registrants. All guidance contained in the Codification carries an equal level of authority. All non-grandfathered, non-SEC accounting literature not included in the Codification is superseded and deemed non-authoritative. SFAS 168 will be effective for our financial statements for periods ending after September 15, 2009 and is not expected have a significant impact on our financial statements.

In May 2009, the FASB issued Statement of Financial Accounting Standards No. 165 (“SFAS 165”), Subsequent Events, which codifies the guidance regarding the disclosure of events occurring subsequent to the balance sheet date. SFAS 165 does not change the definition of a subsequent event (i.e., an event or transaction that occurs after the balance sheet date but before the financial statements are issued) but requires disclosure of the date through which subsequent events were evaluated when determining whether adjustment to or disclosure in the financial statements is required. SFAS 165 was effective for the second quarter of 2009. Since SFAS 165 requires only additional disclosures concerning subsequent events, adoption of the standard did not affect our financial condition, results of operations or cash flows.

In April 2009, FASB issued FASB Staff Position No. FAS 157-4, Determining Fair Value When the Volume and Level of Activity for the Asset or Liability Have Significantly Decreased and Identifying Transactions That Are Not Orderly (“FSP FAS 157-4”). Effective for interim and annual reporting periods ending after June 15, 2009, with early adoption permitted for periods ending after March 15, 2009, FSP FAS 157-4 provides guidelines for making fair value



measurements more consistent with the principles presented in SFAS 157, Fair Value Measurements, when the volume and level of activity for assets or liabilities have significantly decreased. FSP FAS 157-4 relates to determining fair values when there is no active market or where the price inputs being used represent distressed

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

sales. It reaffirms what SFAS 157 states is the objective of fair value measurement – to reflect how much an asset would be sold for in an orderly transaction (as opposed to a distressed or forced transaction) at the date of the financial statements under current market conditions. Specifically, it reaffirms the need to use judgment to ascertain if a formerly active market has become inactive and in determining fair values when markets have become inactive. We adopted FSP FAS 157-4 during the quarter ended June 30, 2009, and the adoption did not have a material impact on our financial condition or results of operations.

In April 2009, FASB issued FASB Staff Position No. FAS 115-2 and FAS 124-2, Recognition and Presentation of Other-Than-Temporary Impairments (“FSP FAS 115-2”). Effective for interim and annual reporting periods ending after June 15, 2009, with early adoption permitted for periods ending after March 15, 2009, FSP FAS 115-2 requires an entity to recognize the credit component of an other-than-temporary impairment of a debt security in earnings and the noncredit component in other comprehensive income when the entity does not intend to sell the security and it is more likely than not that the entity will not be required to sell the security prior to its recovery. FSP FAS 115-2 does not change the recognition of other-than-temporary impairment for equity securities. We adopted FSP FAS 115-2 effective April 1, 2009, which resulted in a \$451,000, pre-tax, reduction in the other-than-temporary impairment charges recorded in earnings for the three month period ended June 30, 2009. The adoption of FSP FAS 115-2 had no effect on any prior periods, as we held no debt securities at the time of its adoption for which an other-than-temporary impairment had been previously recognized. Accordingly, we recorded no cumulative effect adjustment upon adoption of the FSP. The expanded disclosures related to FAS FSP 115-2 are included in Note 5. Securities, below.

In April 2009, FASB issued FASB Staff Position (“FSP”) No. FAS 107-1 and APB 28-1, Interim Disclosures about Fair Value of Financial Instruments (“FSP 107-1”). Effective for interim and annual reporting periods ending after June 15, 2009, with early adoption permitted for periods ending after March 15, 2009, FSP FAS 107-1 amends SFAS 107, Disclosures about Fair Value of Financial Instruments, to require disclosures about fair value of financial instruments for interim reporting periods of publicly traded companies as well as in annual financial statements. FSP FAS 107-1 also amends APB Opinion No. 28, Interim Financial Reporting, to require those disclosures in summarized financial information at interim reporting periods. During second quarter 2009, we adopted FSP FAS 107-1, which only relates to disclosures and therefore it did not have an impact on our financial condition or results of operations. The disclosures required by FAS 107-1 are included in Note 3. Fair Value Measurements, below.

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

In December 2007, the FASB issued Statement 141 (revised 2007) (SFAS 141R), Business Combinations. SFAS 141R will significantly change how the acquisition method will be applied to business combinations. SFAS 141R requires an acquirer, upon initially obtaining control of another entity, to recognize the assets, liabilities and any non-controlling interest in the acquiree at fair value as of the acquisition date. Contingent consideration is required to be recognized and measured at fair value on the date of acquisition rather than at a later date when the amount of that consideration may be determinable beyond a reasonable doubt. This fair value approach replaces the cost-allocation process required under SFAS 141 whereby the cost of an acquisition was allocated to the individual assets acquired

and liabilities assumed based on their estimated fair value. SFAS 141R requires acquirers to expense acquisition-related costs as incurred rather than allocating such costs to the assets acquired and liabilities assumed, as was previously the case under SFAS 141. Under SFAS 141R, the requirements of SFAS 146, Accounting for Costs Associated with Exit or Disposal Activities, would have to be met in order to accrue for a restructuring plan in purchase accounting. Pre-acquisition contingencies are to be recognized at fair value, unless it is a non-contractual

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

contingency that is not likely to materialize, in which case, nothing should be recognized in purchase accounting and, instead, that contingency would be subject to the probable and estimable recognition criteria of SFAS 5, Accounting for Contingencies. Reversals of deferred income tax valuation allowances and income tax contingencies will be recognized in earnings subsequent to the measurement period. The allowance for loan losses of an acquiree will not be permitted to be recognized by the acquirer. Additionally, SFAS 141(R) will require new and modified disclosures surrounding subsequent changes to acquisition-related contingencies, contingent consideration, noncontrolling interests, acquisition-related transaction costs, fair values and cash flows not expected to be collected for acquired loans, and an enhanced goodwill rollforward. We will be required to prospectively apply SFAS 141(R) to all business combinations completed on or after January 1, 2009. Early adoption is not permitted. We are currently evaluating SFAS 141(R) and have not determined the impact it will have on our financial statements.

Note 3. Fair Value Measurements

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

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

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

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

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

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

**Available-for-Sale Securities:** Investment securities available-for-sale are recorded at fair value on a recurring basis. Fair value measurement is based upon quoted prices, if available. If quoted prices are not available, fair values are measured using independent pricing models or other model-based valuation techniques such as the present value of future cash flows, adjusted for the security's credit rating, prepayment assumptions and other factors such as credit loss assumptions. Level 1 securities include those traded on an active exchange, such as the New York Stock Exchange, U.S. Treasury securities that are traded by dealers or brokers in active over-the-counter markets and money market funds. Level 2 securities include mortgage-backed securities issued by government sponsored entities, municipal bonds and corporate debt securities.

**Loans Held for Sale:** Loans held for sale are carried at the lower of cost or market value. The fair value of loans held for sale is based on what secondary markets are currently offering for portfolios with similar characteristics. As such,

we classify loans subject to nonrecurring fair value adjustments as Level 2.

Loans: We do not record loans at fair value on a recurring basis. However, from time to time, a loan is considered impaired and an allowance for loan losses is established. Loans for which it is probable that payment of interest and

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

principal will not be made in accordance with the contractual terms of the loan agreement are considered impaired. Once a loan is identified as individually impaired, management measures impairment in accordance with SFAS 114, Accounting by Creditors for Impairment of a Loan, (SFAS 114). The fair value of impaired loans is estimated using one of several methods, including collateral value, liquidation value and discounted cash flows. Those impaired loans not requiring an allowance represent loans for which the fair value of the expected repayments or collateral exceed the recorded investments in such loans. At June 30, 2009, substantially all of the total impaired loans were evaluated based on the fair value of the collateral. In accordance with SFAS 157, impaired loans where an allowance is established based on the fair value of collateral require classification in the fair value hierarchy. When the fair value of the collateral is based on an observable market price or a current appraised value, we record the impaired loan as nonrecurring Level 2. When an appraised value is not available or management determines the fair value of the collateral is further impaired below the appraised value and there is no observable market price, we record the impaired loan as nonrecurring Level 3.

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

**Assets and Liabilities Recorded at Fair Value on a Recurring Basis**

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

Dollars in thousands	Total at June 30, 2009	Fair Value Measurements Using:		
		Level 1	Level 2	Level 3
<b>Assets</b>				
Available for sale securities	\$ 289,267	\$ -	\$ 282,787	\$ 6,480
Derivatives	12	-	12	-
<b>Liabilities</b>				
Derivatives	\$ 13	\$ -	\$ 13	\$ -

The table below presents a reconciliation of all assets measured at fair value on a recurring basis using significant unobservable inputs (Level 3) for the period ended June 30, 2009.

Dollars in thousands	Available for Sale Securities
Balance January 1, 2009	\$ 11,711

Total realized/unrealized gains (losses)	
Included in earnings	(4,768)
Included in other comprehensive income	3,587
Purchases, sales, issuances and settlements, net	(538)
Transfers between categories	(3,512)
Balance June 30, 2009	\$ 6,480

Summit Financial Group, Inc. and Subsidiaries  
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Assets and Liabilities Recorded at Fair Value on a Nonrecurring Basis

We may be required, from time to time, to measure certain assets at fair value on a nonrecurring basis in accordance with U.S. generally accepted accounting principles. These include assets that are measured at the lower of cost or market that were recognized at fair value below cost at the end of the period. Assets measured at fair value on a nonrecurring basis are included in the table below.

Dollars in thousands	Total at June 30, 2009	Fair Value Measurements Using:		
		Level 1	Level 2	Level 3
Loans held for sale	\$ 841	\$ -	\$ 841	\$ -
Impaired loans	57,467	-	-	57,467

Impaired loans, which are measured for impairment using the fair value of the collateral for collateral-dependent loans, had a carrying amount of \$62,175,000, with a valuation allowance of \$4,708,000, resulting in an additional provision for loan losses of \$3,065,000 for the period.

SFAS 107, Disclosures about Fair Value of Financial Instruments, as amended, requires disclosure of the fair value of financial assets and financial liabilities, including those financial assets and financial liabilities that are not measured and reported at fair value on a recurring basis or non-recurring basis. The following summarizes the methods and significant assumptions we used in estimating our fair value disclosures for financial instruments.

Cash and due from banks: The carrying values of cash and due from banks approximate their estimated fair value.

Interest bearing deposits with other banks: The fair values of interest bearing deposits with other banks are estimated by discounting scheduled future receipts of principal and interest at the current rates offered on similar instruments with similar remaining maturities.

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

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

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

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

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



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

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

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

Derivative financial instruments: The fair values of the interest rate swaps are valued using cash flow projection models.

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

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

Dollars in thousands	June 30, 2009		December 31, 2008	
	Carrying Value	Estimated Fair Value	Carrying Value	Estimated Fair Value
<b>Financial assets:</b>				
Cash and due from banks	\$ 4,281	\$ 4,281	\$ 11,356	\$ 11,356
Interest bearing deposits with other banks	10,505	10,505	108	108
Federal funds sold	-	-	2	2
Securities available for sale	289,267	289,267	327,606	327,606
Other investments	24,000	24,000	23,016	23,016
Loans held for sale, net	841	841	978	978
Loans, net	1,165,653	1,183,979	1,192,157	1,201,884
Accrued interest receivable	6,760	6,760	7,217	7,217
Derivative financial assets	12	12	16	16
	\$ 1,501,319	\$ 1,519,645	\$ 1,562,456	\$ 1,572,183
<b>Financial liabilities:</b>				
Deposits	\$ 954,224	\$ 1,012,412	\$ 965,850	\$ 1,077,942
Short-term borrowings	104,718	104,718	153,100	153,100
Long-term borrowings and subordinated debentures	432,391	446,442	412,337	434,172
Accrued interest payable	4,550	4,550	4,796	4,796
Derivative financial liabilities	13	13	18	18
	\$ 1,495,896	\$ 1,568,135	\$ 1,536,101	\$ 1,670,028

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Note 4. Earnings per Share

The computations of basic and diluted earnings per share follow:

Dollars in thousands , except per share amounts	Three Months Ended June 30,		Six Months Ended June 30,	
	2009	2008	2009	2008
Numerator for both basic and diluted earnings per share:				
Net Income	\$ (3,450)	\$ 2,594	\$ (1,685)	\$ 6,418
<b>Denominator</b>				
Denominator for basic earnings per share - weighted average common shares outstanding	7,419,974	7,410,217	7,417,642	7,409,579
Effect of dilutive securities:				
Stock options	11,995	37,953	15,852	39,395
	11,995	37,953	15,852	39,395
Denominator for diluted earnings per share - weighted average common shares outstanding and assumed conversions	7,431,969	7,448,170	7,433,494	7,448,974
Basic earnings per share	\$ (0.47)	\$ 0.35	\$ (0.23)	\$ 0.87
Diluted earnings per share	\$ (0.46)	\$ 0.35	\$ (0.23)	\$ 0.86

Note 5. Securities

The amortized cost, unrealized gains, unrealized losses and estimated fair values of securities at June 30, 2009, December 31, 2008, and June 30, 2008 are summarized as follows:

Dollars in thousands	Amortized Cost	June 30, 2009		Estimated Fair Value
		Unrealized Gains	Unrealized Losses	
Available for Sale				
Taxable debt securities				
U. S. Government agencies and corporations	\$ 34,836	\$ 855	\$ 40	\$ 35,651
Residential mortgage-backed securities:				
Government-sponsored agencies	117,853	4,379	53	122,179

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Nongovernment-sponsored					
entities		89,836	945	11,253	79,528
State and political subdivisions		3,760	25	5	3,780
Corporate debt securities		349	6	-	355
Total taxable debt securities		246,634	6,210	11,351	241,493
Tax-exempt debt securities					
State and political subdivisions		47,828	699	1,060	47,467
Total tax-exempt debt securities		47,828	699	1,060	47,467
Equity securities		180	127	-	307
Total available for sale securities	\$	294,642	\$ 7,036	\$ 12,411	\$ 289,267

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Dollars in thousands	Amortized Cost	December 31, 2008		Estimated Fair Value
		Unrealized Gains	Losses	
Available for Sale				
Taxable debt securities				
U. S. Government agencies				
and corporations	\$ 36,934	\$ 1,172	\$ 3	\$ 38,103
Residential mortgage-backed securities:				
Government-sponsored				
agencies	147,074	4,291	71	151,294
Nongovernment-sponsored				
entities	95,568	2,335	10,020	87,883
State and political subdivisions	3,760	19	-	3,779
Corporate debt securities	349	5	-	354
Total taxable debt securities	283,685	7,822	10,094	281,413
Tax-exempt debt securities				
State and political subdivisions	46,617	639	1,459	45,797
Total tax-exempt debt securities	46,617	639	1,459	45,797
Equity securities	396	-	-	396
Total available for sale securities	\$ 330,698	\$ 8,461	\$ 11,553	\$ 327,606

Dollars in thousands	Amortized Cost	June 30, 2008		Estimated Fair Value
		Unrealized Gains	Losses	
Available for Sale				
Taxable debt securities				
U. S. Government agencies				
and corporations	\$ 39,058	\$ 361	\$ 234	\$ 39,185
Residential mortgage-backed securities:				
Government-sponsored				
agencies	118,336	1,005	1,109	118,232
Nongovernment-sponsored				
entities	75,800	65	5,194	70,671
State and political subdivisions	3,759	20	-	3,779
Corporate debt securities	1,349	14	15	1,348
Total taxable debt securities	238,302	1,465	6,552	233,215
Tax-exempt debt securities				
State and political subdivisions	45,185	608	520	45,273
Total tax-exempt debt securities	45,185	608	520	45,273
Equity securities	5,913	-	-	5,913
Total available for sale securities	\$ 289,400	\$ 2,073	\$ 7,072	\$ 284,401



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The maturities, amortized cost and estimated fair values of securities at June 30, 2009, are summarized as follows:

Dollars in thousands	Available for Sale	
	Amortized Cost	Estimated Fair Value
Due in one year or less	\$ 85,715	\$ 86,407
Due from one to five years	114,600	112,550
Due from five to ten years	48,256	46,038
Due after ten years	45,891	43,965
Equity securities	180	307
	\$ 294,642	\$ 289,267

The proceeds from sales, calls and maturities of available for sale securities, including principal payments received on mortgage-backed obligations, and the related gross gains and losses realized, for the six months ended June 30, 2009 are as follows:

Dollars in thousands	Sales	Proceeds from Calls and Maturities	Principal Payments	Gross realized	
				Gains	Losses
Securities available for sale	\$ 9,696	\$ 12,540	\$ 40,063	\$ 304	\$ 9

During the three months and six months ended June 30, 2009 and 2008, we recorded other-than-temporary impairment losses on securities as follows:

Dollars in thousands	Three Months Ended			Six Months Ended		
	Residential MBS Nongovernment	Equity Securities	Total	Residential MBS Nongovernment	Equity Securities	Total
June 30, 2009	-	-	-	-	-	-
Total other-than-temporary impairment losses	\$ (5,219)	\$ -	\$ (5,219)	\$ (5,219)	\$ (215)	\$ (5,434)
Portion of loss recognized in						

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other comprehensive income	451	-	451	451	-	451
Net impairment losses recognized in earnings	\$ (4,768)	\$ -	\$ (4,768)	\$ (4,768)	\$ (215)	\$ (4,983)
June 30, 2008						
Total other-than-temporary impairment losses	\$ -	\$ (1,541)	\$ (1,541)	\$ -	\$ (1,541)	\$ (1,541)
Portion of loss recognized in other comprehensive income	-	-	-	-	-	-
Net impairment losses recognized in earnings	\$ -	\$ (1,541)	\$ (1,541)	\$ -	\$ (1,541)	\$ (1,541)



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Activity related to the credit component recognized on debt securities available for sale for which a portion of other-than-temporary impairment was recognized in other comprehensive income for the three months ended June 30, 2009 is as follows:

Dollars in thousands	Total
Balance, April 1, 2009	\$ -
Additions for the credit component on debt securities in which other-than-temporary impairment was not previously recognized	(4,768)
Balance, June 30, 2009	\$ (4,768)

As of June 30, 2009, our debt securities with other-than-temporary impairment in which only the amount of loss related to credit was recognized in earnings consisted solely of residential mortgage-backed securities issued by nongovernment-sponsored entities. We utilize third party vendors to estimate the portion of loss attributable to credit using a discounted cash flow models. The vendors estimate cash flows of the underlying collateral of each mortgage-backed security using models that incorporate their best estimates of current key assumptions, such as default rates, loss severity and prepayment rates. Assumptions utilized vary widely from loan to loan, and are influenced by such factors as loan interest rate, geographical location of the borrower, collateral type and borrower characteristic. Specific such assumptions utilized by our vendors in their valuation of our other-than-temporarily impaired residential mortgage-backed securities issued by nongovernment-sponsored entities were as follows at June 30, 2009:

	Weighted Average	Minimum	Range Maximum
Cumulative default rates	14.5%	4.5%	36.0%
Prepayment rates	27.2%	1.5%	100.0%
Loss severities	42.7%	30.0%	50.0%

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



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Provided below is a summary of securities available for sale which were in an unrealized loss position at June 30, 2009 and December 31, 2008, including debt securities for which a portion of other-than-temporary impairment has been recognized in other comprehensive income.

Dollars in thousands	June 30, 2009					
	Less than 12 months		12 months or more		Total	
	Estimated Fair Value	Unrealized Loss	Estimated Fair Value	Unrealized Loss	Estimated Fair Value	Unrealized Loss
Temporarily impaired securities						
Taxable debt securities						
U. S. Government agencies						
and corporations	\$ 7,450	\$ (37)	\$ 197	\$ (3)	\$ 7,647	\$ (40)
Residential						
mortgage-backed securities:						
Government-sponsored						
agencies	4,285	(51)	140	(2)	4,425	(53)
Nongovernment-sponsored						
entities	36,700	(2,141)	20,944	(8,661)	57,644	(10,802)
Tax-exempt debt securities						
State and political						
subdivisions	15,401	(414)	6,724	(651)	22,125	(1,065)
Total temporarily impaired						
securities	63,836	(2,643)	28,005	(9,317)	91,841	(11,960)
Other-than-temporarily						
impaired securities						
Residential						
mortgage-backed securities:						
Nongovernment-sponsored						
entities	-	-	2,966	(451)	2,966	(451)
Total other-than-temporarily						
impaired securities	-	-	2,966	(451)	2,966	(451)
Total	\$ 63,836	\$ (2,643)	\$ 30,971	\$ (9,768)	\$ 94,807	\$ (12,411)

Dollars in thousands	December 31, 2008					
	Less than 12 months		12 months or more		Total	
	Estimated Fair Value	Unrealized Loss	Estimated Fair Value	Unrealized Loss	Estimated Fair Value	Unrealized Loss
Temporarily impaired securities						
Taxable debt securities						
U. S. Government agencies						
and corporations	\$ 1,240	\$ (3)	\$ -	\$ -	\$ 1,240	\$ (3)
Residential						
mortgage-backed securities:						

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Government-sponsored agencies	7,542	(33)	5,327	(38)	12,869	(71)
Nongovernment-sponsored entities	45,940	(6,612)	16,932	(3,408)	62,872	(10,020)
Tax-exempt debt securities						
State and political subdivisions	19,797	(1,004)	2,481	(455)	22,278	(1,459)
Total temporarily impaired securities	\$ 74,519	\$ (7,652)	\$ 24,740	\$ (3,901)	\$ 99,259	\$ (11,553)

We held 110 available for sale securities, including debt securities with other-than-temporary impairment in which a portion of the impairment remains in other comprehensive income, having an unrealized loss at June 30, 2009. We do not intend to sell these securities, and it is more likely than not that we will not be required to sell these securities before recovery of their amortized cost bases. We believe that this decline in value is primarily attributable to the lack of market liquidity and to changes in market interest rates and not due to credit quality. Accordingly, no additional other-than-temporary impairment charge to earnings is warranted at this time.

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At June 30, 2009, we had \$11.3 million in total unrealized losses related to residential mortgage-backed securities issued by nongovernment sponsored entities. We monitor the performance of the mortgages underlying these bonds. Although there has been some deterioration in their collateral performance, we primarily hold the senior tranches of each issue which provides protection against defaults. We attribute the unrealized loss on these mortgage-backed securities held largely to the current absence of liquidity in the markets for such securities and not to deterioration in credit quality. The mortgages in these asset pools have been made to borrowers with strong credit history and significant equity invested in their homes. Nonetheless, further weakening of economic fundamentals coupled with significant increases in unemployment and substantial deterioration in the value of high end residential properties could extend distress to this borrower population. This could increase default rates and put additional pressure on property values. Should these conditions occur, the value of these securities could decline further and result in the recognition of additional other-than-temporary impairment charges recognized in earnings.

Note 6. Loans

Loans are summarized as follows:

Dollars in thousands	June 30, 2009	December 31, 2008	June 30, 2008
Commercial	\$ 126,661	\$ 130,106	\$ 112,793
Commercial real estate	459,671	452,264	422,393
Construction and development	183,733	215,465	210,417
Residential real estate	376,019	376,026	361,009
Consumer	30,179	31,519	30,361
Other	5,760	6,061	6,206
Total loans	1,182,023	1,211,441	1,143,179
Less unearned income	2,065	2,351	2,347
Total loans net of unearned income	1,179,958	1,209,090	1,140,832
Less allowance for loan losses	14,305	16,933	10,349
Loans, net	\$ 1,165,653	\$ 1,192,157	\$ 1,130,483

Note 7. Allowance for Loan Losses

An analysis of the allowance for loan losses for the six month periods ended June 30, 2009 and 2008, and for the year ended December 31, 2008 is as follows:

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	June 30,		December 31,	
Dollars in thousands	2009	2008	2008	2008
Balance, beginning of period	\$ 16,933	\$ 9,192	\$ 9,192	
Losses:				
Commercial	36	95	198	
Commercial real estate	401	821	1,131	
Construction and development	12,001	-	4,529	
Real estate - mortgage	1,152	606	1,608	
Consumer	116	112	375	
Other	104	91	203	
Total	13,810	1,725	8,044	
Recoveries:				
Commercial	5	2	4	
Commercial real estate	6	7	17	
Construction and development	1,534	-	-	
Real estate - mortgage	11	22	64	
Consumer	53	34	72	
Other	73	67	128	
Total	1,682	132	285	
Net losses	12,128	1,593	7,759	
Provision for loan losses	9,500	2,750	15,500	
Balance, end of period	\$ 14,305	\$ 10,349	\$ 16,933	

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Note 8. Goodwill and Other Intangible Assets

The following tables present our goodwill at June 30, 2009 and other intangible assets at June 30, 2009, December 31, 2008, and June 30, 2008.

Dollars in thousands	Goodwill Activity
Balance, January 1, 2009	\$ 6,198
Acquired goodwill, net	-
Balance, June 30, 2009	\$ 6,198

Dollars in thousands	Other Intangible Assets		
	June 30, 2009	December 31, 2008	June 30, 2008
<b>Unidentifiable intangible assets</b>			
Gross carrying amount	\$ 2,267	\$ 2,267	\$ 2,267
Less: accumulated amortization	1,536	1,461	1,385
Net carrying amount	\$ 731	\$ 806	\$ 882
<b>Identifiable intangible assets</b>			
Gross carrying amount	\$ 3,000	\$ 3,000	\$ 3,000
Less: accumulated amortization	400	300	200
Net carrying amount	\$ 2,600	\$ 2,700	\$ 2,800

We recorded amortization expense of approximately \$176,000 for the six months ended June 30, 2009 relative to our other intangible assets. Annual amortization is expected to be approximately \$351,000 for each of the years ending 2009 through 2011.

Note 9. Deposits

The following is a summary of interest bearing deposits by type as of June 30, 2009 and 2008 and December 31, 2008:

June 30,	December 31,	June 30,
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Dollars in thousands	2009	2008	2008
Interest bearing demand deposits	\$ 152,498	\$ 156,990	\$ 194,255
Savings deposits	105,828	61,689	60,244
Retail time deposits	377,749	380,774	310,596
Brokered time deposits	248,271	296,589	223,742
Total	\$ 884,346	\$ 896,042	\$ 788,837



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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, 2009:

Dollars in thousands	Amount	Percent
Three months or less	\$ 82,522	21.0%
Three through six months	52,861	13.5%
Six through twelve months	69,302	17.7%
Over twelve months	187,767	47.8%
Total	\$ 392,452	100.0%

A summary of the scheduled maturities for all time deposits as of June 30, 2009 is as follows:

Dollars in thousands	
Six month period ending	
December 31, 2009	\$ 241,179
Year ending December 31,	
2010	192,223
Year ending December 31,	
2011	110,456
Year ending December 31,	
2012	66,180
Year ending December 31,	
2013	10,962
Thereafter	5,020
	\$ 626,020

Note 10. Borrowed Funds

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

Dollars in thousands	Six Months Ended June 30, 2009		
	Short-term FHLB Advances	Repurchase Agreements	Federal Funds Purchased and Lines of Credit
Balance at June 30	\$ 100,000	\$ 1,373	\$ 3,345
	119,815	1,467	5,647

Average balance outstanding for the period

Maximum balance outstanding at any month end during period	184,825	2,433	9,663
Weighted average interest rate for the period	0.50%	0.40%	2.01%
Weighted average interest rate for balances outstanding at June 30	0.44%	0.34%	2.94%

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Dollars in thousands	Year Ended December 31, 2008		
	Short-term FHLB Advances	Repurchase Agreements	Federal Funds Purchased and Lines of Credit
Balance at December 31	\$ 142,346	\$ 1,613	\$ 9,141
Average balance outstanding for the period	106,308	3,208	2,867
Maximum balance outstanding at any month end during period	146,821	11,458	9,141
Weighted average interest rate for the period	2.13%	1.74%	2.37%
Weighted average interest rate for balances outstanding at December 31	0.57%	0.48%	1.15%

Dollars in thousands	Six Months Ended June 30, 2008		
	Short-term FHLB Advances	Repurchase Agreements	Federal Funds Purchased and Lines of Credit
Balance at June 30	\$ 146,821	\$ 708	\$ 371
Average balance outstanding for the period	98,597	5,952	856
Maximum balance outstanding at any month end during period	146,821	11,458	1,562
Weighted average interest rate for the period	2.87%	1.84%	4.83%
Weighted average interest rate for balances outstanding at June 30	2.27%	0.46%	4.50%

Long-term borrowings: Our long-term borrowings of \$432,391,000, \$392,748,000 and \$400,186,000 at June 30, 2009, December 31, 2008, and June 30, 2008 respectively, consisted primarily of advances from the Federal Home Loan Bank (“FHLB”). Included in long term borrowings is subordinated debt which qualifies as Tier 2 regulatory

capital totaling \$16 million at June 30, 2009 and \$10 million at December 31, 2008 and June 30, 2008. Of the \$6 million in subordinated debt we issued during the first six months of 2009, \$5 million was issued to an affiliate of a director of Summit. This subordinated debt bears an interest rate of 10 percent per annum, a term of 10 years, and is not prepayable by us within the first five years.

These borrowings bear both fixed and variable rates and mature in varying amounts through the year 2019.

The average interest rate paid on long-term borrowings for the six month period ended June 30, 2009 was 4.71% compared to 4.61% for the first six months of 2008.

**Subordinated Debentures Owed to Unconsolidated Subsidiary Trusts:** We have three statutory business trusts that were formed for the purpose of issuing mandatorily redeemable securities (the “capital securities”) for which we are obligated to third party investors and investing the proceeds from the sale of the capital securities in our junior subordinated debentures (the “debentures”). The debentures held by the trusts are their sole assets. Our subordinated debentures totaled \$19,589,000 at June 30, 2009, December 31, 2008, and June 30, 2008.

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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 and SFG Capital Trust II are redeemable by us quarterly, and the debentures of SFG Capital Trust III are first redeemable by us in March 2011.

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

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

Dollars in thousands	
Year Ending December 31,	Amount
2009	\$ 55,309
2010	76,481
2011	33,589
2012	64,915
2013	40,080
Thereafter	162,017
	\$ 432,391

Note 11. Stock Option Plan

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

Option Plan (collectively the “Plans”) that expired in May 2008.

The fair value of our employee stock options granted is estimated at the date of grant using the Black-Scholes option-pricing model. This model requires the input of highly subjective assumptions, changes to which can materially affect the fair value estimate. Additionally, there may be other factors that would otherwise have a significant effect on the value of employee stock options granted but are not considered by the model. Because our employee stock options have characteristics significantly different from those of traded options and because changes in the subjective input assumptions can materially affect the fair value estimate, in management’s opinion, the existing models do not necessarily provide a reliable single measure of the fair value of its employee stock options at the time of grant. There were no option grants during the first six months of 2009 or 2008.

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All compensation cost related to nonvested awards was previously recognized prior to January 1, 2009. During the first six months of 2008, we recognized \$6,000 of compensation expense for share-based payment arrangements in our income statement, with a deferred tax asset of \$2,000.

A summary of activity in our Plans during the first six months of 2009 and 2008 is as follows:

	For the Six Months Ended			
	June 30, 2009		June 30, 2008	
	Options	Weighted-Average Exercise Price	Options	Weighted-Average Exercise Price
Outstanding, January 1	335,730	\$ 18.36	337,580	\$ 18.28
Granted	-	-	-	-
Exercised	(8,000)	5.36	(1,850)	4.81
Forfeited	(1,600)	5.21	-	-
Outstanding, June 30	326,130	\$ 18.74	335,730	\$ 18.36

Other information regarding options outstanding and exercisable at June 30, 2009 is as follows:

Range of exercise price	# of shares	Options Outstanding			Options Exercisable		
		Wt. Avg. Remaining Contractual WAEP	Life (yrs)	Aggregate Intrinsic Value (in thousands)	# of shares	Wt. Avg. Remaining Contractual WAEP	Aggregate Intrinsic Value (in thousands)
4.63 - \$ \$6.00	60,150	\$ 5.38	3.81	\$ 20	60,150	\$ 5.38	\$ 20
6.01 - 10.00	31,680	9.49	6.51	-	31,680	9.49	-
10.01 - 17.50	3,500	17.43	4.67	-	3,500	17.43	-
17.51 - 20.00	52,300	17.79	7.50	-	51,900	17.79	-
20.01 - 25.93	178,500	25.19	6.07	-	178,500	25.19	-
	326,130	18.74		\$ 20	325,730	18.74	\$ 20

Note 12. Commitments and Contingencies

Off-Balance Sheet Arrangements

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



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

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

	June 30,
Dollars in thousands	2009
Commitments to extend credit:	
Revolving home equity and credit card lines	\$ 45,295
Construction loans	39,774
Other loans	44,430
Standby letters of credit	9,347
Total	\$ 138,846

Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. We evaluate each customer's credit worthiness on a case-by-case basis. The amount of collateral obtained, if we deem necessary upon extension of credit, is based on our credit evaluation. Collateral held varies but may include accounts receivable, inventory, equipment or real estate.

Standby letters of credit are conditional commitments issued to guarantee the performance of a customer to a third party. Standby letters of credit generally are contingent upon the failure of the customer to perform according to the terms of the underlying contract with the third party.

Our exposure to credit loss in the event of nonperformance by the other party to the financial instrument for commitments to extend credit is represented by the contractual amount of those instruments. We use the same credit policies in making commitments and conditional obligations as we do for on-balance sheet instruments.

#### Note 13. 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, 2009, 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.

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

Dollars in thousands As of June 30, 2009	Actual		Minimum Required Regulatory Capital		To be Well Capitalized under Prompt Corrective Action Provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
Total Capital (to risk weighted assets)						
Summit	\$ 127,959	10.7%	\$ 95,745	8.0%	\$ 119,681	10.0%
Summit Community	128,327	10.8%	95,371	8.0%	119,214	10.0%
Tier I Capital (to risk weighted assets)						
Summit	\$ 97,597	8.2%	47,872	4.0%	71,809	6.0%
Summit Community	113,965	9.6%	47,686	4.0%	71,528	6.0%
Tier I Capital (to average assets)						
Summit	\$ 97,597	6.1%	47,823	3.0%	79,705	5.0%
Summit Community	113,965	7.2%	47,295	3.0%	78,825	5.0%
As of December 31, 2008						
Total Capital (to risk weighted assets)						
Summit	\$ 125,091	10.0%	99,694	8.0%	124,618	10.0%
Summit Community	129,369	10.4%	99,225	8.0%	124,031	10.0%
Tier I Capital (to risk weighted assets)						
Summit	99,497	8.0%	49,847	4.0%	74,771	6.0%
Summit Community	113,841	9.2%	49,612	4.0%	74,418	6.0%
Tier I Capital (to average assets)						

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Summit	99,497	6.3%	47,707	3.0%	79,512	5.0%
Summit Community	113,841	7.2%	47,143	3.0%	78,571	5.0%

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## 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. Although our business operates as two separate segments, the insurance segment is not a reportable segment as it is immaterial, and thus our financial information is presented on an aggregated basis. This discussion and analysis should be read in conjunction with our 2008 audited financial statements and Annual Report on Form 10-K and 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.

## 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 of 10.24% for the first six months in 2009 compared to the same period of 2008 resulted in an increase of less than 0.29% in our net interest earnings on a tax equivalent basis. Increased nonaccrual loans continue to negatively impact our net interest earnings and margin.

## CRITICAL ACCOUNTING POLICIES

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

Our most significant accounting policies are presented in Note 1 to the consolidated financial statements of our 2008 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, the valuation of goodwill, and fair value measurements 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.

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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 1 to the consolidated financial statements of our 2008 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 2008 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 2009. We cannot assure you that future goodwill impairment tests will not result in a charge to earnings. See Notes 1 and 11 of the consolidated financial statements of our Annual Report on Form 10-K/A for further discussion of our intangible assets, which include goodwill.

Statement of Financial Accounting Standards No. 157 ("SFAS 157"), Fair Value Measurements, provides a definition of fair value, establishes a framework for measuring fair value, and requires expanded disclosures about fair value measurements. Fair value is the price that could be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants. Based on the observability of the inputs used in the valuation techniques, we classify our financial assets and liabilities measured and disclosed at fair value in accordance with the three-level hierarchy (e.g., Level 1, Level 2 and Level 3) established under SFAS 157. Fair value determination in accordance with SFAS 157 requires that we make a number of significant judgments. In determining the fair value of financial instruments, we use market prices of the same or similar instruments whenever such prices are available. We do not use prices involving distressed sellers in determining fair value. If observable market prices are unavailable or impracticable to obtain, then fair value is estimated using modeling techniques such as discounted cash flow analyses. These modeling techniques incorporate our assessments regarding assumptions that market participants would use in pricing the asset or the liability, including assumptions about the risks inherent in a particular valuation technique and the risk of nonperformance.

Fair value is used on a recurring basis for certain assets and liabilities in which fair value is the primary basis of accounting. Additionally, fair value is used on a non-recurring basis to evaluate assets or liabilities for impairment or for disclosure purposes in accordance with SFAS No. 107, Disclosures About Fair Value of Financial Instruments.

## RESULTS OF OPERATIONS

Earnings Summary

Net income for the six months ended June 30, 2009 declined 126.25% to a loss of \$1,685,000, or \$0.23 per diluted share as compared to net income of \$6,418,000, or \$0.86 per diluted share for the six months ended June 30, 2008. For the quarter ended June 30, 2009, net income decreased 233.00% to a loss of \$3,450,000, or \$0.46 per diluted share as compared to net income of \$2,594,000, or \$0.35 per diluted share for the same period of 2008. Included in earnings for the six months ended June 30, 2009 was an other-than-temporary non-cash impairment charge of \$5.0



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million pre-tax, equivalent to \$3.1 million after-tax, or \$0.42 per diluted share. This impairment charge relates primarily to certain residential mortgage-backed securities, which we continue to own. Included in earnings for the six months ended June 30, 2008 was an other-than-temporary impairment charge of \$1.5 million pre-tax, equivalent to \$971,000 after-tax, or \$0.06 per diluted share, relating primarily to certain preferred stock issuances of the Fannie Mae and Freddie Mac for 2008, which we continue to own. The bulk of these impairment charges occurred during the second quarter of each year, therefore negatively impacting the quarterly results for each period presented. Also negatively impacting our 2009 earnings are higher provisions for loan losses due to our increased nonperforming loans. The provision for loan losses was \$9.5 million for the first six months of 2009 compared to \$2.75 million for the same period of 2008. The second quarter 2009 provision for loan losses totaled \$5.5 million, compared to \$1.75 million for the comparable period of 2008. Returns on average equity and assets for the first six months of 2009 were (3.89%) and (0.21%), respectively, compared with 13.80% and 0.88% for the same period of 2008.

#### Net Interest Income

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

Our net interest income on a fully tax-equivalent basis totaled \$23,084,000 for the six month period ended June 30, 2009 compared to \$23,018,000 for the same period of 2008, representing an increase of \$66,000 or 0.29%. Although average interest earning assets grew 10.24% from \$1,399,342,000 during the first six months of 2008 to \$1,542,674,000 for the first six months of 2009, our net interest income remained relatively flat due to our increased level of nonaccrual loans. The yield on interest earning assets declined to 6.06% for the six months ended June 30, 2009 from 6.88% for the comparable period of 2008. Average interest bearing liabilities grew 11.54% from \$1,290,887,000 at June 30, 2008 to \$1,439,862,000 at June 30, 2009, at an average yield for the first six months of 2009 of 3.26% compared to 3.88% for the same period of 2008.

Our consolidated net interest margin decreased to 3.02% for the six month period ended June 30, 2009, compared to 3.31% for the same period in 2008. Our quarterly net interest margin remained relatively unchanged compared to the linked quarter. The decline in margin for the six month period when compared to June 30, 2008 was driven primarily by the reversal of loan interest income related to nonaccrual loans placed on nonaccrual status during first half of 2009 and the continued reduction in interest income as a result of higher levels of loans remaining on nonaccrual. In addition, our margin continues to be pressured by an extremely competitive environment, both for loans and deposits. The present continued low interest rate environment has served to positively impact our net interest margin due to our liability sensitive balance sheet. For the six months ended June 30, 2009 compared to June 30, 2008, the yields on earning assets decreased 82 basis points, while the cost of our interest bearing funds decreased by 62 basis points.

We anticipate a stable net interest margin in the near term as we do not expect interest rates to rise in the near future, we do not expect significant growth in our interest earning assets, nor do we expect our nonperforming asset balances to decline significantly in the near future. We continue to monitor the net interest margin through net interest income simulation to minimize the potential for any significant negative impact. See the "Market Risk Management" section for further discussion of the impact changes in market interest rates could have on us. Further analysis of our yields on interest earning assets and interest bearing liabilities are presented in Tables I and II below.



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Table I - Average Balance Sheet and Net Interest Income Analysis  
Dollars in thousands

	For the Six Months Ended					
	Average Balance	June 30, 2009 Earnings/ Expense	Yield/ Rate	Average Balance	June 30, 2008 Earnings/ Expense	Yield/ Rate
Interest earning assets						
Loans, net of unearned income						
(1) Taxable	\$ 1,200,625	\$ 36,083	6.06%	\$ 1,088,544	\$ 39,410	7.28%
(2) Tax-exempt	8,134	333	8.26%	8,790	356	8.15%
Securities						
Taxable	285,779	8,418	5.94%	250,414	6,358	5.11%
(2) Tax-exempt	46,254	1,559	6.80%	51,153	1,774	6.97%
Federal funds sold and interest bearing deposits with other banks						
	1,882	1	0.11%	441	6	2.74%
Total interest earning assets	1,542,674	46,394	6.06%	1,399,342	47,904	6.88%
Noninterest earning assets						
Cash & due from banks	18,873			16,691		
Premises and equipment	23,188			22,062		
Other assets	48,919			36,426		
Allowance for loan losses	(21,270)			(9,785)		
Total assets	\$ 1,612,384			\$ 1,464,736		
Interest bearing liabilities						
Interest bearing demand deposits	\$ 155,456	\$ 392	0.51%	\$ 203,707	\$ 1,548	1.53%
Savings deposits	88,103	770	1.76%	51,549	407	1.59%
Time deposits	638,556	11,817	3.73%	511,873	11,604	4.56%
Short-term borrowings	129,928	358	0.56%	105,405	1,490	2.84%

Long-term borrowings and capital trust securities	427,819	9,973	4.70%	418,353	9,837	4.73%
Total interest bearing liabilities	1,439,862	23,310	3.26%	1,290,887	24,886	3.88%
Noninterest bearing liabilities and shareholders' equity						
Demand deposits	77,775			72,203		
Other liabilities	8,028			8,629		
Shareholders' equity	86,719			93,017		
Total liabilities and shareholders' equity	\$ 1,612,384			\$ 1,464,736		
Net interest earnings		\$ 23,084			\$ 23,018	
Net yield on interest earning assets			3.02%			3.31%

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

(2) - 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 \$642,000 and \$705,000 for the periods ended

June 30, 2009 and June 30 2008, 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, 2009 versus June 30, 2008		
	Increase (Decrease) Due to Change in:		
	Volume	Rate	Net
Interest earned on:			
Loans			
Taxable	\$ 3,775	\$ (7,102)	\$ (3,327)
Tax-exempt	(28)	5	(23)
Securities			
Taxable	955	1,105	2,060
Tax-exempt	(170)	(45)	(215)
Federal funds sold and interest bearing deposits with other banks			
	5	(10)	(5)
Total interest earned on interest earning assets			
	4,537	(6,047)	(1,510)
Interest paid on:			
Interest bearing demand deposits			
	(303)	(853)	(1,156)
Savings deposits	314	49	363
Time deposits	2,559	(2,346)	213
Short-term borrowings	286	(1,418)	(1,132)
Long-term borrowings and capital			
trust securities	200	(64)	136
Total interest paid on interest bearing liabilities			
	\$ 3,056	\$ (4,632)	\$ (1,576)

### Noninterest Income

Total noninterest income decreased to \$99,000 for the first six months of 2009, compared to \$3,976,000 for the same period of 2008, with insurance commissions and service fees from deposit accounts being the primary positive components and other-than-temporary impairment of securities being the primary negative component. Further detail regarding noninterest income is reflected in the following table.



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Noninterest Income Dollars in thousands	For the Quarter Ended June 30,		For the Six Months Ended June 30,	
	2009	2008	2009	2008
Insurance commissions	\$ 1,283	\$ 1,275	\$ 2,627	\$ 2,602
Service fees	857	824	1,593	1,567
Realized securities gains (losses)	39	-	295	-
Other-than-temporary impairment of securities	(4,768)	(1,541)	(4,983)	(1,541)
Net cash settlement on derivative instruments	-	-	-	(171)
Change in fair value of derivative instruments	-	-	-	705
Gain (Loss) on sale of assets	(115)	236	(124)	236
Other	362	334	691	578
<b>Total</b>	<b>\$ (2,342)</b>	<b>\$ 1,128</b>	<b>\$ 99</b>	<b>\$ 3,976</b>

Other-than-temporary impairment of securities: During second quarter 2009, we recorded a non-cash other-than temporary impairment charge of \$4,768,000 related to certain residential mortgage-backed securities which we continue to own. The remaining \$215,000 other-than-temporary impairment charge on securities during 2009 was related to an equity investment. During second quarter 2008, we recorded a non-cash other-than temporary impairment charge of \$1,541,000 related to certain preferred stock issuances of the Fannie Mae and Freddie Mac which we continue to own.

Change in fair value of derivative instruments: The \$705,000 change reflected in the six months ended June 30, 2008 period includes the gain realized upon termination of interest rate swaps that did not qualify for hedge accounting.

#### Noninterest Expense

Total noninterest expense increased approximately 21.8% and 15.6% for the quarter ended and six months ended June 30, 2009, respectively, as compared to the same periods in 2008. For both the quarter and six month periods, FDIC premiums and professional fees were the largest increasing components. 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				
	2009	\$	%	2008	2009	\$	%	2008
Salaries and employee	\$ 4,308	\$ 121	2.9%	\$ 4,187	\$ 8,587	\$ 6	0.1%	\$ 8,581

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benefits								
Net occupancy expense	466	23	5.2%	443	1,063	144	15.7%	919
Equipment expense	527	(6)	-1.1%	533	1,095	27	2.5%	1,068
Supplies	248	7	2.9%	241	442	7	1.6%	435
Professional fees	403	221	121.4%	182	737	437	145.7%	300
Amortization of intangibles	88	-	0.0%	88	176	-	0.0%	176
FDIC premiums	1,245	1,065	591.7%	180	1,628	1,274	359.9%	354
Other	1,424	129	10.0%	1,295	2,732	328	13.6%	2,404
Total	\$ 8,709	\$ 1,560	21.8%	\$ 7,149	\$ 16,460	\$ 2,223	15.6%	\$ 14,237



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Professional fees: The six month period increase of \$437,000 and quarterly increase of \$221,000 in professional fees is primarily attributable to legal expenses, a large part of which relates to foreclosed properties.

FDIC premiums: These increased premiums resulted from higher rates charged by the FDIC. The second quarter 2009 total also includes the special FDIC assessment.

#### 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 \$9,500,000 provision for loan losses for the first six months of 2009, compared to \$2,750,000 for the same period in 2008. Net loan charge offs for the first six months of 2009 were \$12,128,000, as compared to net charge offs of \$1,593,000 over the same period of 2008. At June 30, 2009, the allowance for loan losses totaled \$14,305,000 or 1.21% of loans, net of unearned income, compared to \$16,933,000 or 1.40% of loans, net of unearned income at December 31, 2008.

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

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

	June 30,		December
	2009	2008	31, 2008
Accruing loans past due 90 days or more	\$ 668	\$ 5,832	\$ 1,039
Nonperforming assets:			
Nonaccrual loans	61,030	9,782	46,930
Foreclosed properties	20,435	2,537	8,110
Repossessed assets	11	9	3
Total	\$ 82,144	\$ 18,160	\$ 56,082
Total nonperforming loans as a percentage of total loans	5.22%	1.37%	3.97%
Total nonperforming assets as a percentage of total assets	5.19%	1.19%	3.45%

Due to current declining economic conditions, borrowers have in many cases been unable to refinance their loans due to a range of factors including declining property values. As a result, we have experienced higher delinquencies and nonperforming assets, particularly in our residential real estate loan portfolios and in commercial construction loans to residential real estate developers. It is not known when the housing market will stabilize. While management anticipates loan delinquencies will remain higher than historical levels for the foreseeable future, we anticipate that nonperforming assets will remain elevated in the near term.

The following table presents a summary of our 30 to 89 days past due performing loans.

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Loans Past Due 30-89 Days					
Dollars in thousands	June 30, 2009	2008	March 31, 2009	December 31, 2008	
Commercial	\$ 1,368	\$ 1,089	\$ 144	\$ 114	
Commercial real estate	4,320	24,606	3,985	195	
Land development and construction	920	9,919	5,559	2,722	
Residential real estate	5,802	2,962	10,291	5,009	
Consumer	946	979	646	824	
Total	\$ 13,356	\$ 39,555	\$ 20,625	\$ 8,864	

The following table shows our nonperforming loans by category as of June 30, 2009 and 2008, March 31, 2009 and December 31, 2008.

Nonperforming Loans by Type					
Dollars in thousands	June 30, 2009	2008	March 31, 2009	December 31, 2008	
Commercial	\$ 680	\$ 81	\$ 637	\$ 199	
Commercial real estate	23,287	3,184	25,788	24,323	
Land development and construction	29,508	6,460	45,194	18,382	
Residential real estate	8,116	5,521	7,933	4,986	
Consumer	107	368	31	79	
Total nonperforming loans	\$ 61,698	\$ 15,614	\$ 79,583	\$ 47,969	

Commercial real estate nonperforming: One borrower -- a hotel and conference facility, with adjacent commercial real estate, near Front Royal, Virginia -- comprises 87% of the balance of nonperforming commercial real estate loans at June 30, 2009. The debtor has filed for bankruptcy reorganization, and we expect this problem credit to be resolved within the next 18 months.

Land development and construction nonperforming: 62% of the land development and construction nonperforming assets are related to residential development projects while 38% are commercial construction projects. 87 percent of the residential related nonperforming loans is comprised of five credits as follows:

Description	Location	Balance (in millions)
Residential subdivision	Berkeley County, WV	\$ 5.2
Residential subdivision and acreage	Rockingham County, VA	2.8
Residential lots	Culpeper County, VA	4.1
Residential lots and residential home	Frederick County, VA	1.5
Residential lots and subdivision	Front Royal, VA	2.3

One relationship with a commercial contractor comprises \$8.7 million, or 81%, of the commercial construction nonperforming loans.

Residential real estate nonperforming: Nonperforming residential real estate loans continued to increase during first six months of 2009 as many borrowers have been unable to make their payments due to a range of factors stemming from current declining economic conditions. Although, the increase from first quarter 2009 to second quarter 2009 was minimal.

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All nonperforming loans are individually reviewed and adequate reserves are in place. The majority of nonperforming loans are secured by real property with values supported by appraisals.

As a result of our internal loan review process, the ratio of internally classified loans to total loans increased from 9.18% at December 31, 2008 to 9.59% at June 30, 2009. 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 our subsidiary bank's primary regulatory agency. The increase in internally classified loans at June 30, 2009 occurred throughout our portfolios of real estate related loans, as shown in the table below, as several of these loans have been downgraded by management as they fell outside of our internal lending policy guidelines, became past due or were placed on nonaccrual status. Refer to the Asset Quality section of the financial review of the 2008 Annual Report on Form 10-K/A for further discussion of the processes related to internally classified loans.

#### Internally Classified Loans

Dollars in thousands	6/30/2009	12/31/2008
Commerical	\$ 6,652	\$ 984
Commercial real estate	40,359	30,435
Land development & construction	45,547	60,589
Residential real estate	20,244	18,405
Consumer	543	633
Total	\$ 113,345	\$ 111,046

In addition to nonperforming loans discussed above, we have also identified approximately \$11 million of potential problem loans at June 30, 2009 related to 8 relationships. These potential problem loans are loans that were performing at June 30, 2009, but known information about possible credit problems of the related borrowers causes management to have concerns as to the ability of such borrowers to comply with the current loan repayment terms and which may result in disclosure of such loans as nonperforming at some time in the future. Management cannot predict the extent to which economic conditions may worsen or other factors which may impact borrowers and the potential problem loans. Accordingly, there can be no assurance that other loans will not become 90 days or more past due, be placed on nonaccrual, or require increased allowance coverage and provision for loan losses.

#### FINANCIAL CONDITION

Our total assets were \$1,583,910,000 at June 30, 2009, compared to \$1,627,116,000 at December 31, 2008, representing a 2.7% decrease. Table V below serves to illustrate significant changes in our financial position between December 31, 2008 and June 30, 2009.



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Table V - Summary of Significant Changes in Financial Position  
Dollars in thousands

	Balance December 31, 2008	Increase (Decrease) Amount	Percentage	Balance June 30, 2009
<b>Assets</b>				
Securities available for sale	\$ 327,606	\$ (38,339)	-11.7%	\$ 289,267
Loans, net of unearned interest	1,209,090	(29,132)	-2.4%	1,179,958
<b>Liabilities</b>				
Deposits	\$ 965,850	\$ (11,626)	-1.2%	\$ 954,224
Short-term borrowings	153,100	(48,382)	-31.6%	104,718
Long-term borrowings and subordinated debentures	412,337	20,054	4.9%	432,391

Deposits decreased approximately \$11.6 million during the first six months of 2009. This decrease was attributable to a \$37 million growth in retail deposits offset by a \$48 million decrease in brokered deposits. We also repaid a portion of our overnight FHLB borrowings with securities cash flows and replaced approximately \$14 million of them with longer term FHLB borrowings and also issued \$6 million in subordinated debt.

Refer to Notes 5, 6, 9, and 10 of the notes to the accompanying consolidated financial statements for additional information with regard to changes in the composition of our available for sale securities, loans, deposits and borrowings between June 30, 2009 and December 31, 2008.

## 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 \$165 million, or 10.4% of total assets at June 30, 2009 versus \$174 million, or 10.7% of total assets at December 31, 2008.

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.

## 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, 2009 totaled \$83,753,000 compared to \$87,244,000 at December 31, 2008.

During first half 2009, we issued \$6 million of subordinated debt which qualifies as Tier 2 capital. This debt has an interest rate of 10 percent per annum, a term of 10 years, and is not prepayable by us within the first five years.



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During second quarter 2009, our Board of Directors declared and paid the first half 2009 cash dividend of \$0.06 per share compared to \$0.18 paid for the first half of 2008. In an effort to preserve capital, the first half 2009 dividend totaled \$445,000, representing a 66.6% decrease from the \$1,334,000 paid during the first half 2008.

Refer to Note 13 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, 2009.

Dollars in thousands	Long Term Debt	Capital Trust Securities	Operating Leases
2009	\$ 55,309	\$ -	\$ 214
2010	76,481	-	277
2011	33,589	-	148
2012	64,915	-	149
2013	40,080	-	119
Thereafter	162,017	19,589	22
Total	\$ 432,391	\$ 19,589	\$ 929

### 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, 2009 are presented in the following table.

Dollars in thousands	June 30, 2009
Commitments to extend credit:	
Revolving home equity and	
credit card lines	\$ 45,295
Construction loans	39,774
Other loans	44,430
Standby letters of credit	9,347
Total	\$ 138,846

## 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

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Board of Directors. The ALCO actively formulates the economic assumptions that we use in our financial planning and budgeting process and establishes policies which control and monitor our sources, uses and prices of funds.

Some amount of interest rate risk is inherent and appropriate to the banking business. Our net income is affected by changes in the absolute level of interest rates. Our interest rate risk position is liability sensitive in the near 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, 2009 which is well within our ALCO policy limit of +/- 10%:

Change in Interest Rates  (basis points)	Estimated % Change in Net Interest Income Over:	
	0 - 12 Months	13 - 24 Months
Down 100 (1)	-0.24%	5.15%
Up 100 (1)	-1.12%	4.19%
Up 200 (1)	-1.50%	4.09%
Up 400 (2)	-1.49%	2.60%

(1) assumes a parallel shift in the yield curve

(2) assumes 400 bp increase over 24 months

## CONTROLS AND PROCEDURES

Our management, including the Chief Executive Officer and Chief Financial Officer, has conducted as of June 30, 2009, an evaluation of the effectiveness of disclosure controls and procedures as defined in Exchange Act Rule 13a-15(e). Based on that evaluation, the Chief Executive Officer and Chief Financial Officer concluded that the disclosure controls and procedures as of June 30, 2009 were effective. There were no changes in our internal control

over financial reporting that occurred during the quarter ended June 30, 2009 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

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Part II. Other Information

Item 1. Legal Proceedings

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

Item 1A. Risk Factors

In addition to the other information set forth in this report, you should carefully consider the factors discussed in Part I, "Item 1A. Risk Factors" in our Annual Report on Form 10-K/A for the year ended December 31, 2008, 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 14, 2009 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	
James M. Cookman	5,502,654	208,434
Thomas J. Hawse, III	5,529,404	181,684
Gary L. Hinkle	5,543,081	168,007
Gerald W. Huffman	5,550,859	160,229
H. Charles Maddy, III	5,390,024	321,064

The following directors' terms of office continued after the 2009 annual shareholders' meeting: Frank A. Baer, III, Oscar M. Bean, Dewey F. Bensenhaver, John W. Crites, Patrick N. Frye, James P. Geary, II, Phoebe F. Heishman, Duke A. McDaniel, Ronald F. Miller, George R. Ours, Jr. and Charles S. Piccirillo.

2. Approved the 2009 Officer Stock Option Plan.

For	Against	Abstentions
3,726,732	754,625	108,276

3. Ratified Arnett & Foster, PLLC, to serve as our independent registered public accounting firm for the year ending December 31, 2009.

For	Against	Abstentions
5,610,881	21,838	78,369



SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

SUMMIT FINANCIAL GROUP, INC.  
(registrant)

By: /s/ H. Charles Maddy, III  
H. Charles Maddy, III,  
President and Chief Executive Officer

By: /s/ Robert S. Tissue  
Robert S. Tissue,  
Senior Vice President and Chief Financial Officer

By: /s/ Julie R. Cook  
Julie R. Cook,  
Vice President and Chief Accounting Officer

Date: August 7, 2009

