SUMMIT FINANCIAL GROUP INC
Form 10-Q
November 07, 2006

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

FORM 10 - Q

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

For the quarterly period ended **September 30, 2006**.
or

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

Commission File Number **0-16587**

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

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

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

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

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

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

Large accelerated filer o Accelerated filerþ Non-accelerated filer o

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

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

Common Stock, $2.50 par value
7,087,920 shares outstanding as of November 6, 2006

Summit Financial Group, Inc. and Subsidiaries

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PART II. OTHER INFORMATION

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

	September 30, 2006 (unaudited)	December 31, 2005 (*)	September 30, 2005 (unaudited)
ASSETS			
Cash and due from banks	$ 11,604,346	$ 22,535,761	$ 20,830,680
Interest bearing deposits with other banks	119,013	1,536,506	2,196,744
Federal funds sold	399,000	3,650,000	3,573,000
Securities available for sale	246,331,602	223,772,298	215,757,195
Loans held for sale	6,509,914	16,584,990	12,695,050
Loans, net	895,265,891	793,766,837	729,431,309
Property held for sale	249,137	378,287	830,145
Premises and equipment, net	23,505,342	23,089,412	21,163,790
Accrued interest receivable	6,079,101	4,835,763	4,392,003
Intangible assets	3,234,308	3,347,672	3,385,460
Other assets	17,192,969	16,034,499	14,847,760
Total assets	$ 1,210,490,623	$ 1,109,532,025	$ 1,029,103,136
LIABILITIES AND SHAREHOLDERS' EQUITY			
Liabilities			
Deposits			
Non interest bearing	$ 64,750,662	$ 62,631,410	$ 69,346,345
Interest bearing	800,311,691	611,269,308	559,572,582
Total deposits	865,062,353	673,900,718	628,918,927
Short-term borrowings	90,422,000	182,028,113	139,680,652
Long-term borrowings	144,274,780	150,911,835	168,041,711
Subordinated debentures owed to unconsolidated subsidiary trusts	19,589,000	19,589,000	11,341,000
Other liabilities	10,512,864	9,299,134	8,692,039
Total liabilities	1,129,860,997	1,035,728,800	956,674,329
Commitments and Contingencies			
Shareholders' Equity			
Common stock and related surplus, $2.50 par value; authorized 20,000,000 shares, issued and outstanding 2006 - 7,102,720 shares; issued December 2005 - 7,126,220 shares; issued September 2005 - 7,125,820 shares	18,310,230	18,856,774	18,776,686
Retained earnings	63,159,114	56,214,807	54,912,652
Accumulated other comprehensive income	(839,718)	(1,268,356)	(1,260,531)
Total shareholders' equity	80,629,626	73,803,225	72,428,807
Total liabilities and shareholders' equity	$ 1,210,490,623	$ 1,109,532,025	$ 1,029,103,136

(*) - December 31, 2005 financial information has been extracted from audited consolidated financial statements

See Notes to Consolidated Financial Statements

Summit Financial Group, Inc. and Subsidiaries

Consolidated Statements of Income (unaudited)

	Three Months Ended		Nine Months Ended	
	September 30, 2006	September 30, 2005	September 30, 2006	September 30, 2005
Interest income				
Interest and fees on loans				
Taxable	$ 18,102,418	$ 12,422,549	$ 50,179,652	$ 33,420,963
Tax-exempt	113,551	104,328	315,199	320,841
Interest and dividends on securities				
Taxable	2,451,769	1,750,451	6,836,439	5,228,816
Tax-exempt	546,050	533,000	1,594,960	1,603,999
Interest on interest bearing deposits with other banks	2,860	22,743	23,397	68,281
Interest on Federal funds sold	13,482	3,684	29,717	10,960
Total interest income	21,230,130	14,836,755	58,979,364	40,653,860
Interest expense				
Interest on deposits	7,760,937	3,508,549	19,321,871	8,951,622
Interest on short-term borrowings	1,777,008	1,314,966	5,571,751	3,124,289
Interest on long-term borrowings and subordinated debentures	2,461,623	2,203,152	7,393,608	6,009,161
Total interest expense	11,999,568	7,026,667	32,287,230	18,085,072
Net interest income	9,230,562	7,810,088	26,692,134	22,568,788
Provision for loan losses	410,000	424,400	1,285,000	1,179,400
Net interest income after provision for loan losses	8,820,562	7,385,688	25,407,134	21,389,388
Other income				
Insurance commissions	218,771	222,024	695,734	605,189
Service fees	699,718	711,141	2,056,051	1,908,848
Mortgage origination revenue	4,027,645	7,303,889	16,556,948	20,272,788
Securities gains (losses)	-	38,828	-	44,179
Gain (loss) on sale of assets	(4,290)	(592)	(8,165)	(1,667)
Other	135,196	189,863	417,727	518,540
Total other income	5,077,040	8,465,153	19,718,295	23,347,877
Other expense				
Salaries and employee benefits	4,302,421	5,434,668	14,315,068	15,371,119
Net occupancy expense	564,666	479,174	1,705,782	1,371,132
Equipment expense	553,104	464,691	1,648,470	1,440,885
Supplies	228,839	167,965	688,620	507,100
Professional fees	374,184	230,496	1,148,537	699,179
Postage	1,678,196	1,450,635	5,219,246	4,475,850
Advertising	1,191,490	1,163,782	3,844,639	3,710,634
Amortization of intangibles	37,788	37,788	113,364	113,364
Other	1,439,370	1,448,525	4,775,177	4,118,633
Total other expense	10,370,058	10,877,724	33,458,903	31,807,896
Income before income taxes	3,527,544	4,973,117	11,666,526	12,929,369
Income tax expense	1,046,850	1,700,175	3,580,600	4,129,282
Net income	$ 2,480,694	$ 3,272,942	$ 8,085,926	$ 8,800,087

Basic earnings per common share	$	0.35	$	0.46	$	1.13	$	1.24
Diluted earnings per common share	$	0.35	$	0.45	$	1.12	$	1.22
Average common shares outstanding								
Basic		7,127,650		7,125,483		7,130,276		7,082,418
Diluted		7,187,274		7,211,331		7,194,351		7,207,937
Dividends per common share	$	-	$	-	$	0.16	$	0.14

See Notes to Consolidated Financial Statements

Summit Financial Group, Inc. and Subsidiaries

Consolidated Statements of Shareholders' Equity (unaudited)

	Preferred Stock and Related Surplus	Common Stock and Related Surplus	Retained Earnings	Treasury Stock	Accumulated Other Compre-hensive Income	Total Share-holders' Equity
Balance, December 31, 2005	$ -	$ 18,856,774	$ 56,214,807	$ -	$ (1,268,356)	$ 73,803,225
Nine Months Ended September 30, 2006						
Comprehensive income:						
Net income	-	-	8,085,926	-	-	8,085,926
Other comprehensive income,						
net of deferred tax benefit						
of $262,714:						
Net unrealized gain on						
securities of $428,638, net						
of reclassification adjustment						
for gains included in net						
income of $0	-	-	-	-	428,638	428,638
Total comprehensive income						8,514,564
Exercise of stock options	-	43,543	-	-	-	43,543
Excess tax benefit on stock-based compensation	-	26,470	-	-	-	26,470
Repurchase of common shares	-	(616,557)	-	-	-	(616,557)
Cash dividends declared						
($.16 per share)	-	-	(1,141,619)	-	-	(1,141,619)
Balance, September 30, 2006	$ -	$ 18,310,230	$ 63,159,114	$ -	$ (839,718)	$ 80,629,626
Balance, December 31, 2004	$ 1,158,471	$ 18,123,492	$ 47,108,898	$ (627,659)	$ (55,181)	$ 65,708,021
Nine Months Ended September 30, 2005						

Comprehensive income:						
Net income	-	-	8,800,087	-	-	8,800,087
Other comprehensive income,						
net of deferred tax benefit						
of ($738,763):						
Net unrealized (loss) on						
securities of ($1,232,741), net						
of reclassification adjustment						
for gains included in net						
income of $27,391	-	-	-	-	(1,205,350)	(1,205,350)
Total comprehensive income						7,594,737
Exercise of stock options	-	122,382	-	-	-	122,382
Conversion of preferred shares	(1,158,471)	1,158,471	-	-	-	-
Retirement of treasury shares	-	(627,659)	-	627,659	-	-
Cash dividends declared						
($.14 per share)	-	-	(996,333)	-	-	(996,333)
Balance, September 30, 2005	$ -	$ 18,776,686	$ 54,912,652	$ -	$ (1,260,531)	$ 72,428,807

See Notes to Consolidated Financial Statements

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Summit Financial Group, Inc. and Subsidiaries

Consolidated Statements of Cash Flows (unaudited)

	Nine Months Ended September 30, 2006	Nine Months Ended September 30, 2005
Cash Flows from Operating Activities		
Net income	$ 8,085,926	$ 8,800,087
Adjustments to reconcile net earnings to net cash provided by operating activities:		
Depreciation	1,313,456	1,260,195
Provision for loan losses	1,285,000	1,179,400
Stock compensation expense	26,470	-
Deferred income tax (benefit)	(339,450)	(229,618)
Loans originated for sale	(189,951,707)	(236,456,985)
Proceeds from loans sold	206,595,684	246,429,843
(Gain) on sales of loans held for sale	(6,568,901)	(8,393,992)
Securities (gains)	-	(44,179)
Loss on disposal of premises, equipment and other assets	8,165	1,667
Amortization of securities premiums, net	97,582	526,624
Amortization of goodwill and purchase accounting adjustments, net	122,013	122,013
(Decrease) in accrued interest receivable	(1,243,338)	(740,097)
(Increase) in other assets	(186,793)	(747,291)
Increase in other liabilities	1,194,607	1,725,328
Net cash provided by operating activities	20,438,714	13,432,995
Cash Flows from Investing Activities		
Net (increase) decrease in interest bearing deposits with other banks	1,417,493	141,953
Proceeds from maturities and calls of securities available for sale	8,572,439	7,077,028
Proceeds from sales of securities available for sale	14,921,400	11,307,578
Principal payments received on securities available for sale	18,488,157	24,827,642
Purchases of securities available for sale	(63,964,260)	(49,995,187)
Net (increase) decrease in Federal funds sold	3,251,000	(3,525,000)
Net loans made to customers	(102,833,730)	(128,177,978)
Purchases of premises and equipment	(1,763,132)	(1,647,978)
Proceeds from sales of premises, equipment and other assets	197,546	99,500
Purchase of life insurance contracts	(880,000)	(2,500,000)
Net cash (used in) investing activities	(122,593,087)	(142,392,442)
Cash Flows from Financing Activities		
Net increase in demand deposit, NOW and savings accounts	25,773,434	56,922,876

Net increase in time deposits		165,383,132		47,426,912
Net increase (decrease) in short-term borrowings		(91,606,113)		19,051,438
Proceeds from long-term borrowings		18,551,000		32,764,000
Repayment of long-term borrowings		(25,163,862)		(24,917,367)
Exercise of stock options		43,543		122,382
Dividends paid		(1,141,619)		(996,333)
Repurchase of Common Stock		(616,557)		-
Net cash provided by financing activities		91,222,958		130,373,908
Increase (decrease) in cash and due from banks		(10,931,415)		1,414,461
Cash and due from banks:				
Beginning		22,535,761		19,416,219
Ending	$	11,604,346	$	20,830,680

(Continued)

See Notes to Consolidated Financial Statements

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

	Nine Months Ended September 30, 2006	September 30, 2005
Supplemental Disclosures of Cash Flow Information		
Cash payments for:		
Interest	$ 31,809,107	$ 17,099,549
Income taxes	$ 3,856,000	$ 3,735,000
Supplemental Schedule of Noncash Investing and Financing Activities		
Other assets acquired in settlement of loans	$ 49,676	$ 295,244

See Notes to Consolidated Financial Statements

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

Note 1. Basis of Presentation

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

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

The results of operations for the nine months ended September 30, 2006 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 2005 audited financial statements and Annual Report on Form 10-K. Certain accounts in the consolidated financial statements for December 31, 2005 and September 30, 2005, as previously presented, have been reclassified to conform to current year classifications.

Note 2. Earnings per Share

The computations of basic and diluted earnings per share follow:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2006	**2005**	**2006**	**2005**
Numerator:				
Net Income	$ 2,480,694	$ 3,272,942	$ 8,085,926	$ 8,800,087
Denominator:				
Denominator for basic earnings				
per share - weighted average				
common shares outstanding	7,127,650	7,125,483	7,130,276	7,082,418
Effect of dilutive securities:				
Convertible preferred stock	-	-	-	37,707
Stock options	59,624	85,848	64,075	87,812
	59,624	85,848	64,075	125,519
Denominator for diluted earnings				

per share - weighted average								
common shares outstanding and								
assumed conversions		7,187,274		7,211,331		7,194,351		7,207,937
Basic earnings per share	$	0.35	$	0.46	$	1.13	$	1.24
Diluted earnings per share	$	0.35	$	0.45	$	1.12	$	1.22

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

Note 3. Securities

The amortized cost, unrealized gains, unrealized losses and estimated fair values of securities at September 30, 2006, December 31, 2005, and September 30, 2005 are summarized as follows:

		September 30, 2006		
	Amortized	Unrealized		Estimated
	Cost	Gains	Losses	Fair Value
Available for Sale				
Taxable:				
U. S. Government agencies and corporations	$ 38,303,725	$ 3,474	$ 417,259	$ 37,889,940
Mortgage-backed securities	141,371,935	292,390	2,807,581	138,856,744
State and political subdivisions	3,758,861	11,478	12,253	3,758,086
Corporate debt securities	2,184,799	18,958	2,527	2,201,230
Federal Reserve Bank stock	669,000	-	-	669,000
Federal Home Loan Bank stock	12,562,500	-	-	12,562,500
Other equity securities	150,410	-	-	150,410
Total taxable	199,001,230	326,300	3,239,620	196,087,910
Tax-exempt:				
State and political subdivisions	42,691,242	1,229,296	63,163	43,857,375
Other equity securities	5,975,692	427,384	16,759	6,386,317
Total tax-exempt	48,666,934	1,656,680	79,922	50,243,692
Total	$ 247,668,164	$ 1,982,980	$ 3,319,542	$ 246,331,602

		December 31, 2005		
	Amortized	Unrealized		Estimated
	Cost	Gains	Losses	Fair Value
Available for Sale				
Taxable:				
U. S. Government agencies and corporations	$ 40,227,124	$ 33,754	$ 426,554	$ 39,834,324
Mortgage-backed securities	117,530,036	150,766	2,884,861	114,795,941
State and political subdivisions	3,741,271	219	-	3,741,490
Corporate debt securities	3,294,123	37,063	2,206	3,328,980
	571,500	-	-	571,500

Federal Reserve Bank stock				
Federal Home Loan Bank stock	15,761,400	-	-	15,761,400
Other equity securities	150,410	-	-	150,410
Total taxable	181,275,864	221,802	3,313,621	178,184,045
Tax-exempt:				
State and political subdivisions	38,529,013	1,191,186	74,709	39,645,490
Other equity securities	5,978,611	-	35,848	5,942,763
Total tax-exempt	44,507,624	1,191,186	110,557	45,588,253
Total	$ 225,783,488	$ 1,412,988	$ 3,424,178	$ 223,772,298

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

	September 30, 2005			
	Amortized Cost	Unrealized Gains	Unrealized Losses	Estimated Fair Value
Available for Sale				
Taxable:				
U. S. Government agencies and corporations	$ 33,407,618	$ 59,573	$ 176,736	$ 33,290,455
Mortgage-backed securities	112,014,499	174,111	1,722,431	110,466,179
State and political subdivisions	3,742,307	1,378	-	3,743,685
Corporate debt securities	4,046,404	61,573	-	4,107,977
Federal Reserve Bank stock	481,500	-	-	481,500
Federal Home Loan Bank stock	16,054,700	-	-	16,054,700
Other equity securities	175,535	-	-	175,535
Total taxable	169,922,563	296,635	1,899,167	168,320,031
Tax-exempt:				
State and political subdivisions	40,359,216	1,336,740	53,751	41,642,205
Other equity securities	7,479,584	-	1,684,625	5,794,959
Total tax-exempt	47,838,800	1,336,740	1,738,376	47,437,164
Total	$ 217,761,363	$ 1,633,375	$ 3,637,543	$ 215,757,195

The maturities, amortized cost and estimated fair values of securities at September 30, 2006 are summarized as follows:

	Available for Sale	
	Amortized Cost	Estimated Fair Value
Due in one year or less	$ 51,722,749	$ 50,885,728
Due from one to five years	110,746,000	108,889,896
Due from five to ten years	30,718,532	30,776,980
Due after ten years	35,123,281	36,010,771
Equity securities	19,357,602	19,768,227
	$ 247,668,164	$ 246,331,602

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

Note 4. Loans

Loans are summarized as follows:

	September 30, 2006	December 31, 2005
Commercial	**$ 67,352,085**	$ 63,205,991
Commercial real estate	**300,675,588**	266,228,999
Construction and development	**207,544,988**	141,206,211
Residential real estate	**284,635,823**	285,596,743
Consumer	**36,884,746**	36,863,170
Other	**7,085,912**	8,597,768
Total loans	**904,179,142**	801,698,882
Less unearned income	**1,805,904**	1,780,315
Total loans net of unearned income	**902,373,238**	799,918,567
Less allowance for loan losses	**7,107,347**	6,151,730
Loans, net	**$ 895,265,891**	$ 793,766,837

Due to the reclassification of real estate loans to include the construction and development category, real estate loan balances prior to December 31, 2005 conforming to the new classifications are not available.

Note 5. Allowance for Loan Losses

An analysis of the allowance for loan losses for the nine month periods ended September 30, 2006 and 2005, and for the year ended December 31, 2005 is as follows:

	Nine Months Ended September 30,		**Year Ended December 31,**
	2006	**2005**	**2005**
Balance, beginning of period	$ 6,151,730	$ 5,073,286	$ 5,073,286
Losses:			
Commercial	31,744	19,759	35,809
Commercial real estate	38,542	-	-
Real estate - mortgage	147,471	194,583	204,926
Consumer	114,276	142,557	173,020
Other	243,097	230,172	364,311
Total	575,130	587,071	778,066
Recoveries:			
Commercial	1,025	6,495	6,495

Commercial real estate		42,618		24,255		41,228
Real estate - mortgage		6,518		42		42
Consumer		43,628		41,887		55,700
Other		151,958		183,036		273,645
Total		245,747		255,715		377,110
Net losses		329,383		331,356		400,956
Provision for loan losses		1,285,000		1,179,400		1,479,400
Balance, end of period	$	7,107,347	$	5,921,330	$	6,151,730

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

Note 6. Goodwill and Other Intangible Assets

The following tables present our goodwill at September 30, 2006 and other intangible assets at September 30, 2006, December 31, 2005, and September 30, 2005.

	Goodwill Activity by Operating Segment			
	Community Banking	Mortgage Banking	Parent and Other	Total
Balance, January 1, 2006	$ 1,488,030	$ -	$ 600,000	$ 2,088,030
Acquired goodwill, net	-	-	-	-
Balance, September 30, 2006	$ 1,488,030	$ -	$ 600,000	$ 2,088,030

	Unidentifiable Intangible Assets		
	September 30, 2006	December 31, 2005	September 30, 2005
Unidentifiable intangible assets			
Gross carrying amount	$ 2,267,323	$ 2,267,323	$ 2,267,323
Less: accumulated amortization	1,121,045	1,007,681	969,893
Net carrying amount	$ 1,146,278	$ 1,259,642	$ 1,297,430

We recorded amortization expense of approximately $113,000 for the nine months ended September 30, 2006 relative to our unidentifiable intangible assets. Annual amortization is expected to be approximately $151,000 for each of the years ending 2006 through 2010.

Note 7. Deposits

The following is a summary of interest bearing deposits by type as of September 30, 2006 and 2005 and December 31, 2005:

	September 30, 2006	December 31, 2005	September 30, 2005
Interest bearing demand deposits	$ 223,992,153	$ 200,637,520	$ 169,893,431
Savings deposits	44,980,089	44,680,540	45,867,540
Retail time deposits	264,570,379	237,262,760	236,439,907

Brokered time deposits		266,769,070		128,688,488		107,371,704
Total	$	800,311,691	$	611,269,308	$	559,572,582

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

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 September 30, 2006:

	Amount	Percent
Three months or less	$ 34,100,049	11.2%
Three through six months	62,053,077	20.4%
Six through twelve months	104,912,592	34.4%
Over twelve months	103,493,514	34.0%
Total	$ 304,559,232	100.0%

A summary of the scheduled maturities for all time deposits as of September 30, 2006 is as follows:

Three month period ending December 31, 2006	$ 111,893,741
Year Ending December 31, 2007	297,821,360
Year Ending December 31, 2008	67,383,091
Year Ending December 31, 2009	28,493,709
Year Ending December 31, 2010	22,817,367
Thereafter	2,930,181
	$ 531,339,449

Note 8. Borrowed Funds

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

	Nine Months Ended September 30, 2006		
	Short-term FHLB Advances	Repurchase Agreements	Federal Funds Purchased and Lines of Credit
Balance at September 30	$ 84,399,000	$ 5,215,600	$ 807,400
Average balance outstanding for the period	141,997,959	5,971,420	908,290
Maximum balance outstanding at any month end during period	175,407,800	7,036,562	1,164,122

Weighted average interest rate for the period	5.01%	4.00%	7.60%
Weighted average interest rate for balances outstanding at September 30	5.30%	4.15%	7.75%

Summit Financial Group, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (unaudited)

	Year Ended December 31, 2005		
	Short-term FHLB Advances	Repurchase Agreements	Federal Funds Purchased and Lines of Credit
Balance at December 31	$ 175,510,100	$ 6,518,013	$ -
Average balance outstanding for the period	130,023,493	8,060,676	888,214
Maximum balance outstanding at any month end during period	175,510,100	10,881,188	3,395,500
Weighted average interest rate for the period	3.54%	2.27%	4.77%
Weighted average interest rate for balances outstanding at December 31	4.27%	3.65%	-

	Nine Months Ended September 30, 2005		
	Short-term FHLB Advances	Repurchase Agreements	Federal Funds Purchased and Lines of Credit
Balance at September 30	$ 134,540,600	$ 5,140,052	$ -
Average balance outstanding for the period	121,567,880	9,002,881	896,127
Maximum balance outstanding at any month end during period	134,540,600	10,881,188	3,395,500
Weighted average interest rate for the period	3.23%	2.22%	4.49%
Weighted average interest rate for balances outstanding at September 30	3.97%	2.94%	-

Long-term borrowings: Our long-term borrowings of $144,274,780, $150,911,835 and $168,041,711 at September 30, 2006, December 31, 2005, and September 30, 2005 respectively, consisted primarily of advances from the Federal Home Loan Bank ("FHLB").

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

The average interest rate paid on long-term borrowings for the nine month period ended September 30, 2006 was 5.34% compared to 4.56% for the first nine months of 2005.

Subordinated Debentures: We have three statutory business trusts that were formed for the purpose of issuing mandatorily redeemable securities (the "capital securities") for which we are obligated to third party investors and investing the proceeds from the sale of the capital securities in our junior subordinated debentures (the "debentures"). The debentures held by the trusts are their sole assets. Our subordinated debentures totaled $19,589,000 at September 30, 2006 and December 31, 2005, and $11,341,000 at September 30, 2005.

In October 2002, we sponsored SFG Capital Trust I, in March 2004, we sponsored SFG Capital Trust II, and in December 2005, we sponsored SFG Capital Trust III, of which 100% of the common equity of each trust is owned by us. SFG Capital Trust I issued $3,500,000 in capital securities and $109,000 in common securities and invested the proceeds in $3,609,000 of debentures. SFG Capital Trust II issued $7,500,000 in capital securities and $232,000 in common securities and invested the proceeds in $7,732,000 of debentures. SFG Capital Trust III issued $8,000,000 in capital securities and $248,000 in common securities and invested the proceeds in $8,248,000 of debentures. Distributions on the capital securities issued by the trusts are payable quarterly at a variable interest rate equal to 3 month LIBOR plus 345 basis points for SFG Capital Trust I, 3 month LIBOR plus 280 basis points for SFG Capital Trust II, and 3 month LIBOR plus 145 basis points for SFG Capital Trust III, and equals the interest rate earned on the debentures held by the trusts, and is recorded as interest expense by us. The capital securities are subject to mandatory redemption in whole or in part, upon repayment of the debentures. We have entered into agreements which, taken collectively, fully and unconditionally guarantee the capital securities subject to the terms of the guarantee. The debentures of SFG Capital Trust I, SFG Capital Trust II, and SFG Capital Trust III are first redeemable by us in November 2007, March 2009, and March 2011, respectively.

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

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

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

Year Ending December 31,		**Amount**
2006	$	14,816,481
2007		23,318,204
2008		24,585,851
2009		3,911,094
2010		52,674,748
Thereafter		44,557,402
	$	163,863,780

Note 9. Stock Option Plan

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

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

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

The fair value of our employee stock options granted is estimated at the date of grant using the Black-Scholes option-pricing model. This model requires the input of highly subjective assumptions, changes to which can materially affect the fair value estimate. Additionally, there may be other factors that would otherwise have a significant effect on the value of employee stock options granted but are not considered by the model. Because our employee stock options have characteristics significantly different from those of traded options and because changes in the subjective input assumptions can materially affect the fair value estimate, in management's opinion, the existing models do not necessarily provide a reliable single measure of the fair value of its employee stock options at the time of grant. The assumptions used in the Black-Scholes option-pricing model are as follows:

	For the Nine Months Ended September 30,	
	2006	**2005**
Risk-free interest rate	4.40%	3.60%
Expected dividend yield	1.25%	1.04%
Volatility factor	25	20
Expected life of option	8	8

There were no option grants during the first nine months of 2006 or 2005. Therefore, the factors for September 30, 2006 and September 30, 2005 are consistent with amounts reported in our 2005 Annual Report and 2004 Annual Report, respectively.

During the first nine months of 2006, we recognized $26,470 of compensation expense for share-based payment arrangements in our income statement, with a deferred tax asset of $10,000. At September 30, 2006, we had approximately $62,000 total compensation cost related to nonvested awards not yet recognized and we expect to recognize it over the next three years.

The following pro forma disclosures present for the quarter and nine months ended September 30, 2005, our reported net income and basic and diluted earnings per share had we recognized compensation expense for our Officer Stock Option Plan based on the grant date fair values of the options (the fair value method described in Statement of Financial Accounting Standards No. 123). For purposes of computing the pro forma amounts, we estimated the fair value of the options at the date of grant using a Black-Scholes option pricing model. For purposes of the pro forma disclosures, the estimated fair value of the options is amortized to expense over the options' vesting period.

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

(in thousands, except per share data)		Quarter Ended		Nine Months Ended
		September 30, 2005		
Net income:				
As reported	$	3,273	$	8,800
Deduct total stock-based employee compensation expense determined under fair value based method for all awards, net of related tax effects		(37)		(111)
Pro forma	$	3,236	$	8,689
Basic earnings per share:				
As reported	$	0.46	$	1.24
Pro forma	$	0.45	$	1.22
Diluted earnings per share:				
As reported	$	0.45	$	1.22
Pro forma	$	0.44	$	1.20

A summary of activity in our Officer Stock Option Plan during the first nine months of 2006 and 2005 is as follows:

	For the Nine Months Ended					
	September 30, 2006			September 30, 2005		
	Options		Weighted-Average Exercise Price	Options		Weighted-Average Exercise Price
Outstanding, January 1	361,740	$	17.41	284,100	$	15.09
Granted	-		-	-		-
Exercised	(8,900)		4.89	(9,460)		12.94
Forfeited	-		-	-		-
Outstanding, September 30	352,840	$	17.73	274,640	$	15.17

Other information regarding options outstanding and exercisable at September 30, 2006 is as follows:

	Options Outstanding			Options Exercisable	
Range of	# of	Wted. Avg. Remaining Contractual	Aggregate Intrinsic Value	# of	Aggregate Intrinsic Value

exercise price	shares	WAEP	Life (yrs)	(in thousands)	shares	WAEP	(in thousands)
\$4.63 - \$6.00	85,400	\$ 5.35	6.17	1,111	78,600	\$ 5.30	1,027
6.01 - 10.00	33,640	9.49	9.29	298	19,240	9.49	171
10.01 - 17.50	3,500	17.43	7.42	3	3,500	17.43	3
17.51 - 20.00	51,800	17.79	10.21	30	20,600	17.79	12
20.01 - 25.93	178,500	25.19	8.82	-	178,500	25.19	-
	352,840	17.73		1,442	300,440	18.38	1,213

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

Note 10. Commitments and Contingencies

Off-Balance Sheet Arrangements

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

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

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

	September 30, 2006
Commitments to extend credit:	
Revolving home equity and credit card lines	$ 33,587,424
Construction loans	97,271,727
Other loans	41,711,519
Standby letters of credit	14,721,512
Total	$ 187,292,182

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 11. 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.

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

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, 2006, that we and each of our subsidiaries met all capital adequacy requirements to which they were subject.

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

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

(Dollars in thousands)	**Actual**		**Minimum Required Regulatory Capital**		**To be Well Capitalized under Prompt Corrective Action Provisions**	
	Amount	**Ratio**	**Amount**	**Ratio**	**Amount**	**Ratio**
As of September 30, 2006						
Total Capital (to risk weighted assets)						
Summit	$ 104,527	11.1%	$ 75,240	8.0%	$ 94,050	10.0%
Summit Community	59,938	10.7%	44,780	8.0%	55,975	10.0%
Shenandoah	40,219	10.8%	29,818	8.0%	37,272	10.0%
Tier I Capital (to risk weighted assets)						
Summit	97,234	10.3%	37,620	4.0%	56,430	6.0%
Summit Community	55,538	9.9%	22,390	4.0%	33,585	6.0%
Shenandoah	37,326	10.0%	14,909	4.0%	22,363	6.0%
Tier I Capital (to average assets)						
Summit	97,234	8.2%	35,727	3.0%	59,546	5.0%
Summit Community	55,538	7.6%	21,865	3.0%	36,441	5.0%
Shenandoah	37,326	8.3%	13,545	3.0%	22,575	5.0%
As of December 31, 2005						
Total Capital (to risk weighted assets)						
Summit	$ 96,837	11.4%	68,010	8.0%	85,013	10.0%
Summit Community	54,550	10.4%	41,792	8.0%	52,240	10.0%
Shenandoah	35,834	11.2%	25,589	8.0%	31,986	10.0%
Tier I Capital (to risk weighted assets)						

Summit	90,686	10.7%	34,005	4.0%	38,897	6.0%
Summit Community	50,490	9.7%	20,896	4.0%	25,363	6.0%
Shenandoah	33,743	10.5%	12,794	4.0%	13,080	6.0%
Tier I Capital (to average assets)						
Summit	90,686	8.6%	31,764	3.0%	52,940	5.0%
Summit Community	50,490	7.5%	20,251	3.0%	33,752	5.0%
Shenandoah	33,743	9.0%	11,199	3.0%	18,664	5.0%

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

Note 12. Segment Information

We operate two business segments: community banking and mortgage banking. These segments are primarily identified by the products or services offered and the channels through which they are offered. The community banking segment consists of our full service banks which offer customers traditional banking products and services through various delivery channels. The mortgage banking segment consists of our mortgage origination facilities that originate and sell mortgage products. Information for each of our segments is included below:

	For the Quarter Ended September 30, 2006					
Dollars in thousands	Community Banking	Mortgage Banking	Insurance Services	Parent and Other	Eliminations	Total
Condensed Statements of Income						
Interest income	$ 21,096	$ 300	$ -	$ 12	$ (178)	$ 21,230
Interest expense	11,569	144	-	464	(178)	11,999
Net interest income	9,527	156	-	(452)	-	9,231
Provision for loan losses	260	150	-	-	-	410
Net interest income after provision for loan losses	9,267	6	-	(452)	-	8,821
Noninterest income	904	4,027	146	1,462	(1,462)	5,077
Noninterest expense	4,955	5,168	143	1,566	(1,462)	10,370
Income before income taxes	5,216	(1,135)	3	(556)	-	3,528
Income taxes	1,669	(400)	3	(225)	-	1,047
Net income	$ 3,547	$ (735)	$ -	$ (331)	$ -	$ 2,481
Intersegment revenue (expense)	$ (1,235)	$ (219)	$ (8)	$ 1,462	$ -	$ -
Average assets	$ 1,182,638	$ 12,335	$ 1,035	$ 102,458	$ (104,318)	$ 1,194,148

	For the Quarter Ended September 30, 2005					
Dollars in thousands	Community Banking	Mortgage Banking	Insurance Services	Parent and Other	Eliminations	Total
Condensed Statements of Income						
Interest income	$ 14,619	$ 516	$ -	$ 7	$ (305)	$ 14,837
Interest expense	6,805	304	-	223	(305)	7,027
Net interest income	7,814	212	-	(216)	-	7,810
Provision for loan losses	360	64	-	-	-	424

Net interest income after provision for loan losses	7,454	148	-	(216)	-	7,386
Noninterest income	1,012	7,304	149	1,213	(1,213)	8,465
Noninterest expense	4,437	5,969	149	1,536	(1,213)	10,878
Income before income taxes	4,029	1,483	-	(539)	-	4,973
Income taxes	1,277	578	-	(155)	-	1,700
Net income	$ 2,752	$ 905	$ -	$ (384)	$ -	$ 3,273
Intersegment revenue (expense)	$ (841)	$ (364)	$ (8)	$ 1,213	$ -	$ -
Average assets	$ 974,653	$ 24,144	$ 926	$ 84,086	$ (98,603)	$ 985,206

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

	For the Nine Months Ended September 30, 2006					
Dollars in thousands	**Community Banking**	**Mortgage Banking**	**Insurance Services**	**Parent and Other**	**Eliminations**	**Total**
Condensed Statements of Income						
Interest income	$ 58,394	$ 1,274	$ -	$ 35	$ (724)	$ 58,979
Interest expense	31,079	689	-	1,243	(724)	32,287
Net interest income	27,315	585	-	(1,208)	-	26,692
Provision for loan losses	915	370	-	-	-	1,285
Net interest income after provision for loan losses	26,400	215	-	(1,208)	-	25,407
Noninterest income	2,637	16,557	524	4,425	(4,425)	19,718
Noninterest expense	15,101	17,374	496	4,913	(4,425)	33,459
Income before income taxes	13,936	(602)	28	(1,696)	-	11,666
Income taxes	4,445	(192)	11	(684)	-	3,580
Net income	$ 9,491	$ (410)	$ 17	$ (1,012)	$ -	$ 8,086
Intersegment revenue (expense)	$ (3,486)	$ (914)	$ (25)	$ 4,425	$ -	$ -
Average assets	$ 1,149,873	$ 17,606	$ 1,025	$ 99,505	$ (107,825)	$ 1,160,184

	For the Nine Months Ended September 30, 2005					
Dollars in thousands	**Community Banking**	**Mortgage Banking**	**Insurance Services**	**Parent and Other**	**Eliminations**	**Total**
Condensed Statements of Income						
Interest income	$ 40,151	$ 1,303	$ -	$ 19	$ (820)	$ 40,653
Interest expense	17,501	816	-	588	(820)	18,085
Net interest income	22,650	487	-	(569)	-	22,568
Provision for loan losses	1,035	144	-	-	-	1,179
Net interest income after provision for loan losses	21,615	343	-	(569)	-	21,389
Noninterest income	2,606	20,273	469	3,572	(3,572)	23,348
Noninterest expense	13,007	17,622	418	4,333	(3,572)	31,808
Income before income taxes	11,214	2,994	51	(1,330)	-	12,929
Income taxes	3,527	1,108	21	(527)	-	4,129
Net income	$ 7,687	$ 1,886	$ 30	$ (803)	$ -	$ 8,800

Intersegment revenue (expense)	$	(2,568)	$	(981)	$	(23)	$	3,572	$	-	$	-
Average assets	$	926,954	$	22,471	$	973	$	81,184	$	(94,014)	$	937,568

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

INTRODUCTION

The following discussion and analysis focuses on significant changes in our financial condition and results of operations of Summit Financial Group, Inc. ("Company" or "Summit") and our wholly owned subsidiaries, Summit Community Bank ("Summit Community"), Shenandoah Valley National Bank ("Shenandoah"), Summit Mortgage, and Summit Insurance Services, LLC for the periods indicated. This discussion and analysis should be read in conjunction with our 2005 audited financial statements and Annual Report on Form 10-K.

This quarterly report contains comments or information that constitute forward-looking statements (within the meaning of the Private Securities Litigation Act of 1995) that are based on current expectations that involve a number of risks and uncertainties. Words such as "expects", "anticipates", "believes", "estimates" and other similar expressions or future or conditional verbs such as "will", "should", "would" and "could" are intended to identify such forward-looking statements.

Although we believe the expectations reflected in such forward-looking statements are reasonable, actual results may differ materially. Factors that might cause such a difference include changes in interest rates and interest rate relationships; demand for products and services; the degree of competition by traditional and non-traditional competitors; changes in banking laws and regulations; changes in tax laws; the impact of technological advances; the outcomes of contingencies; trends in customer behavior as well as their ability to repay loans; and changes in the national and local economy.

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.

Strong growth in our interest earning assets resulted in an increase of 17.47%, or $4,112,000, in our net interest earnings on a tax equivalent basis for the first nine months in 2006 compared to the same period of 2005. While our community banking segment's net income increased 23.47% for the first nine months of 2006 compared to the same period of 2005, our mortgage banking segment incurred a loss of $410,000 for the first nine months of 2006, compared to net income of $1,886,000 for the first nine months of 2005, as we have experienced a sharp decline in mortgage loan originations during 2006.

CRITICAL ACCOUNTING POLICIES

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

Our most significant accounting policies are presented in Note 1 to the consolidated financial statements of our 2005 Annual Report on Form 10-K. These policies, along with the disclosures presented in the other financial statement notes and in this financial review, provide information on how significant assets and liabilities are valued in the financial statements and how those values are determined.

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

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

The allowance for loan losses represents our estimate of probable credit losses inherent in the loan portfolio. Determining the amount of the allowance for loan losses is considered a critical accounting estimate because it requires significant judgment and the use of estimates related to the amount and timing of expected future cash flows on impaired loans, estimated losses on pools of homogeneous loans based on historical loss experience, and consideration of current economic trends and conditions, all of which may be susceptible to significant change. The loan portfolio also represents the largest asset type on our consolidated balance sheet. To the extent actual outcomes differ from our estimates, additional provisions for loan losses may be required that would negatively impact earnings in future periods. Note 1 to the consolidated financial statements of our 2005 Annual Report on Form 10-K describes the methodology used to determine the allowance for loan losses and a discussion of the factors driving changes in the amount of the allowance for loan losses is included in the Asset Quality section of the financial review of the 2005 Annual Report on Form 10-K.

Goodwill is subject to impairment testing at least annually to determine whether write-downs of the recorded balances are necessary. A fair value is determined based on at least one of three various market valuation methodologies. If the fair value equals or exceeds the book value, no write-down of recorded goodwill is necessary. If the fair value is less than the book value, an expense may be required on our books to write down the goodwill to the proper carrying value. During the third quarter, we completed the required annual impairment test for 2006 and determined that no impairment write-offs were necessary. We cannot assure you that future goodwill impairment tests will not result in a charge to earnings. See Notes 1 and 8 of the consolidated financial statements of our Annual Report on Form 10-K for further discussion of our intangible assets, which include goodwill.

BUSINESS SEGMENT RESULTS

We are organized and managed along two major business segments, as described in Note 12 of the accompanying consolidated financial statements. The results of each business segment are intended to reflect each segment as if it were a stand alone business. Net income by segment follows:

	For the Quarter Ended September 30,		**For the Nine Months Ended September 30,**	
in thousands	**2006**	**2005**	**2006**	**2005**
Community Banking	$ 3,547	$ 2,752	$ 9,491	$ 7,687
Mortgage Banking	(735)	905	(410)	1,886
Parent and Other	(331)	(384)	(995)	(773)
Consolidated net income	$ 2,481	$ 3,273	$ 8,086	$ 8,800

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RESULTS OF OPERATIONS

Earnings Summary

Net income for the nine months ended September 30, 2006 declined 8.11% to $8,086,000, or $1.12 per diluted share as compared to $8,800,000, or $1.22 per diluted share for the nine months ended September 30, 2005. For the quarter ended September 30, 2006, net income declined 24.21% to $2,481,000 from the $3,273,000 net income for the third quarter 2005. Returns on average equity and assets for the first nine months of 2006 were 13.86% and 0.93%, respectively, compared with 16.85% and 1.25% for the same period of 2005.

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 $27,643,000 for the nine month period ended September 30, 2006 compared to $23,531,000 for the same period of 2005, representing an increase of $4,112,000 or 17.47%. This increase resulted from growth in interest earning assets, primarily loans, which served to more than offset the 126 basis points increase in the cost of interest bearing liabilities during the same period. Average interest earning assets grew 24.57% from $885,773,000 during the first nine months of 2005 to $1,103,395,000 for the first nine months of 2006. Average interest bearing liabilities grew 25.81% from $800,960,000 at September 30, 2005 to $1,007,694,000 at September 30, 2006 at an average cost for the first nine months of 2006 of 4.28% compared to 3.02% for the same period of 2005.

Our net yield on interest earning assets decreased to 3.35% for the nine month period ended September 30, 2006, compared to 3.55% for the same period in 2005. On a quarterly basis, our net interest margin increased slightly to 3.33% at September 30, 2006, from 3.32% for the quarter ended June 30, 2006. The positive impact to net interest income of our growth in interest earning assets was somewhat offset by increased cost of interest bearing liabilities, which tend to move more proportionately with rate increases by the Fed. The yields on earning assets increased 98 basis points, while the cost of our interest bearing funds increased by 126 basis points.

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

Summit Financial Group, Inc. and Subsidiaries

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

	For the Nine Months Ended					
	September 30, 2006			September 30, 2005		
	Average Balance	Earnings/ Expense	Yield/ Rate	Average Balance	Earnings/ Expense	Yield/ Rate
Interest earning assets						
Loans, net of unearned income						
Taxable	$ 857,851	$ 50,180	7.82%	$ 663,287	$ 33,421	6.74%
Tax-exempt (1)	8,373	476	7.60%	8,884	485	7.30%
Securities						
Taxable	189,768	6,837	4.82%	162,852	5,229	4.29%
Tax-exempt (1)	45,950	2,385	6.94%	47,984	2,402	6.69%
Federal funds sold and interest bearing deposits with other banks	1,453	52	4.78%	2,766	79	3.82%
Total interest earning assets	1,103,395	59,930	7.26%	885,773	41,616	6.28%
Noninterest earning assets						
Cash & due from banks	13,760			16,567		
Premises and equipment	23,552			20,730		
Other assets	26,160			20,008		
Allowance for loan losses	(6,683)			(5,510)		
Total assets	$ 1,160,184			$ 937,568		
Interest bearing liabilities						
Interest bearing demand deposits	$ 213,518	$ 5,410	3.39%	$ 141,168	$ 1,868	1.77%
Savings deposits	40,826	311	1.02%	48,699	235	0.65%
Time deposits	428,224	13,601	4.25%	308,334	6,849	2.97%
Short-term borrowings	148,876	5,572	5.00%	131,459	3,124	3.18%
Long-term borrowings and capital trust securities	176,250	7,393	5.61%	171,300	6,009	4.69%
Total interest bearing liabilities	1,007,694	32,287	4.28%	800,960	18,085	3.02%

Noninterest bearing liabilities and shareholders' equity						
Demand deposits	64,618			60,252		
Other liabilities	10,059			6,707		
Shareholders' equity	77,813			69,649		
Total liabilities and shareholders' equity	$ 1,160,184			$ 937,568		
Net interest earnings		$ 27,643			$ 23,531	
Net yield on interest earning assets			3.35%			3.55%

(1) - Interest income on tax-exempt securities has been adjusted assuming an effective tax rate of 34% for both periods presented. The tax equivalent adjustment resulted in an increase in interest income of $951,000 and $962,000 for the periods ended September 30, 2006 and 2005, respectively.

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Summit Financial Group, Inc. and Subsidiaries
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Table II - Changes in Interest Margin Attributable to Rate and Volume
(Dollars in thousands)

	For the Nine Months Ended September 30, 2006 versus September 30, 2005 Increase (Decrease) Due to Change in:		
	Volume	**Rate**	**Net**
Interest earned on:			
Loans			
Taxable	$ 10,822	$ 5,937	$ 16,759
Tax-exempt	(29)	20	(9)
Securities			
Taxable	925	683	1,608
Tax-exempt	(104)	87	(17)
Federal funds sold and interest bearing deposits with other banks	(44)	17	(27)
Total interest earned on interest earning assets	11,570	6,744	18,314
Interest paid on:			
Interest bearing demand deposits	1,271	2,271	3,542
Savings deposits	(43)	119	76
Time deposits	3,207	3,545	6,752
Short-term borrowings	459	1,989	2,448
Long-term borrowings and capital trust securities	178	1,206	1,384
Total interest paid on interest bearing liabilities	5,072	9,130	14,202
Net interest income	$ 6,498	$ (2,386)	$ 4,112

Noninterest Income

Total noninterest income decreased to $5,077,000 for the third quarter of 2006, compared to $8,465,000 for the same period of 2005 due to a sharp decline in mortgage origination revenue. Mortgage origination revenue declined to

$4,027,000 for the third quarter of 2006, compared to $7,304,000 for the same period of 2005. This revenue includes mortgage loan origination and sales activity conducted through Summit Mortgage. Further detail regarding noninterest income is reflected in the following table. Also, refer to Note 12 of the accompanying consolidated financial statements for our segment information.

Summit Financial Group, Inc. and Subsidiaries

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Noninterest Income

Dollars in thousands	For the Quarter Ended September 30, 2006	For the Quarter Ended September 30, 2005	For the Nine Months Ended September 30, 2006	For the Nine Months Ended September 30, 2005
Insurance commissions	$ 219	$ 222	$ 696	$ 605
Service fees	700	711	2,056	1,909
Mortgage origination revenue	4,027	7,304	16,557	20,273
Securities gains (losses)	-	39	-	44
Other	131	189	409	517
Total	$ 5,077	$ 8,465	$ 19,718	$ 23,348

Insurance commissions: These commissions increased 15.04% for nine months ended September 30, 2006 over the same period of 2005 primarily due to increased commercial lines commissions earned by Summit Insurance Services, LLC.

Service fees: Total service fees increased 7.70% for the nine months ended September 30, 2006 compared to the same period of 2005. This increase was primarily attributable to an increase in overdraft and nonsufficient funds (NSF) fees due to increased overdrafts by customers.

Mortgage origination revenue: The following table shows our mortgage origination segment's loan activity:

Dollars in thousands	For the Quarter Ended September 30, 2006	For the Quarter Ended September 30, 2005	For the Nine Months Ended September 30, 2006	For the Nine Months Ended September 30, 2005
Loans originated				
1st mortgage				
Amount	$ 14,045	$ 18,771	$ 38,809	$ 43,565
Number	78	104	210	240
2nd mortgage				
Amount	$ 35,500	$ 65,089	$ 150,833	$ 192,840
Number	803	1,463	3,279	4,213
Total				
Amount	$ 49,545	$ 83,860	$ 189,642	$ 236,405
Number	881	1,567	3,489	4,453
Loans sold				

Amount	$ 52,496	$ 87,071	$ 198,186	$ 235,254
Number	935	1,566	3,660	4,410

Summit Mortgage originates loans solely for the purpose of selling them. We do not service these loans, therefore there is no servicing intangible associated with this segment. Our mortgage banking revenue consists entirely of two components: 1) fees collected at the time of origination and 2) the gains we receive when selling the loans. The breakout of these fees and gains follows:

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Mortgage Origination Revenue

Dollars in thousands		For the Quarter Ended September 30, 2006		For the Quarter Ended September 30, 2005		For the Nine Months Ended September 30, 2006		For the Nine Months Ended September 30, 2005
Origination fees, net	$	2,560	$	4,279	$	9,988	$	11,879
Gains		1,467		3,025		6,569		8,394
Total	$	4,027	$	7,304	$	16,557	$	20,273

Loan originations in the third quarter of 2006 were $49.5 million, a decline of 40.9 percent from the prior-year third quarter. For the nine months ended September 30, 2006, loan originations were $189,642,000 as compared to $236,405,000 for the same period of 2005, a decrease of 19.8%. The decrease in activity is principally the result of reduced response rates to our direct mail marketing programs. We continue to revise these programs seeking to improve their efficiency. Also, we believe that several other factors have contributed to this business segment's slowdown, including changes in the legal environment within the industry, increased competition in the overall market for the types of mortgage products offered by Summit Mortgage, and the payment of legal expenses arising from legal compliance reviews and litigation defense. Management is currently conducting an intense review of this business segment, but does not anticipate profitability during 4^{th} quarter 2006. Further, we continue to evaluate this business segment strategically.

Other: Other income decreased 30.69% for the third quarter of 2006 and 20.89% for the nine months ended September 30, 2006 compared to the same respective periods of 2005. Our increase in debit card and ATM income due to increased card usage by customers was more than offset by decreases in both financial services revenue and derivative income.

Noninterest Expense

Total noninterest expense increased approximately $1,651,000, or 5.2% to $33,459,000 during the first nine months of 2006 as compared to the same period in 2005 and declined $508,000 or 4.7% for third quarter 2006 compared to third quarter 2005. The primary factors contributing to the nine month growth in noninterest expense were 1) an increase in postage expense due to the postal service rate increase and 2) an increase in professional fees, as a result of increased legal expenses arising from legal compliance reviews and litigation defense. The quarterly decrease is primarily attributable to decreased salaries and employee benefits due to lower commissions earned by Summit Mortgage employees and reduced performance based incentives paid to both Company management and

Summit Mortgage management. Table III below shows the breakdown of these changes by segment. Also, refer to Note 12 of the accompanying consolidated financial statements for our segment information.

Summit Financial Group, Inc. and Subsidiaries

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Table III - Noninterest Expense

Dollars in thousands

	For the Quarter Ended September 30,				For the Nine Months Ended September 30,			
		Change				Change		
Community Banking and Other	**2006**	$	%	**2005**	**2006**	$	%	**2005**
Salaries and employee benefits	$ 2,817	$ 20	0.7%	$ 2,797	$ 8,921	$ 881	11.0%	$ 8,040
Net occupancy expense	388	28	7.8%	360	1,179	166	16.4%	1,013
Equipment expense	475	54	12.8%	421	1,421	116	8.9%	1,305
Supplies	214	74	52.9%	140	603	174	40.6%	429
Professional fees	188	(13)	-6.5%	201	641	100	18.5%	541
Postage	91	23	33.8%	68	207	34	19.7%	173
Advertising	64	(45)	-41.3%	109	263	(51)	-16.2%	314
Amortization of intangibles	38	-	0.0%	38	113	-	0.0%	113
Other	927	152	19.6%	775	2,737	479	21.2%	2,258
Total	$ 5,202	$ 293	6.0%	$ 4,909	$ 16,085	$ 1,899	13.4%	$ 14,186

		Change				Change		
Mortgage Banking	**2006**	$	%	**2005**	**2006**	$	%	**2005**
Salaries and employee benefits	$ 1,485	$ (1,153)	-43.7%	$ 2,638	$ 5,394	$ (1,937)	-26.4%	$ 7,331
Net occupancy expense	177	58	48.7%	119	527	169	47.2%	358
Equipment expense	78	34	77.3%	44	227	91	66.9%	136
Supplies	15	(13)	-46.4%	28	86	8	10.3%	78
Professional fees	186	157	541.4%	29	508	350	221.5%	158
Postage	1,587	204	14.8%	1,383	5,012	709	16.5%	4,303
Advertising	1,128	73	6.9%	1,055	3,582	185	5.4%	3,397
Other	512	(161)	-23.9%	673	2,038	177	9.5%	1,861
Total	$ 5,168	$ (801)	-13.4%	$ 5,969	$ 17,374	$ (248)	-1.4%	$ 17,622

		Change				Change		

Consolidated	**2006**		**$%**	**2005**	**2006**		**$%**	**2005**
Salaries and employee benefits	**$ 4,302**	**$ (1,133)**	**-20.8%**	**$ 5,435**	**$ 14,315**	**$ (1,056)**	**-6.9%**	**$ 15,371**
Net occupancy expense	**565**	**86**	**18.0%**	**479**	**1,706**	**335**	**24.4%**	**1,371**
Equipment expense	**553**	**88**	**18.9%**	**465**	**1,648**	**207**	**14.4%**	**1,441**
Supplies	**229**	**61**	**36.3%**	**168**	**689**	**182**	**35.9%**	**507**
Professional fees	**374**	**144**	**62.6%**	**230**	**1,149**	**450**	**64.4%**	**699**
Postage	**1,678**	**227**	**15.6%**	**1,451**	**5,219**	**743**	**16.6%**	**4,476**
Advertising	**1,192**	**28**	**2.4%**	**1,164**	**3,845**	**134**	**3.6%**	**3,711**
Amortization of intangibles	**38**	**-**	**0.0%**	**38**	**113**	**-**	**0.0%**	**113**
Other	**1,439**	**(9)**	**-0.6%**	**1,448**	**4,775**	**656**	**15.9%**	**4,119**
Total	**$ 10,370**	**$ (508)**	**-4.7%**	**$ 10,878**	**$ 33,459**	**$ 1,651**	**5.2%**	**$ 31,808**

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Community Banking, Parent and Other Segments

Total noninterest expense for our community banking segment, parent, and other increased $293,000, or 6.0% for the third quarter of 2006, compared to the same period of 2005 and $1,899,000, or 13.4% for the nine months ended September 30, 2006 versus the same period of 2005. The major factors contributing to these increases follow.

Salaries and employee benefits: Salaries and employee benefits expense increased 11.0% for the nine months ended September 30, 2006 compared to the same period of 2005 due to additional staffing requirements needed as a result of our growth, including opening a new community banking office in Warrenton, Virginia in mid-2005 and one in Martinsburg, West Virginia during second quarter 2006. Also included in this increase are general merit raises.

Other: Other expenses increased 19.6% for third quarter 2006 compared to third quarter 2005, and 21.3% for the nine months ended September 30, 2006 compared to the same period of 2005. These increases include $79,000 of losses in fraudulent checks during the nine months ended September 30, 2006.

Mortgage Banking Segment

Total noninterest expense for our mortgage banking segment decreased 13.4% for the third quarter of 2006 compared to third quarter 2005 and 1.4% for the nine months ended September 30, 2006 compared to the same period of 2005.

Salaries and employee benefits: The decrease of $1,153,000 in salaries and employee benefits for the quarter ended September 30, 2006 and $1,937,000 for the nine months ended September 30, 2006 is comprised primarily of 1) lower loan officer commissions paid due to decreased loan production and 2) a decrease in profitability based incentive compensation paid to Summit Mortgage management.

Net occupancy expense: Net occupancy expense increased 48.7% for the third quarter 2006 compared to the same period of 2005 and 47.2% for the first nine months of 2006 compared to comparable period of 2005 due to the relocation of our Summit Mortgage headquarters to Chesapeake, Virginia in late 2005.

Professional fees: Professional fees increased 541.4% for the third quarter 2006, compared to the third quarter 2005, and 221.5% for the nine months ended September 30, 2006 compared to the same period of 2005. This increase is primarily attributable to increased legal expenses arising from legal compliance reviews and litigation defense.

Postage: The increase in postage expense of $204,000 and $709,000 for the quarter and nine months ended September 30, 2006, respectively, was primarily the result of a rate increase by the US Postal Service.

Other: The decrease of $161,000, or 23.9%, in other expenses for third quarter 2006 compared to third quarter 2005 is primarily attributable to decreased loan origination costs directly related to the number of loans originated.

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.

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We recorded a $1,285,000 provision for loan losses for the first nine months of 2006, compared to $1,179,000 for the same period in 2005. Net loan charge offs for the first nine months of 2006 were $329,000, as compared to $331,000 over the same period of 2005. At September 30, 2006, the allowance for loan losses totaled $7,107,000 or 0.78% of loans, both portfolio and held for sale, net of unearned income, compared to $6,152,000 or 0.75% at December 31, 2005. Our asset quality remains sound. As illustrated in Table IV below, our non-performing assets and loans past due 90 days or more and still accruing interest have increased during the past 12 months, but still remain at a historically moderate level.

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

	September 30, 2006	September 30, 2005	December 31, 2005
Accruing loans past due 90 days or more	$ 728	$ 371	$ 799
Nonperforming assets:			
Nonaccrual loans	1,239	646	750
Foreclosed properties	249	830	378
Repossessed assets	6	32	17
Total	$ 2,222	$ 1,879	$ 1,944
Total nonperforming loans as a percentage of total loans	0.22%	0.14%	0.19%
Total nonperforming assets as a percentage of total assets	0.18%	0.18%	0.18%

FINANCIAL CONDITION

Our total assets were $1,210,491,000 at September 30, 2006, compared to $1,109,532,000 at December 31, 2005, representing a 9.1% increase. Table V below serves to illustrate significant changes in our financial position between December 31, 2005 and September 30, 2006.

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

	Balance December 31, 2005	Increase (Decrease) Amount	Increase (Decrease) Percentage	Balance September 30, 2006
Assets				
	$ 223,772	22,560	10.1%	$ 246,332

Securities available for sale							
Loans, net of unearned income		799,919		102,454	12.8%		902,373
Liabilities							
Deposits	$	673,901	$	191,161	28.4%	$	865,062
Short-term borrowings		182,028		(91,606)	-50.3%		90,422
Long-term borrowings and subordinated debentures		170,501		(6,637)	-3.9%		163,864

Loan growth during the first nine months of 2006, occurring principally in the commercial and real estate portfolios, was funded primarily by deposits, including brokered certificates of deposit.

Refer to Notes 3, 4, 7, and 8 of the notes to the accompanying consolidated financial statements for additional information with regard to changes in the composition of our securities, loans, deposits and borrowings between September 30, 2006 and December 31, 2005.

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 $268 million, or 22.2% of total assets at September 30, 2006 versus $125 million, or 11.3% of total assets at December 31, 2005.

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 September 30, 2006 totaled $80,630,000 compared to $73,803,000 at December 31, 2005.

Refer to Note 11 of the notes to the accompanying consolidated financial statements for information regarding regulatory restrictions on our capital as well as our subsidiaries' capital.

On August 8, 2006, the Board of Directors authorized the open market repurchase of up to 225,000 shares (approximately 3%) of the issued and outstanding shares of Summit's common stock. During third quarter 2006, we repurchased 32,400 shares under this plan.

CONTRACTUAL CASH OBLIGATIONS

During our normal course of business, we incur contractual cash obligations. The following table summarizes our contractual cash obligations at September 30, 2006.

	Long Term Debt	Capital Trust Securities	Operating Leases
2006	$ 14,816,481	$ -	$ 271,544
2007	23,318,204	-	1,066,920
2008	24,585,851	-	982,772

2009	3,911,094	-	431,349
2010	52,674,748	-	116,263
Thereafter	44,557,402	19,589,000	257,140
Total	$ 163,863,780	$ 19,589,000	$ 3,125,988

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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 September 30, 2006 are presented in the following table.

		September 30, 2006
Commitments to extend credit:		
Revolving home equity and		
credit card lines	$	33,587,424
Construction loans		97,271,727
Other loans		41,711,519
Standby letters of credit		14,721,512
Total	$	187,292,182

MARKET RISK MANAGEMENT

Market risk is the risk of loss arising from adverse changes in the fair value of financial instruments due to changes in interest rates, exchange rates and equity prices. Interest rate risk is our primary market risk and results from timing differences in the repricing of assets, liabilities and off-balance sheet instruments, changes in relationships between rate indices and the potential exercise of imbedded options. The principal objective of asset/liability management is to minimize interest rate risk and our actions in this regard are taken under the guidance of our Asset/Liability Management Committee ("ALCO"), which is comprised of members of senior management and members of the Board of Directors. The ALCO actively formulates the economic assumptions that we use in our financial planning and budgeting process and establishes policies which control and monitor our sources, uses and prices of funds.

Some amount of interest rate risk is inherent and appropriate to the banking business. Our net income is affected by changes in the absolute level of interest rates. Our interest rate risk position is liability sensitive in year one, with asset sensitivity over the longer period. That is, in the first year, liabilities are likely to reprice faster than assets, resulting in a decrease in net income in a rising rate and environment, and beyond the first year, assets are likely to reprice faster than liabilities, resulting in an increase in net income in a rising rate environment. Our net income would increase modestly 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 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.

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The following table shows our projected earnings sensitivity as of September 30, 2006 which is well within our ALCO policy limit of - 10%:

Change in Interest Rates (basis points)	Estimated % Change in Net Interest Income Over: 12 Months	24 Months
Down 200 (1)	1.41%	3.09%
Down 200, steepening yield curve (2)	2.37%	8.98%
Up 100 (1)	-1.07%	-0.07%
Up 200 (1)	-2.94%	-6.33%

(1) assumes a parallel shift in the yield curve
(2) assumes steepening curve whereby short term rates decline by 200 basis points while long term rates decline by 50 basis points

CONTROLS AND PROCEDURES

Our management, including the Chief Executive Officer and Chief Financial Officer, have conducted as of September 30, 2006, 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 September 30, 2006 were effective. There were no changes in our internal control over financial reporting that occurred during the quarter ended September 30, 2006 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

Summit Financial Group, Inc. and Subsidiaries
Part II. Other Information

Item 1. Legal Proceedings

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

On December 26, 2003, two of our subsidiaries, Summit Financial, LLC and Shenandoah Valley National Bank, and various employees of Summit Financial, LLC were served with a Petition for Temporary Injunction and a Bill of Complaint filed in the Circuit Court of Fairfax County, Virginia by Corinthian Mortgage Corporation. The filings allege various claims against Summit Financial, LLC and Shenandoah Valley National Bank arising out of the hiring of former employees of Corinthian Mortgage Corporation ("Corinthian ") and the alleged use of trade secrets. The individual defendants have also been sued based on allegations arising out of their former employment relationship with Corinthian and their employment with Summit Financial, LLC. Summit Financial, LLC now operates as Summit Mortgage, a division of Shenandoah Valley National Bank.

The plaintiff seeks damages in the amount proven at trial on each claim and punitive damages in the amount of $350,000 on each claim. Plaintiff also seeks permanent and temporary injunctive relief prohibiting the alleged use of trade secrets by Summit Financial and the alleged solicitation of Corinthian's employees. On January 22, 2004, we successfully defeated the Petition for Temporary Injunction brought against us by Corinthian. The Circuit Court of Fairfax County, Virginia denied Corinthian's petition.

After consultation with legal counsel, we believe that significant and meritorious defenses exist as to all the claims. We will continue to evaluate the claims in the Corinthian lawsuit and intend to vigorously defend against them. Management, at the present time, is unable to estimate the impact, if any, an adverse decision may have on our results of operations or financial condition.

On October 13, 2006, Corinthian filed a Motion to Amend its Complaint. Among other things, Corinthian will seek to add Summit Financial Group, Inc as a defendant in the case. The Motion to Amend will be heard on November 17, 2006. The Company does not intend to oppose the filing of the Motion to Amend, but will file appropriate responsive pleadings if the motion is granted.

On January 4, 2006, Mary Forrest, an individual, filed suit in the United States District Court for the Eastern District of Wisconsin, Milwaukee Division, against our subsidiary, Shenandoah Valley National Bank ("Shenandoah"). Further, on May 19, 2006, Marti L. Klutho, an individual, filed suit in the United States District Court for the Eastern District of Missouri, Eastern Division, also against Shenandoah. The plaintiffs in each case claim that Shenandoah violated the Federal Fair Credit Reporting Act ("FCRA") alleging that Shenandoah used information contained in their consumer reports, without extending a "firm offer of credit" within the meaning of the FCRA. Plaintiffs request statutory damages. These cases are purported class actions. Presently, we do not have final information as to the size of the alleged classes. Responsive pleadings have been filed, and discovery is in the initial stages. We will continue to evaluate the claims in these lawsuits and intend to vigorously defend against them. Management, at the present time, is unable to estimate the impact, if any, an adverse decision may have on our results of operations or financial condition.

Item 1A. Risk Factors

In addition to the other information set forth in this report, you should carefully consider the factors discussed in Part I, "Item 1A. Risk Factors" in our Annual Report on Form 10-K for the year ended December 31, 2005, which could materially affect our business, financial condition or future results. The risks described in our Annual Report on Form 10-K are not the only risks facing our Company. Additional risks and uncertainties not currently known to us or that we currently deem to be immaterial also may materially adversely affect our business, financial condition and/or operating results.

Summit Financial Group, Inc. and Subsidiaries
Part II. Other Information

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

(a) Not applicable.

(b) Not applicable.

(c) In August 2006, the Board of Directors authorized the open market repurchase of up to 225,000 shares (approximately 3%) of the issued and outstanding shares of Summit's common stock ("August 2006 Repurchase Plan"). The timing and quantity of purchases under this stock repurchase plan will be at the discretion of management, and the plan may be discontinued, or suspended and reinitiated, at any time.

The following table sets forth certain information regarding Summit's purchase of its common stock under the Repurchase Plan and Summit's Employee Stock Ownership Plan during the quarter ended September 30, 2006.

Period	Total Number of Shares Purchased (a)	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs (b)	Maximum Number of Shares that May Yet be Purchased Under the Plans or Programs (c)
July 1, 2006 - July 31, 2006	2,000	$ 18.60	-	225,000
August 1, 2006 - August 31, 2006	25,000	19.03	18,000	207,000
September 1, 2006 - September 30, 2006	17,600	19.04	14,400	192,600

(a) Includes shares repurchased under the August 2006 Repurchase Plan and shares acquired under the Company's Employee Stock Ownership Plan (the ESOP).

(b) Included in total number of shares purchased [column (a)].

(c) Shares available to be repurchased under the August 2006 Repurchase Plan.

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: November 6, 2006