SUMMIT FINANCIAL GROUP INC
Form 10-Q
May 09, 2018
UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10 – Q

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

For the quarterly period ended March 31, 2018
or
[ ] TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(D) OF THE SECURITIES EXCHANGE ACT OF 1934 For the transition period from ___________ to __________.

Commission File Number 0-16587

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

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

300 North Main Street

Moorefield, West Virginia	26836
(Address of principal executive offices)	(Zip Code)

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

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).
Yes þ No o

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a smaller reporting company, or an emerging growth company. See definition of “large accelerated filer”, “accelerated filer”, “smaller reporting company” and "emerging growth company" in Rule 12b-2 of the Exchange Act.
Large accelerated filer o Accelerated filer þ Non-accelerated filer o
Smaller reporting company o Emerging growth company o

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act. 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
12,468,013 shares outstanding as of May 8, 2018

Table of Contents

Item 1. Financial Statements

Consolidated Balance Sheets (unaudited)

Dollars in thousands, except per share amounts	March 31, 2018 (unaudited)	December 31, 2017 (*)
ASSETS		
Cash and due from banks	$9,042	$9,641
Interest bearing deposits with other banks	38,365	42,990
Cash and cash equivalents	47,407	52,631
Securities available for sale	296,890	328,723
Other investments	13,018	14,934
Loans held for sale	221	—
Loans, net	1,631,150	1,593,744
Property held for sale	21,442	21,470
Premises and equipment, net	35,554	34,209
Accrued interest receivable	8,346	8,329
Goodwill and other intangible assets	27,077	27,513
Cash surrender value of life insurance policies	41,668	41,358
Other assets	12,122	11,329
Total assets	$2,134,895	$2,134,240
LIABILITIES AND SHAREHOLDERS' EQUITY		
Liabilities		
Deposits		
Non interest bearing	$219,293	$217,493
Interest bearing	1,435,230	1,383,108
Total deposits	1,654,523	1,600,601
Short-term borrowings	193,513	250,499
Long-term borrowings	45,747	45,751
Subordinated debentures owed to unconsolidated subsidiary trusts	19,589	19,589
Other liabilities	16,514	16,295
Total liabilities	1,929,886	1,932,735
Commitments and Contingencies		
Shareholders' Equity		
Preferred stock, $1.00 par value, authorized 250,000 shares	—	—
Common stock and related surplus, $2.50 par value; authorized 20,000,000 shares; issued: 2018 - 12,468,013 shares and December 2017 - 12,465,296 shares; outstanding: 2018 - 12,366,360 shares and December 2017 - 12,358,562	81,332	81,098
Unallocated common stock held by Employee Stock Ownership Plan - 2018 - 101,653 shares and December 2017 - 106,734 shares	(1,098)	(1,152)
Retained earnings	125,663	119,827
Accumulated other comprehensive (loss) income	(888)	1,732
Total shareholders' equity	205,009	201,505

Total liabilities and shareholders' equity	$ 2,134,895	$ 2,134,240

(*) - Derived from audited consolidated financial statements

See Notes to Consolidated Financial Statements

Table of Contents

Consolidated Statements of Income (unaudited)

Dollars in thousands, (except per share amounts)	For the Three Months Ended March 31, 2018	2017
Interest income		
Interest and fees on loans		
Taxable	$20,222	$15,550
Tax-exempt	144	121
Interest and dividends on securities		
Taxable	1,372	1,128
Tax-exempt	1,019	723
Interest on interest bearing deposits with other banks	140	152
Total interest income	22,897	17,674
Interest expense		
Interest on deposits	3,549	2,390
Interest on short-term borrowings	1,405	994
Interest on long-term borrowings and subordinated debentures	686	660
Total interest expense	5,640	4,044
Net interest income	17,257	13,630
Provision for loan losses	500	250
Net interest income after provision for loan losses	16,757	13,380
Noninterest income		
Insurance commissions	1,113	968
Trust and wealth management fees	667	100
Service charges on deposit accounts	1,091	683
Bank card revenue	749	534
Realized securities gains (losses), net	732	(58)
Bank owned life insurance income	275	250
Other	249	102
Total noninterest income	4,876	2,579
Noninterest expenses		
Salaries, commissions and employee benefits	6,821	5,187
Net occupancy expense	832	567
Equipment expense	1,083	735
Professional fees	333	285
Advertising and public relations	103	108
Amortization of intangibles	436	97
FDIC premiums	240	210
Merger-related expenses	—	109
Foreclosed properties expense	132	104
Gain on sales of foreclosed properties, net	(64)	(156)
Write-downs of foreclosed properties	257	418
Litigation settlement	—	9,900
Other	2,141	1,452
Total noninterest expenses	12,314	19,016
Income (loss) before income tax expense	9,319	(3,057)
Income tax expense (benefit)	1,876	(1,441)

Net income (loss)	$7,443	$(1,616)
Basic earnings (loss) per common share	$0.60	$(0.15)
Diluted earnings (loss) per common share	$0.60	$(0.15)

See Notes to Consolidated Financial Statements

Table of Contents

Consolidated Statements of Comprehensive Income (Loss) (unaudited)

	For the Three Months Ended March 31,	
Dollars in thousands	2018	2017
Net income (loss)	$7,443	$(1,616)
Other comprehensive (loss) income:		
Net unrealized gain on cashflow hedge of: 2018 - $941, net of deferred taxes of $226; 2017 - $789, net of deferred taxes of $292	715	497
Net unrealized (loss) gain on securities available for sale of: 2018 - ($4,388), net of deferred taxes of ($1,053) and reclassification adjustment for net realized gains included in net income of $732, net of tax of $176; 2017 - $302, net of deferred taxes of $112 and reclassification adjustment for net realized losses included in net income of ($58), net of tax of ($21)	(3,335)	190
Total other comprehensive (loss) income	(2,620)	687
Total comprehensive income (loss)	$4,823	$(929)

See Notes to Consolidated Financial Statements

Table of Contents

Consolidated Statements of Shareholders' Equity (unaudited)

Dollars in thousands (except per share amounts)	Common Stock and Related Surplus	Unallocated Common Stock Held by ESOP	Retained Earnings	Accumulated Other Compre-hensive Income (Loss)	Total Share-holders' Equity
Balance, December 31, 2017	$81,098	$(1,152)	$119,827	$1,732	$201,505
Three Months Ended March 31, 2018					
Net income	—	—	7,443	—	7,443
Other comprehensive loss	—	—	—	(2,620)	(2,620)
Exercise of stock options - 200 shares	4	—	—	—	4
Share-based compensation expense	94	—	—	—	94
Unallocated ESOP shares committed to be released - 5,081 shares	73	54	—	—	127
Common stock issuances from reinvested dividends - 2,517 shares	63	—	—	—	63
Common stock cash dividends declared ($0.13 per share)	—	—	(1,607)	—	(1,607)
Balance, March 31, 2018	$81,332	$(1,098)	$125,663	$(888)	$205,009
Balance, December 31, 2016	$46,757	$(1,583)	$113,448	$(3,262)	$155,360
Three Months Ended March 31, 2017					
Net loss	—	—	(1,616)	—	(1,616)
Other comprehensive income	—	—	—	687	687
Exercise of stock options - 2,000 shares	12	—	—	—	12
Share-based compensation expense	84	—	—	—	84
Unallocated ESOP shares committed to be released - 9,911 shares	132	107	—	—	239
Common stock issuances from reinvested dividends - 1,596 shares	35	—	—	—	35
Common stock cash dividends declared ($0.11 per share)	—	—	(1,182)	—	(1,182)
Balance, March 31, 2017	$47,020	$(1,476)	$110,650	$(2,575)	$153,619

See Notes to Consolidated Financial Statements

Table of Contents

Consolidated Statements of Cash Flows (unaudited)

Dollars in thousands	Three Months Ended March 31, 2018	March 31, 2017
Cash Flows from Operating Activities		
Net income (loss)	$7,443	$(1,616)
Adjustments to reconcile net income (loss) to net cash provided by operating activities:		
Depreciation	527	355
Provision for loan losses	500	250
Share-based compensation expense	94	84
Deferred income tax benefit	(155)	(3,808)
Loans originated for sale	(4,122)	(2,243)
Proceeds from sale of loans	3,984	2,279
Gains on loans held for sale	(83)	(32)
Realized securities (gains) losses, net	(732)	58
Gain on disposal of assets	(72)	(156)
Write-downs of foreclosed properties	257	418
Amortization of securities premiums, net	990	959
Accretion related to acquisitions, net	(204)	(145)
Amortization of intangibles	436	97
Earnings on bank owned life insurance	(309)	(269)
(Increase) decrease in accrued interest receivable	(17)	143
Decrease (increase) in other assets	16	(580)
Increase in other liabilities	2,043	10,947
Net cash provided by operating activities	10,596	6,741
Cash Flows from Investing Activities		
Proceeds from maturities and calls of securities available for sale	55	600
Proceeds from sales of securities available for sale	39,267	3,154
Principal payments received on securities available for sale	6,690	7,686
Purchases of securities available for sale	(18,825)	(27,641)
Purchases of other investments	(2,765)	(3,944)
Proceeds from redemptions of other investments	4,378	3,558
Net loan originations	(38,854)	14,671
Purchases of premises and equipment	(1,872)	(2,995)
Proceeds from disposal of premises and equipment	9	—
Proceeds from sales of repossessed assets & property held for sale	644	1,232
Net cash used in investing activities	(11,273)	(3,679)
Cash Flows from Financing Activities		
Net increase in demand deposit, NOW and savings accounts	27,160	20,636
Net increase (decrease) in time deposits	26,824	(14,910)
Net (decrease) increase in short-term borrowings	(56,987)	4,407
Repayment of long-term borrowings	(4)	(455)
Net proceeds from issuance of common stock	63	35
Exercise of stock options	4	12
Dividends paid on common stock	(1,607)	(1,182)
Net cash (used in) provided by financing activities	(4,547)	8,543
(Decrease) increase in cash and cash equivalents	(5,224)	11,605

Cash and cash equivalents:		
Beginning	52,631	46,616
Ending	$47,407	$58,221

(Continued)

See Notes to Consolidated Financial Statements

Table of Contents

Consolidated Statements of Cash Flows (unaudited) - continued

Dollars in thousands	Three Months Ended March 31, 2018	March 31, 2017
Supplemental Disclosures of Cash Flow Information		
Cash payments for:		
Interest	$5,574	$ 4,047
Income taxes	$—	$ 355
Supplemental Disclosures of Noncash Investing and Financing Activities		
Real property and other assets acquired in settlement of loans	$641	$ 113

See Notes to Consolidated Financial Statements

Table of Contents

NOTE 1. BASIS OF PRESENTATION

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

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

The results of operations for the three months ended March 31, 2018 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 2017 audited financial statements and Annual Report on Form 10-K.

NOTE 2. SIGNIFICANT NEW AUTHORITATIVE ACCOUNTING GUIDANCE

Recently Adopted
In May 2014, the FASB issued ASU No. 2014-09, Revenue from Contracts with Customers: Topic 606. This ASU revised guidance for the recognition, measurement, and disclosure of revenue from contracts with customers. The guidance is applicable to all entities and replaces significant portions of existing industry and transaction-specific revenue recognition rules with a more principles-based recognition model. Since the guidance does not apply to revenue associated with financial instruments, including loans and securities that are accounted for under other GAAP, the new guidance did not have a material impact on revenue most closely associated with financial instruments, including interest income and expense. We completed our overall assessment of revenue streams and review of related contracts potentially affected by the ASU, including service fees on deposit accounts, bank card revenue, trust and wealth management fees, insurance commissions and gains and losses on sales of foreclosed properties. Based on this assessment, we concluded that ASU 2014-09 did not materially change the method in which we currently recognize revenue for these revenue streams. We also completed our evaluation of certain costs related to these revenue streams to determine whether such costs should be presented as expenses or contra-revenue (i.e., gross vs. net). Based on our evaluation, we determined that any classification changes are immaterial to both revenue and expense. We adopted ASU 2014-09 and its related amendments on its required effective date of January 1, 2018 utilizing the modified retrospective approach. Since there was no net income impact upon adoption of the new guidance, a cumulative effect adjustment to opening retained earnings was not deemed necessary.
ASU 2016-01, Financial Instruments – Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities, among other things, (i) requires equity investments, with certain exceptions, to be measured at fair value with changes in fair value recognized in net income, (ii) simplifies the impairment assessment of equity investments without readily determinable fair values by requiring a qualitative assessment to identify impairment, (iii) eliminates the requirement for public business entities to disclose the methods and significant assumptions used to estimate the fair value that is required to be disclosed for financial instruments measured at amortized cost on the balance sheet, (iv) requires public business entities to use the exit price notion when measuring the fair value of financial instruments for disclosure purposes, (v) requires an entity to present separately in other comprehensive income the portion of the total change in the fair value of a liability resulting from a change in the instrument-specific credit risk when the entity has elected to measure the liability at fair value in accordance with the fair value option for financial instruments, (vi) requires separate presentation of financial assets and financial liabilities by measurement

category and form of financial asset on the balance sheet or the accompanying notes to the financial statements and (viii) clarifies that an entity should evaluate the need for a valuation allowance on a deferred tax asset related to available-for-sale. ASU 2016-01 was effective for us on January 1, 2018 and did not have a significant impact on our financial statements. In accordance with (iv) above, we measured the fair value of our loan portfolio as of March 31, 2018 using exit price notion (see Note 3. Fair Vale Measurements).

Pending Adoption
In February 2016, the FASB issued ASU No. 2016-02, Leases (Topic 842). Among other things, in the amendments in ASU 2016-02, lessees will be required to recognize the following for all leases (with the exception of short-term leases) at the commencement date: (1) A lease liability, which is a lessee‘s obligation to make lease payments arising from a lease, measured on a discounted basis; and (2) A right-of-use asset, which is an asset that represents the lessee’s right to use, or control the use

of, a specified asset for the lease term. Under the new guidance, lessor accounting is largely unchanged. Certain targeted improvements were made to align, where necessary, lessor accounting with the lessee accounting model and Topic 606, Revenue from Contracts with Customers. The amendments in this ASU are effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. Early application is permitted upon issuance. Lessees (for capital and operating leases) and lessors (for sales-type, direct financing and operating leases) must apply a modified retrospective transition approach for leases existing at, or entered into after, the beginning of the earliest comparative period presented in the financial statements. The modified retrospective approach would not require any transition accounting for leases that expired before the earliest comparative period presented. Lessees and lessors may not apply a full retrospective transition approach. While we are currently assessing the impact of the adoption of this pronouncement, we expect the primary impact to our consolidated financial position upon adoption will be the recognition, on a discounted basis, of our minimum commitments under non-cancellable operating leases on our consolidated balance sheets resulting in the recording of right of use assets and lease obligations. Our current minimum commitments under long-term operating leases are disclosed in Note 12, Commitments and Contingencies.

During June 2016, the FASB issued ASU No. 2016-13, Financial Instruments - Credit Losses (Topic 326) - Measurement of Credit Losses on Financial Instruments. The amendments in this ASU, among other things, require the measurement of all expected credit losses for financial assets held at the reporting date based on historical experience, current conditions and reasonable and supportable forecasts. Financial institutions and other organizations will now use forward-looking information to better inform their credit loss estimates. Many of the loss estimation techniques applied today will still be permitted, although the inputs to those techniques will change to reflect the full amount of expected credit losses. In addition, the ASU amends the accounting for credit losses on available-for-sale debt securities and purchased financial assets with credit deterioration. The amendments in this ASU are effective for SEC filers for fiscal years and interim periods within those fiscal years, beginning after December 15, 2019. We will adopt the guidance by the first quarter of 2020 with a cumulative-effect adjustment to retained earnings as of the beginning of the year of adoption. In this regard, we have thus far formed a cross-functional implementation team comprised of personnel from risk management, operations and information technology, loan administration and finance and engaged a third-party to assist us. The implementation team has developed a project plan and is staying informed about the broader industry's perspectives and insights, and is identifying and researching key decision points. We will soon prepare a readiness assessment and gap analysis relative to required data which will serve to direct our areas of focus. We will continue to evaluate the impact the new standard will have on our consolidated financial statements as the final impact will be dependent, among other items, upon the loan portfolio composition and credit quality at the adoption date, as well as economic conditions, financial models used and forecasts at that time.

In March of 2017, the FASB issued ASU No. 2017-08, Receivables-Nonrefundable Fees and Other Costs (Subtopic 310-20): Premium Amortization on Purchased Callable Debt Securities. This guidance shortens the amortization period for premiums on certain callable debt securities to the earliest call date (with an explicit, noncontingent call feature that is callable at a fixed price and on a preset date), rather than contractual maturity date as currently required under GAAP. The ASU does not impact instruments without preset call dates such as mortgage-backed securities. For instruments with contingent call features, once the contingency is resolved and the security is callable at a fixed price and preset date, the security is within the scope of the ASU. ASU 2017-08 is effective for fiscal years beginning after December 15, 2018, and interim periods within those fiscal years, and early adoption is permitted. The adoption of the new pronouncement will not have a significant impact on our consolidated financial statements.

In August 2017, the FASB issued ASU No. 2017-12, Targeted Improvements to Accounting for Hedging Activities which will make more financial and nonfinancial hedging strategies eligible for hedge accounting. It also amends the presentation and disclosure requirements and changes how companies assess effectiveness. It is intended to more closely align hedge accounting with companies’ risk management strategies, simplify the application of hedge accounting, and increase transparency as to the scope and results of hedging programs. The guidance is effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2018. Early adoption is permitted, including adoption in an interim period. We are assessing the impact of ASU 2017-12 and do not expect it to have a material impact on our consolidated financial statements.

NOTE 3. FAIR VALUE MEASUREMENTS

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

Dollars in thousands	Balance at March 31, 2018	Fair Value Measurements Using: Level 1	Level 2	Level 3
Available for sale securities				
U.S. Government sponsored agencies	$32,453	$ —	$32,453	$ —
Mortgage backed securities:				
Government sponsored agencies	101,971	—	101,971	—
Nongovernment sponsored entities	1,649	—	1,649	—
State and political subdivisions	19,098	—	19,098	—
Corporate debt securities	10,728	—	10,728	—
Other equity securities	137	—	137	—
Tax-exempt state and political subdivisions	130,854	—	130,854	—
Total available for sale securities	$296,890	$ —	$296,890	$ —
Derivative financial assets				
Interest rate swaps	$764	$ —	$764	$ —
Derivative financial liabilities				
Interest rate swaps	$1,116	$ —	$1,116	$ —

Dollars in thousands	Balance at December 31, 2017	Fair Value Measurements Using: Level 1	Level 2	Level 3
Available for sale securities				
U.S. Government sponsored agencies	$ 31,613	$ —	$31,613	$ —
Mortgage backed securities:				
Government sponsored agencies	121,321	—	121,321	—
Nongovernment sponsored entities	2,077	—	2,077	—
State and political subdivisions	17,677	—	17,677	—
Corporate debt securities	16,245	—	16,245	—
Other equity securities	137	—	137	—
Tax-exempt state and political subdivisions	139,653	—	139,653	—
Total available for sale securities	$ 328,723	$ —	$328,723	$ —
Derivative financial assets				
Interest rate swaps	$ 312	$ —	$312	$ —
Derivative financial liabilities				
Interest rate swaps	$ 2,057	$ —	$2,057	$ —

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.

Table of Contents

Dollars in thousands	Balance at March 31, 2018	Fair Value Measurements Using: Level 1	Level 2	Level 3
Residential mortgage loans held for sale	$ 221	$ —	$ 221	$ —
Collateral-dependent impaired loans				
Construction and development	$ 941	$ —	$ 941	$ —
Residential real estate	330	—	203	127
Total collateral-dependent impaired loans	$ 1,271	$ —	$ 1,144	$ 127
Property held for sale				
Commercial real estate	$ 1,677	$ —	$ 1,677	$ —
Construction and development	15,712	—	15,712	—
Residential real estate	462	—	462	—
Total property held for sale	$ 17,851	$ —	$ 17,851	$ —

Dollars in thousands	Balance at December 31, 2017	Fair Value Measurements Using: Level 1	Level 2	Level 3
Residential mortgage loans held for sale	$ —	$ —	$ —	$ —
Collateral-dependent impaired loans				
Commercial real estate	$ 518	$ —	$ 518	$ —
Construction and development	940	—	940	—
Residential real estate	203	—	203	—
Total collateral-dependent impaired loans	$ 1,661	$ —	$ 1,661	$ —
Property held for sale				
Commercial real estate	$ 1,493	$ —	$ 1,493	$ —
Construction and development	16,177	—	16,177	—
Residential real estate	322	—	322	—
Total property held for sale	$ 17,992	$ —	$ 17,992	$ —

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

	March 31, 2018		Fair Value Measurements Using:		
Dollars in thousands	Carrying Value	Estimated Fair Value	Level 1	Level 2	Level 3
Financial assets					
Cash and cash equivalents	$47,407	$47,407	$ —	$47,407	$ —
Securities available for sale	296,890	296,890	—	296,890	—
Other investments	13,018	13,018	—	13,018	—
Loans held for sale, net	221	221	—	221	—

Loans, net	1,631,150	1,616,759	—	1,144	1,615,615
Accrued interest receivable	8,346	8,346	—	8,346	—
Derivative financial assets	764	764	—	764	—
	$1,997,796	$1,983,405	$—	$367,790	$1,615,615
Financial liabilities					
Deposits	$1,654,523	$1,676,651	$—	$1,676,651	$—
Short-term borrowings	193,513	193,513			