

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

FORM 10 – Q

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 (IRS Employer  
incorporation or organization) Identification No.)  
300 North Main Street  
Moorefield, West Virginia 26836  
(Address of principal executive offices) (Zip Code)  
(304) 530-1000  
(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Sections 13 or 15(d) of the Securities and Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes  No

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

Yes  No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, 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  Accelerated filer  Non-accelerated filer   
Smaller reporting company  Emerging growth company

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.

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

Yes  No

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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

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## Item 1. Financial Statements

## Consolidated Balance Sheets (unaudited)

|  | March 31,<br>2018<br>(unaudited) | December 31,<br>2017<br>(*) |
|--|----------------------------------|-----------------------------|
| Dollars in thousands, except per share amounts   |                                  |                             |
| <b>ASSETS</b>  |                                  |                             |
| 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                 |
| <b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>  |                                  |                             |
| 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:<br>2018 - 12,468,013 shares and December 2017 - 12,465,296 shares; outstanding: 2018 -<br>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<br>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

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## Consolidated Statements of Income (unaudited)

| Dollars in thousands, (except per share amounts)             | For the Three<br>Months Ended<br>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 ) |

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|  |         |            |
|--|---------|------------|
| 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 |         |            |

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## Consolidated Statements of Comprehensive Income (Loss) (unaudited)

|  | For the Three<br>Months Ended<br>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 (3,335 ) 190 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

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## Consolidated Statements of Shareholders' Equity (unaudited)

| Dollars in thousands (except per share amounts)                 | Common<br>Stock<br>and<br>Related<br>Surplus | Unallocated<br>Common<br>Stock Held<br>by ESOP | Retained<br>Earnings | Accumulated<br>Other<br>Compre-<br>hensive<br>Income<br>(Loss) | Total<br>Share-<br>holders'<br>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

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## Consolidated Statements of Cash Flows (unaudited)

|  | Three Months<br>Ended |                   |
|--|-----------------------|-------------------|
| Dollars in thousands   | March 31,<br>2018     | March 31,<br>2017 |
| <b>Cash Flows from Operating Activities</b>  |                       |                   |
| 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             |
| <b>Cash Flows from Investing Activities</b>  |                       |                   |
| 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 )          |
| <b>Cash Flows from Financing Activities</b>  |                       |                   |
| 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

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Consolidated Statements of Cash Flows (unaudited) - continued

|  | Three Months<br>Ended |                   |
|--|-----------------------|-------------------|
| Dollars in thousands   | March 31,<br>2018     | March 31,<br>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            |

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## 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 Value 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

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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<br>at<br>March 31,<br>2018 | Fair Value<br>Measurements<br>Using: |           |            |
|---|------------------------------------|--------------------------------------|-----------|------------|
|   |                                    | Level<br>1                           | Level 2   | Level<br>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<br>December 31,<br>2017 | Fair Value<br>Measurements<br>Using: |           |            |
|   |                                    | Level<br>1                           | Level 2   | Level<br>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.

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| Dollars in thousands                      | Balance<br>at<br>March 31,<br>2018 | Fair Value<br>Measurements<br>Using: |          |            |
|---|------------------------------------|--------------------------------------|----------|------------|
|   |                                    | Level<br>1                           | Level 2  | Level<br>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<br>December 31,<br>2017 | Fair Value<br>Measurements<br>Using: |          |            |
|---|------------------------------------|--------------------------------------|----------|------------|
|   |                                    | Level<br>1                           | Level 2  | Level<br>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:

| Dollars in thousands          | March 31, 2018    |                            | Fair Value<br>Measurements Using: |                    |
|-------------------------------|-------------------|----------------------------|-----------------------------------|--------------------|
|                               | Carrying<br>Value | Estimated<br>Fair<br>Value | Level<br>1                        | Level 2<br>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                |

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|  |             |             |              |             |
|--|-------------|-------------|--------------|-------------|
| 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     | -193,513     | —           |
| Long-term borrowings   | 45,747      | 46,096      | -46,096      | —           |
| Subordinated debentures owed to unconsolidated subsidiary trusts | 19,589      | 19,589      | -19,589      | —           |
| Accrued interest payable   | 982         | 982         | -982         | —           |
| Derivative financial liabilities                                 | 1,116       | 1,116       | -1,116       | —           |
|  | \$1,915,470 | \$1,937,947 | \$-1,937,947 | \$—         |

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| Dollars in thousands   | December 31, 2017 |                      | Fair Value Measurements Using: |             |           |
|--|-------------------|----------------------|--------------------------------|-------------|-----------|
|  | Carrying Value    | Estimated Fair Value | Level 1                        | Level 2     | Level 3   |
| Financial assets   |                   |                      |                                |             |           |
| Cash and cash equivalents  | \$52,631          | \$52,631             | \$52,631                       | \$—         | \$—       |
| Securities available for sale                                    | 328,723           | 328,723              | —                              | 328,723     | —         |
| Other investments  | 14,934            | 14,934               | —                              | 14,934      | —         |
| Loans held for sale, net   | —                 | —                    | —                              | —           | —         |
| Loans, net   | 1,593,744         | 1,592,821            | —                              | 1,661       | 1,591,160 |
| Accrued interest receivable                                      | 8,329             | 8,329                | —                              | 8,329       | —         |
| Derivative financial assets                                      | 312               | 312                  | —                              | 312         | —         |
|  | \$1,998,673       | \$1,997,750          | \$406,590                      | \$1,591,160 | \$—       |
| Financial liabilities  |                   |                      |                                |             |           |
| Deposits   | \$1,600,601       | \$1,620,033          | \$1,620,033                    | \$—         | \$—       |
| Short-term borrowings  | 250,499           | 250,499              | —                              | 250,499     | —         |
| Long-term borrowings   | 45,751            | 46,530               | —                              | 46,530      | —         |
| Subordinated debentures owed to unconsolidated subsidiary trusts | 19,589            | 19,589               | —                              | 19,589      | —         |
| Accrued interest payable   | 987               | 987                  | —                              | 987         | —         |
| Derivative financial liabilities                                 | 2,057             | 2,057                | —                              | 2,057       | —         |
|  | \$1,919,484       | \$1,939,695          | \$1,939,695                    | \$—         | \$—       |

## NOTE 4. EARNINGS/(LOSS) PER SHARE

The computations of basic and diluted earnings/(loss) per share follow:

| Dollars in thousands,<br>except per share amounts | For the Three Months Ended March 31,<br>2018 |                                   |              | 2017                  |                                   |              |
|---|--|-----------------------------------|--------------|-----------------------|-----------------------------------|--------------|
|   | Income<br>(Numerator)                        | Common<br>Shares<br>(Denominator) | Per<br>Share | Income<br>(Numerator) | Common<br>Shares<br>(Denominator) | Per<br>Share |
| Net income (loss)                                 | \$7,443                                      |                                   |              | \$(1,616)             |                                   |              |
| Basic earnings/(loss) per share                   | \$7,443                                      | 12,358,849                        | \$0.60       | \$(1,616)             | 10,738,365                        | \$(0.15)     |
| Effect of dilutive securities:                    |  |                                   |              |                       |                                   |              |
| Stock options                                     |  | 7,521                             |              |                       | —                                 |              |
| Stock appreciation rights (SARs)                  |  | 17,387                            |              |                       | —                                 |              |
| Diluted earnings/(loss) per share                 | \$7,443                                      | 12,383,757                        | \$0.60       | \$(1,616)             | 10,738,365                        | \$(0.15)     |

Stock option and stock appreciation right (SAR) grants are disregarded in this computation if they are determined to be anti-dilutive. Our anti-dilutive stock options for the quarters ended March 31, 2018 and March 31, 2017 were 15,600 shares and 49,140 shares respectively. Our anti-dilutive SARs for quarters ended March 31, 2018 and March 31, 2017 were 87,615 and 254,332, respectively.

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|                                     |           |         |         |           |
|-------------------------------------|-----------|---------|---------|-----------|
| Electric revenues                   | 6,205     | 128     | —       | 6,333     |
| Sales tax revenues                  | 4,126     | 140     | —       | 4,266     |
| University revenues                 | 5,272     | 38      | 9       | 5,301     |
| Other revenues                      | 19,101    | 616     | —       | 19,717    |
| Total tax-exempt debt securities    | 136,396   | 3,469   | 212     | 139,653   |
| Equity securities                   | 137       | —       | —       | 137       |
| Total available for sale securities | \$324,908 | \$5,329 | \$1,514 | \$328,723 |

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The below information is relative to the five states where issuers with the highest volume of state and political subdivision securities held in our portfolio are located. We own no such securities of any single issuer which we deem to be a concentration.

| Dollars in thousands | March 31, 2018 |                  |                   | Estimated Fair Value |
|----------------------|----------------|------------------|-------------------|----------------------|
|                      | Amortized Cost | Unrealized Gains | Unrealized Losses |                      |
| Texas                | \$18,779       | \$283            | \$ 87             | \$ 18,975            |
| Michigan             | 14,716         | 95               | 227               | 14,584               |
| California           | 14,290         | 173              | 90                | 14,373               |
| New York             | 11,319         | 123              | 126               | 11,316               |
| West Virginia        | 10,806         | 83               | 42                | 10,847               |

Management performs pre-purchase and ongoing analysis to confirm that all investment securities meet applicable credit quality standards.

The maturities, amortized cost and estimated fair values of securities at March 31, 2018, are summarized as follows:

| Dollars in thousands       | Amortized Cost | Estimated Fair Value |
|----------------------------|----------------|----------------------|
| Due in one year or less    | \$ 35,349      | \$35,433             |
| Due from one to five years | 68,946         | 68,958               |
| Due from five to ten years | 45,860         | 45,010               |
| Due after ten years        | 147,171        | 147,352              |
| Equity securities          | 137            | 137                  |
|                            | \$297,463      | \$296,890            |

The proceeds from sales, calls and maturities of available for sale securities, including principal payments received on mortgage-backed obligations, and the related gross gains and losses realized, for the three months ended March 31, 2018 and 2017 are as follows:

| Dollars in thousands                      | Proceeds from |                      |                    | Gross realized |        |
|---|---------------|----------------------|--------------------|----------------|--------|
|   | Sales         | Calls and Maturities | Principal Payments | Gains          | Losses |
| For the Three Months Ended March 31, 2018 |               |                      |                    |                |        |
| Securities available for sale             | \$39,267      | \$ 55                | \$ 6,690           | \$1,474        | \$ 742 |
| 2017                                      |               |                      |                    |                |        |
| Securities available for sale             | \$3,154       | \$ 600               | \$ 7,686           | \$61           | \$ 119 |

We held 119 available for sale securities having an unrealized loss at March 31, 2018. We do not intend to sell these securities, and it is more likely than not that we will not be required to sell these securities before recovery of their amortized cost bases. We believe that this decline in value is primarily attributable to the lack of market liquidity and to changes in market interest rates and not due to credit quality. Accordingly, no other-than-temporary impairment charge to earnings is warranted at this time.

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Provided below is a summary of securities available for sale which were in an unrealized loss position at March 31, 2018 and December 31, 2017.

| Dollars in thousands                      | March 31, 2018             |                    |                            |                    |                            |                    |
|---|----------------------------|--------------------|----------------------------|--------------------|----------------------------|--------------------|
|   | Less than 12 months        |                    | 12 months or more          |                    | Total                      |                    |
|   | Estimated<br>Fair<br>Value | Unrealized<br>Loss | Estimated<br>Fair<br>Value | Unrealized<br>Loss | Estimated<br>Fair<br>Value | Unrealized<br>Loss |
| Temporarily impaired securities           |                            |                    |                            |                    |                            |                    |
| Taxable debt securities                   |                            |                    |                            |                    |                            |                    |
| U.S. Government agencies and corporations | \$ 19,052                  | \$ (206 )          | \$ 2,199                   | \$ (49 )           | \$ 21,251                  | \$ (255 )          |
| Residential mortgage-backed securities:   |                            |                    |                            |                    |                            |                    |
| Government-sponsored agencies             | 32,858                     | (516 )             | 18,412                     | (715 )             | 51,270                     | (1,231 )           |
| Nongovernment-sponsored entities          | 218                        | (1 )               | 677                        | (4 )               | 895                        | (5 )               |
| State and political subdivisions:         |                            |                    |                            |                    |                            |                    |
| General obligations                       | 5,904                      | (184 )             | —                          | —                  | 5,904                      | (184 )             |
| Other revenues                            | 12,351                     | (283 )             | —                          | —                  | 12,351                     | (283 )             |
| Corporate debt securities                 | 964                        | (36 )              | 3,684                      | (110 )             | 4,648                      | (146 )             |
| Tax-exempt debt securities                |                            |                    |                            |                    |                            |                    |
| State and political subdivisions:         |                            |                    |                            |                    |                            |                    |
| General obligations                       | 19,967                     | (407 )             | 3,903                      | (153 )             | 23,870                     | (560 )             |
| Water and sewer revenues                  | 5,990                      | (94 )              | —                          | —                  | 5,990                      | (94 )              |
| Lease revenues                            | 2,234                      | (22 )              | —                          | —                  | 2,234                      | (22 )              |
| Sales tax revenues                        | 2,261                      | (41 )              | —                          | —                  | 2,261                      | (41 )              |
| Other revenues                            | 19,289                     | (336 )             | —                          | —                  | 19,289                     | (336 )             |
| Total temporarily impaired securities     | 121,088                    | (2,126 )           | 28,875                     | (1,031 )           | 149,963                    | (3,157 )           |
| Total                                     | \$ 121,088                 | \$ (2,126 )        | \$ 28,875                  | \$ (1,031 )        | \$ 149,963                 | \$ (3,157 )        |

| Dollars in thousands                      | December 31, 2017          |                    |                            |                    |                            |                    |
|---|----------------------------|--------------------|----------------------------|--------------------|----------------------------|--------------------|
|   | Less than 12 months        |                    | 12 months or more          |                    | Total                      |                    |
|   | Estimated<br>Fair<br>Value | Unrealized<br>Loss | Estimated<br>Fair<br>Value | Unrealized<br>Loss | Estimated<br>Fair<br>Value | Unrealized<br>Loss |
| Temporarily impaired securities           |                            |                    |                            |                    |                            |                    |
| Taxable debt securities                   |                            |                    |                            |                    |                            |                    |
| U.S. Government agencies and corporations | \$ 10,864                  | \$ (91 )           | \$ 2,394                   | \$ (54 )           | \$ 13,258                  | \$ (145 )          |
| Residential mortgage-backed securities:   |                            |                    |                            |                    |                            |                    |
| Government-sponsored agencies             | 32,156                     | (269 )             | 22,584                     | (634 )             | 54,740                     | (903 )             |
| Nongovernment-sponsored entities          | 5                          | —                  | 810                        | (7 )               | 815                        | (7 )               |
| State and political subdivisions:         |                            |                    |                            |                    |                            |                    |
| General obligations                       | 6,035                      | (55 )              | —                          | —                  | 6,035                      | (55 )              |
| Other revenues                            | 7,532                      | (62 )              | —                          | —                  | 7,532                      | (62 )              |
| Corporate debt securities                 | 3,008                      | (39 )              | 1,659                      | (91 )              | 4,667                      | (130 )             |
| Tax-exempt debt securities                |                            |                    |                            |                    |                            |                    |
| State and political subdivisions:         |                            |                    |                            |                    |                            |                    |
| General obligations                       | 2,999                      | (20 )              | 9,937                      | (178 )             | 12,936                     | (198 )             |
| Water and sewer revenues                  | 282                        | (3 )               | —                          | —                  | 282                        | (3 )               |
| Lease revenues                            | 569                        | (2 )               | —                          | —                  | 569                        | (2 )               |
| University revenues                       | 1,749                      | (9 )               | —                          | —                  | 1,749                      | (9 )               |

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|                                       |          |         |   |          |         |   |           |           |   |
|---------------------------------------|----------|---------|---|----------|---------|---|-----------|-----------|---|
| Total temporarily impaired securities | 65,199   | (550    | ) | 37,384   | (964    | ) | 102,583   | (1,514    | ) |
| Total                                 | \$65,199 | \$ (550 | ) | \$37,384 | \$ (964 | ) | \$102,583 | \$ (1,514 | ) |

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## NOTE 6. LOANS

Loans are summarized as follows:

| Dollars in thousands              | March 31,<br>2018 | December 31,<br>2017 |
|-----------------------------------|-------------------|----------------------|
| Commercial                        | \$189,586         | \$ 189,981           |
| Commercial real estate            |                   |                      |
| Owner-occupied                    | 265,075           | 250,202              |
| Non-owner occupied                | 498,445           | 484,902              |
| Construction and development      |                   |                      |
| Land and land development         | 66,841            | 67,219               |
| Construction                      | 33,327            | 33,412               |
| Residential real estate           |                   |                      |
| Non-jumbo                         | 346,477           | 354,101              |
| Jumbo                             | 67,169            | 62,267               |
| Home equity                       | 83,382            | 84,028               |
| Mortgage warehouse lines          | 45,702            | 30,757               |
| Consumer                          | 34,825            | 36,202               |
| Other                             | 12,578            | 13,238               |
| Total loans, net of unearned fees | 1,643,407         | 1,606,309            |
| Less allowance for loan losses    | 12,257            | 12,565               |
| Loans, net                        | \$1,631,150       | \$ 1,593,744         |

The outstanding balance and the recorded investment of acquired loans included in the consolidated balance sheet at March 31, 2018 and December 31, 2017 are as follows:

| Dollars in thousands         | Acquired Loans<br>March 31, 2018 |                         |           | December 31, 2017               |                         |           |
|------------------------------|----------------------------------|-------------------------|-----------|---------------------------------|-------------------------|-----------|
|                              | Purchased<br>Credit<br>Impaired  | Purchased<br>Performing | Total     | Purchased<br>Credit<br>Impaired | Purchased<br>Performing | Total     |
| Outstanding balance          | \$5,292                          | \$ 196,608              | \$201,900 | \$5,923                         | \$ 220,131              | \$226,054 |
| Recorded investment          |                                  |                         |           |                                 |                         |           |
| Commercial                   | \$—                              | \$ 17,945               | \$17,945  | \$9                             | \$ 25,125               | \$25,134  |
| Commercial real estate       |                                  |                         |           |                                 |                         |           |
| Owner-occupied               | 689                              | 20,323                  | 21,012    | 689                             | 21,893                  | 22,582    |
| Non-owner occupied           | 1,316                            | 32,148                  | 33,464    | 1,837                           | 33,293                  | 35,130    |
| Construction and development |                                  |                         |           |                                 |                         |           |
| Land and land development    | —                                | 6,846                   | 6,846     | —                               | 7,512                   | 7,512     |
| Construction                 | —                                | —                       | —         | —                               | 2,760                   | 2,760     |
| Residential real estate      |                                  |                         |           |                                 |                         |           |
| Non-jumbo                    | 1,453                            | 100,734                 | 102,187   | 1,485                           | 109,570                 | 111,055   |
| Jumbo                        | 993                              | 4,074                   | 5,067     | 999                             | 3,400                   | 4,399     |
| Home equity                  | —                                | 3,236                   | 3,236     | —                               | 3,311                   | 3,311     |
| Consumer                     | —                                | 9,434                   | 9,434     | —                               | 11,229                  | 11,229    |
| Other                        | —                                | 155                     | 155       | —                               | 211                     | 211       |
| Total recorded investment    | \$4,451                          | \$ 194,895              | \$199,346 | \$5,019                         | \$ 218,304              | \$223,323 |

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The following table presents a summary of the change in the accretable yield of the PCI loan portfolio for the three months ended March 31, 2018 and 2017:

| Dollars in thousands   | Three Months Ended March 31, 2018 | Three Months Ended March 31, 2017 |
|--|-----------------------------------|-----------------------------------|
| Accretable yield, January 1  | \$ 745                            | \$ 290                            |
| Accretion  | (37 )                             | (31 )                             |
| Reclassification of nonaccretable difference due to improvement in expected cash flows | —                                 | —                                 |
| Other changes, net   | —                                 | (14 )                             |
| Accretable yield, March 31   | \$ 708                            | \$ 245                            |

The following table presents the contractual aging of the recorded investment in past due loans by class as of March 31, 2018 and December 31, 2017.

| Dollars in thousands         | At March 31, 2018   |                     |                    | Total    | Current     | > 90 days and Accruing |
|------------------------------|---------------------|---------------------|--------------------|----------|-------------|------------------------|
|                              | Past Due 30-59 days | Past Due 60-89 days | Past Due > 90 days |          |             |                        |
| Commercial                   | \$675               | \$22                | \$378              | \$1,075  | \$188,511   | \$ 49                  |
| Commercial real estate       |                     |                     |                    |          |             |                        |
| Owner-occupied               | 130                 | 295                 | 351                | 776      | 264,299     | —                      |
| Non-owner occupied           | 196                 | 610                 | 1,852              | 2,658    | 495,787     | —                      |
| Construction and development |                     |                     |                    |          |             |                        |
| Land and land development    | 179                 | —                   | 3,637              | 3,816    | 63,025      | —                      |
| Construction                 | —                   | —                   | —                  | —        | 33,327      | —                      |
| Residential mortgage         |                     |                     |                    |          |             |                        |
| Non-jumbo                    | 3,392               | 1,503               | 4,611              | 9,506    | 336,971     | —                      |
| Jumbo                        | 969                 | —                   | —                  | 969      | 66,200      | —                      |
| Home equity                  | 76                  | 98                  | 272                | 446      | 82,936      | 64                     |
| Mortgage warehouse lines     | —                   | —                   | —                  | —        | 45,702      | —                      |
| Consumer                     | 293                 | 185                 | 104                | 582      | 34,243      | 32                     |
| Other                        | —                   | —                   | —                  | —        | 12,578      | —                      |
| Total                        | \$5,910             | \$2,713             | \$11,205           | \$19,828 | \$1,623,579 | \$ 145                 |

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| Dollars in thousands         | At December 31, 2017      |               |              | Total    | Current     | > 90 days<br>and<br>Accruing |
|------------------------------|---------------------------|---------------|--------------|----------|-------------|------------------------------|
|                              | Past Due<br>30-59<br>days | 60-89<br>days | > 90<br>days |          |             |                              |
| Commercial                   | \$488                     | \$98          | \$229        | \$815    | \$189,166   | \$ —                         |
| Commercial real estate       |                           |               |              |          |             |                              |
| Owner-occupied               | 626                       | 162           | 507          | 1,295    | 248,907     | —                            |
| Non-owner occupied           | 369                       | 150           | 2,065        | 2,584    | 482,318     | 237                          |
| Construction and development |                           |               |              |          |             |                              |
| Land and land development    | 1,132                     | —             | 3,563        | 4,695    | 62,524      | —                            |
| Construction                 | —                         | —             | —            | —        | 33,412      | —                            |
| Residential mortgage         |                           |               |              |          |             |                              |
| Non-jumbo                    | 4,220                     | 2,379         | 4,451        | 11,050   | 343,051     | —                            |
| Jumbo                        | —                         | —             | —            | —        | 62,267      | —                            |
| Home equity                  | 1,978                     | —             | 530          | 2,508    | 81,520      | —                            |
| Mortgage warehouse lines     | —                         | —             | —            | —        | 30,757      | —                            |
| Consumer                     | 417                       | 196           | 167          | 780      | 35,422      | 37                           |
| Other                        | —                         | —             | —            | —        | 13,238      | —                            |
| Total                        | \$9,230                   | \$2,985       | \$11,512     | \$23,727 | \$1,582,582 | \$ 274                       |

Nonaccrual loans: The following table presents the nonaccrual loans included in the net balance of loans at March 31, 2018 and December 31, 2017.

| Dollars in thousands         | March<br>31,<br>2018 | December<br>31,<br>2017 |
|------------------------------|----------------------|-------------------------|
| Commercial                   | \$685                | \$ 696                  |
| Commercial real estate       |                      |                         |
| Owner-occupied               | 561                  | 726                     |
| Non-owner occupied           | 2,840                | 2,201                   |
| Construction and development |                      |                         |
| Land & land development      | 3,642                | 3,569                   |
| Construction                 | —                    | —                       |
| Residential mortgage         |                      |                         |
| Non-jumbo                    | 7,101                | 6,944                   |
| Jumbo                        | —                    | —                       |
| Home equity                  | 355                  | 712                     |
| Mortgage warehouse lines     | —                    | —                       |
| Consumer                     | 128                  | 201                     |
| Total                        | \$15,312             | \$ 15,049               |

Impaired loans: Impaired loans include the following:

Loans which we risk-rate (loan relationships having aggregate balances in excess of \$2.5 million, or loans exceeding \$500,000 and exhibiting credit weakness) through our normal loan review procedures and which, based on current information and events, it is probable that we will be unable to collect all amounts due in accordance with the original contractual terms of the loan agreement. Risk-rated loans with insignificant delays or insignificant short falls in the amount of payments expected to be collected are not considered to be impaired.

Loans that have been modified in a troubled debt restructuring.

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Both commercial and consumer loans are deemed impaired upon being contractually modified in a troubled debt restructuring. Troubled debt restructurings typically result from our loss mitigation activities and occur when we grant a concession to a borrower who is experiencing financial difficulty in order to minimize our economic loss and to avoid foreclosure or repossession of collateral. Once restructured, a loan is generally considered impaired until its maturity, regardless of whether the borrower performs under the modified terms. Although such a loan may be returned to accrual status if the criteria set forth in accounting principles generally accepted in the United States are met, the loan would continue to be evaluated for an asset-specific allowance for loan losses and we would continue to report the loan in the impaired loan table below.

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The following tables present loans individually evaluated for impairment at March 31, 2018 and December 31, 2017.

March 31, 2018

| Dollars in thousands              | Recorded Investment | Unpaid Principal Balance | Related Allowance | Average Impaired Balance | Interest Income Recognized while impaired |
|-----------------------------------|---------------------|--------------------------|-------------------|--------------------------|---|
| Without a related allowance       |                     |                          |                   |                          |   |
| Commercial                        | \$318               | \$318                    | \$ —              | \$220                    | \$ 10                                     |
| Commercial real estate            |                     |                          |                   |                          |   |
| Owner-occupied                    | 2,718               | 2,719                    | —                 | 2,719                    | 130                                       |
| Non-owner occupied                | 9,752               | 9,757                    | —                 | 9,757                    | 491                                       |
| Construction and development      |                     |                          |                   |                          |   |
| Land & land development           | 5,017               | 5,017                    | —                 | 5,017                    | 104                                       |
| Construction                      | —                   | —                        | —                 | —                        | —   |
| Residential real estate           |                     |                          |                   |                          |   |
| Non-jumbo                         | 4,266               | 4,273                    | —                 | 3,575                    | 166                                       |
| Jumbo                             | 3,520               | 3,519                    | —                 | 3,519                    | 167                                       |
| Home equity                       | 523                 | 523                      | —                 | 523                      | 27  |
| Mortgage warehouse lines          | —                   | —                        | —                 | —                        | —   |
| Consumer                          | 15                  | 15                       | —                 | 15                       | 2   |
| Total without a related allowance | \$26,129            | \$26,141                 | \$ —              | \$25,345                 | \$ 1,097                                  |
| With a related allowance          |                     |                          |                   |                          |   |
| Commercial                        | \$—                 | \$—                      | \$ —              | \$—                      | \$ —                                      |
| Commercial real estate            |                     |                          |                   |                          |   |
| Owner-occupied                    | 6,756               | 6,756                    | 124               | 6,756                    | 274                                       |
| Non-owner occupied                | 329                 | 331                      | 24                | 331                      | 23  |
| Construction and development      |                     |                          |                   |                          |   |
| Land & land development           | 1,455               | 1,456                    | 515               | 1,456                    | 54  |
| Construction                      | —                   | —                        | —                 | —                        | —   |
| Residential real estate           |                     |                          |                   |                          |   |
| Non-jumbo                         | 1,872               | 1,873                    | 192               | 1,873                    | 73  |
| Jumbo                             | 834                 | 834                      | 13                | 834                      | 49  |
| Home equity                       | —                   | —                        | —                 | —                        | —   |
| Mortgage warehouse lines          | —                   | —                        | —                 | —                        | —   |
| Consumer                          | —                   | —                        | —                 | —                        | —   |
| Total with a related allowance    | \$11,246            | \$11,250                 | \$ 868            | \$11,250                 | \$ 473                                    |
| Total                             |                     |                          |                   |                          |   |
| Commercial                        | \$26,345            | \$26,354                 | \$ 663            | \$26,256                 | \$ 1,086                                  |
| Residential real estate           | 11,015              | 11,022                   | 205               | 10,324                   | 482                                       |
| Consumer                          | 15                  | 15                       | —                 | 15                       | 2   |
| Total                             | \$37,375            | \$37,391                 | \$ 868            | \$36,595                 | \$ 1,570                                  |

The table above does not include PCI loans.

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| Dollars in thousands              | December 31, 2017   |                          |                   | Average Impaired Balance | Interest Income Recognized while impaired |
|-----------------------------------|---------------------|--------------------------|-------------------|--------------------------|---|
|                                   | Recorded Investment | Unpaid Principal Balance | Related Allowance |                          |   |
| Without a related allowance       |                     |                          |                   |                          |   |
| Commercial                        | \$243               | \$243                    | \$ —              | \$259                    | \$ 13                                     |
| Commercial real estate            |                     |                          |                   |                          |   |
| Owner-occupied                    | 7,109               | 7,111                    | —                 | 5,149                    | 265                                       |
| Non-owner occupied                | 9,105               | 9,106                    | —                 | 9,736                    | 684                                       |
| Construction and development      |                     |                          |                   |                          |   |
| Land & land development           | 5,018               | 5,018                    | —                 | 4,743                    | 329                                       |
| Construction                      | —                   | —                        | —                 | —                        | —   |
| Residential real estate           |                     |                          |                   |                          |   |
| Non-jumbo                         | 4,190               | 4,199                    | —                 | 4,214                    | 240                                       |
| Jumbo                             | 3,555               | 3,554                    | —                 | 3,592                    | 228                                       |
| Home equity                       | 523                 | 523                      | —                 | 523                      | 35  |
| Mortgage warehouse lines          | —                   | —                        | —                 | —                        | —   |
| Consumer                          | 17                  | 17                       | —                 | 28                       | 3   |
| Total without a related allowance | \$29,760            | \$29,771                 | \$ —              | \$28,244                 | \$ 1,797                                  |
| With a related allowance          |                     |                          |                   |                          |   |
| Commercial                        | \$252               | \$252                    | \$ 252            | \$262                    | \$ —                                      |
| Commercial real estate            |                     |                          |                   |                          |   |
| Owner-occupied                    | 2,436               | 2,436                    | 125               | 2,451                    | 161                                       |
| Non-owner occupied                | 1,338               | 1,344                    | 517               | 676                      | 43  |
| Construction and development      |                     |                          |                   |                          |   |
| Land & land development           | 1,464               | 1,464                    | 524               | 1,477                    | 74  |
| Construction                      | —                   | —                        | —                 | —                        | —   |
| Residential real estate           |                     |                          |                   |                          |   |
| Non-jumbo                         | 1,717               | 1,718                    | 158               | 1,691                    | 100                                       |
| Jumbo                             | 838                 | 839                      | 14                | 845                      | 57  |
| Home equity                       | —                   | —                        | —                 | —                        | —   |
| Mortgage warehouse lines          | —                   | —                        | —                 | —                        | —   |
| Consumer                          | —                   | —                        | —                 | —                        | —   |
| Total with a related allowance    | \$8,045             | \$8,053                  | \$ 1,590          | \$7,402                  | \$ 435                                    |
| Total                             |                     |                          |                   |                          |   |
| Commercial                        | \$26,965            | \$26,974                 | \$ 1,418          | \$24,753                 | \$ 1,569                                  |
| Residential real estate           | 10,823              | 10,833                   | 172               | 10,865                   | 660                                       |
| Consumer                          | 17                  | 17                       | —                 | 28                       | 3   |
| Total                             | \$37,805            | \$37,824                 | \$ 1,590          | \$35,646                 | \$ 2,232                                  |

The table above does not include PCI loans.

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Included in impaired loans are TDRs of \$27.5 million, of which \$27.4 million were current with respect to restructured contractual payments at March 31, 2018, and \$28.4 million, all of which were current with respect to restructured contractual payments at December 31, 2017. There were no commitments to lend additional funds under these restructurings at either balance sheet date.

The following table presents by class the TDRs that were restructured during the three months ended March 31, 2018 and March 31, 2017. Generally, the modifications were extensions of term, modifying the payment terms from principal and interest to interest only for an extended period, or reduction in interest rate. All TDRs are evaluated individually for allowance for loan loss purposes.

| Dollars in thousands    | For the Three Months Ended<br>March 31, 2018 |                                       | For the Three Months Ended<br>March 31, 2017 |                                       |
|-------------------------|--|---------------------------------------|--|---------------------------------------|
|                         | Number of Recorded Modifications             | Post-modification Recorded Investment | Number of Recorded Modifications             | Post-modification Recorded Investment |
| Residential real estate |  |                                       |  |                                       |
| Non-jumbo               | 1  | \$ 63                                 | 4  | \$ 880                                |
| Total                   | 1  | \$ 63                                 | 4  | \$ 880                                |

The following table presents defaults during the stated period of TDRs that were restructured during the past twelve months. For purposes of these tables, a default is considered as either the loan was past due 30 days or more at any time during the period, or the loan was fully or partially charged off during the period.

| Dollars in thousands         | For the Three Months Ended March 31, 2018     |
|------------------------------|---|
|                              | Recorded Number of Investment at Default Date |
| Commercial real estate       |   |
| Non-owner occupied           | 1 \$ 341                                      |
| Construction and development |   |
| Land & land development      | 1 438   |
| Residential real estate      |   |
| Non-jumbo                    | 1 64  |
| Total                        | 3 \$ 843                                      |

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The following tables detail the activity regarding TDRs by loan type, net of fees, for the three months ended March 31, 2018, and the related allowance on TDRs.

For the Three Months Ended March 31, 2018

| Dollars in thousands                              | Construction & Land Development |              | Commercial Real Estate |                | Residential Real Estate |           |          |             | Mortgage Warehouse Lines | Consumer | Other | Total      |
|---|---------------------------------|--------------|------------------------|----------------|-------------------------|-----------|----------|-------------|--------------------------|----------|-------|------------|
|   | Land Development                | Construction | Commercial             | Owner Occupied | Non-Owner Occupied      | Non-jumbo | Jumbo    | Home Equity |                          |          |       |            |
| Troubled debt restructurings                      |                                 |              |                        |                |                         |           |          |             |                          |          |       |            |
| Balance January 1, 2018                           | \$ 3,043                        | \$ —         | -\$ 412                | \$ 9,545       | \$ 5,234                | \$ 5,195  | \$ 4,393 | \$ 523      | \$ —                     | -\$ 18   | \$ —  | \$ -28,363 |
| Additions   | —                               | —            | —                      | —              | —                       | 63        | —        | —           | —                        | —        | —     | 63         |
| Charge-offs                                       | —                               | —            | —                      | —              | —                       | —         | —        | —           | —                        | —        | —     | —          |
| Net (paydowns) advances                           | (75 )                           | —            | (270 )                 | (71 )          | 244                     | (739 )    | (39 )    | —           | —                        | (3 )     | —     | (953 )     |
| Transfer into foreclosed properties               | —                               | —            | —                      | —              | —                       | —         | —        | —           | —                        | —        | —     | —          |
| Refinance out of TDR status                       | —                               | —            | —                      | —              | —                       | —         | —        | —           | —                        | —        | —     | —          |
| Balance, March 31, 2018                           | \$ 2,968                        | \$ —         | -\$ 142                | \$ 9,474       | \$ 5,478                | \$ 4,519  | \$ 4,354 | \$ 523      | \$ —                     | -\$ 15   | \$ —  | \$ -27,473 |
| Allowance related to troubled debt restructurings | \$ 441                          | \$ —         | \$ —                   | \$ 124         | \$ 24                   | \$ 192    | \$ 13    | \$ —        | \$ —                     | \$ —     | \$ —  | \$ -794    |

The following table presents the recorded investment in construction and development, commercial, and commercial real estate loans which are generally evaluated based upon our internal risk ratings.

Loan Risk Profile by Internal Risk Rating

| Dollars in thousands   | Construction and Development |              |            |            | Commercial Real Estate |                    |                |                    | Mortgage Warehouse Lines |            |           |           |
|------------------------|------------------------------|--------------|------------|------------|------------------------|--------------------|----------------|--------------------|--------------------------|------------|-----------|-----------|
|                        | Land and Land Development    | Construction | Commercial | Commercial | Owner Occupied         | Non-Owner Occupied | Owner Occupied | Non-Owner Occupied | 3/31/2018                | 12/31/2017 |           |           |
| Pass                   | \$ 61,155                    | \$ 60,850    | \$ 33,266  | \$ 33,412  | \$ 186,740             | \$ 186,941         | \$ 257,856     | \$ 242,702         | \$ 488,813               | \$ 474,522 | \$ 45,702 | \$ 30,000 |
| OLEM (Special Mention) | 706                          | 1,397        | 61         | —          | 2,146                  | 2,267              | 3,483          | 3,534              | 1,698                    | 2,221      | —         | —         |
| Substandard            | 4,980                        | 4,972        | —          | —          | 700                    | 773                | 3,736          | 3,966              | 7,934                    | 8,159      | —         | —         |
| Doubtful               | —                            | —            | —          | —          | —                      | —                  | —              | —                  | —                        | —          | —         | —         |
| Loss                   | —                            | —            | —          | —          | —                      | —                  | —              | —                  | —                        | —          | —         | —         |
| Total                  | \$ 66,841                    | \$ 67,219    | \$ 33,327  | \$ 33,412  | \$ 189,586             | \$ 189,981         | \$ 265,075     | \$ 250,202         | \$ 498,445               | \$ 484,902 | \$ 45,702 | \$ 30,000 |

The following table presents the recorded investment and payment activity in consumer, residential real estate, and home equity loans, which are generally evaluated based on the aging status of the loans.

| Dollars in thousands    | Performing |            | Nonperforming |            |
|-------------------------|------------|------------|---------------|------------|
|                         | 3/31/2018  | 12/31/2017 | 3/31/2018     | 12/31/2017 |
| Residential real estate |            |            |               |            |
| Non-jumbo               | \$339,376  | \$ 347,183 | \$7,101       | \$ 6,918   |
| Jumbo                   | 67,169     | 62,267     | —             | —          |
| Home Equity             | 83,027     | 83,316     | 355           | 712        |
| Consumer                | 34,650     | 35,932     | 175           | 270        |
| Other                   | 12,578     | 13,238     | —             | —          |
| Total                   | \$536,800  | \$ 541,936 | \$7,631       | \$ 7,900   |

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## NOTE 7. ALLOWANCE FOR LOAN LOSSES

An analysis of the allowance for loan losses for the three month period ended March 31, 2018 and for the year ended December 31, 2017 is as follows:

|                              | March<br>31,<br>2018 | December<br>31,<br>2017 |
|------------------------------|----------------------|-------------------------|
| Dollars in thousands         |                      |                         |
| Balance, beginning of year   | \$12,565             | \$ 11,674               |
| Charge-offs:                 |                      |                         |
| Commercial                   | 39                   | 23                      |
| Commercial real estate       |                      |                         |
| Owner occupied               | 38                   | 5                       |
| Non-owner occupied           | 500                  | 65                      |
| Construction and development |                      |                         |
| Land and land development    | —                    | 3                       |
| Construction                 | —                    | 33                      |
| Residential real estate      |                      |                         |
| Non-jumbo                    | 260                  | 359                     |
| Jumbo                        | —                    | 2                       |
| Home equity                  | —                    | 158                     |
| Mortgage warehouse lines     | —                    | —                       |
| Consumer                     | 52                   | 389                     |
| Other                        | 71                   | 251                     |
| Total                        | 960                  | 1,288                   |
| Recoveries:                  |                      |                         |
| Commercial                   | 1                    | 124                     |
| Commercial real estate       |                      |                         |
| Owner occupied               | 6                    | 89                      |
| Non-owner occupied           | 2                    | 91                      |
| Construction and development |                      |                         |
| Land and land development    | 7                    | 278                     |
| Construction                 | 1                    | —                       |
| Residential real estate      |                      |                         |
| Non-jumbo                    | 53                   | 134                     |
| Jumbo                        | —                    | —                       |
| Home equity                  | 1                    | 30                      |
| Mortgage warehouse lines     | —                    | —                       |
| Consumer                     | 44                   | 82                      |
| Other                        | 37                   | 101                     |
| Total                        | 152                  | 929                     |
| Net charge-offs              | 808                  | 359                     |
| Provision for loan losses    | 500                  | 1,250                   |
| Balance, end of period       | \$12,257             | \$ 12,565               |

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The following table presents the activity in the allowance for loan losses, balance in the allowance for loan losses and recorded investment in loans by portfolio segment and based on impairment during the first three months of 2018:

|                              | Allowance for loan losses |             |            |           |                | Allowance related to:                       |   |   |          | Loans                                       |   |   |             |
|------------------------------|---------------------------|-------------|------------|-----------|----------------|---|---|---|----------|---|---|---|-------------|
|                              | Beginning Balance         | Charge-offs | Recoveries | Provision | Ending Balance | Loans individually evaluated for impairment | Loans collectively evaluated for impairment | Loans acquired with deteriorated credit quality (PCI) | Total    | Loans individually evaluated for impairment | Loans collectively evaluated for impairment | Loans acquired with deteriorated credit quality (PCI) | Total       |
| Commercial                   | \$1,303                   | \$(39)      | \$1        | \$(245)   | \$1,020        | \$—   | \$1,020                                     | \$—   | \$1,020  | \$318                                       | \$189,268                                   | \$—   | \$189,586   |
| Commercial real estate       |                           |             |            |           |                |   |   |   |          |   |   |   |             |
| Owner occupied               | 2,424                     | (38)        | 6          | 91        | 2,483          | 124   | 2,359                                       | —   | 2,483    | 9,474                                       | 254,912                                     | 689   | 265,075     |
| Non-owner occupied           | 4,950                     | (500)       | 2          | 581       | 5,033          | 24  | 5,008                                       | 1   | 5,033    | 10,081                                      | 487,048                                     | 1,316   | 498,445     |
| Construction and development |                           |             |            |           |                |   |   |   |          |   |   |   |             |
| Land and development         | 641                       | —           | 7          | 37        | 685            | 515   | 170   | —   | 685      | 6,472                                       | 60,369                                      | —   | 66,841      |
| Construction                 | 153                       | —           | 1          | 5         | 159            | —   | 159   | —   | 159      | —   | 33,327                                      | —   | 33,327      |
| Residential real estate      |                           |             |            |           |                |   |   |   |          |   |   |   |             |
| Non-jumbo                    | 1,911                     | (260)       | 53         | 285       | 1,989          | 192   | 1,792                                       | 5   | 1,989    | 6,138                                       | 338,886                                     | 1,453   | 346,477     |
| Jumbo                        | 72                        | —           | —          | 302       | 374            | 13  | 361   | —   | 374      | 4,354                                       | 61,822                                      | 993   | 67,169      |
| Home equity                  | 638                       | —           | 1          | (459)     | 180            | —   | 180   | —   | 180      | 523   | 82,859                                      | —   | 83,382      |
| Mortgage warehouse lines     | —                         | —           | —          | —         | —              | —   | —   | —   | —        | —   | 45,702                                      | —   | 45,702      |
| Consumer                     | 210                       | (52)        | 44         | (40)      | 162            | —   | 162   | —   | 162      | 15  | 34,810                                      | —   | 34,825      |
| Other                        | 263                       | (71)        | 37         | (57)      | 172            | —   | 172   | —   | 172      | —   | 12,578                                      | —   | 12,578      |
| Total                        | \$12,565                  | \$(960)     | \$152      | \$500     | \$12,257       | \$868                                       | \$11,383                                    | \$6   | \$12,257 | \$37,375                                    | \$1,601,581                                 | \$4,451   | \$1,643,407 |

NOTE 8. GOODWILL AND OTHER INTANGIBLE ASSETS

The following tables present our goodwill by reporting unit at March 31, 2018 and other intangible assets by reporting unit at March 31, 2018 and December 31, 2017.

| Dollars in thousands          | Goodwill Activity       |                    |          |
|-------------------------------|-------------------------|--------------------|----------|
|                               | Community Banking       | Insurance Services | Total    |
| Balance, January 1, 2018      | \$10,562                | \$4,710            | \$15,272 |
| Reclassifications to goodwill | —                       | —                  | —        |
| Acquired goodwill, net        | —                       | —                  | —        |
| Balance, March 31, 2018       | \$10,562                | \$4,710            | \$15,272 |
|                               | Other Intangible Assets |                    |          |

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| Dollars in thousands           | March 31, 2018      |                  |           | December 31, 2017   |                  |           |
|--------------------------------|---------------------|------------------|-----------|---------------------|------------------|-----------|
|                                | Community Insurance | Banking Services | Total     | Community Insurance | Banking Services | Total     |
| Identifiable intangible assets |                     |                  |           |                     |                  |           |
| Gross carrying amount          | \$ 12,598           | \$ 3,000         | \$ 15,598 | \$ 12,598           | \$ 3,000         | \$ 15,598 |
| Less: accumulated amortization | 1,643               | 2,150            | 3,793     | 1,257               | 2,100            | 3,357     |
| Net carrying amount            | \$ 10,955           | \$ 850           | \$ 11,805 | \$ 11,341           | \$ 900           | \$ 12,241 |

We recorded amortization expense of approximately \$436,000 and \$97,000 for the three months ended March 31, 2018 and 2017, respectively, relative to our identifiable intangible assets.

Amortization relative to our identifiable intangible assets is expected to approximate the following during the next five years:

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|                      | Core<br>Deposit | Customer<br>Intangible |
|----------------------|-----------------|------------------------|
| Dollars in thousands | Intangible      | Intangible             |
| 2018                 | \$ 1,471        | \$ 200                 |
| 2019                 | 1,368           | 200                    |
| 2020                 | 1,265           | 200                    |
| 2021                 | 1,162           | 200                    |
| 2022                 | 1,060           | 100                    |

## NOTE 9. DEPOSITS

The following is a summary of interest bearing deposits by type as of March 31, 2018 and December 31, 2017:

| Dollars in thousands              | March 31,<br>2018 | December 31,<br>2017 |
|-----------------------------------|-------------------|----------------------|
| Demand deposits, interest bearing | \$447,172         | \$ 410,606           |
| Savings deposits                  | 346,962           | 358,168              |
| Time deposits                     | 641,096           | 614,334              |
| Total                             | \$1,435,230       | \$ 1,383,108         |

Included in time deposits are deposits acquired through a third party (“brokered deposits”) totaling \$256.8 million and \$216.9 million at March 31, 2018 and December 31, 2017, respectively.

A summary of the scheduled maturities for all time deposits as of March 31, 2018 is as follows:

| Dollars in thousands                       |            |
|--|------------|
| Nine month period ending December 31, 2018 | \$ 188,743 |
| Year ending December 31, 2019              | 179,211    |
| Year ending December 31, 2020              | 124,020    |
| Year ending December 31, 2021              | 73,128     |
| Year ending December 31, 2022              | 43,069     |
| Thereafter                                 | 32,925     |
| Total                                      | \$641,096  |

The following is a summary of the maturity distribution of all certificates of deposit in denominations of \$100,000 or more as of March 31, 2018:

| Dollars in thousands      | Amount    | Percent |
|---------------------------|-----------|---------|
| Three months or less      | \$49,572  | 11.2 %  |
| Three through six months  | 21,611    | 4.9 %   |
| Six through twelve months | 72,494    | 16.3 %  |
| Over twelve months        | 299,966   | 67.6 %  |
| Total                     | \$443,643 | 100.00% |

## NOTE 10. BORROWED FUNDS

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

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| Dollars in thousands  | Three Months Ended March 31, |   |                          |   |  |   |
|---|------------------------------|---|--------------------------|---|--|---|
|   | 2018                         |   | 2017                     |   |  |   |
|   | Short-term FHLB Advances     | Federal Funds Purchased and Lines of Credit | Short-term FHLB Advances | Federal Funds Purchased and Lines of Credit |  |   |
| Balance at March 31   | \$ 190,000                   | \$ 3,513                                    | \$ 225,400               | \$ 3,468                                    |  |   |
| Average balance outstanding for the period                          | 240,179                      | 3,506                                       | 193,481                  | 3,465                                       |  |   |
| Maximum balance outstanding at any month end during period          | 262,000                      | 3,513                                       | 225,400                  | 3,468                                       |  |   |
| Weighted average interest rate for the period                       | 1.72                         | % 1.50                                      | % 0.84                   | % 0.78                                      |  | % |
| Weighted average interest rate for balances outstanding at March 31 | 2.02                         | % 1.75                                      | % 1.02                   | % 1.00                                      |  | % |

| Dollars in thousands   | Year Ended December 31, 2017 |                                  |   |  |  |   |
|--|------------------------------|----------------------------------|---|--|--|---|
|  | Short-term FHLB Advances     | Short-term Repurchase Agreements | Federal Funds Purchased and Lines of Credit |  |  |   |
| Balance at December 31   | \$ 247,000                   | \$ —                             | 3,499                                       |  |  |   |
| Average balance outstanding for the period                             | 201,712                      | 519                              | 3,512                                       |  |  |   |
| Maximum balance outstanding at any month end during period             | 247,000                      | —                                | 3,499                                       |  |  |   |
| Weighted average interest rate for the period                          | 1.19                         | % 0.12                           | % 1.10                                      |  |  | % |
| Weighted average interest rate for balances outstanding at December 31 | 1.60                         | % —                              | % 1.50                                      |  |  | % |

Long-term borrowings: Our long-term borrowings of \$45.7 million and \$45.8 million at March 31, 2018 and December 31, 2017, respectively, consisted primarily of advances from the Federal Home Loan Bank (“FHLB”) and structured repurchase agreements with unaffiliated institutions. All FHLB advances are collateralized primarily by similar amounts of residential mortgage loans, certain commercial loans, mortgage backed securities and securities of U. S. Government agencies and corporations.

|                                 | Balance at March 31, 2018 | Balance at December 31, 2017 |
|---------------------------------|---------------------------|------------------------------|
| Dollars in thousands            |                           |                              |
| Long-term FHLB advances         | \$ 747                    | \$ 751                       |
| Long-term repurchase agreements | 45,000                    | 45,000                       |
| Total                           | \$ 45,747                 | \$ 45,751                    |

Our long term FHLB borrowings and repurchase agreements bear both fixed and variable rates and mature in varying amounts through the year 2026.

The average interest rate paid on long-term borrowings for the three month period ended March 31, 2018 was 4.28% compared to 4.26% for the first three months of 2017.

Subordinated debentures owed to unconsolidated subsidiary trusts: We have three statutory business trusts that were formed for the purpose of issuing mandatorily redeemable securities (the “capital securities”) for which we are obligated to third party investors and investing the proceeds from the sale of the capital securities in our junior subordinated debentures (the “debentures”). The debentures held by the trusts are their sole assets. Our subordinated debentures totaled \$19.6 million at March 31, 2018 and December 31, 2017.

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

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

| Dollars in thousands          | Long-term<br>borrowings | Subordinated<br>debentures<br>owed<br>to<br>unconsolidated<br>subsidiary<br>trusts |
|-------------------------------|-------------------------|--|
| Year Ending December 31, 2018 | \$ 45,013               | \$ —   |
| 2019                          | 18                      | —  |
| 2020                          | 19                      | —  |
| 2021                          | 19                      | —  |
| 2022                          | 20                      | —  |
| Thereafter                    | 658                     | 19,589   |
|                               | \$ 45,747               | \$ 19,589  |

#### NOTE 11. SHARE-BASED COMPENSATION

The 2014 Long-Term Incentive Plan (“2014 LTIP”) was adopted by our shareholders in May 2014 to enhance the ability of the Company to attract and retain exceptionally qualified individuals to serve as key employees. The LTIP provides for the issuance of up to 500,000 shares of common stock, in the form of equity awards including stock options, restricted stock, restricted stock units, stock appreciation rights (“SARs”), performance units, other stock-based awards or any combination thereof, to our key employees.

Stock options awarded under the 2009 Officer Stock Option Plan and the 1998 Officer Stock Option Plan (collectively, the “Plans”) were not altered by the 2014 LTIP, and remain subject to the terms of the Plans. However, under the terms of the 2014 LTIP, all shares of common stock remaining issuable under the Plans at the time the 2014 LTIP was adopted ceased to be available for future issuance.

Under the 2014 LTIP and the Plans, stock options and SARs have generally been granted with an exercise price equal to the fair value of Summit's common stock on the grant date. We periodically grant employee stock options to individual employees. During first quarter 2017, we granted 53,309 SARs that become exercisable ratably over five years (20% per year) and expire ten years after the grant date and granted 34,306 SARs that become exercisable ratably over seven years (14.29% per year) and expire ten years after the grant date. There were no grants of stock options or SARs during the three months ended March 31, 2018.

The fair value of our employee stock options and SARs granted under the Plans 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 and SARs granted but are not considered by the model. Because our employee stock options and SARs 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 and SARs at the time of grant. The assumptions used to value SARs issued during 2017 were as follows:

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|                                  | 5-year<br>vesting<br>SARs | 7-year<br>vesting<br>SARs |   |
|----------------------------------|---------------------------|---------------------------|---|
| Risk-free interest rate          | 2.16                      | % 2.24                    | % |
| Expected dividend yield          | 1.45                      | % 1.45                    | % |
| Expected common stock volatility | 60.05                     | % 59.60                   | % |
| Expected life                    | 6.5 years                 | 7.0 years                 |   |

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We recognize compensation expense based on the estimated number of stock awards expected to actually vest, exclusive of the awards expected to be forfeited. During the first three months of 2018 and 2017, our share-based compensation expense was \$94,000 and \$84,000 and the related deferred tax benefits were approximately \$23,000 and \$31,000.

A summary of activity in our Plans during the first three months of 2018 and 2017 is as follows:

|                        | For the Three Months Ended March 31,<br>2018 |                           |                                   |                                 |
|------------------------|--|---------------------------|-----------------------------------|---------------------------------|
|                        | Options/Shares                               | Aggregate Intrinsic Value | Remaining Contractual Term (Yrs.) | Weighted-Average Exercise Price |
| Outstanding, January 1 | 250,291                                      |                           |                                   | \$ 17.75                        |
| Granted                | —  |                           |                                   | —                               |
| Exercised              | (200 )                                       |                           |                                   | 17.79                           |
| Forfeited              | (3,000 )                                     |                           |                                   | 26.01                           |
| Expired                | —  |                           |                                   | —                               |
| Outstanding, March 31  | 247,091                                      | \$ 1,918                  | 7.08                              | \$ 17.65                        |
| Exercisable, March 31  | 77,581                                       | \$ 618                    | 5.50                              | \$ 17.42                        |

|                        | For the Three Months Ended March 31,<br>2017 |                           |                                   |                                 |
|------------------------|--|---------------------------|-----------------------------------|---------------------------------|
|                        | Options/Shares                               | Aggregate Intrinsic Value | Remaining Contractual Term (Yrs.) | Weighted-Average Exercise Price |
| Outstanding, January 1 | 217,857                                      |                           |                                   | \$ 13.56                        |
| Granted                | 87,615                                       |                           |                                   | 26.01                           |
| Exercised              | (2,000 )                                     |                           |                                   | 6.21                            |
| Forfeited              | —  |                           |                                   | —                               |
| Expired                | —  |                           |                                   | —                               |
| Outstanding, March 31  | 303,472                                      | \$ 1,812                  | 7.61                              | \$ 17.20                        |
| Exercisable, March 31  | 82,483                                       | \$ 541                    | 4.48                              | \$ 16.23                        |

## NOTE 12. COMMITMENTS AND CONTINGENCIES

### Off-Balance Sheet Arrangements

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

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:

| Dollars in thousands                        | March 31,<br>2018 |
|---|-------------------|
| Commitments to extend credit:               |                   |
| Revolving home equity and credit card lines | \$ 69,825         |
| Construction loans                          | 43,734            |
| Other loans                                 | 120,481           |
| Standby letters of credit                   | 3,957             |
| Total                                       | \$ 237,997        |

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.

#### Litigation

We are not a party to litigation except for matters that arise in the normal course of business. While it is impossible to ascertain the ultimate resolution or range of financial liability if any, with respect to these contingent matters, in the opinion of management, the outcome of these matters will not have a significant adverse effect on the consolidated financial statements.

#### NOTE 13. REGULATORY MATTERS

We and our subsidiaries are subject to various regulatory capital requirements administered by the banking regulatory agencies. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, we and each of our subsidiaries must meet specific capital guidelines that involve quantitative measures of our and our subsidiaries' assets, liabilities and certain off-balance sheet items as calculated under regulatory accounting practices. We and each of our subsidiaries' capital amounts and classifications are also subject to qualitative judgments by the regulators about components, risk weightings and other factors.

Quantitative measures established by regulation to ensure capital adequacy require us and each of our subsidiaries to maintain minimum amounts and ratios of Common Equity Tier ("CET1") 1, Total capital 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 March 31, 2018, 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 CET1, Total risk-based, Tier I risk-based, and Tier I leverage ratios as set forth in the table below.



The Basel III Capital Rules became effective for us on January 1, 2015, with full compliance with all of the final rule's requirements phased in over a multi-year schedule, to be fully phased-in by January 1, 2019. As of March 31, 2018, our capital levels remained characterized as "well-capitalized" under the new rules. See the Capital Requirements section included in Part I Item 1 Business of our 2017 Annual Report on Form 10-K for further discussion of Basel III.

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The following table presents Summit's, as well as our subsidiary, Summit Community Bank's ("Summit Community"), actual and required minimum capital amounts and ratios as of March 31, 2018 and December 31, 2017 under the Basel III Capital Rules. The minimum required capital levels presented below reflect the minimum required capital levels (inclusive of the full capital conservation buffers) that will be effective as of January 1, 2019 when the Basel III Capital Rules have been fully phased-in. Capital levels required to be considered well capitalized are based upon prompt corrective action regulations, as amended to reflect the changes under the Basel III Capital Rules.

|  | Actual    |       | Minimum Required Capital - Basel III Fully Phased-in |        | Minimum Required To Be Well Capitalized |       |
|--|-----------|-------|--|--------|---|-------|
|  | Amount    | Ratio | Amount   | Ratio  | Amount                                  | Ratio |
| Dollars in thousands                     |           |       |  |        |   |       |
| As of March 31, 2018                     |           |       |  |        |   |       |
| CET1 (to risk weighted assets)           |           |       |  |        |   |       |
| Summit                                   | \$181,567 | 10.7% | \$118,782  | 7.0 %  | \$110,298                               | 6.5 % |
| Summit Community                         | 199,727   | 11.7% | 119,495  | 7.0 %  | 110,959                                 | 6.5 % |
| Tier I Capital (to risk weighted assets) |           |       |  |        |   |       |
| Summit                                   | 200,567   | 11.8% | 144,476  | 8.5 %  | 135,978                                 | 8.0 % |
| Summit Community                         | 199,727   | 11.7% | 145,101  | 8.5 %  | 136,565                                 | 8.0 % |
| Total Capital (to risk weighted assets)  |           |       |  |        |   |       |
| Summit                                   | 212,825   | 12.5% | 178,773  | 10.5 % | 170,260                                 | 10.0% |
| Summit Community                         | 211,985   | 12.5% | 178,067  | 10.5 % | 169,588                                 | 10.0% |
| Tier I Capital (to average assets)       |           |       |  |        |   |       |
| Summit                                   | 200,567   | 9.5 % | 84,449   | 4.0 %  | 105,562                                 | 5.0 % |
| Summit Community                         | 199,727   | 9.5 % | 84,096   | 4.0 %  | 105,119                                 | 5.0 % |
|  | Actual    |       | Minimum Required Capital - Basel III Fully Phased-in |        | Minimum Required To Be Well Capitalized |       |
|  | Amount    | Ratio | Amount   | Ratio  | Amount                                  | Ratio |
| Dollars in thousands                     |           |       |  |        |   |       |
| As of December 31, 2017                  |           |       |  |        |   |       |
| CET1 (to risk weighted assets)           |           |       |  |        |   |       |
| Summit                                   | 177,010   | 10.6% | 116,893  | 7.0 %  | 108,544                                 | 6.5 % |
| Summit Community                         | 195,008   | 11.7% | 116,671  | 7.0 %  | 108,338                                 | 6.5 % |
| Tier I Capital (to risk weighted assets) |           |       |  |        |   |       |
| Summit                                   | 196,010   | 11.8% | 141,194  | 8.5 %  | 132,888                                 | 8.0 % |
| Summit Community                         | 195,008   | 11.7% | 141,672  | 8.5 %  | 133,339                                 | 8.0 % |
| Total Capital (to risk weighted assets)  |           |       |  |        |   |       |
| Summit                                   | 208,575   | 12.5% | 175,203  | 10.5 % | 166,860                                 | 10.0% |
| Summit Community                         | 207,573   | 12.5% | 174,361  | 10.5 % | 166,058                                 | 10.0% |
| Tier I Capital (to average assets)       |           |       |  |        |   |       |
| Summit                                   | 196,010   | 9.4 % | 83,409   | 4.0 %  | 104,261                                 | 5.0 % |
| Summit Community                         | 195,008   | 9.4 % | 82,982   | 4.0 %  | 103,728                                 | 5.0 % |

NOTE 14. SEGMENT INFORMATION

We operate three business segments: community banking, insurance services and trust and wealth management services. These segments are primarily identified by the products or services offered. The community banking segment consists of our full service banks which offer customers traditional banking products and services through

various delivery channels. The insurance services segment includes two insurance agency offices that sell insurance products. The trust and wealth management segment includes Summit Community Bank's trust division and other non-bank investment products. The accounting policies discussed throughout the notes to the consolidated financial statements apply to each of our business segments.

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Inter-segment revenue and expense consists of management fees allocated to the community banking, insurance services and trust and wealth management segments for all centralized functions that are performed by the parent, including overall direction in the areas of strategic planning, investment portfolio management, asset/liability management, financial reporting and other financial and administrative services. Information for each of our segments is included below:

| Dollars in thousands                                | Three Months Ended March 31, 2018 |                             |                    |           |              |             |
|---|-----------------------------------|-----------------------------|--------------------|-----------|--------------|-------------|
|   | Community Banking                 | Trust and Wealth Management | Insurance Services | Parent    | Eliminations | Total       |
| Net interest income                                 | \$17,448                          | \$ —                        | \$—                | \$(191 )  | \$—          | \$17,257    |
| Provision for loan losses                           | 500                               | —                           | —                  | —         | —            | 500         |
| Net interest income after provision for loan losses | 16,948                            | —                           | —                  | (191 )    | —            | 16,757      |
| Other income  | 3,094                             | 667                         | 1,115              | 389       | (389 )       | 4,876       |
| Other expenses                                      | 10,651                            | 526                         | 897                | 629       | (389 )       | 12,314      |
| Income (loss) before income taxes                   | 9,391                             | 141                         | 218                | (431 )    | —            | 9,319       |
| Income tax expense (benefit)                        | 1,857                             | 34                          | 51                 | (66 )     | —            | 1,876       |
| Net income (loss)                                   | \$7,534                           | \$ 107                      | \$ 167             | \$(365 )  | \$—          | \$7,443     |
| Inter-segment revenue (expense)                     | \$(359 )                          | \$ —                        | \$(30 )            | \$389     | \$—          | \$—         |
| Average assets                                      | \$2,148,443                       | \$ —                        | \$ 5,985           | \$224,541 | \$(248,238 ) | \$2,130,731 |
| Capital expenditures                                | \$1,850                           | \$ —                        | \$ 12              | \$10      | \$—          | \$1,872     |

  

| Dollars in thousands                                | Three Months Ended March 31, 2017 |                             |                    |           |              |             |
|---|-----------------------------------|-----------------------------|--------------------|-----------|--------------|-------------|
|   | Community Banking                 | Trust and Wealth Management | Insurance Services | Parent    | Eliminations | Total       |
| Net interest income                                 | \$13,795                          | \$ —                        | \$—                | \$(165 )  | \$—          | \$13,630    |
| Provision for loan losses                           | 250                               | —                           | —                  | —         | —            | 250         |
| Net interest income after provision for loan losses | 13,545                            | —                           | —                  | (165 )    | —            | 13,380      |
| Other income  | 1,507                             | 100                         | 972                | 491       | (491 )       | 2,579       |
| Other expenses                                      | 18,067                            | 144                         | 874                | 422       | (491 )       | 19,016      |
| Income (loss) before income taxes                   | (3,015 )                          | (44 )                       | 98                 | (96 )     | —            | (3,057 )    |
| Income tax expense (benefit)                        | (1,434 )                          | (16 )                       | 41                 | (32 )     | —            | (1,441 )    |
| Net income (loss)                                   | \$(1,581 )                        | \$ (28 )                    | \$ 57              | \$(64 )   | \$—          | \$(1,616 )  |
| Inter-segment revenue (expense)                     | \$(451 )                          | \$ —                        | \$(40 )            | \$491     | \$—          | \$—         |
| Average assets                                      | \$1,750,059                       | \$ —                        | \$ 6,174           | \$180,393 | \$(206,991 ) | \$1,729,635 |
| Capital expenditures                                | \$2,992                           | \$ —                        | \$ 3               | \$—       | \$—          | \$2,995     |

#### NOTE 15. DERIVATIVE FINANCIAL INSTRUMENTS

We have entered into three forward-starting, pay-fixed/receive LIBOR interest rate swaps. \$40 million notional with an effective date of July 18, 2016, was designated as a cash flow hedge of \$40 million of forecasted variable rate Federal Home Loan Bank advances. Under the terms of this swap we will pay a fixed rate of 2.98% for a 3 year period. \$30 million notional with an effective date of April 18, 2016, was designated as a cash flow hedge of \$30 million of forecasted variable rate Federal Home Loan Bank advances. Under the terms of this swap we will pay a fixed rate of 2.89% for a 4.5 year period. \$40 million notional with an effective date of October 18, 2016, was designated as a cash flow hedge of \$40 million of forecasted variable rate Federal Home Loan Bank advances. Under the terms of the swap we will pay a fixed rate of 2.84% for a 3 year period.

We have entered into two pay fixed/receive variable interest rate swaps to hedge fair value variability of two commercial fixed rate loans with the same principal, amortization, and maturity terms of the underlying loans, which are designated as fair value hedges. Under the terms of a \$9.95 million original notional swap with an effective date of January 15, 2015, we will pay a

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The following presents the financial effects of adjustments recognized in the statement of income for the three months ended March 31, 2018 and 2017 related to business combinations that occurred during 2016 and 2017.

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| Dollars in thousands             | Income increase<br>(decrease)                    |  |
|----------------------------------|--|--|
|                                  | Three<br>Months<br>Ended<br>March<br>31,<br>2018 | Three<br>Months<br>Ended<br>March<br>31,<br>2017 |
| Interest and fees on loans       | \$ 145   | \$ 144   |
| Interest expense on deposits     | 61   | 4  |
| Amortization of intangibles      | (386 )   | (47 )  |
| Income before income tax expense | \$(180)  | \$ 101   |

## NOTE 17. ACCUMULATED OTHER COMPREHENSIVE LOSS

The following is changes in accumulated other comprehensive loss by component, net of tax, for the three months ending March 31, 2018 and 2017.

| Dollars in thousands   | For the Three Months Ended<br>March 31, 2018                         |   |   | Total      |
|--|--|---|---|------------|
|  | Gains<br>and<br>Losses<br>on<br>Other<br>Post-Retirement<br>Benefits | Gains<br>and<br>Losses<br>on Cash<br>Flow<br>Retirement<br>Hedges | Unrealized Gains<br>(Losses) on<br>Available-for-Sale<br>Securities |            |
| Beginning balance  | \$398  | \$(1,564)   | \$ 2,898  | \$1,732    |
| Other comprehensive income (loss) before reclassification        | —  | 715   | (2,779)   | ) (2,064 ) |
| Amounts reclassified from accumulated other comprehensive income | —  | —   | (556)   | ) (556 )   |
| Net current period other comprehensive income (loss)             | —  | 715   | (3,335)   | ) (2,620 ) |
| Ending balance   | \$398  | \$(849 )  | \$ (437 )   | ) \$(888 ) |

| Dollars in thousands   | For the Three Months Ended<br>March 31, 2017                         |   |   | Total     |
|--|--|---|---|-----------|
|  | Gains<br>and<br>Losses<br>on<br>Other<br>Post-Retirement<br>Benefits | Gains<br>and<br>Losses<br>on Cash<br>Flow<br>Retirement<br>Hedges | Unrealized Gains<br>(Losses) on<br>Available-for-Sale<br>Securities |           |
| Beginning balance  | \$(2,906)  | \$ (356)  | )   | \$(3,262) |
| Other comprehensive income before reclassification               | —497   | 153   | )   | 650       |
| Amounts reclassified from accumulated other comprehensive income | —  | 37  | )   | 37        |
| Net current period other comprehensive income                    | —497   | 190   | )   | 687       |
| Ending balance   | \$(2,409)  | \$ (166)  | )   | \$(2,575) |

## NOTE 18. INCOME TAXES



Our income tax expense (benefit) for the three months ended March 31, 2018 and March 31, 2017 totaled \$1.9 million and \$(1.4) million, respectively. Our effective tax rate (income tax expense as a percentage of income before taxes) for the quarters ended March 31, 2018 and 2017 was 20.2% and 47.1%, respectively. A reconciliation between the statutory income tax rate and our effective income tax rate for the three and nine months ended March 31, 2018 and 2017 is as follows:

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|   | For the Three<br>Months Ended<br>March 31, |         |
|---|--|---------|
| Dollars in thousands  | 2018                                       | 2017    |
|   | Percent                                    | Percent |
| Applicable statutory rate                                       | 21.0 %                                     | 35.0 %  |
| Increase (decrease) in rate resulting from:                     |  |         |
| Tax-exempt interest and dividends, net                          | (2.6 )%                                    | 9.6 %   |
| State income taxes (benefit), net of Federal income tax benefit | 2.2 %                                      | 2.6 %   |
| Low-income housing and rehabilitation tax credits               | (1.0 )%                                    | — %     |
| Other, net  | 0.6 %                                      | (0.1 )% |
| Effective income tax rate                                       | 20.2 %                                     | 47.1 %  |

The components of applicable income tax expense for the three months ended March 31, 2018 and 2017 are as follows:

|                      | For the Three<br>Months Ended<br>March 31, |           |
|----------------------|--|-----------|
| Dollars in thousands | 2018                                       | 2017      |
| Current              |  |           |
| Federal              | \$1,753                                    | \$2,178   |
| State                | 278  | 189       |
|                      | 2,031                                      | 2,367     |
| Deferred             |  |           |
| Federal              | (134 )                                     | (3,498 )  |
| State                | (21 )                                      | (310 )    |
|                      | (155 )                                     | (3,808 )  |
| Total                | \$1,876                                    | \$(1,441) |
| +                    |  |           |

#### NOTE 19. REVENUE FROM CONTRACTS WITH CUSTOMERS

Interest income, loan fees, realized securities gains and losses, bank owned life insurance income and mortgage banking revenue are not in the scope of ASC Topic 606, Revenue from Contracts with Customers. With the exception of gains or losses on sales of foreclosed properties, all of our revenue from contracts with customers in the scope of ASC 606 is recognized within Noninterest Income in the Consolidated Statements of Income. Incremental costs of obtaining a contract are expensed when incurred when the amortization period is one year or less.

As of March 31, 2018, remaining performance obligations consisted of insurance products with an original expected length of one year or less.

A description of our significant sources of revenue accounted for under ASC 606 follows:

Service fees on deposit accounts are fees we charge our deposit customers for transaction-based, account maintenance and overdraft services. Transaction-based fees, which are earned based on specific transactions or customer activity within a customer's deposit account, are recognized at the time the related transaction or activity occurs, as it is at this point when we fulfill the customer's request. Account maintenance fees, which relate primarily to monthly maintenance, are earned over the course of a month, representing the period over which Summit satisfied the performance obligation. Overdraft fees are recognized when the overdraft occurs. Service fees on deposit accounts are paid through a direct charge to the customer's account.

Bank card revenue is comprised of interchange revenue and ATM fees. Interchange revenue is earned when Summit's debit and credit cardholders conduct transactions through Mastercard and other payment networks. Interchange fees represent a percentage of the underlying cardholder's transaction value and are generally recognized daily, concurrent

with the transaction processing services provided to the cardholder. ATM fees are earned when a non-Summit cardholder uses a Summit ATM. ATM fees are recognized daily, as the related ATM transactions are settled. Trust and wealth management fees consist of 1) trust fees and 2) commissions earned from an independent, third-party broker-dealer. We earn trust fees from our contracts with trust clients to administer or manage assets for investment. Trust fees are earned over time (generally monthly) as Summit provides the contracted services and are assessed based on the value of assets under management at each month-end. We earn commissions from investment brokerage services provided to our clients by an

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independent, third-party broker-dealer. We receive monthly commissions from the third-party broker-dealer based upon client activity for the previous month.

Insurance commissions principally consist of commissions we earn as agents of insurers for selling group employee benefit and property and casualty insurance products to clients. Group employee benefit insurance commissions are recognized over time (generally monthly) as the related customary implied servicing obligations of group policyholders are fulfilled. Property and casualty insurance commissions are recognized using methods which approximate the time of placement of the underlying policy. We are paid insurance commissions ratably as the related policy premiums are paid by clients.

The following table illustrates our total non-interest income segregated by revenues within the scope of ASC Topic 606 and those which are within the scope of other ASC Topics:

| Dollars in thousands                                     | Three<br>Months<br>Ended<br>March<br>31,<br>2018 |
|--|--|
| Service fees on deposit accounts                         | \$ 1,091   |
| Bank card revenue  | 749  |
| Trust and wealth management fees                         | 667  |
| Insurance commissions                                    | 1,113  |
| Other  | 53   |
| Net revenue from contracts with customers                | 3,673  |
| Non-interest income within the scope of other ASC topics | 1,203  |
| Total noninterest income                                 | \$ 4,876   |

Gain or loss on sale of foreclosed properties is recorded when control of the property transfers to the buyer, which generally occurs at the time of transfer of the deed. If Summit finances the sale of a foreclosed property to the buyer, we assess whether the buyer is committed to perform their obligations under the contract and whether collectability of the transaction price is probable. Once these criteria are met, the foreclosed property is derecognized and the gain or loss on sale is recorded upon transfer of control of the property to the buyer. For the three months ended March 31, 2018, net gains on sales of foreclosed properties were \$64,000.

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## Item 2. 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 its operating subsidiaries, Summit Community Bank ("Summit Community") and Summit Insurance Services, LLC, for the periods indicated. See Note 14 of the accompanying consolidated financial statements for our segment information. This discussion and analysis should be read in conjunction with our 2017 audited financial statements and Annual Report on Form 10-K.

The Private Securities Litigation Act of 1995 indicates that the disclosure of forward-looking information is desirable for investors and encourages such disclosure by providing a safe harbor for forward-looking statements by us. Our following discussion and analysis of financial condition and results of operations contains certain forward-looking statements that involve risk and uncertainty. In order to comply with the terms of the safe harbor, we note that a variety of factors could cause our actual results and experience to differ materially from the anticipated results or other expectations expressed in those forward-looking statements.

## OVERVIEW

On October 1, 2016, we acquired Highland County Bankshares, Inc. ("HCB") and its subsidiary, First and Citizens Bank, headquartered in Monterey, Virginia. On April 1, 2017, we acquired First Century Bankshares, Inc. ("FCB") and its subsidiary, First Century Bank, headquartered in Bluefield, West Virginia. Since results of the two acquisitions are included in our results from the acquisition dates forward, comparisons to prior periods are significantly impacted by the acquired companies' results.

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.

Primarily due to our FCB acquisition, interest earning assets increased by 23.41% for the first three months in 2018 compared to the same period of 2017 while our net interest earnings on a tax equivalent basis increased 24.74%. Our tax equivalent net interest margin increased 4 basis points as our yield on interest earning assets increased 18 basis points while our cost of interest bearing funds increased 17 basis points.

We recorded a charge of \$9.9 million, or \$6.2 million after-tax, to noninterest expense in the first quarter of 2017 to recognize our full resolution of the ResCap Litigation which had been pending since 2014.

## BUSINESS SEGMENT RESULTS

We are organized and managed along three major business segments, as described in Note 14 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:

|                             | Three Months<br>Ended March 31, |           |
|-----------------------------|---------------------------------|-----------|
| Dollars in thousands        | 2018                            | 2017      |
| Community banking           | \$7,534                         | \$(1,581) |
| Trust and wealth management | 107                             | (28 )     |
| Insurance services          | 167                             | 57        |
| Parent                      | (365 )                          | (64 )     |
| Consolidated net income     | \$7,443                         | \$(1,616) |

## 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.

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Our most significant accounting policies are presented in the notes to the consolidated financial statements of our 2017 Annual Report on Form 10-K. These policies, along with the other disclosures presented in the financial statement notes and in this financial review, provide information on how significant assets and liabilities are valued in the financial statements and how those values are determined.

Based on the valuation techniques used and the sensitivity of financial statement amounts to the methods, assumptions and estimates underlying those amounts, we have identified the determination of the allowance for loan losses, the valuation of goodwill, fair value measurements, accounting for acquired loans and deferred tax assets 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.

For additional information regarding critical accounting policies, refer to Critical Accounting Policies section in Management's Discussion and Analysis of Financial Condition and Results of Operations included in the 2017 Form 10-K. There have been no significant changes in our application of critical accounting policies since December 31, 2017.

## RESULTS OF OPERATIONS

### Earnings Summary

Net income for the three months ended March 31, 2018 was \$7.4 million, or \$0.60 per diluted share, compared to a loss of \$1.6 million, or (\$0.15) per diluted share for the same period of 2017. The loss for the 2017 period was primarily attributable to the charge for a \$9.9 million pre-tax litigation settlement. Otherwise, net income for the quarter ended March 31, 2018, compared to the same period of 2017, was positively impacted by increased net interest income, increased fee income including trust and wealth management fees and fees related to deposit accounts and larger gains on sales of securities while being negatively impacted by generally higher operating expenses due to the FCB acquisition. Returns on average equity and assets for the first three months of 2018 were 14.73% and 1.40%, respectively, compared with (4.11%) and (0.37%) for the same period of 2017.

FCB's results of operations are included in our consolidated results of operations from the date of acquisition, and therefore our quarter ended March 31, 2018 results reflect increased levels of average balances, income and expense as compared to the same periods of 2017 results. At consummation (prior to fair value acquisition adjustments), FCB had total assets of \$406.2 million, net loans of \$226.5 million, and deposits of \$349.7 million.

### 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. Due to increases in interest earnings assets and interest bearing liabilities from the HCB and FCB acquisitions and recent FOMC increases to its target Federal funds rate, we have experienced higher levels of net interest income and an increased net interest margin.

For the quarter ended March 31, 2018, our net interest income on a fully taxable-equivalent basis increased \$3.5 million to \$17.6 million compared to \$14.1 million for the quarter end March 31, 2017. Our taxable-equivalent earnings on interest earning assets increased \$5.1 million, while the cost of interest bearing liabilities increased \$1.6 million (see Tables I and II).

For the three months ended March 31, 2018 average interest earning assets increased 23.4% to \$1.99 billion compared to \$1.61 billion for the three months ended March 31, 2017, while average interest bearing liabilities increased 20.9% from \$1.41 billion at March 31, 2017 to \$1.70 billion at March 31, 2018.

For the quarter ended March 31, 2018, our net interest margin increased to 3.58%, compared to 3.54% for the same period of 2017, as the yields on earning assets increased 18 basis points, while the cost of our interest bearing funds increased by 17 basis points. The 7 basis point decline in net interest margin from fourth quarter 2017 to first quarter 2018 is primarily due to lower taxable-equivalent yields on tax-exempt interest earning assets resulting from reduction in the corporate income tax rate upon enactment of TCJA.

Excluding the impact of accretion and amortization of fair value acquisition accounting adjustments related to the interest earning assets and interest bearing liabilities acquired from FCB and HCB, Summit's net interest margin was 3.53% and 3.50% for the three months ended March 31, 2018 and 2017.

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Table I - Average Balance Sheet and Net Interest Income Analysis

| Dollars in thousands  | For the Quarter Ended |                  |            |                   |                  |            |                 |                  |            |
|---|-----------------------|------------------|------------|-------------------|------------------|------------|-----------------|------------------|------------|
|   | March 31, 2018        |                  |            | December 31, 2017 |                  |            | March 31, 2017  |                  |            |
|   | Average Balance       | Earnings/Expense | Yield/Rate | Average Balance   | Earnings/Expense | Yield/Rate | Average Balance | Earnings/Expense | Yield/Rate |
| Interest earning assets   |                       |                  |            |                   |                  |            |                 |                  |            |
| Loans, net of unearned fees (1)                                   |                       |                  |            |                   |                  |            |                 |                  |            |
| Taxable   | \$1,611,813           | \$20,223         | 5.09%      | \$1,562,978       | \$19,879         | 5.05%      | \$1,278,386     | \$15,549         | 4.93%      |
| Tax-exempt (2)  | 16,307                | 182              | 4.53%      | 16,902            | 234              | 5.49%      | 13,292          | 186              | 5.68%      |
| Securities  |                       |                  |            |                   |                  |            |                 |                  |            |
| Taxable   | 191,713               | 1,372            | 2.90%      | 202,377           | 1,328            | 2.60%      | 186,332         | 1,128            | 2.46%      |
| Tax-exempt (2)  | 132,306               | 1,290            | 3.95%      | 142,641           | 1,668            | 4.64%      | 95,300          | 1,112            | 4.73%      |
| Federal funds sold and interest bearing deposits with other banks | 39,656                | 140              | 1.43%      | 42,021            | 144              | 1.36%      | 40,698          | 152              | 1.51%      |
| Total interest earning assets                                     | 1,991,795             | 23,207           | 4.73%      | 1,966,919         | 23,253           | 4.69%      | 1,614,008       | 18,127           | 4.55%      |
| Noninterest earning assets  |                       |                  |            |                   |                  |            |                 |                  |            |
| Cash & due from banks   | 9,962                 |                  |            | 9,753             |                  |            | 4,631           |                  |            |
| Premises and equipment  | 34,586                |                  |            | 34,263            |                  |            | 24,504          |                  |            |
| Property held for sale  | 21,326                |                  |            | 22,137            |                  |            | 24,258          |                  |            |
| Other assets  | 85,799                |                  |            | 89,459            |                  |            | 73,995          |                  |            |
| Allowance for loan losses   | (12,737)              |                  |            | (12,628)          |                  |            | (11,761)        |                  |            |
| Total assets  | \$2,130,731           |                  |            | \$2,109,903       |                  |            | \$1,729,635     |                  |            |
| Interest bearing liabilities                                      |                       |                  |            |                   |                  |            |                 |                  |            |
| Interest bearing demand deposits                                  |                       |                  |            |                   |                  |            |                 |                  |            |
| Interest bearing demand deposits                                  | \$423,095             | \$632            | 0.61%      | 405,307           | 447              | 0.44%      | 262,849         | 148              | 0.23%      |
| Savings deposits  | 346,358               | 717              | 0.84%      | 360,630           | 684              | 0.75%      | 339,930         | 625              | 0.75%      |
| Time deposits   | 622,543               | 2,200            | 1.43%      | 629,871           | 2,093            | 1.32%      | 540,692         | 1,616            | 1.21%      |
| Short-term borrowings   | 243,686               | 1,405            | 2.34%      | 220,027           | 1,240            | 2.24%      | 196,946         | 995              | 2.05%      |
| Long-term borrowings and capital trust securities                 | 65,338                | 686              | 4.26%      | 65,342            | 685              | 4.16%      | 66,146          | 660              | 4.05%      |
| Total interest bearing liabilities                                | 1,701,020             | 5,640            | 1.34%      | 1,681,177         | 5,149            | 1.22%      | 1,406,563       | 4,044            | 1.17%      |
| Noninterest bearing liabilities and shareholders' equity          |                       |                  |            |                   |                  |            |                 |                  |            |
| Demand deposits   | 210,883               |                  |            | 214,624           |                  |            | 148,286         |                  |            |
| Other liabilities   | 16,771                |                  |            | 12,886            |                  |            | 17,700          |                  |            |
| Total liabilities   | 1,928,674             |                  |            | 1,908,687         |                  |            | 1,572,549       |                  |            |
| Shareholders' equity  | 202,057               |                  |            | 201,216           |                  |            | 157,086         |                  |            |
|   | \$2,130,731           |                  |            | \$2,109,903       |                  |            | \$1,729,635     |                  |            |

|  |           |        |           |           |
|--|-----------|--------|-----------|-----------|
| Total liabilities and shareholders' equity |           |        |           |           |
| Net interest earnings                      | \$ 17,567 |        | \$ 18,104 | \$ 14,083 |
| Net yield on interest earning assets       |           | 3.58 % |           | 3.65 %    |
|  |           |        |           | 3.54 %    |

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

- Interest income on tax-exempt securities and loans has been adjusted assuming a Federal tax rate of 21% for the three months ended March 31, 2018 and 35% for the three months ended December 31, 2017 and March 31, 2017.

(2) The tax equivalent adjustment resulted in an increase in interest income of \$310,000, \$666,000 and \$453,000 for the three months ended March 31, 2018, December 31, 2017 and March 31, 2017, respectively.

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Table II - Changes in Interest Margin Attributable to Rate and Volume

| Dollars in thousands  | For the Quarter Ended<br>March 31, 2018 vs.<br>December 31, 2017 |         |         | For the Quarter Ended<br>March 31, 2018 vs.<br>March 31, 2017 |         |         |
|---|--|---------|---------|---|---------|---------|
|   | Increase (Decrease)<br>Due to Change in:<br>Volume               | Rate    | Net     | Increase (Decrease) Due<br>to Change in:<br>Volume            | Rate    | Net     |
| Interest earned on:   |  |         |         |   |         |         |
| Loans   |  |         |         |   |         |         |
| Taxable   | \$271  | \$73    | \$344   | \$4,169   | \$505   | \$4,674 |
| Tax-exempt  | (9)  | (43)    | (52)    | 37  | (41)    | (4)     |
| Securities  |  |         |         |   |         |         |
| Taxable   | (80)   | 124     | 44      | 34  | 210     | 244     |
| Tax-exempt  | (124)  | (254)   | (378)   | 382   | (204)   | 178     |
| Federal funds sold and interest bearing deposits with other banks | (10)   | 6       | (4)     | (4)   | (8)     | (12)    |
| Total interest earned on interest earning assets                  | 48   | (94)    | (46)    | 4,618   | 462     | 5,080   |
| Interest paid on:   |  |         |         |   |         |         |
| Interest bearing demand deposits                                  | 19   | 166     | 185     | 130   | 354     | 484     |
| Savings deposits  | (31)   | 64      | 33      | 12  | 80      | 92      |
| Time deposits   | (30)   | 137     | 107     | 265   | 319     | 584     |
| Short-term borrowings   | 115  | 50      | 165     | 257   | 153     | 410     |
| Long-term borrowings and capital trust securities                 | —  | 1       | 1       | (8)   | 34      | 26      |
| Total interest paid on interest bearing liabilities               | 73   | 418     | 491     | 656   | 940     | 1,596   |
| Net interest income   | \$(25)   | \$(512) | \$(537) | \$3,962   | \$(478) | \$3,484 |

## Noninterest Income

Total noninterest income for the three months ended March 31, 2018 increased 89.1% compared to same period in 2017 principally due to increased trust and wealth management fees and service fees on deposit accounts as a result of the FCB acquisition and increased gains on sales of securities. Further detail regarding noninterest income is reflected in the following table.

Table III - Noninterest Income

| Dollars in thousands                | For the Quarter<br>Ended March<br>31, |         |
|-------------------------------------|---------------------------------------|---------|
|                                     | 2018                                  | 2017    |
| 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           | 732                                   | (58)    |
| Bank owned life insurance income    | 275                                   | 250     |
| Other                               | 249                                   | 102     |
| Total                               | \$4,876                               | \$2,579 |

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## Noninterest Expense

Total noninterest expense decreased 35.2% for the three months ended March 31, 2018, as compared to the same period in 2017. Excluding the \$9.9 million litigation charge during 2017, total noninterest expense increased 35.1% with higher salaries, commissions, and employee benefits having the largest negative impact. Table IV below shows the breakdown of the changes.

Table IV - Noninterest Expense

| Dollars in thousands                          | For the Quarter Ended March 31, |           |         |            |
|---|---------------------------------|-----------|---------|------------|
|   | 2018                            | Change    |         | 2017       |
|   | \$                              | \$        | %       | \$         |
| Salaries, commissions, and employee benefits  | \$6,821                         | \$1,634   | 31.5    | % \$5,187  |
| Net occupancy expense                         | 832                             | 265       | 46.7    | % 567      |
| Equipment expense                             | 1,083                           | 348       | 47.3    | % 735      |
| Professional fees                             | 333                             | 48        | 16.8    | % 285      |
| Advertising and public relations              | 103                             | (5 )      | (4.6 )  | % 108      |
| Amortization of intangibles                   | 436                             | 339       | 349.5   | % 97       |
| FDIC premiums                                 | 240                             | 30        | 14.3    | % 210      |
| Merger-related expenses                       | —                               | (109 )    | (100.0) | % 109      |
| Foreclosed properties expense                 | 132                             | 28        | 26.9    | % 104      |
| (Gain) loss on sales of foreclosed properties | (64 )                           | 92        | (59.0 ) | % (156 )   |
| Write-downs of foreclosed properties          | 257                             | (161 )    | (38.5 ) | % 418      |
| Litigation settlement                         | —                               | (9,900 )  | (100.0) | % 9,900    |
| Other   | 2,141                           | 689       | 47.5    | % 1,452    |
| Total   | \$12,314                        | \$(6,702) | (35.2 ) | % \$19,016 |

Salaries, commissions, and employee benefits: These expenses are 31.5% higher in the first three months of 2018 compared to first three months of 2017 due to an increase in number of employees, primarily those in conjunction with the FCB acquisition, and general merit raises.

Net occupancy expense: The increase in net occupancy expense is primarily due to the acquired FCB locations

Equipment: The increase in equipment expense is primarily increased depreciation and amortization related to various technological upgrades, both hardware and software, made during the past two years and also the FCB acquisition in Q2 2017.

Amortization of intangibles: Amortization of intangibles increased during 2018 as a result of the additional amortization of the core deposit intangibles associated with the FCB acquisition.

Litigation settlement: We recorded a \$9.9 million pre-tax charge in Q1 2017 as full resolution of the ResCap Litigation which had been pending since 2014.

Other: The increase in other expenses is primarily due to increased operating expenses as a result of the acquisition of FCB.

## Income Taxes

Our income tax expense (benefit) for the three months ended March 31, 2018 and March 31, 2017 totaled \$1.9 million and \$(1.4) million, respectively. Our effective tax rate (income tax expense as a percentage of income before taxes) for the quarters ended March 31, 2018 and 2017 was 20.2% and 47.1%, respectively. This decrease in effective rate is primarily attributable to the recent enactment of the Tax Cuts and Jobs Act and our increased portfolio of tax-exempt

municipal securities. Refer to Note 18 of the accompanying notes to consolidated financial statements for further information regarding our income taxes.

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## Credit Experience

For purposes of this discussion, we define nonperforming assets to include foreclosed properties, other repossessed assets, and nonperforming loans, which is comprised of loans 90 days or more past due and still accruing interest and nonaccrual loans. Performing TDRs are excluded from nonperforming loans.

The provision for loan losses represents charges to earnings necessary to maintain an adequate allowance for probable credit losses inherent in the loan portfolio. Our determination of the appropriate level of the allowance is based on an ongoing analysis of credit quality and loss potential in the loan portfolio, change in the composition and risk characteristics of the loan portfolio, and the anticipated influence of national and local economic conditions. The adequacy of the allowance for loan losses is reviewed quarterly and adjustments are made as considered necessary.

We recorded \$500,000 and \$250,000 provision for loan losses for the first three months of 2018 and 2017. The increase is primarily due to organic loan growth.

As illustrated in Table V below, our non-performing assets have decreased since year end 2017.

Table V - Summary of Non-Performing Assets

|  | March 31, |          | December 31, |   |
|--|-----------|----------|--------------|---|
| Dollars in thousands   | 2018      | 2017     | 2017         |   |
| Accruing loans past due 90 days or more                          | \$145     | \$68     | \$274        |   |
| Nonaccrual loans   |           |          |              |   |
| Commercial   | 685       | 226      | 696          |   |
| Commercial real estate   | 3,401     | 4,734    | 2,927        |   |
| Commercial construction and development                          | —         | —        | —            |   |
| Residential construction and development                         | 3,642     | 3,936    | 3,569        |   |
| Residential real estate  | 7,456     | 5,885    | 7,656        |   |
| Consumer   | 128       | 94       | 201          |   |
| Total nonaccrual loans   | 15,312    | 14,875   | 15,049       |   |
| Foreclosed properties  |           |          |              |   |
| Commercial   | —         | —        | —            |   |
| Commercial real estate   | 1,875     | 1,749    | 1,789        |   |
| Commercial construction and development                          | 7,140     | 8,276    | 7,392        |   |
| Residential construction and development                         | 11,053    | 12,635   | 11,182       |   |
| Residential real estate  | 1,374     | 831      | 1,107        |   |
| Total foreclosed properties                                      | 21,442    | 23,491   | 21,470       |   |
| Repossessed assets   | 18        | 12       | 68           |   |
| Total nonperforming assets                                       | \$36,917  | \$38,446 | \$36,861     |   |
| Total nonperforming loans as a percentage of total loans         | 0.94      | % 1.15   | % 0.95       | % |
| Total nonperforming assets as a percentage of total assets       | 1.73      | % 2.16   | % 1.73       | % |
| Allowance for loan losses as a percentage of nonperforming loans | 79.30     | % 78.42  | % 82.00      | % |
| Allowance for loan losses as a percentage of period end loans    | 0.75      | % 0.90   | % 0.78       | % |

The following table details the activity regarding our foreclosed properties for three months ended March 31, 2018 and 2017.

Table VI - Foreclosed Property Activity

|                      | For the Three Months Ended |           |
|----------------------|----------------------------|-----------|
| Dollars in thousands | March 31,                  | March 31, |
|                      | 2018                       | 2017      |
|                      |                            |           |

|                          |          |          |
|--------------------------|----------|----------|
| Beginning balance        | \$21,470 | \$24,504 |
| Acquisitions             | 641      | 113      |
| Improvements             | 101      | 219      |
| Disposals                | (513 )   | (927 )   |
| Writedowns to fair value | (257 )   | (418 )   |
| Balance March 31         | \$21,442 | \$23,491 |

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Refer to Note 6 of the accompanying consolidated financial statements for information regarding our past due loans, impaired loans, nonaccrual loans, and troubled debt restructurings and to Note 8 of the notes to the consolidated financial statements of our 2017 Annual Report on Form 10-K for a summary of the methodology we employ on a quarterly basis to evaluate the overall adequacy of our allowance for loan losses.

Substantially all of our nonperforming loans are secured by real estate. The majority of these loans were underwritten in accordance with our loan-to-value policy guidelines which range from 70-85% at the time of origination. The fair values of the underlying collateral value or the discounted cash flows remain in excess of the recorded investment in many of our nonperforming loans and therefore, no specific reserve allocation is required.

At March 31, 2018 and December 31, 2017, our allowance for loan losses totaled \$12.3 million, or 0.75% of total loans and \$12.6 million, or 0.78% of total loans. If the acquired FCB and HCB loans are excluded, the allowance for loan losses to total loans ratio at March 31, 2018 and December 31, 2017 would have been 0.85% and 0.91%, respectively. The allowance for loan losses is considered adequate to cover our estimate of probable credit losses inherent in our loan portfolio. The decline in the allowance for loan losses as a percentage of total loans at quarter end March 31, 2018 is primarily attributable to a \$500,000 charge-off on a commercial real-estate loan that was reserved for in a prior period.

At March 31, 2018 and December 31, 2017 we had approximately \$21.4 million and \$21.5 million in foreclosed properties which was obtained as the result of foreclosure proceedings. Although foreclosed property is recorded at fair value less estimated costs to sell, the prices ultimately realized upon their sale may or may not result in us recognizing additional losses.

## FINANCIAL CONDITION

Our total assets were \$2.13 billion at March 31, 2018 and December 31, 2017. Table VII below is a summary of significant changes in our financial position between December 31, 2017 and March 31, 2018.

Table VII - Summary of Significant Changes in Financial Position

|   | Balance<br>December<br>31,<br>2017 | Increase<br>(Decrease) | Balance<br>March 31,<br>2018 |
|---|------------------------------------|------------------------|------------------------------|
| Dollars in thousands                            |                                    |                        |                              |
| Assets  |                                    |                        |                              |
| Cash and cash equivalents                       | \$52,631                           | \$ (5,224 )            | \$47,407                     |
| Securities available for sale                   | 328,723                            | (31,833 )              | 296,890                      |
| Other investments                               | 14,934                             | (1,916 )               | 13,018                       |
| Loans, net                                      | 1,593,744                          | 37,406                 | 1,631,150                    |
| Property held for sale                          | 21,470                             | (28 )                  | 21,442                       |
| Premises and equipment                          | 34,209                             | 1,345                  | 35,554                       |
| Goodwill and other intangibles                  | 27,513                             | (436 )                 | 27,077                       |
| Cash surrender value of life insurance policies | 41,358                             | 310                    | 41,668                       |
| Other assets                                    | 19,658                             | 1,031                  | 20,689                       |
| Total Assets                                    | \$2,134,240                        | \$ 655                 | \$2,134,895                  |
| Liabilities                                     |                                    |                        |                              |
| Deposits  | \$1,600,601                        | \$ 53,922              | \$1,654,523                  |
| Short-term borrowings                           | 250,499                            | (56,986 )              | 193,513                      |
| Long-term borrowings                            | 45,751                             | (4 )                   | 45,747                       |
| Subordinated debentures owed to                 | 19,589                             | —                      | 19,589                       |

|  |             |        |             |
|--|-------------|--------|-------------|
| unconsolidated subsidiary trusts           |             |        |             |
| Other liabilities                          | 16,295      | 219    | 16,514      |
| Shareholders' Equity                       | 201,505     | 3,504  | 205,009     |
| Total liabilities and shareholders' equity | \$2,134,240 | \$ 655 | \$2,134,895 |

The following is a discussion of the significant changes in our financial position during the first three months of 2018:

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Securities available for sale: The net decrease of \$31.8 million in securities available for sale is principally a result of sales of our lowest yielding mortgage-backed and municipal securities which funded loan growth, primarily in the commercial real estate portfolio.

Deposits and short-term borrowings: The net change in our deposits during the first three months of 2018 resulted primarily from a net increase of \$39 million in brokered certificates of deposit issued strategically prior to anticipated higher funding costs, \$37 million growth in interest bearing checking accounts (primarily our indexed T-fund checking product), a \$12 million reduction in direct certificates of deposit and \$11 million decline in savings accounts. This net increase in deposits was used to pay off short-term FHLB advances.

Shareholders' equity: Changes in shareholders' equity are a result of net income, other comprehensive income and dividends.

Refer to Notes 5, 6, 9, and 10 of the notes to the accompanying consolidated financial statements for additional information with regard to changes in the composition of our securities, loans, deposits and borrowings between March 31, 2018 and December 31, 2017.

## LIQUIDITY AND CAPITAL RESOURCES

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 (net of float and reserves), Federal funds sold, non-pledged securities, and available lines of credit with the Federal Home Loan Bank of Pittsburgh ("FHLB") and Federal Reserve Bank of Richmond, which totaled approximately \$924 million or 43.27% of total consolidated assets at March 31, 2018.

Our liquidity strategy is to fund loan growth with deposits and other borrowed funds while maintaining an adequate level of short- and medium-term investments to meet normal daily loan and deposit activity. As a member of the FHLB, we have access to approximately \$748 million. As of March 31, 2018 and December 31, 2017, these advances totaled approximately \$191 million and \$248 million, respectively. At March 31, 2018, we had additional borrowing capacity of \$557 million through FHLB programs. We have established a line with the Federal Reserve Bank to be used as a contingency liquidity vehicle. The amount available on this line at March 31, 2018 was approximately \$160 million, which is secured by a pledge of our consumer and commercial and industrial loan portfolios. We have a \$6 million unsecured line of credit with a correspondent bank. Also, we classify all of our securities as available for sale to enable us to liquidate them if the need arises.

Liquidity risk represents the risk of loss due to the possibility that funds may not be available to satisfy current or future commitments based on external market issues, customer or creditor perception of financial strength, and events unrelated to Summit such as war, terrorism, or financial institution market specific issues. The Asset/Liability Management Committee ("ALCO"), comprised of members of senior management and certain members of the Board of Directors, oversees our liquidity risk management process. The ALCO develops and recommends policies and limits governing our liquidity to the Board of Directors for approval with the objective of ensuring that we can obtain cost-effective funding to meet current and future obligations, as well as maintain sufficient levels of on-hand liquidity, under both normal and "stressed" circumstances.

We continuously monitor our liquidity position 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.

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 March 31, 2018 totaled \$205.0 million compared to \$201.5 million at December 31, 2017.

Refer to Note 13 of the notes to the accompanying consolidated financial statements for additional information regarding regulatory restrictions on our capital as well as our subsidiaries' capital.

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## CONTRACTUAL CASH OBLIGATIONS

During our normal course of business, we incur contractual cash obligations. The following table summarizes our contractual cash obligations at March 31, 2018.

Table IX - Contractual Cash Obligations

| Dollars in thousands | Long<br>Term<br>Debt | Capital<br>Trust<br>Securities | Operating<br>Leases |
|----------------------|----------------------|--------------------------------|---------------------|
| 2018                 | \$45,013             | \$ —                           | \$ 195              |
| 2019                 | 18                   | —                              | 200                 |
| 2020                 | 19                   | —                              | 53                  |
| 2021                 | 19                   | —                              | 31                  |
| 2022                 | 20                   | —                              | 32                  |
| Thereafter           | 658                  | 19,589                         | 106                 |
| Total                | \$45,747             | \$ 19,589                      | \$ 617              |

## 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 March 31, 2018 are presented in the following table.

| Table X - Off-Balance Sheet Arrangements    | March<br>31,<br>2018 |
|---|----------------------|
| Dollars in thousands                        |                      |
| Commitments to extend credit:               |                      |
| Revolving home equity and credit card lines | \$69,825             |
| Construction loans                          | 43,734               |
| Other loans                                 | 120,481              |
| Standby letters of credit                   | 3,957                |
| Total                                       | \$237,997            |

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## Item 3. Quantitative and Qualitative Disclosures about Market Risk

## 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 modestly asset sensitive over the next twenty-four months. That is, absent any changes in the volumes of our interest earning assets or interest bearing liabilities, assets are likely to reprice faster than liabilities, resulting in an increase in net income in a rising rate environment. Net income would decrease 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 decrease our earnings due to the compression of earning asset yields and funding rates, while a steepening would increase earnings as margins widen.

Several techniques are available to monitor and control the level of interest rate risk. We primarily use earnings simulations modeling to monitor interest rate risk. The earnings simulation model forecasts the effects on net interest income under a variety of interest rate scenarios that incorporate changes in the absolute level of interest rates and changes in the shape of the yield curve. Each increase or decrease in interest rates is assumed to gradually take place over the next 12 months, and then remain stable, except for the up 400 scenario, which assumes a gradual increase in rates over 24 months. Assumptions used to project yields and rates for new loans and deposits are derived from historical analysis. Securities portfolio maturities and prepayments are reinvested in like instruments. Mortgage loan prepayment assumptions are developed from industry estimates of prepayment speeds. Noncontractual deposit repricings are modeled on historical patterns.

The following table presents the estimated sensitivity of our net interest income to changes in interest rates, as measured by our earnings simulation model as of March 31, 2018. The sensitivity is measured as a percentage change in net interest income given the stated changes in interest rates (gradual change over 12 months, stable thereafter for the down 100 and the up 200 scenarios, and gradual change over 24 months for the up 400 scenario) compared to net interest income with rates unchanged in the same period. The estimated changes set forth below are dependent on the assumptions discussed above.

| Change in<br>Interest Rates | Estimated %<br>Change in<br>Net Interest Income<br>over: |         |                   |        |
|-----------------------------|--|---------|-------------------|--------|
|                             | 0 - 12<br>Months   |         | 13 - 24<br>Months |        |
|                             | Actual   | Actual  | Actual            | Actual |
| Down 100 basis points (1)   | -0.32 %  | -0.05 % |                   |        |
| Up 200 basis points (1)     | 0.24 %   | 3.83 %  |                   |        |
| Up 400 basis points (2)     | 0.52 %   | 1.81 %  |                   |        |

- (1) assumes a parallel shift in the yield curve over 12 months
- (2) assumes a parallel shift in the yield curve over 24 months

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Item 4. Controls and Procedures

Our management, including the Chief Executive Officer and Chief Financial Officer, has conducted as of March 31, 2018, 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 March 31, 2018 were effective. There were no changes in our internal control over financial reporting that occurred during the quarter ended March 31, 2018 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

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Part II. Other Information

Item 1. Legal Proceedings

Refer to Note 12 of the Notes to the Consolidated Financial Statements in Part I, Item 1 for information regarding legal proceedings not reportable under this Item.

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, 2017.

Item 6. Exhibits

Exhibit  
3.i Amended and Restated Articles of Incorporation of Summit Financial Group, Inc.

Exhibit  
3.ii Articles of Amendment 2009

Exhibit  
3.iii Articles of Amendment 2011

Exhibit  
3.iv Amended and Restated By-Laws of Summit Financial Group, Inc.

Exhibit  
11 Statement re: Computation of Earnings per Share – Information contained in Note 4 to the Consolidated Financial Statements on page 13 of this Quarterly Report is incorporated herein by reference.

Exhibit  
31.1 Sarbanes-Oxley Act Section 302 Certification of Chief Executive Officer

Exhibit  
31.2 Sarbanes-Oxley Act Section 302 Certification of Chief Financial Officer

Exhibit  
32.1 Sarbanes-Oxley Act Section 906 Certification of Chief Executive Officer

Exhibit  
32.2 Sarbanes-Oxley Act Section 906 Certification of Chief Financial Officer

Exhibit  
101 Interactive Data File (XBRL)

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EXHIBIT INDEX

| Exhibit No. | Description   | Page<br>Number |
|-------------|---|----------------|
| (3)         | Articles of Incorporation and By-laws:  |                |
|             | <u>(i) Amended and Restated Articles of Incorporation of Summit Financial Group, Inc.</u> | (a)            |
|             | <u>(ii) Articles of Amendment 2009</u>  | (b)            |
|             | <u>(iii) Articles of Amendment 2011</u>   | (c)            |
|             | <u>(iv) Amended and Restated By-laws of Summit Financial Group, Inc.</u>                  | (d)            |
| 11          | <u>Statement re: Computation of Earnings per Share</u>                                    | 15             |
| 31.1        | <u>Sarbanes-Oxley Act Section 302 Certification of Chief Executive Officer</u>            |                |
| 31.2        | <u>Sarbanes-Oxley Act Section 302 Certification of Chief Financial Officer</u>            |                |
| 32.1*       | <u>Sarbanes-Oxley Act Section 906 Certification of Chief Executive Officer</u>            |                |
| 32.2*       | <u>Sarbanes-Oxley Act Section 906 Certification of Chief Financial Officer</u>            |                |
| 101**       | Interactive data file (XBRL)  |                |

\*Furnished, not filed.

\*\* As provided in Rule 406T of Regulation S-T, this information is furnished and not filed for purposes of Sections 11 and 12 of the Securities Act of 1933 and Section 18 of the Securities Exchange Act of 1934.

- (a) Incorporated by reference to Exhibit 3.i of Summit Financial Group, Inc.'s filing on Form 10-Q dated March 31, 2006.
- (b) Incorporated by reference to Exhibit 3.1 of Summit Financial Group, Inc.'s filing on Form 8-K dated September 30, 2009.
- (c) Incorporated by reference to Exhibit 3.1 of Summit Financial Group, Inc.'s filing on Form 8-K dated November 3, 2011.
- (d) Incorporated by reference to Exhibit 3.1 of Summit Financial Group, Inc.'s filing on Form 10-Q dated March 31, 2007.

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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. Markwood  
Julie R. Markwood,  
Vice President and Chief Accounting Officer

Date: May 9, 2018

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