SUMMIT FINANCIAL GROUP INC
Form 10-Q
May 10, 2006

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

FORM 10 - Q

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

For the quarterly period ended **March 31, 2006**.

or

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

Commission File Number **0-16587**

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

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

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

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

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

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

Large accelerated filer o Accelerated filerþ Non-accelerated filer o

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

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

Common Stock, $2.50 par value
7,135,120 shares outstanding as of May 9, 2006

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PART II. OTHER INFORMATION

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

	March 31, 2006 (unaudited)	December 31, 2005 (*)	March 31, 2005 (unaudited)
ASSETS			
Cash and due from banks	$ 14,780,214	$ 22,535,761	$ 13,243,838
Interest bearing deposits with other banks	1,658,080	1,536,506	2,161,772
Federal funds sold	607,000	3,650,000	1,615,000
Securities available for sale	233,804,893	223,772,298	209,223,443
Loans held for sale, net	12,342,886	16,584,990	15,766,266
Loans, net	825,021,590	793,766,837	623,862,573
Property held for sale	343,287	378,287	593,137
Premises and equipment, net	23,476,910	23,089,412	20,690,209
Accrued interest receivable	4,857,217	4,835,763	3,942,548
Intangible assets	3,309,885	3,347,672	3,461,036
Other assets	17,489,568	16,034,499	12,703,790
Total assets	$ 1,137,691,530	$ 1,109,532,025	$ 907,263,612
LIABILITIES AND SHAREHOLDERS' EQUITY			
Liabilities			
Deposits			
Non interest bearing	$ 62,859,549	$ 62,631,410	$ 57,008,292
Interest bearing	667,876,124	611,269,308	480,403,692
Total deposits	730,735,673	673,900,718	537,411,984
Short-term borrowings	136,482,684	182,028,113	129,696,988
Long-term borrowings	163,547,368	150,911,835	154,042,527
Subordinated debentures owed to unconsolidated subsidiary trusts	19,589,000	19,589,000	11,341,000
Other liabilities	11,520,645	9,299,134	8,371,156
Total liabilities	1,061,875,370	1,035,728,800	840,863,655
Commitments and Contingencies			
Shareholders' Equity			
Preferred stock and related surplus, $1.00 par value;			
authorized 250,000 shares, issued 2004 - 33,400 shares	-	-	1,158,471
Common stock and related surplus, $2.50 par value;			
authorized 20,000,000 shares, issued and outstanding			
2006 - 7,134,920 shares; issued December 2005 - 7,126,220			
	18,905,744	18,856,774	17,501,134

shares; issued March 2005 - 7,125,820 shares						
Retained earnings		59,186,406		56,214,807		49,519,803
Accumulated other comprehensive income		(2,275,990)		(1,268,356)		(1,779,451)
Total shareholders' equity		75,816,160		73,803,225		66,399,957
Total liabilities and shareholders' equity	$	1,137,691,530	$	1,109,532,025	$	907,263,612

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

See Notes to Consolidated Financial Statements

Summit Financial Group, Inc. and Subsidiaries

Consolidated Statements of Income (unaudited)

	Three Months Ended	
	March 31, 2006	March 31, 2005
Interest income		
Interest and fees on loans		
Taxable	$ 15,392,181	$ 9,901,344
Tax-exempt	99,745	108,396
Interest and dividends on securities		
Taxable	2,134,877	1,729,715
Tax-exempt	511,765	528,602
Interest on interest bearing deposits with other banks	16,457	22,568
Interest on Federal funds sold	7,768	2,433
Total interest income	18,162,793	12,293,058
Interest expense		
Interest on deposits	5,153,192	2,516,673
Interest on short-term borrowings	1,963,989	754,027
Interest on long-term borrowings and subordinated debentures	2,414,469	1,867,330
Total interest expense	9,531,650	5,138,030
Net interest income	8,631,143	7,155,028
Provision for loan losses	395,000	330,000
Net interest income after provision for loan losses	8,236,143	6,825,028
Other income		
Insurance commissions	230,066	148,039
Service fees	630,890	546,559
Mortgage origination revenue	6,583,913	5,856,149
Gain (loss) on sale of assets	(3,875)	(2,325)
Other	146,279	119,032
Total other income	7,587,273	6,667,454
Other expense		
Salaries and employee benefits	5,158,032	4,542,210
Net occupancy expense	570,727	429,153
Equipment expense	519,859	493,022
Supplies	205,150	157,725
Professional fees	285,041	226,926
Postage	1,791,474	1,567,124
Advertising	1,339,315	1,325,040
Amortization of intangibles	37,788	37,788
Other	1,610,581	1,276,109
Total other expense	11,517,967	10,055,097
Income before income taxes	4,305,449	3,437,385
Income tax expense	1,333,850	1,026,480
Net income	$ 2,971,599	$ 2,410,905

Basic earnings per common share	$	0.42	$	0.34
Diluted earnings per common share	$	0.41	$	0.34
Average common shares outstanding				
Basic		7,128,076		7,039,783
Diluted		7,192,924		7,171,099
Dividends per common share	$	-	$	-

See Notes to Consolidated Financial Statements

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

	Preferred Stock and Related Surplus	Common Stock and Related Surplus	Retained Earnings	Treasury Stock	Accumulated Other Compre-hensive Income	Total Share-holders' Equity
Balance, December 31, 2005	$ -	$ 18,856,774	$ 56,214,807	$ -	$ (1,268,356)	$ 73,803,225
Three Months Ended March 31, 2006						
Comprehensive income:						
Net income	-	-	2,971,599	-	-	2,971,599
Other comprehensive income, net of deferred tax benefit of ($617,582):						
Net unrealized (loss) on securities of ($1,007,634), net of reclassification adjustment for gains included in net income of $0	-	-	-	-	(1,007,634)	(1,007,634)
Total comprehensive income						1,963,965
Exercise of stock options	-	48,970	-	-	-	48,970
Balance, March 31, 2006	$ -	$ 18,905,744	$ 59,186,406	$ -	$ (2,275,990)	$ 75,816,160
Balance, December 31, 2004	$ 1,158,471	$ 18,123,492	$ 47,108,898	$ (627,659)	$ (55,181)	$ 65,708,021
Three Months Ended March 31, 2005						
Comprehensive income:						
Net income	-	-	2,410,905	-	-	2,410,905
Other comprehensive income, net of deferred tax benefit of ($1,056,811):						

Net unrealized (loss) on securities of ($1,724,270)	-	-	-	-	(1,724,270)	(1,724,270)
Total comprehensive income						686,635
Exercise of stock options	-	5,301	-	-	-	5,301
Cancellation of treasury shares	-	(627,659)	-	627,659	-	-
Balance, March 31, 2005	$ 1,158,471	$ 17,501,134	$ 49,519,803	$ -	$ (1,779,451)	$ 66,399,957

See Notes to Consolidated Financial Statements

Summit Financial Group, Inc. and Subsidiaries

Consolidated Statements of Cash Flows (unaudited)

	Three Months Ended March 31, 2006	March 31, 2005
Cash Flows from Operating Activities		
Net income	$ 2,971,599	$ 2,410,905
Adjustments to reconcile net earnings to net cash provided by operating activities:		
Depreciation	411,139	415,827
Provision for loan losses	395,000	330,000
Stock compensation expense	6,617	-
Deferred income tax (benefit)	(127,450)	(129,320)
Loans originated for sale	(73,051,790)	(68,939,267)
Proceeds from loans sold	80,031,236	69,752,985
(Gain) on sales of loans held for sale	(2,737,342)	(2,306,068)
Securities (gains)	-	-
Loss on disposal of other assets	3,875	2,325
Amortization of securities premiums, net	66,874	192,265
Amortization of goodwill and purchase accounting adjustments, net	40,670	40,671
(Decrease) in accrued interest receivable	(21,454)	(290,642)
(Increase) in other assets	(281,102)	(678,287)
Increase in other liabilities	1,695,198	1,010,150
Net cash provided by (used in) operating activities	9,403,070	1,811,544
Cash Flows from Investing Activities		
Net (increase) decrease in interest bearing deposits with other banks	(121,574)	176,926
Proceeds from maturities and calls of securities available for sale	955,937	2,957,625
Proceeds from sales of securities available for sale	2,905,400	2,321,100
Principal payments received on securities available for sale	5,585,097	7,331,803
Purchases of securities available for sale	(21,145,507)	(13,401,766)
Net (increase) decrease in Federal funds sold	3,043,000	(1,567,000)
Net loans made to customers	(31,652,753)	(21,479,998)
Purchases of premises and equipment	(798,637)	(330,029)
Proceeds from sales of other assets	16,695	52,700
Purchase of life insurance contracts	(440,000)	-
Net cash provided by (used in) investing activities	(41,652,342)	(23,938,639)
Cash Flows from Financing Activities		
Net increase in demand deposit, NOW and		

savings accounts		8,955,789		13,971,073
Net increase(decrease) in time deposits		47,937,426		(1,172,786)
Net increase(decrease) in short-term borrowings		(45,545,429)		9,067,774
Proceeds from long-term borrowings		15,000,000		718,000
Repayment of long-term borrowings		(1,896,415)		(6,634,648)
Exercise of stock options		42,354		5,301
Net cash provided by financing activities		24,493,725		15,954,714
Increase (decrease) in cash and due from banks		(7,755,547)		(6,172,381)
Cash and due from banks:				
Beginning		22,535,761		19,416,219
Ending	$	14,780,214	$	13,243,838

(Continued)

See Notes to Consolidated Financial Statements

Summit Financial Group, Inc. and Subsidiaries

Consolidated Statements of Cash Flows (unaudited)

	Three Months Ended			
	March 31, 2006		March 31, 2005	
Supplemental Disclosures of Cash Flow Information				
Cash payments for:				
Interest	$	8,976,219	$	4,994,309
Income taxes	$	-	$	-
Supplemental Schedule of Noncash Investing and Financing Activities				
Other assets acquired in settlement of loans	$	3,000	$	15,400

See Notes to Consolidated Financial Statements

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

Note 1. Basis of Presentation

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

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

The results of operations for the three months ended March 31, 2006 are not necessarily indicative of the results to be expected for the full year. The consolidated financial statements and notes included herein should be read in conjunction with our 2005 audited financial statements and Annual Report on Form 10-K. Certain accounts in the consolidated financial statements for December 31, 2005 and March 31, 2005, as previously presented, have been reclassified to conform to current year classifications.

Note 2. Earnings per Share

The computations of basic and diluted earnings per share follow:

	Three Months Ended March 31,	
	2006	**2005**
Numerator:		
Net Income	$ 2,971,599	$ 2,410,905
Denominator:		
Denominator for basic earnings per share - weighted average common shares outstanding	7,128,076	7,039,783
Effect of dilutive securities:		
Convertible preferred stock	-	39,445
Stock options	64,848	91,871
	64,848	131,316

Denominator for diluted earnings per share - weighted average common shares outstanding and assumed conversions		7,192,924		7,171,099
Basic earnings per share	$	0.42	$	0.34
Diluted earnings per share	$	0.41	$	0.34

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

Note 3. Securities

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

			March 31, 2006					
		Amortized		**Unrealized**				**Estimated**
		Cost		**Gains**		**Losses**		**Fair Value**
Available for Sale								
Taxable:								
U. S. Government agencies and corporations	$	42,089,023	$	13,026	$	671,421	$	41,430,628
Mortgage-backed securities		127,013,475		87,964		4,000,383		123,101,056
State and political subdivisions		3,889,504		-		15,969		3,873,535
Corporate debt securities		3,290,502		24,114		3,893		3,310,723
Federal Reserve Bank stock		639,000		-		-		639,000
Federal Home Loan Bank stock		16,384,900		-		-		16,384,900
Other equity securities		150,410		-		-		150,410
Total taxable		193,456,814		125,104		4,691,666		188,890,252
Tax-exempt:								
State and political subdivisions		37,981,230		832,995		127,911		38,686,314
Other equity securities		5,977,638		269,909		19,220		6,228,327
Total tax-exempt		43,958,868		1,102,904		147,131		44,914,641
Total	$	237,415,682	$	1,228,008	$	4,838,797	$	233,804,893

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

	December 31, 2005			
	Amortized Cost	Unrealized Gains	Unrealized Losses	Estimated Fair Value
Available for Sale				
Taxable:				
U. S. Government agencies and corporations	$ 40,227,124	$ 33,754	$ 426,554	$ 39,834,324
Mortgage-backed securities	117,530,036	150,766	2,884,861	114,795,941
State and political subdivisions	3,741,271	219	-	3,741,490
Corporate debt securities	3,294,123	37,063	2,206	3,328,980
Federal Reserve Bank stock	571,500	-	-	571,500
Federal Home Loan Bank stock	15,761,400	-	-	15,761,400
Other equity securities	150,410	-	-	150,410
Total taxable	181,275,864	221,802	3,313,621	178,184,045
Tax-exempt:				
State and political subdivisions	38,529,013	1,191,186	74,709	39,645,490
Other equity securities	5,978,611	-	35,848	5,942,763
Total tax-exempt	44,507,624	1,191,186	110,557	45,588,253
Total	$ 225,783,488	$ 1,412,988	$ 3,424,178	$ 223,772,298

	March 31, 2005			
	Amortized Cost	Unrealized Gains	Unrealized Losses	Estimated Fair Value
Available for Sale				
Taxable:				
U. S. Government agencies and corporations	$ 23,773,908	$ 78,764	$ 282,784	$ 23,569,888
Mortgage-backed securities	116,243,844	243,813	2,550,706	113,936,951
State and political subdivisions	3,744,254	3,876	-	3,748,130
Corporate debt securities	5,000,123	106,583	461	5,106,245
Federal Reserve Bank stock	436,500	-	-	436,500
Federal Home Loan Bank stock	14,289,100	-	-	14,289,100
Other equity securities	175,535	-	-	175,535
Total taxable	163,663,264	433,036	2,833,951	161,262,349
Tax-exempt:				
State and political subdivisions	40,915,050	1,135,196	116,551	41,933,695
Other equity securities	7,481,530	-	1,454,131	6,027,399
Total tax-exempt	48,396,580	1,135,196	1,570,682	47,961,094

Total	$ 212,059,844	$ 1,568,232	$ 4,404,633	$ 209,223,443

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

The maturities, amortized cost and estimated fair values of securities at March 31, 2006, are summarized as follows:

	Available for Sale	
	Amortized Cost	Estimated Fair Value
Due in one year or less	$ 44,681,789	$ 43,745,117
Due from one to five years	111,642,308	108,525,127
Due from five to ten years	33,060,278	32,778,820
Due after ten years	24,879,359	25,353,192
Equity securities	23,151,948	23,402,637
	$ 237,415,682	$ 233,804,893

Note 4. Loans

Loans are summarized as follows:

	March 31, 2006	December 31, 2005
Commercial	**$ 66,563,444**	$ 63,205,991
Commercial real estate	**275,896,117**	266,228,999
Construction and development	**165,026,192**	141,206,211
Residential real estate	**282,013,023**	285,596,743
Consumer	**37,356,618**	36,863,170
Other	**6,381,884**	8,597,768
Total loans	**833,237,278**	801,698,882
Less unearned income	**1,730,728**	1,780,315
Total loans net of unearned income	**831,506,550**	799,918,567
Less allowance for loan losses	**6,484,960**	6,151,730
Loans, net	**$ 825,021,590**	$ 793,766,837

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

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

Note 5. Allowance for Loan Losses

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

	Three Months Ended March 31, 2006	Three Months Ended March 31, 2005	Year Ended December 31, 2005
Balance, beginning of period	$ 6,151,730	$ 5,073,286	$ 5,073,286
Losses:			
Commercial	-	19,759	35,809
Commercial real estate	-	-	-
Real estate - mortgage	60,000	50,200	204,926
Consumer	72,724	32,427	173,020
Other	47,410	54,731	364,311
Total	180,134	157,117	778,066
Recoveries:			
Commercial	1,025	-	6,495
Commercial real estate	19,447	6,577	41,228
Real estate - mortgage	82	-	42
Consumer	15,970	17,979	55,700
Other	81,840	45,069	273,645
Total	118,364	69,625	377,110
Net losses	61,770	87,492	400,956
Provision for loan losses	395,000	330,000	1,479,400
Balance, end of period	$ 6,484,960	$ 5,315,794	$ 6,151,730

Note 6. Goodwill and Other Intangible Assets

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

	Goodwill Activity by Operating Segment			
	Community Banking	Mortgage Banking	Parent and Other	Total
Balance, January 1, 2006	$ 1,488,030	$ -	$ 600,000	$ 2,088,030
Acquired goodwill, net	-	-	-	-
Balance, March 31, 2006	$ 1,488,030	$ -	$ 600,000	$ 2,088,030

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

	Unidentifiable Intangible Assets		
	March 31, 2006	December 31, 2005	March 31, 2005
Unidentifiable intangible assets			
Gross carrying amount	$ 2,267,323	$ 2,267,323	$ 2,267,323
Less: accumulated amortization	1,045,468	1,007,681	894,317
Net carrying amount	$ 1,221,855	$ 1,259,642	$ 1,373,006

We recorded amortization expense of approximately $38,000 for the three months ended March 31, 2006 relative to our unidentifiable intangible assets. Annual amortization is expected to be approximately $151,000 for each of the years ending 2006 through 2009.

Note 7. Deposits

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

	March 31, 2006	December 31, 2005	March 31, 2005
Interest bearing demand deposits	$ 214,571,646	$ 200,637,520	$ 134,500,291
Savings deposits	39,474,064	44,680,540	50,646,930
Retail time deposits	243,645,391	236,775,248	240,540,471
Brokered time deposits	170,185,023	129,176,000	54,716,000
Total	$ 667,876,124	$ 611,269,308	$ 480,403,692

Brokered deposits represent certificates of deposit acquired through a third party. The following is a summary of the maturity distribution of certificates of deposit in denominations of $100,000 or more as of March 31, 2006:

	Amount	Percent
Three months or less	$ 26,462,733	12.0%
	31,618,246	14.3%

Three through six months			
Six through twelve months		58,521,663	26.6%
Over twelve months		103,754,753	47.1%
Total	$	220,357,395	100.0%

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

A summary of the scheduled maturities for all time deposits as of March 31, 2006 is as follows:

Nine month period ending December 31, 2006	$ 191,140,078
Year Ending December 31, 2007	143,050,876
Year Ending December 31, 2008	46,309,904
Year Ending December 31, 2009	18,287,243
Year Ending December 31, 2010	12,857,730
Thereafter	2,184,583
	$ 413,830,414

Note 8. Borrowed Funds

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

	Quarter Ended March 31, 2006		
	Short-term FHLB Advances	**Repurchase Agreements**	**Federal Funds Purchased and Lines of Credit**
Balance at March 31	$ 128,538,400	$ 7,036,562	$ 907,722
Average balance outstanding for the period	165,480,730	6,594,377	305,069
Maximum balance outstanding at any month end during period	175,407,800	7,036,562	907,722
Weighted average interest rate for the period	4.56%	3.72%	6.40%
Weighted average interest rate for balances outstanding at March 31	4.79%	4.00%	7.25%

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

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

	Quarter Ended March 31, 2005		
	Short-term FHLB Advances	**Repurchase Agreements**	**Federal Funds Purchased and Lines of Credit**
Balance at March 31	$ 118,115,800	$ 10,881,188	$ 700,000
Average balance outstanding for the period	105,859,989	10,561,099	506,293
Maximum balance outstanding at any month end during period	118,115,800	10,881,188	700,000
Weighted average interest rate for the period	2.65%	1.88%	2.88%
Weighted average interest rate for balances outstanding at March 31	2.91%	2.13%	5.00%

Long-term borrowings: Our long-term borrowings of $163,547,368, $150,911,835 and $154,042,527 at March 31, 2006, December 31, 2005, and March 31, 2005 respectively, consisted primarily of advances from the Federal Home Loan Bank ("FHLB").

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

The average interest rate paid on long-term borrowings for the three month period ended March 31, 2006 was 5.03% compared to 4.27% for the first three months of 2005.

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

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

November 2007, March 2009, and March 2011, respectively.

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

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

Year Ending December 31,		Amount
2006	$	20,051,398
2007		23,318,204
2008		26,085,851
2009		2,110,094
2010		62,263,419
Thereafter		49,307,402
	$	183,136,368

Note 9. Stock Option Plan

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

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

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

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

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	For the Three Months Ended March 31,	
	2006	**2005**
Risk-free interest rate	4.40%	3.60%
Expected dividend yield	1.25%	1.04%
Volatility factor	25	20
Expected life of option	8	8

There were no option grants during the first three months of 2006 or the first three months of 2005. Therefore, the factors for March 31, 2006 and March 31, 2005 are consistent with amounts reported in our 2005 Annual Report and 2004 Annual Report, respectively.

During first quarter 2006, we recognized $6,617 of compensation expense for share-based payment arrangements in our income statement, with a deferred tax asset of $2,250. At March 31, 2006, we had approximately $37,500 total compensation cost related to nonvested awards not yet recognized and we expect to recognize it over the next three years.

The following pro forma disclosures present for the quarter ended March 31, 2005, our reported net income and basic and diluted earnings per share had we recognized compensation expense for our Officer Stock Option Plan based on the grant date fair values of the options (the fair value method described in Statement of Financial Accounting Standards No. 123). For purposes of computing the pro forma amounts, we estimated the fair value of the options at the date of grant using a Black-Scholes option pricing model. For purposes of the pro forma disclosures, the estimated fair value of the options is amortized to expense over the options' vesting period.

(in thousands, except per share data)	**Quarter Ended March 31, 2005**
Net income:	
As reported	$ 2,411
Deduct total stock-based employee compensation expense determined under fair value based method for all awards, net of related tax effects	(41)
Pro forma	$ 2,370
Basic earnings per share:	
As reported	$ 0.34

Pro forma	$	0.33
Diluted earnings per share:		
As reported	$	0.34
Pro forma	$	0.33

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

	Quarter Ended			
	March 31, 2006		March 31, 2005	
	Options	Weighted-Average Exercise Price	Options	Weighted-Average Exercise Price
Outstanding, January 1	361,740	$ 17.41	284,100	$ 15.09
Granted	-	-	-	-
Exercised	(8,700)	4.87	(300)	17.67
Forfeited	-	-	-	-
Outstanding, March 31	353,040	$ 17.72	283,800	$ 15.09

Other information regarding options outstanding and exercisable at March 31, 2006 is as follows:

	Options Outstanding				Options Exercisable		
Range of exercise price	# of shares	WAEP	Wted. Avg. Remaining Contractual Life (yrs)	Aggregate Intrinsic Value (in thousands)	# of shares	WAEP	Aggregate Intrinsic Value (in thousands)
$4.63 - $6.00	85,600	$ 5.36	6.68	1266	78,800	$ 5.30	1,169
6.01 - 10.00	33,640	9.49	9.79	358	19,240	9.49	205
10.01 - 17.50	3,500	17.43	7.92	9	3,500	17.43	9
17.51 - 20.00	51,800	17.79	10.72	122	20,600	17.79	48
20.01 - 25.93	178,500	25.19	9.32	-	178,500	25.19	-
	353,040	17.72		1,755	300,640	18.37	1,431

Note 10. Commitments and Contingencies

Off-Balance Sheet Arrangements

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

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

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

		March 31, 2006
Commitments to extend credit:		
Revolving home equity and credit card lines	$	29,721,912
Construction loans		93,553,614
Other loans		36,181,376
Standby letters of credit		12,772,599
Total	$	172,229,501

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.