

SUMMIT BANCSHARES INC /TX/
Form 10-Q
May 10, 2006

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-Q

Mark One

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 0-11986

SUMMIT BANCSHARES, INC.

(Exact name of registrant as specified in its charter)

Texas

75-1694807

(State of Incorporation)

(I.R.S. Employer Identification No.)

3880 Hulen St., Fort Worth, Texas 76107

(Address of principal executive offices)

(817) 336-6817

(Registrant's telephone number, including area code)

No Change

(Former name, former address and former fiscal year if changed since last report)

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities 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 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

Accelerated filer

Non-accelerated filer

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

Yes No

The number of shares of common stock, \$1.25 par value, of the issuer outstanding at April 30, 2006 was 12,561,617 shares.

SUMMIT BANCSHARES, INC.

INDEX

| | <u>Page No.</u> |
|--|-----------------|
| <u>PART I - FINANCIAL INFORMATION</u> | |
| <u>Item 1. Financial Statements</u> | |
| <u>Consolidated Balance Sheets at March 31, 2006 and 2005 and at December 31, 2005</u> | 3 |
| <u>Consolidated Statements of Income for the Three Months Ended March 31, 2006 and 2005 and for the Year Ended December 31, 2005</u> | 4 |
| <u>Consolidated Statements of Changes in Shareholders' Equity for the Three Months Ended March 31, 2006 and 2005 and for the Year Ended December 31, 2005</u> | 5 |
| <u>Consolidated Statements of Cash Flows for the Three Months Ended March 31, 2006 and 2005 and for the Year Ended December 31, 2005</u> | 6 |
| <u>Notes to Consolidated Financial Statements for the Three Months Ended March 31, 2006 and 2005 and for the Year Ended December 31, 2005</u> | 7-21 |
| <p>The March 31, 2006 and 2005 financial statements included herein are unaudited; however, such information reflects all adjustments (consisting solely of normal recurring adjustments), which are, in the opinion of management of the registrant, necessary to a fair statement of the results for the interim periods. The financial statements for the year ended December 31, 2005 included herein are headed unaudited. These financial statements were reported as audited in our Annual Report on Form 10-K for the year ended December 31, 2005 filed with the Securities and Exchange Commission but are required to be reflected herein as unaudited because of the absence of an independent auditor's report.</p> | |
| <u>Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations</u> | 22-32 |
| <u>Item 3. Quantitative and Qualitative Disclosures about Market Risk</u> | 32 |
| <u>Item 4. Controls and Procedures</u> | 32 |
| <u>PART II - OTHER INFORMATION</u> | |
| <u>Item 1. Legal Proceedings</u> | 33 |
| <u>Item 1 A. Risk Factors</u> | 33 |
| <u>Item 2. Unregistered Sales of Equity Securities and Use of Proceeds</u> | 33 |
| <u>Item 3. Defaults Upon Senior Securities</u> | 33 |
| <u>Item 4. Submission of Matters to a Vote of Security Holders</u> | 34 |
| <u>Item 5. Other Information</u> | 34 |
| <u>Item 6. Exhibits</u> | 34 |

PART I - FINANCIAL INFORMATION**Item 1 - Financial Statements**SUMMIT BANCSHARES, INC. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS

| | (Unaudited) March 31, | | (Unaudited) December 31, 2005 |
|--|--------------------------|-------------------|-------------------------------------|
| | 2006 | 2005 | 2005 |
| (In Thousands) | | | |
| ASSETS | | | |
| CASH AND DUE FROM BANKS NOTE 1 | \$ 29,332 | \$ 28,823 | \$ 32,558 |
| INTEREST-BEARING DEPOSITS | 404 | 523 | 892 |
| FEDERAL FUNDS SOLD | 2,000 | 8,475 | -0- |
| INVESTMENT SECURITIES NOTE 3 | | | |
| Securities Available-for-Sale, at fair value | 247,882 | 214,222 | 256,842 |
| LOANS NOTES 4, 15 AND 21 | | | |
| Loans, Net of Unearned Income | 808,606 | 716,714 | 774,886 |
| Allowance for Loan Losses | (13,092) | (10,519) | (11,208) |
| LOANS, NET | 795,514 | 706,195 | 763,678 |
| PREMISES AND EQUIPMENT NOTE 5 | 16,855 | 15,462 | 16,515 |
| GOODWILL NOTE 6 | 9,060 | 8,993 | 9,060 |
| OTHER INTANGIBLE ASSETS, NET NOTE 6 | 2,106 | 2,396 | 2,191 |
| ACCRUED INCOME RECEIVABLE | 6,345 | 4,954 | 6,273 |
| OTHER REAL ESTATE NOTE 7 | 387 | -0- | -0- |
| OTHER ASSETS | 11,384 | 9,871 | 11,726 |
| TOTAL ASSETS | \$ 1,121,269 | \$ 999,914 | \$ 1,099,735 |
| LIABILITIES AND SHAREHOLDERS EQUITY | | | |
| DEPOSITS NOTE 8 | | | |
| Noninterest-Bearing Demand | \$ 262,087 | \$ 232,556 | \$ 263,027 |
| Interest-Bearing | 627,810 | 565,002 | 615,749 |
| TOTAL DEPOSITS | 889,897 | 797,558 | 878,776 |
| SHORT TERM BORROWINGS NOTE 9 | 132,155 | 109,885 | 121,859 |
| NOTE PAYABLE NOTE 10 | -0- | 1,750 | -0- |
| JUNIOR SUBORDINATED DEFERRABLE DEBENTURES NOTE 11 | 12,372 | 12,372 | 12,372 |
| ACCRUED INTEREST PAYABLE | 1,203 | 680 | 1,014 |
| OTHER LIABILITIES | 3,301 | 3,232 | 4,381 |
| TOTAL LIABILITIES | 1,038,928 | 925,477 | 1,018,402 |
| COMMITMENTS AND CONTINGENCIES NOTES 16, 18, 20 AND 22 | | | |
| SHAREHOLDERS EQUITY NOTES 17, 19 AND 23 | | | |
| Common Stock - \$1.25 Par Value; 20,000,000 shares authorized; 12,483,513, 12,419,356 and 12,443,518 shares issued and outstanding at March 31, 2006 and 2005 and at December 31, 2005, respectively | 15,604 | 15,524 | 15,554 |
| Capital Surplus | 8,487 | 7,971 | 8,170 |
| Retained Earnings | 62,388 | 53,959 | 60,964 |

Edgar Filing: SUMMIT BANCSHARES INC /TX/ - Form 10-Q

| | | | | |
|--|---------------------------------------|---------------------|-------------------|---------------------|
| Accumulated Other Comprehensive Income | Unrealized Loss on Available-for-Sale | | | |
| Investment Securities, Net of Tax Benefit | | (3,949) | (2,475) | (3,349) |
| Treasury Stock at Cost (10,000 shares at March 31, 2006) | | (189) | (542) | (6) |
| | | <u> </u> | <u> </u> | <u> </u> |
| TOTAL SHAREHOLDERS EQUITY | | 82,341 | 74,437 | 81,333 |
| | | <u> </u> | <u> </u> | <u> </u> |
| TOTAL LIABILITIES AND SHAREHOLDERS EQUITY | | \$ 1,121,269 | \$ 999,914 | \$ 1,099,735 |
| | | <u> </u> | <u> </u> | <u> </u> |

The accompanying Notes should be read with these financial statements.

SUMMIT BANCSHARES, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF INCOME

| | (Unaudited) For the Three Months Ended March 31, | | (Unaudited) Year Ended December 31, 2005 |
|--|--|-----------------|---|
| | 2006 | 2005 | |
| (In Thousands, Except Per Share Data) | | | |
| INTEREST INCOME | | | |
| Interest and Fees on Loans | \$ 15,048 | \$ 11,346 | \$ 51,064 |
| Interest and Dividends on Investment Securities: | | | |
| Taxable | 2,398 | 1,926 | 8,281 |
| Exempt from Federal Income Taxes | 104 | 70 | 324 |
| Interest on Federal Funds Sold and Interest-Bearing Deposits | 16 | 31 | 292 |
| TOTAL INTEREST INCOME | 17,566 | 13,373 | 59,961 |
| INTEREST EXPENSE | | | |
| Interest on Deposits | 3,738 | 2,332 | 11,663 |
| Interest on Short Term Borrowings | 1,558 | 624 | 3,317 |
| Interest on Note Payable | 1 | 23 | 57 |
| Interest on Junior Subordinated Deferrable Debentures | 219 | 161 | 731 |
| TOTAL INTEREST EXPENSE | 5,516 | 3,140 | 15,768 |
| NET INTEREST INCOME | 12,050 | 10,233 | 44,193 |
| LESS: PROVISION FOR LOAN LOSSES NOTE 4 | 2,000 | 225 | 1,105 |
| NET INTEREST INCOME AFTER PROVISION FOR LOAN LOSSES | 10,050 | 10,008 | 43,088 |
| NON-INTEREST INCOME | | | |
| Service Charges and Fees on Deposits | 921 | 982 | 3,938 |
| Other Income | 952 | 898 | 4,066 |
| TOTAL NON-INTEREST INCOME | 1,873 | 1,880 | 8,004 |
| NON-INTEREST EXPENSE | | | |
| Salaries and Employee Benefits - NOTE 18 | 4,893 | 4,269 | 18,277 |
| Occupancy Expense - Net | 810 | 604 | 2,834 |
| Furniture and Equipment Expense | 620 | 598 | 2,341 |
| Other Real Estate Owned Expense - Net | -0- | 3 | (11) |
| Intangible Amortization | 85 | 82 | 334 |
| Other Expense NOTE 13 | 1,728 | 1,696 | 6,883 |
| TOTAL NON-INTEREST EXPENSE | 8,136 | 7,252 | 30,658 |
| INCOME BEFORE INCOME TAXES | 3,787 | 4,636 | 20,434 |
| APPLICABLE INCOME TAXES NOTE 14 | 1,361 | 1,623 | 7,258 |
| NET INCOME | \$ 2,426 | \$ 3,013 | \$ 13,176 |
| NET INCOME PER SHARE NOTE 19 | | | |
| Basic | \$ 0.19 | \$ 0.24 | \$ 1.06 |

| | | | |
|---------|------|------|------|
| Diluted | 0.19 | 0.24 | 1.04 |
|---------|------|------|------|

The accompanying Notes should be read with these financial statements.

SUMMIT BANCSHARES, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS EQUITY
FOR THE THREE MONTHS ENDED MARCH 31, 2006 AND 2005
AND FOR THE YEAR ENDED DECEMBER 31, 2005
(Unaudited)

| | Common Stock | | Capital Surplus | Retained Earnings | Accumulated Other Comprehensive Income - Net Unrealized Loss on Investment Securities | Treasury Stock | Total Share- Holders Equity |
|--|--------------|-----------|--------------------|----------------------|--|-------------------|--------------------------------------|
| | Shares | Amount | | | | | |
| (Dollars in Thousands, Except Per Share Data) | | | | | | | |
| Balance at December 31, 2004 | 12,359,232 | \$ 15,449 | \$ 7,705 | \$ 51,810 | \$ (474) | \$ -0- | \$ 74,490 |
| Stock Options Exercised | 60,124 | 75 | 266 | | | | 341 |
| Retirement of Stock Held in Treasury | | | | | | (542) | (542) |
| Cash Dividend - \$.07 Per Share | | | | (864) | | | (864) |
| Net Income for the Three Months Ended March 31, 2005 | | | | 3,013 | | | 3,013 |
| Securities Available-for-Sale Adjustment | | | | | (2,001) | | (2,001) |
| Total Comprehensive Income NOTE 26 | | | | | | | 1,012 |
| Balance at March 31, 2005 | 12,419,356 | 15,524 | 7,971 | 53,959 | (2,475) | (542) | 74,437 |
| Stock Options Exercised | 55,900 | 70 | 199 | | | | 269 |
| Purchases of Stock Held in Treasury | | | | | | (52) | (52) |
| Retirement of Stock Held in Treasury | (31,738) | (40) | | (548) | | 588 | -0- |
| Cash Dividend - \$.21 Per Share | | | | (2,610) | | | (2,610) |
| Net Income for the Nine Months Ended December 31, 2005 | | | | 10,163 | | | 10,163 |
| Securities Available-for-Sale Adjustment | | | | | (874) | | (874) |
| Total Comprehensive Income NOTE 26 | | | | | | | 9,289 |
| Balance at December 31, 2005 | 12,443,518 | 15,554 | 8,170 | 60,964 | (3,349) | (6) | 81,333 |
| Stock Options Exercised | 40,295 | 50 | 273 | | | | 323 |
| Stock-Based Compensation Expense | | | 44 | | | | 44 |
| Purchases of Stock Held in Treasury | | | | | | (189) | (189) |
| Retirement of Stock Held in Treasury | (300) | | | (6) | | 6 | -0- |
| | | | | (996) | | | (996) |

Edgar Filing: SUMMIT BANCSHARES INC /TX/ - Form 10-Q

Cash Dividend - \$.08 Per Share

| | | | | | | | | | | |
|--|--|--|--|--|--|--|--|--|-------|-------|
| Net Income for the Three Months Ended March 31, 2006 | | | | | | | | | 2,426 | 2,426 |
| Securities Available-for-Sale Adjustment | | | | | | | | | (600) | (600) |
| Total Comprehensive Income NOTE 26 | | | | | | | | | | 1,826 |

| | | | | | | | |
|---------------------------|------------|-----------|----------|-----------|------------|----------|-----------|
| Balance at March 31, 2006 | 12,483,513 | \$ 15,604 | \$ 8,487 | \$ 62,388 | \$ (3,949) | \$ (189) | \$ 82,341 |
|---------------------------|------------|-----------|----------|-----------|------------|----------|-----------|

The accompanying Notes should be read with these financial statements.

SUMMIT BANCSHARES, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
FOR THE THREE MONTHS ENDED MARCH 31, 2006 AND 2005
AND FOR THE YEAR ENDED DECEMBER 31, 2005

| | (Unaudited) For the Three Months Ended March 31, | | (Unaudited) Year Ended December 31, 2005 |
|--|--|-----------------|---|
| | 2006 | 2005 | |
| (In Thousands) | | | |
| CASH FLOWS FROM OPERATING ACTIVITIES: | | | |
| Net Income | \$ 2,426 | \$ 3,013 | \$ 13,176 |
| Adjustments to Reconcile Net Income to Net Cash Provided by Operating Activities: | | | |
| Stock-Based Compensation Expense | 44 | -0- | -0- |
| Depreciation and Amortization | 490 | 487 | 1,946 |
| Net Premium Amortization of Investment Securities | 265 | 387 | 1,309 |
| Amortization of Intangible Assets | 85 | 82 | 334 |
| Provision for Loan Losses | 2,000 | 225 | 1,105 |
| Deferred Income Taxes Expense (Benefit) | (747) | 240 | (533) |
| Net Gain From Sale of Other Real Estate & Repossessed Assets | -0- | -0- | (19) |
| Net Gain From Sale of Premises and Equipment | (2) | -0- | (247) |
| Net (Increase) Decrease in Accrued Income and Other Assets | 1,277 | 832 | (1,322) |
| Net Increase (Decrease) in Accrued Expenses and Other Liabilities | (891) | (357) | 1,126 |
| Total Adjustments | 2,521 | 1,896 | 3,699 |
| NET CASH PROVIDED BY OPERATING ACTIVITIES | 4,947 | 4,909 | 16,875 |
| CASH FLOWS FROM INVESTING ACTIVITIES: | | | |
| Net (Increase) Decrease in Interest Bearing Deposits | 488 | (153) | (522) |
| Net (Increase) Decrease in Federal Funds Sold | (2,000) | (3,825) | 4,650 |
| Proceeds from Matured and Prepaid Investment Securities - Available-for-Sale | 9,125 | 6,140 | 524,266 |
| Proceeds from Sales and Redemptions of Investment Securities | -0- | -0- | 700 |
| Purchase of Investment Securities - Available-for-Sale | (1,339) | (445) | (563,976) |
| Net Assets Acquired in the Purchase of Dignum Financial | -0- | (976) | (1,043) |
| Loans Originated and Principal Repayments, Net | (34,680) | (14,179) | (72,857) |
| Recoveries of Loans Previously Charged-Off | 141 | 191 | 458 |
| Proceeds from Sale of Premises and Equipment | 32 | -0- | 338 |
| Proceeds from Sale of Other Real Estate & Repossessed Assets | 365 | -0- | 67 |
| Purchases of Premises and Equipment | (860) | (200) | (2,808) |
| NET CASH USED BY INVESTING ACTIVITIES | (28,728) | (13,447) | (110,727) |
| CASH FLOWS FROM FINANCING ACTIVITIES: | | | |
| Net Increase (Decrease) in Demand Deposits, Savings Accounts and Interest-Bearing Transaction Accounts | (9,157) | (2,253) | 48,070 |
| Net Increase in Certificates of Deposit | 20,278 | 7,547 | 38,442 |
| Net Increase in Short Term Borrowings | 10,296 | 5,913 | 17,887 |
| Repayment of Note Payable | -0- | -0- | (1,750) |
| Payments of Cash Dividends | (996) | (864) | (3,474) |
| Proceeds from Stock Options Exercised | 323 | 341 | 610 |
| Purchase of Treasury Stock | (189) | (542) | (594) |

Edgar Filing: SUMMIT BANCSHARES INC /TX/ - Form 10-Q

| | | | |
|--|-----------|-----------|-----------|
| NET CASH PROVIDED BY FINANCING ACTIVITIES | 20,555 | 10,142 | 99,191 |
| NET (DECREASE) INCREASE IN CASH AND DUE FROM BANKS | (3,226) | 1,604 | 5,339 |
| CASH AND DUE FROM BANKS AT BEGINNING OF PERIOD | 32,558 | 27,219 | 27,219 |
| CASH AND DUE FROM BANKS AT END OF PERIOD | \$ 29,332 | \$ 28,823 | \$ 32,558 |
| SUPPLEMENTAL SCHEDULE OF OPERATING AND INVESTING ACTIVITIES: | | | |
| Interest Paid | \$ 5,327 | \$ 3,061 | \$ 15,355 |
| Income Taxes Paid | 25 | -0- | 7,476 |
| Other Real Estate and Other Assets Acquired in Settlement of Loans | 721 | -0- | 461 |

The accompanying Notes should be read with these financial statements.

SUMMIT BANCSHARES, INC. AND SUBSIDIARIES
FOR THE THREE MONTHS ENDED MARCH 31, 2006 AND 2005 (UNAUDITED)
AND FOR THE YEAR ENDED DECEMBER 31, 2005 (UNAUDITED)

NOTE 1 - Summary of Significant Accounting and Reporting Policies

The accounting and reporting policies of Summit Bancshares, Inc. are in accordance with accounting principles generally accepted in the United States of America and the prevailing practices within the banking industry. A summary of the more significant policies follows:

Basis of Presentation and Principles of Consolidation

The consolidated financial statements of Summit Bancshares, Inc. (hereinafter, collectively with its subsidiaries, the Corporation), include its accounts and its direct and indirect wholly-owned subsidiaries, Summit Delaware Financial Corporation, Summit Bank, National Association (the Bank) and SIA Insurance Agency, Inc. (SIA). All significant intercompany balances and transactions have been eliminated in consolidation.

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management 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 periods. Actual results could differ materially from those estimates.

Cash and Due From Banks

The Bank is required to maintain certain noninterest-bearing cash balances at the Federal Reserve Bank based on its level of deposits. During the first three months of 2006, the average cash balance maintained at the Federal Reserve Bank was \$3,345,000. Compensating balances held at correspondent banks, to minimize service charges, averaged approximately \$24,901,000 during the same period.

Investment Securities

The Corporation has adopted Statement of Financial Accounting Standards No. 115, *Accounting for Certain Investments in Debt and Equity Securities* (SFAS 115). At the date of purchase, the Corporation is required to classify debt and equity securities into one of three categories: held-to-maturity, trading or available-for-sale. At each reporting date, the appropriateness of the classification is reassessed. Investments in debt securities are classified as held-to-maturity and measured at amortized cost in the financial statements only if management has the positive intent and ability to hold those securities to maturity. Securities that are bought and held principally for the purpose of selling them in the near term are classified as trading and measured at fair value in the financial statements with unrealized gains and losses included in earnings. Investments not classified as either held-to-maturity or trading are classified as available-for-sale and measured at fair value in the financial statements with unrealized gains and losses reported, net of tax, in a separate component of shareholders' equity until realized.

The Corporation has the ability and intent to hold to maturity its investment securities classified as held-to-maturity; accordingly, no adjustment has been made for the excess, if any, of amortized cost over market. In determining the investment category classifications at the time of purchase of securities, management considers its asset/liability strategy, changes in interest rates and prepayment risk, the need to increase capital and other factors. Under certain circumstances (including the deterioration of the issuer's creditworthiness, a change in tax law, or statutory or regulatory requirements), the Corporation may change the investment security classification. In the periods reported for 2006 and 2005, the Corporation held no securities that would have been classified as trading securities.

All investment securities are adjusted for amortization of premiums and accretion of discounts. Amortization of premiums and accretion of discounts are recorded to income over the contractual maturity or estimated life of the individual investment on the level yield method. Gain or loss on sale of investments is based upon the specific identification method and the gain or loss is recorded in non-interest income. Income earned on the Corporation's investments in securities issued by state and political subdivisions is not taxable.

Loans and Allowance for Loan Losses

Loans are stated at the principal amount outstanding less unearned discount, deferred fees and the allowance for loan losses. Unearned discount on installment loans is recognized as income over the terms of the loans by a method approximating the interest method. Interest

Edgar Filing: SUMMIT BANCSHARES INC /TX/ - Form 10-Q

income on all other loans is recognized based upon the principal amounts outstanding, the simple interest method. Loan origination fee income, net of direct loan origination costs, is deferred and amortized over the life of the related loan. The accrual of interest on a loan is discontinued when, in the opinion of management, there is doubt about the ability of the borrower to pay interest or principal. Interest previously earned, but uncollected on such loans, is written off. After loans are placed on non-accrual all payments received are applied to principal and no interest income is recorded until the loan is returned to accrual status or the principal balance has been reduced to zero.

NOTE 1 - Summary of Significant Accounting and Reporting Policies (cont d.)

The Corporation has adopted Statement of Financial Accounting Standards No. 114, Accounting by Creditors for Impairment of a Loan, as amended by Statement of Financial Accounting Standards No. 118, Accounting by Creditors for Impairment of a Loan - Income Recognition and Disclosure. Under this standard, the allowance for loan losses related to loans that are identified for evaluation in accordance with Statement No. 114 (impaired loans) is based on discounted cash flows using the loan's initial effective rate or the fair value of the collateral for certain collateral dependent loans.

The allowance for loan losses is comprised of amounts charged against income in the form of a provision for loan losses for certain loans when it is probable that all amounts due pursuant to the contractual terms of the loan will not be collected. In these situations, a valuation allowance is recorded when the carrying amount of the loan exceeds the discounted cash flows using the loan's initial effective interest rate or the fair value of the collateral for certain collateral dependent loans. Income on impaired loans is recognized based on the collectibility of the principal amount. Adjustments to the allowance for loan losses will be reported in the period such adjustments become known or are reasonably estimable.

The amount maintained in the allowance reflects management's continuing assessment of the potential losses inherent in its loan portfolio based on its evaluation of a number of factors, including the Bank's loss experience in relation to outstanding loans and the existing level of the allowance, prevailing and prospective economic conditions, and management's continuing review of the discounted cash flow values of impaired loans and its evaluation of the quality of the loan portfolio. Loans are charged against the allowance for loan losses when management believes that the collectibility of the principal is unlikely.

The evaluation of the adequacy of loan collateral is often based upon estimates and appraisals. Because of changing economic conditions, the valuations determined from such estimates and appraisals may also change. Accordingly, the Corporation may ultimately incur losses which vary materially from management's current estimates.

Premises and Equipment

Land is carried at cost. Premises and equipment are stated at cost less accumulated depreciation and amortization. Depreciation expense is computed on the straight-line method based upon the estimated useful lives of the assets ranging from three to forty years. Maintenance and repairs are charged to non-interest expense. Renewals and betterments are added to the asset accounts and depreciated over the periods benefited. Depreciable assets sold or retired are removed from the asset and related accumulated depreciation accounts and any gain or loss is reflected in the income and expense accounts.

Other Real Estate

Other real estate is foreclosed property held pending disposition and is valued at the lower of its fair value or the recorded investment in the related loan. At foreclosure, if the fair value, less estimated costs to sell, of the real estate acquired is less than the Corporation's recorded investment in the related loan, a write-down is recognized through a charge to the allowance for loan losses. Any subsequent reduction in value is recognized by a charge to income. Operating expenses of such properties, net of related income, and gains and losses on their disposition are included in non-interest expense.

Federal Income Taxes

The Corporation joins with its subsidiaries in filing a consolidated federal income tax return. The subsidiaries pay to the parent a charge equivalent to their current federal income tax based on the separate taxable income of the subsidiaries.

The Corporation and the subsidiaries maintain their records for financial reporting and income tax reporting purposes on the accrual basis of accounting. Deferred income taxes are provided in accordance with Statement of Financial Accounting Standards No. 109, Accounting for Income Taxes. Deferred income taxes are provided for accumulated temporary differences due to basic differences for assets and liabilities for financial reporting and income tax purposes.

Realization of net deferred tax assets is dependent on generating sufficient future taxable income. Although realization is not assured, management believes it is more likely than not that all of the net deferred tax assets will be realized. The amount of the net deferred tax asset considered realizable, however, could be reduced in the near term if estimates of future taxable income are reduced.

Cash and Cash Equivalents

Edgar Filing: SUMMIT BANCSHARES INC /TX/ - Form 10-Q

For the purpose of presentation in the Statements of Cash Flows, cash and cash equivalents include cash on hand, clearings and exchanges, and balances due from correspondent banks.

Reclassification

Certain reclassifications have been made to the 2005 financial statements to conform to the 2006 presentation.

NOTE 1 - Summary of Significant Accounting Policies (cont d.)Earnings Per Common and Common Equivalent Shares

Statement of Financial Accounting Standards No. 128 (SFAS 128), Earnings Per Share, requires presentation of basic and diluted earnings per share. Basic earnings per share has been computed by dividing net income available to common shareholders by the weighted average number of common shares outstanding for the reporting period. Diluted earnings per share reflects the potential dilution that could occur if securities or other contracts to issue common stock were exercised or converted into common stock. Net income per common share for all periods presented has been calculated in accordance with SFAS 128. Outstanding stock options issued by the Corporation represent the only dilutive effect reflected in diluted weighted average shares.

Stock-Based Compensation

On January 1, 2006, the Corporation changed its accounting policy related to stock-based compensation in connection with the adoption of Statement of Financial Accounting Standards (SFAS) No. 123, Share-Based Payment (Revised 2004). See Note 12 Stock-Based Compensation for additional information.

Advertising Costs

Advertising costs are expensed as incurred.

Comprehensive Income

Comprehensive income includes all changes in shareholders' equity during a period, except those resulting from investments by and distributions to owners and treasury stock transactions. Besides net income, the other component of the Corporation's comprehensive income is the after tax effect of changes in the fair value of securities available-for-sale. Comprehensive income for the periods ended March 31, 2006 and 2005 and for the year ended December 31, 2005 is reported in Note 26, Comprehensive Income.

Audited Financial Statements

The consolidated balance sheet as of December 31, 2005, and the consolidated statements of income, changes in shareholders' equity and cash flows for the year ended December 31, 2005 are headed "unaudited" in these financial statements. These statements were reported as "audited" in our Annual Report of Form 10-K for the year ended December 31, 2005 filed with the Securities and Exchange Commission but are required to be reflected in these statements as unaudited because of the absence of an independent auditor's report.

NOTE 2 - Acquisition

On March 21, 2005, the Corporation acquired Dignum Financial Services (DFS) for a purchase price of approximately \$1.0 million. DFS was a proprietorship engaged in financial planning and management services. Of the purchase price \$0.5 million is subject to the earnings performance of Summit Financial Partners (formerly DFS), a division of the Bank.

NOTE 3 - Investment Securities

A summary of amortized cost and estimated fair values of investment securities as of March 31, 2006 is as follows (in thousands):

| | March 31, 2006 | | | |
|---|-------------------|------------------------------|-------------------------------|---------------|
| | Amortized Cost | Gross Unrealized Gains | Gross Unrealized Losses | Fair Value |
| Investment Securities - Available-for-Sale | | | | |
| U.S. Government Agencies and Corporations | \$ 167,219 | \$ -0- | \$ (3,878) | \$ 163,341 |
| U.S. Government Agency Mortgage Backed Securities | 65,960 | -0- | (2,048) | 63,912 |
| Obligations of States and Political Subdivisions | 12,947 | 50 | (23) | 12,974 |
| Community Reinvestment Act Investment Fund | 3,025 | -0- | (84) | 2,941 |

Edgar Filing: SUMMIT BANCSHARES INC /TX/ - Form 10-Q

| | | | | |
|-------------------------------------|-------------------|--------------|-------------------|-------------------|
| Other Securities | <u>4,714</u> | <u>-0-</u> | <u>-0-</u> | <u>4,714</u> |
| Total Available-for-Sale Securities | <u>\$ 253,865</u> | <u>\$ 50</u> | <u>\$ (6,033)</u> | <u>\$ 247,882</u> |

9

NOTE 3 - Investment Securities (cont d.)

All investment securities are carried on the consolidated balance sheet as of March 31, 2006 at fair value. The net unrealized loss of \$5,983,000 is included in the Available-for-Sale Investment Securities balance. The unrealized loss, net of tax benefit, is included in Shareholders' Equity.

Included in the Other Securities category at March 31, 2006 is \$3,838,000 of Federal Home Loan Bank Stock and \$800,000 of Federal Reserve Stock which are classified as restricted investment securities, carried at cost, and evaluated for impairment. No impairment losses were recorded as of March 31, 2006. The Bank was required at March 31, 2006 to have stock holdings of Federal Home Loan Bank Stock equal to .09% of the Corporation's total assets as of the previous quarter end plus 4.10% of its outstanding advances from the Federal Home Loan Bank (FHLB). The Bank is also required to have stock holdings of Federal Reserve Stock equal to 6% of its Capital Stock and Surplus.

A summary of amortized cost and estimated fair values of investment securities as of March 31, 2005 is as follows (in thousands):

| | March 31, 2005 | | | |
|---|-------------------|------------------------------|-------------------------------|-------------------|
| | Amortized Cost | Gross Unrealized Gains | Gross Unrealized Losses | Fair Value |
| Investment Securities - Available-for-Sale | | | | |
| U.S. Government Agencies and Corporations | \$ 159,514 | \$ 87 | \$ (2,563) | \$ 157,038 |
| U.S. Government Agency Mortgage Backed Securities | 42,183 | 41 | (1,314) | 40,910 |
| Obligations of States and Political Subdivisions | 8,012 | 69 | (59) | 8,022 |
| Community Reinvestment Act Investment Fund | 3,000 | -0- | (11) | 2,989 |
| Other Securities | 5,263 | -0- | -0- | 5,263 |
| Total Available-for-Sale Securities | \$ 217,972 | \$ 197 | \$ (3,947) | \$ 214,222 |

All investment securities were carried on the consolidated balance sheet as of March 31, 2005 at fair value. The net unrealized loss of \$3,750,000 was included in the Available-for-Sale Investment Securities balance. The unrealized loss, net of tax benefit, was included in Shareholders' Equity.

Included in the Other Securities category at March 31, 2005 was \$4,381,000 of Federal Home Loan Bank Stock and \$800,000 of Federal Reserve Stock which were classified as restricted investment securities, carried at cost, and evaluated for impairment. No impairment losses were recorded as of March 31, 2005. The Bank was required at March 31, 2005 to have stock holdings of Federal Home Loan Bank Stock equal to .14% of the Corporation's total assets as of the previous year end plus 4.25% of its outstanding advancements from the FHLB. The Bank was also required to have stock holdings of Federal Reserve Stock equal to 6% of its Capital Stock and Surplus.

NOTE 4 - Loans and Allowance for Loan Losses

The book values of loans by major type follow (in thousands):

| | March 31, | | December 31, 2005 |
|------------------------------------|----------------|----------------|----------------------|
| | 2006 | 2005 | |
| Commercial and Industrial | \$ 283,536 | \$ 266,782 | \$ 277,827 |
| Real Estate Mortgage - Commercial | 268,365 | 228,701 | 260,736 |
| Real Estate Mortgage - Residential | 93,879 | 85,293 | 91,183 |
| Real Estate - Construction | 125,926 | 94,940 | 106,227 |
| Loans to Individuals | 36,900 | 40,998 | 38,913 |
| | 808,606 | 716,714 | 774,886 |
| Allowance for Loan Losses | (13,092) | (10,519) | (11,208) |

Edgar Filing: SUMMIT BANCSHARES INC /TX/ - Form 10-Q

| | | | | | | |
|-------------|----|---------|----|---------|----|---------|
| Loans - Net | \$ | 795,514 | \$ | 706,195 | \$ | 763,678 |
|-------------|----|---------|----|---------|----|---------|

Loans are net of unearned income of \$1,117,000 and \$905,000 at March 31, 2006 and 2005, respectively, and \$1,101,000 at December 31, 2005.

NOTE 4 - Loans and Allowance for Loan Losses (cont d.)

Transactions in the allowance for loan losses are summarized as follows (in thousands):

| | Three Months Ended March 31, | | Year Ended December 31, 2005 |
|--|---------------------------------|-----------|------------------------------------|
| | 2006 | 2005 | |
| Balance, Beginning of Period | \$ 11,208 | \$ 10,187 | \$ 10,187 |
| Provisions, Charged to Income | 2,000 | 225 | 1,105 |
| Loans Charged-Off | (257) | (84) | (542) |
| Recoveries of Loans Previously Charged-Off | 141 | 191 | 458 |
| Net Loans (Charged-Off) Recovered | (116) | 107 | (84) |
| Balance, End of Period | \$ 13,092 | \$ 10,519 | \$ 11,208 |

The provisions for loan losses charged to operating expenses during the three months ended March 31, 2006 and March 31, 2005 of \$2,000,000 and \$225,000, respectively, were considered adequate to maintain the allowance in accordance with the policy discussed in Note 1. For the year ended December 31, 2005, a provision of \$1,105,000 was recorded.

At March 31, 2006, the recorded investment in loans that are considered to be impaired under Statement of Financial Accounting Standards No. 114 was \$10,293,000 (of which \$10,293,000 were on non-accrual status). The related allowance for loan losses for these loans was \$4,118,000. The average recorded investment in impaired loans during the three months ended March 31, 2006 was approximately \$11,336,000. For this period, the Corporation recognized interest income of \$14,000 on these impaired loans.

NOTE 5 - Premises and Equipment

The investment in premises and equipment stated at cost and net of accumulated amortization and depreciation is as follows (in thousands):

| | March 31, | | December 31, 2005 |
|---|-----------|-----------|----------------------|
| | 2006 | 2005 | |
| Land | \$ 3,302 | \$ 3,038 | \$ 3,296 |
| Buildings and Improvements | 13,359 | 12,453 | 12,957 |
| Furniture & Equipment | 12,500 | 11,943 | 12,104 |
| Total Cost | 29,161 | 27,434 | 28,357 |
| Less: Accumulated Amortization and Depreciation | 12,306 | 11,972 | 11,842 |
| Net Book Value | \$ 16,855 | \$ 15,462 | \$ 16,515 |

NOTE 6 Goodwill and Other Intangible Assets

Goodwill represents the excess of the purchase price over the fair value of net assets acquired in business combinations under the purchase method of accounting. The Corporation has adopted Financial Accounting Standards Board Statement No. 142 (FAS 142), Goodwill and Other Intangible Assets. FAS 142 eliminates amortization of goodwill associated with business combinations completed after June 30, 2001. Goodwill is periodically assessed for impairment when events or changes in circumstances indicate that the carrying value of the asset may not be recoverable. The Corporation bases its evaluation on such impairment factors as the nature of the assets, the future economic benefit of the assets, any historical or future profitability measurements, as well as other external market conditions or factors that may be present.

NOTE 6 Goodwill and Other Intangible Assets (cont d.)

On May 3, 2004, the Corporation completed its merger with ANB Financial Corporation and its wholly-owned subsidiary, Arlington National Bank of Arlington, Texas (collectively ANB). A premium of \$10.7 million was paid in connection with the acquisition of ANB, \$2.7 million of which was identified as core deposit intangibles. The remaining \$8.0 million has been recorded as goodwill. In accordance with FAS 142, the goodwill will not be amortized. The core deposit intangibles are being amortized using a straight line method over their estimated useful life of 8 years. Amortization expense on the core deposit intangibles was \$82,000, \$328,000 and \$82,000 for the three months ended March 31, 2006, the year ended December 31, 2005 and the three months ended March 31, 2005, respectively.

On March 21, 2005, the Corporation completed the acquisition of DFS. Goodwill of \$1.0 million was recorded in connection with the acquisition.

As of March 31, 2006, the Corporation had other intangible assets with a net book value of \$38,000. Amortization expense of \$6,000 and \$3,000 has been recorded on the other intangible assets for the year ended December 31, 2005 and for the three months ended March 31, 2006, respectively.

NOTE 7 - Other Real Estate

The carrying value of other real estate is as follows (in thousands):

| | March 31, | | December 31, 2005 |
|-------------------|-----------|--------|----------------------|
| | 2006 | 2005 | |
| Other Real Estate | \$ 387 | \$ -0- | \$ -0- |

There were no direct write-downs of other real estate charged to income for the three months ended March 31, 2006 or March 31, 2005. There were also no direct write-downs of other real estate charged to income for the year ended December 31, 2005.

NOTE 8 Deposits

The book values of deposits by major type follow (in thousands)

| | March 31, | | December 31, 2005 |
|---|-------------------|-------------------|----------------------|
| | 2006 | 2005 | |
| Noninterest-Bearing Demand Deposits | \$ 262,087 | \$ 232,556 | \$ 263,027 |
| Interest-Bearing Deposits: | | | |
| Interest-Bearing Transaction Accounts and Money Market Accounts | 268,832 | 235,632 | 268,116 |
| Savings | 147,529 | 169,094 | 156,462 |
| Certificates of Deposits under \$100,000 and IRAs | 91,575 | 75,634 | 88,273 |
| Certificates of Deposits \$100,000 or more | 112,824 | 84,492 | 99,848 |
| Other | 7,050 | 150 | 3,050 |
| Total | 627,810 | 565,002 | 615,749 |
| Total Deposits | \$ 889,897 | \$ 797,558 | \$ 878,776 |

NOTE 9 - Short Term Borrowings

Securities sold under repurchase agreements generally represent borrowings with maturities ranging from one to thirty days. Information relating to these and other borrowings is summarized as follows (in thousands):

| | Three Months Ended March 31, | | Year Ended December 31, 2005 |
|---|---------------------------------|-----------|------------------------------------|
| | 2006 | 2005 | |
| Securities Sold Under Repurchase Agreements: | | | |
| Average Balance | \$ 100,070 | \$ 44,336 | \$ 50,825 |
| Period-End Balance | 82,155 | 49,885 | 61,559 |
| Maximum Month-End Balance During Period | 105,986 | 49,885 | 67,494 |
| Interest Rate: | | | |
| Average | 4.11% | 1.95% | 2.72% |
| Period-End | 4.24 | 2.03 | 3.65 |
| Federal Home Loan Bank Advances: | | | |
| Average Balance | \$ 56,667 | \$ 62,167 | \$ 61,808 |
| Period-End Balance | 50,000 | 60,000 | 55,000 |
| Maximum Month-End Balance During Period | 60,000 | 60,000 | 70,000 |
| Interest Rate: | | | |
| Average | 3.82% | 2.44% | 3.10% |
| Period-End | 3.77 | 2.56 | 3.44 |
| Federal Funds Purchased: | | | |
| Average Balance | \$ 243 | \$ 874 | \$ 534 |
| Period-End Balance | -0- | -0- | 5,300 |
| Maximum Month-End Balance During Period | -0- | -0- | 5,300 |
| Interest Rate: | | | |
| Average | 4.40% | 2.73% | 3.54% |
| Period-End | -0- | -0- | 4.33 |

The Corporation has available a line of credit with the FHLB of Dallas which allows it to borrow on a collateralized basis at a fixed term. The borrowings are collateralized by a blanket floating lien on certain real estate loans, the FHLB capital stock owned by the Corporation and any funds on deposit with FHLB. At March 31, 2006, the Corporation had \$50.0 million of borrowings outstanding under the line of credit at a rate of 3.77%, \$35.0 million of which matures in 2006 and the remaining \$15.0 million of which matures in 2007. At March 31, 2006, the Corporation had average borrowings under the line of credit of \$56.7 million. For the three months ended March 31, 2005, the Corporation had \$60.0 million of borrowings outstanding under the line of credit at a rate of 2.50%, \$30.0 million of which matured in 2005. At December 31, 2005, \$55.0 million of borrowings were outstanding at an average rate of 3.44%. For the year ended December 31, 2005, the Corporation had average borrowings of \$61.8 million.

NOTE 10 Note Payable

On September 15, 2005, the Corporation obtained a line of credit from a bank under which the Corporation may borrow \$10,000,000 at a floating rate (three month LIBOR plus margin of 2.00%). The line of credit is secured by stock of the Bank and matures on September 15, 2006, whereupon, if balances are outstanding, the line converts to a term note having a five year term. The Corporation will not pay a fee for any unused portion of the line. As of March 31, 2006, there were no borrowings under this line.

NOTE 11 - Junior Subordinated Deferrable Debentures

On May 3, 2004, the Corporation formed SBI Trust and SBI Trust subsequently issued \$12.0 million of floating rate (three month LIBOR plus a margin of 2.65%) Capital Securities (the Trust Capital Securities). Concurrent with the issuance of the Trust Capital Securities, SBI Trust issued trust common securities to the Corporation in the aggregate liquidation value of \$372,000. The proceeds of the issuance of the Trust Capital Securities and trust common securities were invested in the Corporation's Floating Rate Junior Subordinated Deferrable Debentures (the Deferrable Debentures), which mature on July 7, 2034 and have a call feature that permits the Corporation to redeem any or all of the securities after July 7, 2009. The interest rate on the Deferrable Debentures at March 31, 2006 and December 31, 2005 was 7.25% and 6.80%, respectively. The Deferrable Debentures, which are the only assets of SBI Trust, are subordinated and junior in right of payment to all present and future senior indebtedness (as defined in the Indenture dated May 3, 2004) of the Corporation.

NOTE 12 - Stock -Based Compensation

Prior to January 1, 2006, the Corporation accounted for stock-based compensation utilizing the intrinsic value method in accordance with the provisions of Accounting Principles Board Opinion No. 25 (APB 25), Accounting for Stock Issued to Employees and related Interpretations. Accordingly no compensation expense was recognized for stock option plans because the exercise prices of stock options equaled or exceeded the market prices of the underlying stock on the dates of the grants. However, stock-based compensation has been included in pro forma disclosures in the financial statement footnotes in prior periods.

Effective January 1, 2006, the Corporation adopted the fair value recognition provisions of SFAS No. 123R, Share-Based Payment using a modified version of prospective application. Under this method, compensation expense will be recorded for all awards granted after the date of adoption and for the unvested portion of previously granted awards that were outstanding as of the beginning of the period of adoption.

For the three months ended March 31, 2006, stock-based compensation expense was \$44,000. The following table illustrates the effect on net income and earnings per share if the Corporation had applied the fair value recognition provisions of SFAS 123R to stock based compensation for the three months ended March 31, 2005 (in thousands, except for per share data):

| | Three Months Ended March 31, 2005 | |
|--|--|--------------|
| | \$ | |
| Net Income, as Reported | \$ | 3,013 |
| Deduct: Total stock-based compensation expense determined under fair value based method for all awards, net of related tax effects | | (59) |
| Pro Forma Net Income | \$ | 2,954 |
| Earnings Per Share: | | |
| Basic - as Reported | \$ | 0.24 |
| Basic - Pro Forma | | 0.23 |
| Diluted - as Reported | | 0.24 |
| Diluted - Pro Forma | | 0.23 |

NOTE 13 - Other Non-Interest Expense

The significant components of other non-interest expense are as follows (in thousands):

| | Three Months Ended March 31, | | Year Ended December 31, 2005 |
|---------------------------------|---|-----------------|---|
| | 2006 | 2005 | |
| | \$ | \$ | \$ |
| Business Development | 280 | 248 | 1,097 |
| Legal and Professional Fees | 289 | 382 | 1,282 |
| Data and Item Processing | 231 | 200 | 822 |
| Printing and Supplies | 124 | 107 | 476 |
| Regulatory Fees and Assessments | 87 | 87 | 325 |
| Other | 717 | 672 | 2,881 |
| Total | \$ 1,728 | \$ 1,696 | \$ 6,883 |

NOTE 14 - Income Taxes

Federal income taxes included in the consolidated balance sheets were as follows (in thousands):

| | March 31, | | December 31, 2005 |
|---------------------------------------|-----------------|-----------------|----------------------|
| | 2006 | 2005 | |
| Current Tax Liability | \$ (2,139) | \$ (1,677) | \$ (56) |
| Net Deferred Tax Asset | 6,075 | 4,349 | 5,020 |
| Total Included in Other Assets | \$ 3,936 | \$ 2,672 | \$ 4,964 |

The net deferred tax asset at March 31, 2006 of \$6,075,000 included \$2,034,000, a deferred tax asset related to unrealized losses on Available-for-Sale Securities.

The components of income tax expense were as follows (in thousands):

| | Three Months Ended March 31, | | Year Ended December 31, 2005 |
|---|---------------------------------|-----------------|------------------------------------|
| | 2006 | 2005 | |
| Federal Income Tax Expense: | | | |
| Current | \$ 2,108 | \$ 1,383 | \$ 7,791 |
| Deferred (Benefit) | (747) | 240 | (533) |
| Total Federal Income Tax Expense | \$ 1,361 | \$ 1,623 | \$ 7,258 |
| Effective Tax Rates | 35.00% | 35.0% | 35.0% |

The reasons for the difference between income tax expense and the amount computed by applying the statutory federal income tax rate to operating earnings are as follows (in thousands):

| | Three Months Ended March 31, | | Year Ended December 31, 2005 |
|---|---------------------------------|-----------------|------------------------------------|
| | 2006 | 2005 | |
| Federal Income Taxes at Statutory Rate of 35.0% | \$ 1,325 | \$ 1,644 | \$ 7,152 |
| Effect of Tax Exempt Interest Income | (34) | (24) | (108) |
| Non-deductible Expenses | 74 | 54 | 228 |
| Other | (4) | (51) | (14) |
| Income Taxes Per Income Statement | \$ 1,361 | \$ 1,623 | \$ 7,258 |

NOTE 14 - Income Taxes (cont d.)

Deferred income tax expense (benefit) results from differences between amounts of assets and liabilities as measured for income tax return and financial reporting purposes. The significant components of federal deferred tax assets and liabilities are in the following table (in thousands):

| | March 31, | | December 31, 2005 |
|--|-----------------|-----------------|----------------------|
| | 2006 | 2005 | |
| Federal Deferred Tax Assets: | | | |
| Allowance for Loan Losses | \$ 4,582 | \$ 3,728 | \$ 3,923 |
| Interest on Non-accrual Loans | 168 | 95 | 135 |
| Unrealized Losses on Available-for-Sale Securities | 2,034 | 1,275 | 1,725 |
| Deferred Compensation | 797 | 719 | 747 |
| Net Operating Loss Carryover | 93 | 141 | 105 |
| Other | 51 | -0- | 48 |
| | <u>7,725</u> | <u>5,958</u> | <u>6,683</u> |
| Federal Deferred Tax Liabilities: | | | |
| Depreciation and Amortization | 1,325 | 1,467 | 1,385 |
| Accretion | 145 | 48 | 113 |
| Other | 180 | 94 | 165 |
| | <u>1,650</u> | <u>1,609</u> | <u>1,663</u> |
| Net Deferred Tax Asset | \$ 6,075 | \$ 4,349 | \$ 5,020 |

NOTE 15 - Related Party Transactions

The Bank has made loan transactions in the ordinary course of business with certain of its and the Corporation's officers, directors and their affiliates. All loans included in such transactions are made on substantially the same terms, including interest rate and collateral, as those prevailing at the time for comparable transactions with other unrelated persons and all such loans are current as to principal and interest payments. Total loans outstanding to such related parties amounted to approximately \$10,369,000 at March 31, 2006 and \$9,356,000 at December 31, 2005.

NOTE 16 - Commitments and Contingent Liabilities

In the normal course of business, there are various outstanding commitments and contingent liabilities, such as guarantees and commitments to extend credit, which are not reflected in the financial statements. No losses are anticipated as a result of these transactions. Commitments are most frequently extended for real estate, commercial and industrial loans.

At March 31, 2006, outstanding documentary and standby letters of credit totaled \$8,607,000 and commitments to extend credit totaled \$231,880,000.

In addition, the Corporation leases certain office facilities under operating leases. Rent expense for all operating leases totaled \$356,000 and \$297,000 for the three months ended March 31, 2006 and 2005, respectively, and \$1,305,000 for the year ended December 31, 2005.

NOTE 17 - Stock Option Plans

The Corporation has two Incentive Stock Option Plans, the 1993 Plan and the 1997 Plan, (each, a Plan, and, collectively, the Plans). No more options may be granted under the 1993 Plan. The 1997 Plan has reserved 1,200,000 shares (adjusted for two-for-one stock splits in 1997 and 2004) of common stock for grants thereunder. The Plans provide for the granting to executive management and other key employees of the Corporation and its subsidiaries incentive stock options, as defined under the current tax law. The options granted under the Plans will be exercisable for ten years from the date of grant and generally vest ratably over a five year period. Options will be and have been granted at prices which will not be less than 100-110% of the fair market value of the underlying common stock at the date of grant.

The following is a summary of transactions during the periods presented:

| | Shares Under Option Plans | |
|--|--------------------------------------|---------------------------------|
| | Three Months Ended March 31, 2006 | Year Ended December 31, 2005 |
| Outstanding, Beginning of Period | 616,354 | 679,578 |
| Additional Options Granted During the Period | -0- | 55,200 |
| Forfeited During the Period | (10,000) | (2,400) |
| Exercised During the Period | (40,295) | (116,024) |
| Outstanding, End of Period | 566,059 | 616,354 |

Options outstanding at March 31, 2006 have exercise prices between \$5.19 to 18.75 per share with a weighted average exercise price of \$10.02 and 497,099 shares exercisable. At March 31, 2006, there remained 501,596 shares reserved for future grants of options under the 1997 Plan. See Note 12 Stock Based Compensation for information regarding the dilutive impact of these stock options.

On April 18, 2006, the shareholders of the Corporation approved the 2006 Long-Term Incentive Plan of the Corporation (the 2006 Plan). The 2006 Plan replaced the 1997 Plan. The 2006 Plan is intended to enable the Corporation to remain competitive and innovative in its ability to attract, motivate, reward and retain the services of key employees. The 2006 Plan provides for the granting of stock options, stock appreciation rights, restricted stock, restricted stock units, performance awards, dividend equivalent rights, and other awards which may be paid in cash or stock. The 2006 Plan is expected to provide flexibility to the Corporation s compensation methods in order to adapt the compensation of key employees to a changing business environment, after giving due consideration to competitive conditions and the impact of federal tax laws. Subject to certain adjustments, the number of the Corporation s shares of common stock that may be issued pursuant to awards under the 2006 Plan is 1,250,000 shares, less the total number of shares of common stock issued pursuant to the 2006 Plan or issuable upon the exercise of awards granted under predecessor Plans.

NOTE 18 - Employee Benefit Plans401(k) Plan

The Corporation implemented a 401(k) plan in December 1997 covering substantially all employees. The Corporation made no contribution to this plan in 1998 or 1999. Beginning in 2000, the Corporation made matching contributions, not to exceed 6% of the employee s annual compensation, to the participant s deferrals of compensation up to 100% of the employee contributions.

The amount expensed in support of the plan was \$188,000 and \$146,000 during the first three months of 2006 and 2005, respectively, and \$592,000 for the year 2005.

Supplemental Executive Retirement Plan

In 2002, the Corporation established a Supplemental Executive Retirement Plan (the Retirement Plan) to provide key employees with retirement, death or disability benefits. For currently employed employees, the Retirement Plan replaces the previous Management Security Plan. The Retirement Plan is a defined contribution plan and the expense charged to earnings relating to the Retirement Plan was \$125,000 and \$72,000 for the first three months of 2006 and 2005, respectively, and \$458,000 for the year 2005.

Employment Contracts

Edgar Filing: SUMMIT BANCSHARES INC /TX/ - Form 10-Q

The Chief Executive Officer of the Corporation has entered into a severance agreement providing for salary and fringe benefits in the event of termination for other than cause and under certain changes in control.

Other Post Retirement Benefits

The Corporation provides certain health care benefits for certain retired employees who bear all costs of these benefits. These benefits are covered under the Consolidated Omnibus Budget Reconciliation Act.

NOTE 18 - Employee Benefit Plans (cont d.)Compensated Absences

Employees of the Corporation are entitled to paid vacation, paid sick days and other personal days off, depending on job classification, length of service and other factors. It is impracticable to estimate the amount of compensation for future absences, and accordingly, no liability has been recorded in the accompanying financial statements. The Corporation's policy is to recognize the costs of compensated absences when actually paid to employees.

NOTE 19 - Earnings per Share

The following data shows the amounts used in computing earnings per share (EPS) and the weighted average number of shares of dilutive potential common stock (dollars in thousands):

| | Three Months Ended March 31, | | Year Ended December 31, 2005 |
|--|---------------------------------|------------|------------------------------------|
| | 2006 | 2005 | |
| Net income | \$ 2,426 | \$ 3,013 | \$ 13,176 |
| Weighted average number of common shares used in Basic EPS | 12,454,593 | 12,377,350 | 12,414,366 |
| Effect of dilutive stock options | 284,324 | 340,779 | 295,957 |
| Weighted number of common shares and dilutive potential common stock used in Diluted EPS | 12,738,917 | 12,718,129 | 12,710,323 |

The incremental shares for the assumed exercise of the outstanding options were determined by application of the treasury stock method.

NOTE 20 - Financial Instruments with Off-Balance Sheet Risk

The Corporation is a party to financial instruments with off-balance sheet risk in the normal course of business to meet the financing needs of its customers. These financial instruments include loan commitments, standby letters of credit and documentary letters of credit. The instruments involve, to varying degrees, elements of credit and interest rate risk in excess of the amount recognized in the financial statements.

The Corporation's exposure to credit loss in the event of non-performance by the other party of these loan commitments and letters of credit is represented by the contractual amount of those instruments. The Corporation uses the same credit policies in making commitments and conditional obligations as it does for on-balance sheet instruments.

The total contractual amounts of financial instruments with off-balance sheet risk are as follows (in thousands):

| | March 31, | |
|--|------------|------------|
| | 2006 | 2005 |
| Financial Instruments Whose Contract Amounts Represent Credit Risk: | | |
| Loan Commitments Including Unfunded Lines of Credit | \$ 231,880 | \$ 197,554 |
| Letters of Credit | 8,607 | 6,495 |

Loan commitments are agreements to lend to a customer as long as there is no customer 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. Letters of credit are conditional commitments by the Corporation to guarantee the performance of a customer to a third party. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loan facilities to customers.

Since many of the loan commitments and letters of credit may expire without being drawn upon, the total commitment amount does not necessarily represent future cash requirements. The Corporation evaluates each customer's credit worthiness on a case-by-case basis. The

amount of collateral obtained, if deemed necessary by the Corporation upon extension of credit, is based on management's credit evaluation of the counterparty. Collateral held varies but may include accounts receivable, inventory, property, plant and equipment, owner-occupied real estate and income-producing commercial properties.

NOTE 20 - Financial Instruments with Off-Balance Sheet Risk (cont. d.)

The Corporation originates real estate, commercial and consumer loans primarily to customers in the Tarrant County area. Although the Corporation has a diversified loan portfolio, a substantial portion of its customers' ability to honor their contracts is dependent upon the local economy and the real estate market.

The Corporation maintains funds on deposit at correspondent banks which at times exceed the federally insured limits. Management of the Corporation monitors the balance in these accounts and periodically assesses the financial condition of correspondent banks.

NOTE 21 - Concentrations of Credit Risk

The Bank makes commercial, consumer and real estate loans in its direct market which is defined as Fort Worth and its surrounding area. The Board of Directors of the Bank monitors concentrations of credit by purpose, collateral and industry at least quarterly. Certain limitations for concentration are set by the Board of Directors of the Bank. Additional loans in excess of these limits must have prior approval of the Bank's directors' loan committee. Although the Bank has a diversified loan portfolio, a substantial portion of its debtors' abilities to honor their contracts is dependent upon the strength of the local and state economy.

NOTE 22 - Litigation

The Corporation is involved in legal actions arising in the ordinary course of business. It is the opinion of management, after reviewing such actions with outside legal counsel, that the settlement of these matters is not expected to materially adversely affect the Corporation's financial position.

NOTE 23 - Stock Repurchase Plan

On April 19, 2005, the Board of Directors of the Corporation approved a stock repurchase plan (the 2005 Stock Purchase Plan) authorizing management to purchase up to 620,467 shares of the Corporation's common stock on behalf of the Corporation over the twelve-month period beginning April 19, 2005 and ending on April 18, 2006, including in open market transactions, privately negotiated transactions or other transactions in accordance with all applicable state and federal laws and regulations.

In the quarter ended March 31, 2006, 10,000 shares were purchased by the Corporation pursuant to the 2005 Stock Purchase Plan in privately negotiated transactions. 12,378 shares of the Corporation's common stock, in the aggregate, were purchased by the Corporation pursuant to the 2005 Stock Purchase Plan from the period beginning April 19, 2005 through April 18, 2006. No more shares may be purchased pursuant to the 2005 Stock Purchase Plan.

On April 18, 2006, the Board of Directors of the Corporation approved a stock purchase plan (the 2006 Stock Purchase Plan) authorizing management to purchase up to 623,675 shares of the Corporation's common stock on behalf of the Corporation over the twelve-month period beginning April 19, 2006 and ending on April 18, 2007, including in open market transactions, privately negotiated transactions or other transactions in accordance with all applicable state and federal laws and regulations.

The Corporation's ability to purchase shares of the Corporation's common stock is subject to various banking laws, regulations and policies as well as rules and regulations of the Securities and Exchange Commission. The Corporation anticipates purchasing shares of the Corporation's common stock pursuant to the 2006 Stock Purchase Plan as conditions warrant.

NOTE 24 - Subsequent Events

On April 18, 2006, the Board of Directors of the Corporation approved a quarterly dividend of \$.08 per share to be paid on May 15, 2006 to shareholders of record on April 28, 2006.

On April 18, 2006, the Board of Directors of the Corporation approved a stock purchase plan (the 2006 Stock Purchase Plan) authorizing management to purchase up to 623,675 shares of the Corporation's common stock on behalf of the Corporation over the twelve-month period beginning April 19, 2006 and ending on April 18, 2007, including in open market transactions, privately negotiated transactions or other transactions in accordance with all applicable state and federal laws and regulations.

On April 18, 2006, the shareholders of the Corporation approved the 2006 Long-Term Incentive Plan of the Corporation (the 2006 Plan). The 2006 Plan replaced the 1997 Plan. The 2006 Plan is intended to enable the Corporation to remain competitive and innovative in its ability to

attract, motivate, reward and retain the services of key employees. The 2006 Plan provides for the granting of stock options, stock appreciation rights, restricted stock, restricted stock units, performance awards, dividend equivalent rights, and other awards which may be paid in cash or stock. The 2006 Plan is expected to provide flexibility to the Corporation's compensation methods in order to adapt the compensation of key employees to a changing business environment, after giving due consideration to competitive conditions and the impact of federal tax laws. Subject to certain adjustments, the number of the Corporation's shares of common stock that may be issued pursuant to awards under the 2006 Plan is 1,250,000 shares, less the total number of shares of common stock issued pursuant to the 2006 Plan or issuable upon the exercise of awards granted under predecessor Plans.

NOTE 25 - Fair Values of Financial Instruments

The following methods and assumptions were used by the Corporation in estimating its fair value disclosures for financial instruments:

Cash and cash equivalents: The carrying amounts reported in the balance sheet for cash and due from banks and federal funds sold approximate those assets' fair values.

Investment securities (including mortgage backed securities): Fair values for investment securities are based on quoted market prices, where available. If quoted market prices are not available, fair values are based on quoted market prices of comparable instruments.

Loans: For variable rate loans, fair values are based on carrying values. The fair values for fixed rate loans such as mortgage loans (e.g., one-to-four family residential) and installment loans are estimated using discounted cash flow analysis. The carrying amount of accrued interest receivable approximates its fair value.

Deposit liabilities: The fair value disclosed for interest-bearing and noninterest-bearing demand deposits, passbook savings, and certain types of money market accounts are, by definition, equal to the amount payable on demand at the reporting date or their carrying amounts. Fair values for fixed rate certificates of deposit are estimated using a discounted cash flow calculation that applies interest rates currently being offered on certificates to a schedule of aggregated expected monthly maturities on time deposits.

Short term borrowings: The carrying amounts of borrowings under repurchase agreements, Federal Home Loan Bank advances and Federal Funds Purchased approximate their fair values.

The estimated fair values of the Corporation's financial instruments are as follows (in thousands):

| | March 31, | | | |
|--|--------------------|---------------|--------------------|---------------|
| | 2006 | | 2005 | |
| | Carrying Amount | Fair Value | Carrying Amount | Fair Value |
| Financial Assets: | | | | |
| Cash and due from banks | \$ 29,332 | \$ 29,332 | \$ 28,823 | \$ 28,823 |
| Federal funds sold and interest bearing deposits | 2,404 | 2,404 | 8,998 | 8,998 |
| Investment securities | 247,882 | 247,882 | 214,222 | 214,222 |
| Loans | 808,606 | 783,475 | 716,714 | 707,428 |
| Allowance for loan losses | (13,092) | (13,092) | (10,519) | (10,519) |
| Financial Liabilities: | | | | |
| Deposits | 889,897 | 890,939 | 797,558 | 797,964 |
| Short term borrowings | 132,155 | 132,155 | 109,885 | 109,885 |
| Off-balance Sheet Financial Instruments: | | | | |
| Loan commitments | | 231,880 | | 197,554 |
| Letters of credit | | 8,607 | | 6,495 |

NOTE 26 - Comprehensive Income

The Corporation has adopted Financial Accounting Standards Board Statement of Financial Accounting Standards No. 130 Reporting Comprehensive Income . This standard requires an entity to report and display comprehensive income and its components. Comprehensive income is as follows (in thousands):

| | Three Months Ended March 31, | | Year Ended December 31, 2005 |
|---|---------------------------------|-----------------|------------------------------------|
| | 2006 | 2005 | |
| Net Income | \$ 2,426 | \$ 3,013 | \$ 13,176 |
| Other Comprehensive Income: | | | |
| Change in unrealized gain (loss) on securities available-for-sale, net of tax (benefit) | (600) | (2,001) | (2,875) |
| Comprehensive Income | \$ 1,826 | \$ 1,012 | \$ 10,301 |

NOTE 27 - Dividends from Subsidiaries

The primary source of funds for the Corporation is cash dividends received from the Bank. The amount of dividends that the Bank may pay in any one year, without the approval of the Comptroller of the Currency, is the sum of the retained net profits for the preceding two years plus its total of the retained net profits for the current year. Under this formula, as defined, as of March 31, 2006, the Bank can legally initiate dividend payments of \$13,599,000 for the remainder of 2006. The Bank is also restricted from paying dividends that would cause the Bank to be under-capitalized.

Internal dividend policies limit dividends paid by the Bank if its equity capital falls below certain minimum levels as determined by the Bank's Board of Directors.

Item 2 - Management's Discussion and Analysis of Financial Condition and Results of Operations

The following discussion should be read in conjunction with the consolidated financial statements, accompanying notes and selected financial data appearing elsewhere in this Quarterly Report on Form 10-Q and in our most recent Annual Report on Form 10-K and may contain certain forward-looking statements that are based on current management expectations. Generally, verbs in the future tense and the words believe, expect, anticipate, estimate, intends, opinion, potential and similar expressions identify forward-looking statements. Examples of this forward-looking information can be found in, but are not limited to, the expected effects of accounting pronouncements and government regulation applicable to our operations, the discussion of allowance for loan losses, and quantitative and qualitative disclosure about market risk. Our actual results could differ materially from the forward-looking statements and management expectations. Further information concerning our business, including additional risk factors and uncertainties that could cause actual results to differ materially from the forward-looking statements contained in this Quarterly Report on Form 10-Q, are set forth below under the heading

Risk Factors. These risk factors and uncertainties should be considered in evaluating forward-looking statements and undue reliance should not be placed on such statements. The forward-looking statements contained herein speak only as of the date of this Quarterly Report on Form 10-Q and, except as may be required by applicable law and regulation, we do not undertake, and specifically disclaim any obligation to, publicly update or revise such statements to reflect events or circumstances after the date of such statements or to reflect the occurrence of anticipated or unanticipated events. Except as the context otherwise requires, references herein to the Corporation, we, or our refer to the business of Summit Bancshares, Inc. and its consolidated subsidiaries.

Overview

Our business has been conducted primarily through our wholly-owned subsidiaries, Summit Bank, National Association (the Bank), Summit Delaware Financial Corporation and SIA Insurance Agency, Inc. (SIA). The Bank currently operates its branch offices in twelve locations in Tarrant County, Texas.

Our results of operations are primarily dependent on net interest income, which is the difference between the income earned on our loans and investment portfolios and our cost of funds, consisting of the interest paid on deposits and borrowings. Results of operations are also affected by our allowance for loan losses, investment activities, loan servicing fees and other fees. Our non-interest expense principally consists of salary and benefits, occupancy and equipment expense, business development costs, professional fees, data processing expense and other expenses.

Net income for the first quarter of 2006 decreased \$587,000, or 19.5%, to \$2,426,000 from \$3,013,000 recorded for the first quarter of 2005. On a weighted average share basis, net income for the first quarter of 2006 was \$0.19 per diluted share as compared to \$0.24 per diluted share for the first quarter of 2005, a decrease of 20.8%. The decrease in earnings during the first quarter of 2006 from the first three months of 2005 was primarily due to an increase of \$1,775,000 in the provision for loan losses. The increase in the provision for loan losses reflected a higher level of loans on nonaccrual status. Nonaccrual loans were \$11,164,000 as of March 31, 2006, an increase of \$7,870,000 from the amount reported as of March 31, 2005 and an increase of \$8,164,000 from the amount reported as of December 31, 2005.

Total loans at March 31, 2006 were \$808.6 million, which represented an increase of \$91.9 million, or 12.8%, over total loans at March 31, 2005 and an increase of \$33.7 million, or 4.4% over total loans at December 31, 2005. Total deposits at March 31, 2006 of \$889.9 million increased \$92.3 million, or 11.6%, from \$797.6 million at March 31, 2005 and increased \$11.1 million, or 1.3%, from \$878.8 million at December 31, 2005. Compared to the first quarter of 2005, we experienced growth in every category of deposits during the first quarter of 2006, except for savings accounts. Shareholders' equity was \$82.3 million at March 31, 2006, an increase of \$7.9 million, or 10.6%, compared to shareholders' equity of \$74.4 million at March 31, 2005. See the Statement of Changes in Shareholders' Equity on page 5 for a detail of the changes.

Edgar Filing: SUMMIT BANCSHARES INC /TX/ - Form 10-Q

The following table shows selected performance ratios for the first quarters of 2006 and 2005 that management believes to be key indicators of our performance:

| | Three Months Ended | |
|--|--------------------|-------------------|
| | March 31, 2006 | March 31, 2005 |
| Annualized Return on Average Assets (ROAA) | 0.88% | 1.23% |
| Annualized Return on Average Shareholders' Equity (ROAE) | 11.91 | 16.16 |
| Shareholders' Equity to Assets - Average | 7.40 | 7.63 |
| Dividend Payout Ratio | 41.06 | 28.68 |
| Net Interest Margin (tax equivalent) | 4.68 | 4.47 |
| Efficiency Ratio | 58.20 | 59.69 |
| Net Income Per Share - Diluted | \$ 0.19 | \$ 0.24 |

The return on average assets ratio is calculated by dividing annualized net income by average total assets for the period. Our return on average assets ratio was 0.88% for the first quarter of 2006 compared with the average return on average assets ratio of 1.45% for the first quarter of 2006 for other financial institutions in our peer group. Our peer group is comprised of six (6) other publicly traded bank holding companies headquartered in Texas with assets ranging from \$11.3 billion to \$2.7 billion and was selected by our management. Our return on average assets for the first quarter of 2006 was negatively affected by the level of the provision for loan losses.

The return on average shareholders' equity ratio is calculated by dividing annualized net income by average shareholders' equity for the period. Our return on average shareholders' equity ratio was 11.91% in the first quarter of 2006 compared with the average return on average shareholders' equity ratio of 15.27% for the same period for the other financial institutions in our peer group. Our return on average shareholders' equity for the first quarter of 2006 was also negatively affected by the loan loss provision recorded in the first quarter.

The shareholders' equity to assets ratio is calculated by dividing average shareholders' equity by average total assets for the period. Our shareholders' equity to assets ratio was 7.40% in the first quarter of 2006 compared with the average shareholders' equity to asset ratio of 9.49% for the first quarter of 2006 of the other financial institutions in our peer group.

The dividend payout ratio is determined by dividing the total dividends paid by net income for the period. For the first quarter of 2006, our dividend payout ratio resulted in a yield-to-market price return that compared favorably to our peer group.

Net interest margin is calculated by dividing annualized net interest income on a tax equivalent basis by average total earning assets. Management believes our net interest margin of 4.68% in the first quarter of 2006 compares favorably to the net interest margin ratio of other financial institutions in our peer group, which averaged 4.19% in the first quarter of 2006.

The efficiency ratio is calculated by dividing non-interest expenses by the sum of total non-interest income and tax equivalent interest income for the period. The efficiency ratio provides a measure of the extent to which our revenues are absorbed by our non-interest expenses. Management believes our efficiency ratio of 58.20% in the first quarter of 2006 compares favorably to the average efficiency ratio of other financial institutions in our peer group, which was 56.80% in the first quarter of 2006.

Summary of Earning Assets and Interest-Bearing Liabilities

The following schedule presents average balance sheets that highlight earning assets and interest-bearing liabilities and their related rates earned and paid for the first quarters of 2006 and 2005 (rates on tax equivalent basis):

Three Months Ended March 31,

| | 2006 | | | 2005 | | |
|--|---------------------|---------------|--------------------|-------------------|---------------|--------------------|
| | Average Balances | Interest | Average Yield/Rate | Average Balances | Interest | Average Yield/Rate |
| (Dollars in Thousands) | | | | | | |
| Earning Assets: | | | | | | |
| Federal Funds Sold & Interest Bearing Deposits | \$ 1,459 | \$ 16 | 4.45% | \$ 5,195 | \$ 31 | 2.40% |
| Investment Securities (Taxable) | 241,226 | 2,398 | 3.98% | 212,152 | 1,926 | 3.63% |
| Investment Securities (Tax-exempt) | 11,971 | 160 | 5.35% | 8,009 | 106 | 5.30% |
| Loans, Net of Unearned Discount ⁽¹⁾ | 793,536 | 15,048 | 7.69% | 706,902 | 11,346 | 6.51% |
| Total Earning Assets | 1,048,192 | 17,622 | 6.82% | 932,258 | 13,409 | 5.83% |
| Non-interest Earning Assets: | | | | | | |
| Cash and Due From Banks | 33,404 | | | 30,059 | | |
| Other Assets | 46,804 | | | 41,164 | | |
| Allowance for Loan Losses | (11,741) | | | (10,327) | | |
| Total Assets | \$ 1,116,659 | | | \$ 993,154 | | |
| Interest-Bearing Liabilities: | | | | | | |
| Interest-Bearing Transaction Accounts and Money Market Funds | \$ 259,589 | 1,187 | 1.85% | \$ 235,691 | 717 | 1.23% |
| Savings | 148,493 | 820 | 2.24% | 168,346 | 636 | 1.53% |
| Certificates of Deposit under \$100,000 and IRAs | 89,789 | 748 | 3.38% | 75,733 | 449 | 2.40% |
| Certificates of Deposit \$100,000 or more | 106,431 | 935 | 3.56% | 79,933 | 529 | 2.68% |
| Other Time | 4,317 | 48 | 4.51% | 150 | 1 | 3.03% |
| Other Borrowings | 169,405 | 1,778 | 4.26% | 128,174 | 808 | 2.56% |
| Total Interest-Bearing Liabilities | 778,024 | 5,516 | 2.88% | 688,027 | 3,140 | 1.85% |
| Non-interest Bearing Liabilities: | | | | | | |
| Demand Deposits | 251,034 | | | 225,519 | | |
| Other Liabilities | 4,992 | | | 4,006 | | |
| Shareholders' Equity | 82,609 | | | 75,602 | | |
| Total Liabilities and Shareholders' Equity | \$ 1,116,659 | | | \$ 993,154 | | |
| Net Interest Income and Margin (Tax-equivalent Basis)⁽²⁾ | | | | | | |
| | | \$ 12,106 | 4.68% | \$ 10,269 | | 4.47% |

(1) Loan interest income includes fees and loan volumes include loans on non-accrual. The loan fees include loan origination fees which are considered adjustments to interest income. These fees aggregated \$489,000 and \$390,000 at March 31, 2006 and 2005, respectively. Related

Edgar Filing: SUMMIT BANCSHARES INC /TX/ - Form 10-Q

loan origination costs are not separately allocated to loans, but are charged to non-interest expense. For the purpose of calculating loan yields, average loan balances include non-accrual loans with no related interest income.

(2) Presented on tax equivalent basis using a federal income tax rate of 35% for 2006 and 34% for 2005.

The net interest margin was 4.68% for the first quarter of 2006, which represented an increase of 21 basis points from the first quarter of 2005. This increase in net interest margin reflected a 99 basis point increase in yield on earning assets from the first quarter of 2005 to the first quarter of 2006, which was partially offset by a 103 basis point increase in rates paid on interest-bearing liabilities from the first quarter of 2005 to the first quarter of 2006. The increase in the net interest margin also reflected the impact of our non-interest bearing funding sources, primarily demand deposits and shareholders' equity, in the higher interest rate environment in the first quarter of 2006.

In the event that our average loans continue to grow during 2006 and we are unable to fund such growth solely through the generation of additional deposits, we may be required to obtain funding from secondary sources, such as the Federal Home Loan Bank, Federal Funds purchased, or brokered deposits, which could have a negative impact on our net interest margin. Therefore, we may experience a slower growth in net interest margin during the remainder of 2006 as a result of any such borrowings, but will benefit as our investment portfolio and maturing fixed rate loans reprice at higher rates. Because of the composition of our balance sheet and our emphasis on commercial lending, we are market interest rate sensitive and expect to benefit from any market interest rate increases, assuming that interest rates on deposits and borrowings do not increase significantly faster than interest rates on earning assets.

Net Interest Income

Net interest income (tax equivalent) for the first quarter of 2006 was \$12,106,000, which represented an increase of \$1,837,000, or 17.9%, compared to the first quarter of 2005. In the first quarter of 2006, tax equivalent interest income increased \$4,213,000, or 31.4%, while interest expense increased \$2,376,000, or 75.7%, compared to the first quarter of 2005. The increase in net interest income resulted from a 12.4% growth in average earning assets for the first quarter of 2006 compared to the first quarter of 2005, along with a 200 basis point increase in market interest rates (as measured by the prime rate as published in the *Wall Street Journal*) from March 2005 through March 2006.

The table below analyzes the increase in net interest income on a fully tax equivalent basis for the three month periods ended March 31, 2006 and 2005. Non-accruing loans have been included in assets for these computations, thereby reducing yields on total loans. For purposes of this table, changes attributable to both rate and volume which cannot be segregated have been allocated to rate.

ANALYSIS OF CHANGES IN NET INTEREST INCOME (Dollars in Thousands)

| | 1st Qtr. 2006 vs. 1st Qtr. 2005 Increase (Decrease) Due to Changes in: | | | 1st Qtr. 2005 vs. 1st Qtr. 2004 Increase (Decrease) Due to Changes in: | | |
|--|--|---------------|-----------------|--|---------------|-----------------|
| | Volume | Rate | Total | Volume | Rate | Total |
| Interest Earning Assets: | | | | | | |
| Federal Funds Sold & Interest Bearing | | | | | | |
| Deposits | \$ (23) | \$ 8 | \$ (15) | \$ (1) | \$ 19 | \$ 18 |
| Investment Securities | 305 | 221 | 526 | 308 | (83) | 225 |
| Loans, Net of Unearned Discount | 1,391 | 2,311 | 3,702 | 1,935 | 997 | 2,932 |
| Total Interest Income | 1,673 | 2,540 | 4,213 | 2,242 | 933 | 3,175 |
| Interest-Bearing Liabilities: | | | | | | |
| Deposits | 274 | 1,132 | 1,406 | 376 | 315 | 691 |
| Other Borrowings | 223 | 747 | 970 | 35 | 499 | 534 |
| Total Interest Expense | 497 | 1,879 | 2,376 | 411 | 814 | 1,225 |
| Net Interest Income | \$ 1,176 | \$ 661 | \$ 1,837 | \$ 1,831 | \$ 119 | \$ 1,950 |

Non-Interest Income

Non-interest income for the first quarter of 2006 was \$1,873,000, which represented a decrease of \$7,000, or 0.4%, from the first quarter of 2005. The major component of non-interest income is various charges and fees that we earn on deposit accounts and related services. The following table reflects the changes in non-interest income during the periods presented (dollars in thousands):

| Three Months Ended March 31, | | |
|---------------------------------|------|-------------|
| 2006 | 2005 | % Change |
| | | |

Edgar Filing: SUMMIT BANCSHARES INC /TX/ - Form 10-Q

| | | | |
|-------------------------------------|-----------------|-----------------|---------------|
| Service Charges on Deposit Accounts | \$ 921 | \$ 982 | (6.2)% |
| Non-recurring Income | -0- | 134 | (100.0) |
| Other Non-interest Income | 952 | 764 | 24.6 |
| Total Non-interest Income | \$ 1,873 | \$ 1,880 | (0.4)% |

The decrease in service charges on deposit accounts during the first quarter of 2006 was largely the result of a reduction in fees earned on commercial accounts that are on account analysis. The decrease reflects the impact of the higher interest rate environment on earnings credits for commercial deposit account balances.

Edgar Filing: SUMMIT BANCSHARES INC /TX/ - Form 10-Q

The non-recurring income for the first three months of 2005 resulted from an extraordinary payment from PULSE EFT as a participant in that ATM network.

The increase in other non-interest income in the first quarter of 2006, as compared to the same period last year, is primarily due to increases in investment service fees and insurance commissions. Investment service fees were \$236,000 for the first quarter of 2006 compared with \$107,000 for the first quarter of 2005. The increase in investment services fees is attributable to the operation of Summit Financial Partners, our financial planning and asset management division. Insurance commissions through SIA were \$59,000 for the first quarter, up from \$25,000 for the comparable period last year.

Non-interest Expense

Non-interest expenses include all expenses other than interest expense, the provision for loan losses and income tax expense. The following table summarizes the changes in non-interest expense during the periods presented (dollars in thousands):

| | Three Months Ended March 31, | | |
|---|---------------------------------|-----------------|--------------|
| | 2006 | 2005 | % Change |
| Salaries & Employee Benefits | \$ 4,893 | \$ 4,269 | 14.6% |
| Occupancy Expense - Net | 810 | 604 | 34.1 |
| Furniture and Equipment Expense | 620 | 598 | 3.7 |
| Other Real Estate and Foreclosed Asset Expense - Net | -0- | 3 | (100.0) |
| Intangible Asset Amortization | 85 | 82 | 3.7 |
| Other Expenses: | | | |
| Business Development | 280 | 248 | 12.9 |
| Insurance - Other | 76 | 42 | 81.0 |
| Legal & Professional Fees | 289 | 382 | (24.3) |
| Data & Item Processing | 231 | 200 | 15.5 |
| Franchise Taxes | 18 | 13 | 38.5 |
| Postage & Courier | 119 | 123 | (3.3) |
| Printing & Supplies | 124 | 107 | 15.9 |
| Regulatory Fees & Assessments | 87 | 87 | -0- |
| Other Operating Expenses | 504 | 494 | 2.0 |
| | 1,728 | 1,696 | 1.9 |
| Total Other Expenses | 1,728 | 1,696 | 1.9 |
| | \$ 8,136 | \$ 7,252 | 12.2% |
| Total Non-interest Expense | \$ 8,136 | \$ 7,252 | 12.2% |

Total non-interest expense increased 12.2% in the first quarter of 2006 over the first quarter of 2005, reflecting increases primarily in salaries and benefits, occupancy, business development expenses, and insurance expense. As a percent of average assets, non-interest expenses were 2.95% in the first quarter of 2006 (annualized) and 2.96% for the same period of 2005.

The efficiency ratio (non-interest expenses divided by total non-interest income plus net interest income) was 58.20% for the first quarter of 2006 compared to 59.69% for the first quarter of 2005.

The increase in salaries and benefits during the first quarter of 2006 compared to the prior year period was due to salary merit increases, increases in the cost of employee benefit programs, expenses associated with Summit Financial Partners, and the recognition of expense related to employee stock options. Effective January 1, 2006, the Corporation adopted the fair value recognition provisions of SFAS No. 123R,

Share-Based Payment using a modified version of prospective application. Under this method, compensation expense will be recorded for all awards granted after the date of adoption and for the unvested portion of previously granted awards that were outstanding as of the beginning of the period of adoption. For the three months ended March 31, 2006, stock-based compensation expense was \$44,000. For periods prior to January 1, 2006, stock based compensation has been included in pro forma disclosures in the financial statement footnotes.

The increase of \$206,000 in occupancy expense for the first quarter of 2006 compared to the same period of the prior year was due to several factors; including increases in rent expense, utilities and ad valorem taxes. Also contributing to the increase in occupancy expense was

the loss of tenant rents at a bank-owned facility.

Business development expenses increased \$32,000 in the first quarter of 2006. Contributing to the increase were higher levels of public relations expenditures and customer expenses.

Insurance expense was \$34,000 higher in the first quarter of 2006. The increase is largely attributable to higher costs of blanket bond and directors and officers liability policies.

Legal and professional expenses decreased \$93,000 in the first quarter of 2006 compared to the first quarter of 2005 due to lower levels of legal fees and expenses incurred in relation to compliance with the Sarbanes-Oxley Act of 2002 and other corporate governance initiatives.

Allowance for Loan Losses and Non-Performing Assets

The allowance for loan losses was \$13,092,000, or 1.62% of total loans, as of March 31, 2006 compared to \$10,519,000, or 1.47% of total loans, as of March 31, 2005. The provision for loan losses was \$2,000,000 for the first quarter of 2006 compared with \$225,000 for the same period last year. For the three months ended March 31, 2006 and 2005, net charge-offs (recoveries) were 0.01% and (0.02)% of loans, respectively, not annualized.

Transactions in the provision for loan losses are summarized as follows (in thousands):

| | Three Months Ended March 31, | |
|--|---|------------------|
| | 2006 | 2005 |
| Balance, Beginning of Period | \$ 11,208 | \$ 10,187 |
| Provisions, Charged to Income | 2,000 | 225 |
| Loans Charged-Off | (257) | (84) |
| Recoveries of Loans Previously Charged-Off | 141 | 191 |
| Net Loans (Charged-Off) Recovered | (116) | 107 |
| Balance, End of Period | \$ 13,092 | \$ 10,519 |

The increase in the provision for loan losses reflected an increase in non-accrual loans from \$3,000,000 at December 31, 2005 to \$11,164,000 at March 31, 2006. We reported in a filing on Form 8-K in February that our largest classified borrower had experienced further deterioration in its financial condition and had requested a deferral of future principal and interest payments until such time as the borrower's financial condition could be restructured, the borrower or certain of its assets sold or other arrangements for payment can be made. All loans to this borrower were placed on non-accrual status in February 2006 with an agreement, subject to an infusion of a specified amount of capital and certain other conditions, to defer all payments of principal and interest from this borrower until June 30, 2006. Also in February 2006, an outside investor contributed to the borrower the specified amount of additional capital in the form of debt subordinated to the Corporation's loans. As of March 31, 2006, our exposure on these credits was approximately \$7.5 million. In March 2006, we placed loans to a second borrower on non-accrual based on deterioration in that borrower's financial condition. The loans to the second borrower had a combined balance of approximately \$2.2 million as of March 31, 2006. The ultimate loss, if any, on these two credits cannot be determined at this time, but management thought that it would be prudent to record the additional provision for loan losses. The Corporation's management will continue to monitor these credits very closely.

As of March 31, 2006, the allowance for loan losses as a percentage of non-accrual loans was 117.3% compared with 373.7% as of December 31, 2005. Total non-performing assets as a percentage of loans and foreclosed assets was 1.43% at March 31, 2006 compared with 0.39% as of December 31, 2005.

The following table summarizes the non-performing assets as of the end of the last five quarters (in thousands):

| | March 31, 2006 | December 31, 2005 | September 30, 2005 | June 30, 2005 | March 31, 2005 |
|--|---------------------------|------------------------------|-------------------------------|--------------------------|---------------------------|
| Non-Accrual Loans | \$ 11,164 | \$ 3,000 | \$ 4,989 | \$ 3,372 | \$ 3,294 |
| Renegotiated Loans | -0- | -0- | -0- | -0- | -0- |
| Other Real Estate Owned and Other Foreclosed Assets | 387 | -0- | -0- | -0- | -0- |
| Total Non-Performing Assets | \$ 11,551 | \$ 3,000 | \$ 4,989 | \$ 3,372 | \$ 3,294 |
| As a Percent of: | | | | | |
| Total Assets | 1.03% | 0.27% | 0.46% | 0.33% | 0.33% |
| Total Loans and Other Real Estate/ Foreclosed Assets | 1.43% | 0.39% | 0.66% | 0.47% | 0.46% |
| Loans Past Due 90 days or More and Still Accruing | \$ -0- | \$ -0- | \$ 2,178 | \$ 36 | \$ -0- |

Edgar Filing: SUMMIT BANCSHARES INC /TX/ - Form 10-Q

As of March 31, 2006, non-accrual loans were comprised of \$10,818,000 in commercial loans, \$307,000 in real estate mortgage loans and \$39,000 in consumer loans.

The following table summarizes the relationship between non-performing loans, criticized loans and the allowance for loan losses (dollars in thousands):

| | <u>March 31, 2006</u> | <u>December 31, 2005</u> | <u>September 30, 2005</u> | <u>June 30, 2005</u> | <u>March 31, 2005</u> |
|--|---------------------------|------------------------------|-------------------------------|--------------------------|---------------------------|
| Non-Performing Loans | \$ 11,164 | \$ 3,000 | \$ 4,989 | \$ 3,372 | \$ 3,294 |
| Criticized Loans | 30,732 | 35,161 | 39,450 | 35,580 | 38,110 |
| Allowance for Loan Losses | 13,092 | 11,208 | 11,131 | 10,798 | 10,519 |
| Allowance for Loan Losses as a Percent of: | | | | | |
| Non-Performing Loans | 117% | 374% | 223% | 320% | 319% |
| Criticized Loans | 43% | 32% | 28% | 30% | 28% |

Loans are graded on a system similar to that used by the banking industry regulators. The first level of criticized loans is Other Assets Especially Mentioned (OAEM). These loans are fundamentally sound but have potential weaknesses which may, if not corrected, weaken the asset or inadequately protect the bank's credit position at some future date. The second level is Substandard, which are loans inadequately protected by current sound net worth, paying capacity or pledged collateral of the borrower. The last level of criticized loans, before they are charged-off, is Doubtful. Doubtful loans are considered to have inherent weaknesses because collection or liquidation in full is highly questionable. In addition to the above grading system, the Corporation maintains a separate watch list which further aids the Corporation in monitoring loan quality. Watch list loans show warning elements where the present status portrays one or more deficiencies that require attention in the short run or where pertinent ratios of the account have weakened to a point where more frequent monitoring is warranted. The Corporation remains diligent in its efforts to identify any loan that might reflect weakness of the borrower as soon as possible. Management is not aware of any potential loan problems that have not been disclosed to which serious doubt exist as to the ability of the borrower to substantially comply with the present repayment terms.

Total criticized loans were \$30.7 million at March 31, 2006, a decrease of \$4.4 million and \$7.4 million from the levels of December 31, 2005, and March 31, 2005, respectively. Criticized loans as a percentage of total loans were 3.80%, 4.54% and 5.32% as of March 31, 2006, December 31, 2005, and March 31, 2005, respectively.

Interest Rate Sensitivity

Interest rate sensitivity is the relationship between changes in market interest rates and net interest income due to the repricing characteristics of assets and liabilities.

The following table, commonly referred to as a static GAP report, indicates the interest rate sensitivity position at March 31, 2006 and may not be reflective of positions in subsequent periods (dollars in thousands):

| | Matures or Reprices within: | | | Total Rate Sensitive One Year or Less | Repriced After 1 Year or Non-interest Sensitive | Total |
|--|-----------------------------|---------------------|---------------------|---|---|-------------------|
| | 30 Days or Less | 31-180 Days | 181 to One Year | | | |
| Earning Assets: | | | | | | |
| Loans | \$ 368,787 | \$ 63,886 | \$ 55,611 | \$ 488,284 | \$ 320,322 | \$ 808,606 |
| Investment Securities | 13,184 | 25,999 | 41,350 | 80,533 | 167,349 | 247,882 |
| Federal Funds Sold and Interest Bearing Deposits | 2,404 | -0- | -0- | 2,404 | -0- | 2,404 |
| Total Earning Assets | 384,375 | 89,885 | 96,961 | 571,221 | 487,671 | 1,058,892 |
| Interest Bearing Liabilities: | | | | | | |
| Interest-Bearing Transaction Accounts and Savings | 416,361 | -0- | -0- | 416,361 | -0- | 416,361 |
| Certificates of Deposit under \$100,000 and IRAs | 7,102 | 23,900 | 30,444 | 61,446 | 30,129 | 91,575 |
| Certificates of Deposit \$100,000 or More | 8,827 | 38,118 | 32,444 | 79,389 | 40,485 | 119,874 |
| Borrowings | 104,527 | 20,000 | 5,000 | 129,527 | 15,000 | 144,527 |
| Total Interest Bearing Liabilities | 536,817 | 82,018 | 67,888 | 686,723 | 85,614 | 772,337 |
| Interest Sensitivity Gap | \$ (152,442) | \$ 7,867 | \$ 29,073 | \$ (115,502) | \$ 402,057 | \$ 286,555 |
| Cumulative Gap | \$ (152,442) | \$ (144,575) | \$ (115,502) | | | |
| Periodic Gap to Total Assets | (13.60)% | 0.70% | 2.59% | | | |
| Cumulative Gap to Total Assets | (13.60)% | (12.89)% | (10.30)% | | | |

The preceding static GAP report reflects a cumulative liability sensitive position during the one year horizon. An inherent weakness of this report is that it ignores the relative volatility any one category may have in relation to other categories or market rates in general. For instance, the rate paid on NOW accounts typically moves slower than the three month T-Bill. Management attempts to capture this relative volatility by utilizing a simulation model with a beta factor adjustment which estimates the volatility of rate sensitive assets and/or liabilities in relation to other market rates.

Beta factors are an estimation of the long term, multiple interest rate environment relation between an individual account and market rates in general. For instance, NOW, savings and money market accounts, which are repricable within 30 days, will have considerably lower beta factors than variable rate loans and most investment categories. Taking this into consideration, it is quite possible for a bank with a negative cumulative GAP to total asset ratio to have a positive beta adjusted GAP risk position. As a result of applying the beta factors established by management to the earning assets and interest bearing liabilities in the static gap report via a simulation model, the negative cumulative GAP to total assets ratio at one year of (10.30%) was reversed to a positive 24.59% beta adjusted GAP position. Management feels that the beta adjusted GAP risk technique more accurately reflects the Corporation's GAP position.

Capital

Edgar Filing: SUMMIT BANCSHARES INC /TX/ - Form 10-Q

At March 31, 2006, shareholders' equity totaled \$82.3 million, an increase of \$1.0 million, or 1.2%, compared to December 31, 2005, and an increase of \$7.9 million, or 10.6%, compared to March 31, 2005. This increase reflects the increase in retained earnings which was partially offset by the payment of dividends, the increase in the unrealized loss on available-for-sale investment securities and the impact of the purchase of treasury stock. The unrealized loss on available-for-sale investment securities increased \$600 thousand in the three months ended March 31, 2006.

Edgar Filing: SUMMIT BANCSHARES INC /TX/ - Form 10-Q

On April 19, 2005, the Board of Directors of the Corporation approved a stock repurchase plan (the 2005 Stock Purchase Plan) authorizing management to purchase up to 620,467 shares of the Corporation's common stock on behalf of the Corporation over the twelve-month period beginning April 19, 2005 and ending on April 18, 2006, including in open market transactions, privately negotiated transactions or other transactions in accordance with all applicable state and federal laws and regulations.

In the quarter ended March 31, 2006, 10,000 shares were purchased by the Corporation pursuant to the 2005 Stock Purchase Plan in privately negotiated transactions. 12,738 shares of the Corporation's common stock, in the aggregate, were purchased pursuant to the 2005 Stock Purchase Plan from the period beginning April 19, 2005 through April 18, 2006. No more shares may be purchased pursuant to the 2005 Stock Purchase Plan.

On April 18, 2006, the Board of Directors of the Corporation approved a stock purchase plan (the 2006 Stock Purchase Plan) authorizing management to purchase up to 623,675 shares of the Corporation's common stock on behalf of the Corporation over the twelve-month period beginning April 19, 2006 and ending on April 18, 2007, including in open market transactions, privately negotiated transactions or other transactions in accordance with all applicable state and federal laws and regulations.

The Corporation's ability to purchase shares of the Corporation's common stock is subject to various banking laws, regulations and policies as well as rules and regulations of the Securities and Exchange Commission. The Corporation anticipates purchasing shares of the Corporation's common stock pursuant to the 2006 Stock Purchase Plan as conditions warrant.

We and the Bank are subject to capital adequacy guidelines established by the Federal Reserve Board and other regulatory authorities. The table below illustrates the Bank's and our compliance with the capital adequacy guidelines as of March 31, 2006 and 2005 (dollars in thousands):

| | March 31, 2006 | | March 31, 2005 | |
|--------------------------------------|------------------------------|-------------------|------------------------------|-------------------|
| | The Consolidated Corporation | Summit Bank, N.A. | The Consolidated Corporation | Summit Bank, N.A. |
| Total Assets | \$ 1,121,269 | \$ 1,120,701 | \$ 999,914 | \$ 999,384 |
| Risk Weighted Assets | 836,511 | 836,321 | 767,540 | 767,000 |
| Equity Capital (Tier 1) | 87,068 | 86,225 | 77,487 | 78,760 |
| Qualifying Allowance for Loan Losses | 10,488 | 10,487 | 9,606 | 9,588 |
| Total Capital | \$ 97,556 | \$ 96,712 | \$ 87,093 | \$ 88,348 |
| Leverage Ratio | 7.88% | 7.80% | 7.80% | 8.05% |
| Risk Capital Ratio: | | | | |
| Tier I Capital | 10.41% | 10.31% | 10.10% | 10.27% |
| Total Capital | 11.66 | 11.56 | 11.35 | 11.52 |

As of March 31, 2006, the Bank exceeded our risk-based capital and leverage requirements set by regulatory authorities and satisfied the criteria for classification as a well capitalized institution under the rules of the Federal Deposit Insurance Corporation Improvement Act of 1991.

Liquidity

Our primary internal sources of liquidity consist of the federal funds that we sell and our portfolio of marketable investment securities, particularly those with shorter maturities. Federal funds sold and investment securities maturing within 90 days represented \$11.0 million, or 1.0%, of total assets as of March 31, 2006. Additionally, our ability to sell loan participations, purchase federal funds and obtain advances from the Federal Home Loan Bank serve as secondary sources of liquidity. The Bank has approved federal funds lines at other banks.

Our liquidity is enhanced by the fact that 86.4% of our total deposits at March 31, 2006 were core deposits. Core deposits are defined as total deposits less public funds, brokered deposits and certificates of deposit greater than \$100,000. Core deposits are generally more stable (i.e., less likely to be withdrawn) than other deposits. Additionally interest-bearing core deposits may have lower interest rates than other interest-bearing deposits. Our loan to deposit ratio averaged 92.3% for the three month period ended March 31, 2006.

In the event that our average loans continue to grow during 2006 and we are unable to fund any such growth solely through the generation of additional deposits, we may be required to obtain funding from secondary sources, including purchasing federal funds, obtaining advances

Edgar Filing: SUMMIT BANCSHARES INC /TX/ - Form 10-Q

from the Federal Home Loan Bank or other secondary sources. In such an event, our business, results of operations and financial condition could be negatively impacted.

Our income, which provides funds for the payment of dividends to our shareholders and for other corporate purposes, is derived from our investment in the Bank.

On May 3, 2004, the Corporation formed SBI Trust and SBI Trust subsequently issued \$12.0 million of floating rate (three month LIBOR plus a margin of 2.65%) Capital Securities (the Trust Capital Securities). Concurrent with the issuance of the Trust Capital Securities, SBI Trust issued trust common securities to the Corporation in the aggregate liquidation value of \$372,000. The proceeds of the issuance of the Trust Capital Securities and trust common securities were invested in the Corporation's Floating Rate Junior Subordinated Deferrable Debentures (the Deferrable Debentures), which mature on July 7, 2034 and have a call feature that permits the Corporation to redeem any or all of the securities after July 7, 2009. The interest rate on the Deferrable Debentures at March 31, 2006 was 7.25%. The Deferrable Debentures, which are the only asset of SBI Trust, are subordinated and junior in right of payment to all present and future senior indebtedness (as defined in the Indenture date May 3, 2004) of the Corporation.

On September 15, 2005, we obtained a line of credit from a bank under which we may borrow \$10,000,000 at a floating rate (three month LIBOR plus a margin of 2.00%). The line of credit is secured by stock of the Bank and matures on September 15, 2006, whereupon, if balances are outstanding, the line converts to a term note having a five year term. The Corporation will not pay a fee for any unused portion of this line. At March 31, 2006, there were no amounts outstanding under the line. The purpose of the line is to provide an additional liquidity source.

Off-Balance-Sheet Arrangements, Commitments, Guarantees and Contractual Obligations

Except as set forth herein, during the three months ended March 31, 2006, there have been no material changes outside the ordinary course of the Corporation's business in the contractual obligations specified in Item 7: Management's Discussion and Analysis of Financial Condition and Results of Operations - Off-Balance-Sheet Arrangements, Commitments, Guarantees and Contractual Obligations in our Annual Report on Form 10-K for the year ended December 31, 2005.

At March 31, 2006, outstanding documentary and standby letters of credit totaled \$8,607,000 and commitments to extend credit totaled \$231,880,000. Documentary and standby letters of credit and commitments to extend credit totaled \$6,637,000 and \$227,031,000 at December 31, 2005. The increase in commitments to extend credit reflects the continued demand for credit facilities in our market.

Related Party Transactions

The Bank has made loan transactions in the ordinary course of business with certain of its and the Corporation's officers, directors and their affiliates. All loans included in such transactions are made on substantially the same terms, including interest rate and collateral, as those prevailing at the time for comparable transactions with other unrelated persons and all such loans are current as to principal and interest payments. Total loans outstanding to such related parties amounted to approximately \$10,369,000 at March 31, 2006 and \$9,356,000 at December 31, 2005.

Subsequent Events

On April 18, 2006, the Board of Directors of the Corporation approved a quarterly dividend of \$.08 per share to be paid on May 15, 2006 to shareholders of record on April 28, 2006.

On April 18, 2006, the Board of Directors of the Corporation approved the 2006 Stock Purchase Plan authorizing management to purchase up to 623,675 shares of the Corporation's common stock on behalf of the Corporation over the twelve-month period beginning April 19, 2006, including in open market transactions, privately negotiated transactions or other transactions in accordance with all applicable state and federal laws and regulations.

On April 18, 2006, the shareholders of the Corporation approved the 2006 Long-Term Incentive Plan of the Corporation (the 2006 Plan). The 2006 Plan replaced the 1997 Plan. The 2006 Plan is intended to enable the Corporation to remain competitive and innovative in its ability to attract, motivate, reward and retain the services of key employees. The 2006 Plan provides for the granting of stock options, stock appreciation rights, restricted stock, restricted stock units, performance awards, dividend equivalent rights, and other awards which may be paid in cash or stock. The 2006 Plan is expected to provide flexibility to the Corporation's compensation methods in order to adapt the compensation of key employees to a changing business environment, after giving due consideration to competitive conditions and the impact of federal tax laws. Subject to certain adjustments, the number of the Corporation's shares of common stock that may be issued pursuant to awards under the 2006 Plan is 1,250,000 shares, less the total number of shares of common stock issued pursuant to the 2006 Plan or issuable upon the exercise of awards granted under predecessor Plans. As of March 31, 2006, stock option awards for 566,059 shares of common stock were outstanding.

Critical Accounting Policies

Our accounting policies are fundamental to understanding management's discussion and analysis of results of operations and financial condition. We have identified our policy with respect to allowance for loan losses as critical because it requires management to make

particularly difficult, subjective or complex judgments about matters that are inherently uncertain and because of the likelihood that materially different amounts would be reported under different conditions or using different assumptions. We, in consultation with our Audit Committee of the Board of Directors, have reviewed and approved this critical accounting policy, which is further described under the captions "Loan and Allowance for Loan Losses" in Note 1 ("Summary of Significant Accounting Policies") to the Financial Statements.

These evaluations are inherently subjective because, even though they are based on objective data, it is management's interpretation of that data that determines the amount of the appropriate allowance. Therefore, from time to time (but at least quarterly), management reviews the actual performance and write-off history of the loan portfolio and compares that to previously determined allowance coverage percentages. In this manner, management evaluates the impact the previously mentioned variables may have had on the loan portfolio to determine which changes, if any, should be made to the assumptions and analyses. Recent analysis has indicated that projections of estimated losses inherent in the loan portfolio have approximated actual write-off experience during the current economic environment.

Actual results could differ materially from estimates as a result of changes in economic or market conditions and other factors. Changes in our evaluations and the assumptions underlying these evaluations could result in a material change in the allowance. While we believe that the allowance for loan losses has been established and maintained at levels adequate to reflect the risks inherent in the loan portfolio, future increases may be necessary if economic or market conditions and other factors differ substantially from the conditions that existed at the time of the initial determination.

The Corporation adopted FAS No. 123R, Share-Based Payments, effective January 1, 2006, utilizing the modified prospective method as described in the standard. Under the modified prospective method, compensation cost is recognized for all share-based payments granted after the effective date and for all unvested awards granted prior to the effective date. Prior to adoption, the Corporation accounted for stock-based compensation under the recognition and measurement principles of Accounting Principles Board Opinion No. 25, Accounting for Stock Issued to Employees, and related interpretations. The Corporation recognized \$44,000 in total stock-based compensation expense during the first quarter of 2006.

There have been no significant changes in critical accounting policies or management estimates since the year ended December 31, 2005 other than the adoption of FAS No. 123R as described above. A comprehensive discussion of the Company's critical accounting policies and management estimates is included in Management's Discussion and Analysis of Financial Condition and Results of Operations in the Company's Annual Report on Form 10-K for the year ended December 31, 2005.

Item 3 Quantitative and Qualitative Disclosure about Market Risk

There were no material changes in market risks faced by the Corporation from December 31, 2005 to March 31, 2006. For more information regarding quantitative and qualitative disclosures about market risk, please refer to the Corporation's Annual Report on Form 10-K as of and for the year ended December 31, 2005, and in particular, Item 7 Management's Discussion and Analysis of Financial Condition and Results of Operations Interest Rate Sensitivity and Liquidity.

Item 4 Controls and Procedures

The Corporation's management, including the Corporation's principal executive officer and principal financial officer, has evaluated the effectiveness of the Corporation's disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934) as of the end of the Corporation's fiscal quarter ended March 31, 2006. Based on that evaluation, the Corporation's principal executive officer and principal financial officer have concluded that the Corporation's disclosure controls and procedures were effective as of the end of the Corporation's fiscal quarter ended March 31, 2006.

There were no changes in the Corporation's internal control over financial reporting identified in connection with the evaluation required by paragraph (d) of Rule 13a-15 or Rule 15d-15 under the Exchange Act that occurred during the Corporation's fiscal quarter ended March 31, 2006 that have materially affected, or are reasonably likely to materially affect, the Corporation's internal control over financial reporting.

PART II - OTHER INFORMATION**Item 1. Legal Proceedings**

Not applicable

Item 1A. Risk Factors

There have been no material changes from the risk factors previously disclosed in the Corporation's Annual Report on Form 10-K for the year ended December 31, 2005 in response to Item 1A. to Part I of Form 10-K.

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

On April 19, 2005, the Board of Directors of the Corporation approved the 2005 Stock Purchase Plan authorizing management to purchase up to 620,467 shares of the Corporation's common stock on behalf of the Corporation over the twelve-month period beginning April 19, 2005 and ending on April 18, 2006, including in open market transactions, privately negotiated transactions or other transactions in accordance with all applicable state and federal laws and regulations.

12,738 shares of the Corporation's common stock, in the aggregate, were purchased by the Corporation pursuant to the 2005 Stock Purchase Plan from the period beginning April 19, 2005 through April 18, 2006. No more shares may be purchased pursuant to the 2005 Stock Purchase Plan.

The Corporation purchased (but did not retire) 10,000 shares of the Corporation's common stock pursuant to the 2005 Stock Purchase Plan in privately negotiated transactions in the quarter covered by this report. The following table furnishes information for these purchases:

| Period | Total Number of Shares Purchased | Average Price Paid per Share | Shares Purchased as Part of Publicly Announced Plans or Programs | Maximum Number of Shares that May Yet Be Purchased Under the Plans or Programs |
|---|-------------------------------------|---------------------------------|---|--|
| Month #1 (January 1, 2006 January 31, 2006) | -0- | \$ -0- | -0- | 617,729 |
| Month #2 (February 1, 2006 February 28, 2006) | -0- | -0- | -0- | 617,729 |
| Month #3 (March 1, 2006 March 31, 2006) | 10,000 | 18.92 | 10,000 | 607,729 |
| Total: | 10,000 | \$ 18.92 | 10,000 | 607,729 |

- (1) These shares were purchased pursuant to the 2005 Stock Purchase Plan.
- (2) The 2005 Stock Purchase Plan was announced on May 10, 2005.
- (3) The Board of Directors of the Corporation approved the Corporation to purchase up to 620,467 shares of the Corporation's common stock over the twelve-month period beginning April 19, 2005 pursuant to the 2005 Stock Purchase Plan.
- (4) The expiration date of the 2005 Stock Purchase Plan was April 18, 2006.

On April 18, 2006, the Board of Directors of the Corporation approved a stock purchase plan (the 2006 Stock Purchase Plan) authorizing management to purchase up to 623,675 shares of the Corporation's common stock on behalf of the Corporation over the twelve-month period beginning April 19, 2006 and ending on April 18, 2007, including in open market transactions, privately negotiated transactions or other transactions in accordance with all applicable state and federal laws and regulations.

The Corporation's ability to purchase shares of the Corporation's common stock is subject to various banking law regulations and policies as well as rules and regulations of the Securities and Exchange Commission.

Item 3. Defaults Upon Senior Securities

Not applicable

Item 4. Submission of Matters to a Vote of Security Holders

Not applicable

Item 5. Other Information

Not applicable

Item 6. Exhibits

- 3.1 Restated Articles of Incorporation of the Corporation (incorporated herein by Reference to Exhibit 3(a) to the Corporation's Annual Report on Form 10-K for the year ended December 31, 1998)
- 3.2 Amended and Restated Bylaws of the Corporation (incorporated herein by reference to Exhibit 3(b) to the Corporation's Annual Report on Form 10-K for the year ended December 31, 2002)
- 3.3 Amendment to the Amended and Restated Bylaws of the Corporation adopted by resolution of the Board of Directors of the Corporation (incorporated herein by reference to Exhibit 99.1 to the Corporation's Current Report on Form 8-K filed February 22, 2005)
- 4.1 Rights Agreement, dated April 17, 1990, by and between the Corporation and Summit Bancservices, Inc. (incorporated herein by reference to Exhibit 1 to the Corporation's Current Report on Form 8-K dated April 18, 1990 filed on April 24, 1990)
- 4.2 Amendment No. 1 to Rights Agreement, effective as of April 16, 2000, by and between the Corporation and Summit Bancservices, Inc. (incorporated herein by reference to Exhibit 4(b) to the Corporation's Quarterly Report on Form 10-Q for the quarterly period ended September 30, 2000)
- 4.3 Junior Subordinated Debt Securities Indenture Agreement dated May 3, 2004 (incorporated herein by reference to Exhibit 4(a) to the Corporation's Quarterly Report on Form 10-Q for the quarterly period ended September 30, 2004)
- 4.4 Junior Subordinated Debt Securities Due 2034 (incorporated herein by reference to Exhibit 4(b) to the Corporation's Quarterly Report on Form 10-Q for the quarterly period ended September 30, 2004)
- 4.5 Loan Agreement dated September 15, 2005 between the Corporation and Frost National Bank (incorporated herein by reference to Exhibit 10 to the Corporation's Quarterly Report on Form 10-Q/A for the quarterly period ended September 30, 2005)
- 11 Computation of Earnings Per Common Share
- 31.1 Certification of Principal Executive Officer of Summit Bancshares, Inc. pursuant to Rule 13a-14(a) of the Securities Exchange Act of 1934.
- 31.2 Certification of Principal Financial Officer of Summit Bancshares, Inc. pursuant to Rule 13a-14(a) of the Securities Exchange Act of 1934.
- 32.1 Certification of Principal Executive Officer of Summit Bancshares, Inc. pursuant to Section 1350, Chapter 63 of Title 18 of the United States Code, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
- 32.2 Certification of Principal Financial Officer of Summit Bancshares, Inc. pursuant to Section 1350, Chapter 63 of Title 18 of the United States Code, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

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 BANCSHARES, INC.
Registrant

Date: May 10, 2006

By: /s/ Philip E. Norwood

Philip E. Norwood,
Chairman, President and
Chief Executive Officer

Date: May 10, 2006

By: /s/ Bob G. Scott

Bob G. Scott,
Executive Vice President and
Chief Operating Officer
(Chief Financial Officer)

EXHIBIT INDEX

| Exhibit | Description |
|---------|---|
| 3.1 | Restated Articles of Incorporation of the Corporation (incorporated herein by Reference to Exhibit 3(a) to the Corporation's Annual Report on Form 10-K for the year ended December 31, 1998) |
| 3.2 | Amended and Restated Bylaws of the Corporation (incorporated herein by reference to Exhibit 3(b) to the Corporation's Annual Report on Form 10-K for the year ended December 31, 2002) |
| 3.3 | Amendment to the Amended and Restated Bylaws of the Corporation adopted by resolution of the Board Directors of the Corporation (incorporated herein by reference to Exhibit 99.1 to the Corporation's Current Report on Form 8-K filed February 22, 2005) |
| 4.1 | Rights Agreement, dated April 17, 1990, by and between the Corporation and Summit Bancservices, Inc. (incorporated herein by reference to Exhibit 1 to the Corporation's Current Report on Form 8-K dated April 18, 1990 filed on April 24, 1990) |
| 4.2 | Amendment No. 1 to Rights Agreement, effective as of April 16, 2000, by and between the Corporation and Summit Bancservices, Inc. (incorporated herein by reference to Exhibit 4(b) to the Corporation's Quarterly Report on Form 10-Q for the quarterly period ended September 30, 2000) |
| 4.3 | Junior Subordinated Debt Securities Indenture Agreement dated May 3, 2004 (incorporated herein by reference to Exhibit 4(a) to the Corporation's Quarterly Report on Form 10-Q for the quarterly period ended September 30, 2004) |
| 4.4 | Junior Subordinated Debt Securities Due 2034 (incorporated herein by reference to Exhibit 4(b) to the Corporation's Quarterly Report on Form 10-Q for the quarterly period ended September 30, 2004) |
| 4.5 | Loan Agreement dated September 15, 2005 between the Corporation and Frost National Bank (incorporated herein by reference to Exhibit 10 to the Corporation's Quarterly Report on Form 10-Q/A for the quarterly period ended September 30, 2005) |
| 11 | Computation of Earnings Per Common Share |
| 31.1 | Certification of Principal Executive Officer of Summit Bancshares, Inc. pursuant to Rule 13a-14(a) of the Securities Exchange Act of 1934. |
| 31.2 | Certification of Principal Financial Officer of Summit Bancshares, Inc. pursuant to Rule 13a-14(a) of the Securities Exchange Act of 1934. |
| 32.1 | Certification of Principal Executive Officer of Summit Bancshares, Inc. pursuant to Section 1350, Chapter 63 of Title 18 of the United States Code, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. |
| 32.2 | Certification of Principal Financial Officer of Summit Bancshares, Inc. pursuant to Section 1350, Chapter 63 of Title 18 of the United States Code, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. |