

C & F FINANCIAL CORP  
Form 10-Q  
August 07, 2012

---

---

UNITED STATES  
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 June 30, 2012

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: 000-23423

---

C&F Financial Corporation  
(Exact name of registrant as specified in its charter)

---

Virginia  
(State or other jurisdiction of incorporation or organization)

54-1680165  
(I.R.S. Employer Identification No.)

802 Main Street West Point, VA  
(Address of principal executive offices)

23181  
(Zip Code)

(804) 843-2360  
(Registrant's telephone number, including area code)

N/A  
(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

Edgar Filing: C & F FINANCIAL CORP - Form 10-Q

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer

Accelerated filer

Non-accelerated filer  (Do not check if a smaller reporting company)

Smaller reporting company

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

At August 3, 2012, the latest practicable date for determination, 3,216,140 shares of common stock, \$1.00 par value, of the registrant were outstanding.

---

---

---

## TABLE OF CONTENTS

|                                | Page   |
|--------------------------------|--|
| Part I - Financial Information |  |
| Item 1.                        | Financial Statements   |
|                                | <u>Consolidated Balance Sheets - June 30, 2012 (unaudited) and December 31, 2011</u> 2                                   |
|                                | <u>Consolidated Statements of Income (unaudited) - Three and six months ended June 30, 2012 and 2011</u> 3               |
|                                | <u>Consolidated Statements of Comprehensive Income (unaudited) – Three and six months ended June 30, 2012 and 2011</u> 4 |
|                                | <u>Consolidated Statements of Shareholders' Equity (unaudited) - Six months ended June 30, 2012 and 2011</u> 5           |
|                                | <u>Consolidated Statements of Cash Flows (unaudited) - Six months ended June 30, 2012 and 2011</u> 6                     |
|                                | <u>Notes to Consolidated Financial Statements (unaudited)</u> 7  |
| Item 2.                        | <u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u> 26                          |
| Item 3.                        | <u>Quantitative and Qualitative Disclosures About Market Risk</u> 46   |
| Item 4.                        | <u>Controls and Procedures</u> 46  |
| Part II - Other Information    |  |
| Item 1A.                       | <u>Risk Factors</u> 46   |
| Item 2.                        | <u>Unregistered Sales of Equity Securities and Use of Proceeds</u> 46  |
| Item 6.                        | <u>Exhibits</u> 47   |
|                                | <u>Signatures</u> 48   |

Table of Contents

## PART I - FINANCIAL INFORMATION

## ITEM 1. FINANCIAL STATEMENTS

CONSOLIDATED BALANCE SHEETS  
(In thousands, except for share and per share amounts)

|   | June 30,<br>2012<br>(Unaudited) | December<br>31,<br>2011 |
|---|---------------------------------|-------------------------|
| <b>ASSETS</b>   |                                 |                         |
| Cash and due from banks   | \$ 5,994                        | \$ 5,787                |
| Interest-bearing deposits in other banks  | 4,938                           | 4,723                   |
| Federal funds sold  | --                              | 997                     |
| Total cash and cash equivalents   | 10,932                          | 11,507                  |
| Securities-available for sale at fair value, amortized cost of \$132,825 and \$137,575, respectively                      | 141,289                         | 144,646                 |
| Loans held for sale, net  | 79,171                          | 70,062                  |
| Loans, net of allowance for loan losses of \$35,457 and \$33,677, respectively  | 634,621                         | 616,984                 |
| Federal Home Loan Bank stock, at cost   | 3,749                           | 3,767                   |
| Corporate premises and equipment, net   | 28,003                          | 28,462                  |
| Other real estate owned, net of valuation allowance of \$4,122 and \$3,927, respectively                                  | 5,236                           | 6,059                   |
| Accrued interest receivable   | 5,360                           | 5,242                   |
| Goodwill  | 10,724                          | 10,724                  |
| Other assets  | 30,629                          | 30,671                  |
| Total assets  | \$ 949,714                      | \$ 928,124              |
| <b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>   |                                 |                         |
| <b>Deposits</b>   |                                 |                         |
| Noninterest-bearing demand deposits   | \$ 109,418                      | \$ 95,556               |
| Savings and interest-bearing demand deposits  | 255,772                         | 242,917                 |
| Time deposits   | 292,257                         | 307,943                 |
| Total deposits  | 657,447                         | 646,416                 |
| Short-term borrowings   | 22,383                          | 7,544                   |
| Long-term borrowings  | 132,987                         | 132,987                 |
| Trust preferred capital notes   | 20,620                          | 20,620                  |
| Accrued interest payable  | 974                             | 1,111                   |
| Other liabilities   | 21,398                          | 23,356                  |
| Total liabilities   | 855,809                         | 832,034                 |
| Commitments and contingent liabilities  | —                               |                         |
| <b>Shareholders' equity</b>   |                                 |                         |
| Preferred stock (\$1.00 par value, 3,000,000 shares authorized, 0 and 10,000 shares issued and outstanding, respectively) | —                               | 10                      |
|   | 3,120                           | 3,091                   |

Edgar Filing: C & F FINANCIAL CORP - Form 10-Q

Common stock (\$1.00 par value, 8,000,000 shares authorized, 3,214,376 and 3,178,510 shares issued and outstanding, respectively)

|   |            |            |
|---|------------|------------|
| Additional paid-in capital                  | 4,415      | 13,438     |
| Retained earnings                           | 82,085     | 76,167     |
| Accumulated other comprehensive income, net | 4,285      | 3,384      |
| Total shareholders' equity                  | 93,905     | 96,090     |
| Total liabilities and shareholders' equity  | \$ 949,714 | \$ 928,124 |

The accompanying notes are an integral part of the consolidated financial statements.

Table of Contents

CONSOLIDATED STATEMENTS OF INCOME  
(Unaudited)  
(In thousands, except for share and per share amounts)

|   | Three Months Ended<br>June 30, |                | Six Months Ended<br>June 30, |                |
|---|--------------------------------|----------------|------------------------------|----------------|
|   | 2012                           | 2011           | 2012                         | 2011           |
| <b>Interest income</b>  |                                |                |                              |                |
| Interest and fees on loans                                    | \$17,824                       | \$17,043       | \$35,300                     | \$33,389       |
| Interest on money market investments                          | 5                              | 16             | 13                           | 31             |
| <b>Interest and dividends on securities</b>                   |                                |                |                              |                |
| U.S. government agencies and corporations                     | 52                             | 55             | 109                          | 106            |
| Tax-exempt obligations of states and political subdivisions   | 1,186                          | 1,225          | 2,373                        | 2,419          |
| Corporate bonds and other                                     | 31                             | 30             | 59                           | 56             |
| <b>Total interest income</b>                                  | <b>19,098</b>                  | <b>18,369</b>  | <b>37,854</b>                | <b>36,001</b>  |
| <b>Interest expense</b>                                       |                                |                |                              |                |
| Savings and interest-bearing deposits                         | 197                            | 274            | 450                          | 606            |
| Certificates of deposit, \$100 or more                        | 547                            | 663            | 1,187                        | 1,336          |
| Other time deposits   | 637                            | 819            | 1,361                        | 1,669          |
| Borrowings  | 967                            | 966            | 1,940                        | 1,932          |
| Trust preferred capital notes                                 | 248                            | 246            | 497                          | 489            |
| <b>Total interest expense</b>                                 | <b>2,596</b>                   | <b>2,968</b>   | <b>5,435</b>                 | <b>6,032</b>   |
| <b>Net interest income</b>                                    | <b>16,502</b>                  | <b>15,401</b>  | <b>32,419</b>                | <b>29,969</b>  |
| Provision for loan losses                                     | 2,860                          | 3,390          | 5,585                        | 6,210          |
| <b>Net interest income after provision for loan losses</b>    | <b>13,642</b>                  | <b>12,011</b>  | <b>26,834</b>                | <b>23,759</b>  |
| <b>Noninterest income</b>                                     |                                |                |                              |                |
| Gains on sales of loans                                       | 4,718                          | 3,696          | 8,821                        | 7,496          |
| Service charges on deposit accounts                           | 825                            | 846            | 1,626                        | 1,694          |
| Other service charges and fees                                | 1,608                          | 1,314          | 2,976                        | 2,406          |
| Net gains on calls and sales of available for sale securities | 8                              | --             | 8                            | --             |
| Other income  | 570                            | 502            | 1,681                        | 1,219          |
| <b>Total noninterest income</b>                               | <b>7,729</b>                   | <b>6,358</b>   | <b>15,112</b>                | <b>12,815</b>  |
| <b>Noninterest expenses</b>                                   |                                |                |                              |                |
| Salaries and employee benefits                                | 9,596                          | 8,430          | 19,338                       | 16,922         |
| Occupancy expenses  | 1,677                          | 1,611          | 3,398                        | 3,137          |
| Other expenses  | 3,954                          | 3,928          | 7,548                        | 7,859          |
| <b>Total noninterest expenses</b>                             | <b>15,227</b>                  | <b>13,969</b>  | <b>30,284</b>                | <b>27,918</b>  |
| <b>Income before income taxes</b>                             | <b>6,144</b>                   | <b>4,400</b>   | <b>11,662</b>                | <b>8,656</b>   |
| Income tax expense  | 1,963                          | 1,317          | 3,701                        | 2,604          |
| <b>Net income</b>   | <b>4,181</b>                   | <b>3,083</b>   | <b>7,961</b>                 | <b>6,052</b>   |
| Effective dividends on preferred stock                        | 165                            | 290            | 311                          | 579            |
| <b>Net income available to common shareholders</b>            | <b>\$4,016</b>                 | <b>\$2,793</b> | <b>\$7,650</b>               | <b>\$5,473</b> |

Edgar Filing: C & F FINANCIAL CORP - Form 10-Q

| Per common share data                                 |           |           |           |           |
|---|-----------|-----------|-----------|-----------|
| Net income – basic                                    | \$1.25    | \$0.89    | \$2.39    | \$1.75    |
| Net income – assuming dilution                        | \$1.22    | \$0.88    | \$2.33    | \$1.73    |
| Cash dividends declared                               | \$0.26    | \$0.25    | \$0.52    | \$0.50    |
| Weighted average number of shares – basic             | 3,208,792 | 3,131,203 | 3,199,655 | 3,127,536 |
| Weighted average number of shares – assuming dilution | 3,296,145 | 3,159,260 | 3,280,560 | 3,163,210 |

The accompanying notes are an integral part of the consolidated financial statements.

Table of Contents

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME  
(Unaudited)  
(In thousands)

|  | Three Months Ended |         | Six Months Ended |         |
|--|--------------------|---------|------------------|---------|
|  | June 30,           |         | June 30,         |         |
|  | 2012               | 2011    | 2012             | 2011    |
| Net income   | \$4,181            | \$3,083 | \$7,961          | \$6,052 |
| Other comprehensive income, net:   | 5                  | 3       | 12               | 7       |
| Changes in defined benefit plan assets and benefit obligations, net        |                    |         |                  |         |
| Unrealized loss on cash flow hedging instruments, net                      | (19 )              | (138 )  | (16 )            | (84 )   |
| Unrealized holding gains on securities, net of reclassification adjustment | 780                | 1,591   | 905              | 2,146   |
| Comprehensive income, net  | \$4,947            | \$4,539 | \$8,862          | \$8,121 |

The accompanying notes are an integral part of the consolidated financial statements.



Table of Contents

## CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY

(Unaudited)

(In thousands, except per share amounts)

|   | Preferred<br>Stock | Common<br>Stock | Additional<br>Paid-In<br>Capital | Retained<br>Earnings | Accumulated Other<br>Comprehensive<br>Income, Net | Total<br>Shareholders'<br>Equity |
|---|--------------------|-----------------|----------------------------------|----------------------|---|----------------------------------|
| Balance December 31, 2011                                   | \$ 10              | \$ 3,091        | \$ 13,438                        | \$ 76,167            | \$ 3,384  | \$ 96,090                        |
| Comprehensive income:                                       |                    |                 |                                  |                      |   |                                  |
| Net income  | —                  | —               | —                                | 7,961                | —   | 7,961                            |
| Other comprehensive<br>income, net                          | —                  | —               | —                                | —                    | 901   | 901                              |
| Comprehensive income  | —                  | —               | —                                | —                    | —   | 8,862                            |
| Stock options exercised                                     | —                  | 23              | 478                              | —                    | —   | 501                              |
| Share-based compensation                                    | —                  | —               | 242                              | —                    | —   | 242                              |
| Restricted stock vested                                     | —                  | 3               | (3 )                             | —                    | —   | —                                |
| Preferred stock redemption                                  | (10 )              | —               | (9,990 )                         | —                    | —   | (10,000 )                        |
| Accretion of preferred stock<br>discount                    | —                  | —               | 172                              | (172 )               | —   | —                                |
| Common stock issued   | —                  | 3               | 78                               | —                    | —   | 81                               |
| Cash dividends paid –<br>common stock (\$0.52 per<br>share) | —                  | —               | —                                | (1,668 )             | —   | (1,668 )                         |
| Cash dividends paid –<br>preferred stock (5% per<br>annum)  | —                  | —               | —                                | (203 )               | —   | (203 )                           |
| Balance June 30, 2012                                       | \$—                | \$ 3,120        | \$ 4,415                         | \$ 82,085            | \$ 4,285  | \$ 93,905                        |
|   |                    |                 |                                  |                      |   |                                  |
|   | Preferred<br>Stock | Common<br>Stock | Additional<br>Paid-In<br>Capital | Retained<br>Earnings | Accumulated Other<br>Comprehensive<br>Income, Net | Total<br>Shareholders'<br>Equity |
| Balance December 31, 2010                                   | \$ 20              | \$ 3,032        | \$ 22,112                        | \$ 67,542            | \$ 71   | \$ 92,777                        |
| Comprehensive income:                                       |                    |                 |                                  |                      |   |                                  |
| Net income  | —                  | —               | —                                | 6,052                | —   | 6,052                            |
| Other comprehensive income,<br>net                          | —                  | —               | —                                | —                    | 2,069   | 2,069                            |
| Comprehensive income  | —                  | —               | —                                | —                    | —   | 8,121                            |
| Stock options exercised                                     | —                  | 8               | 134                              | —                    | —   | 142                              |
| Share-based compensation                                    | —                  | —               | 132                              | —                    | —   | 132                              |
| Restricted stock vested                                     | —                  | 5               | (5 )                             | —                    | —   | —                                |
| Accretion of preferred stock<br>discount                    | —                  | —               | 79                               | (79 )                | —   | —                                |
| Cash dividends paid –<br>common stock (\$0.50 per<br>share) | —                  | —               | —                                | (1,564 )             | —   | (1,564 )                         |
| Cash dividends paid –<br>preferred stock (5% per<br>annum)  | —                  | —               | —                                | (500 )               | —   | (500 )                           |
| Balance June 30, 2011                                       | \$ 20              | \$ 3,045        | \$ 22,452                        | \$ 71,451            | \$ 2,140  | \$ 99,108                        |

The accompanying notes are an integral part of the consolidated financial statements.

Table of Contents

CONSOLIDATED STATEMENTS OF CASH FLOWS  
(Unaudited)  
(In thousands)

|   | Six Months Ended June<br>30, |            |
|---|------------------------------|------------|
|   | 2012                         | 2011       |
| Operating activities:   |                              |            |
| Net income  | \$7,961                      | \$6,052    |
| Adjustments to reconcile net income to net cash provided by operating activities: |                              |            |
| Depreciation  | 1,119                        | 1,025      |
| Provision for loan losses   | 5,585                        | 6,210      |
| Provision for indemnifications  | 455                          | 406        |
| Provision for other real estate owned losses                                      | 350                          | 411        |
| Share-based compensation  | 242                          | 132        |
| Accretion of discounts and amortization of premiums on securities, net            | 366                          | 388        |
| Net realized gain on securities   | (8 )                         | --         |
| Realized losses on sales of other real estate owned                               | 13                           | 21         |
| Proceeds from sales of loans held for sale  | 370,848                      | 297,725    |
| Origination of loans held for sale  | (379,957 )                   | (273,062 ) |
| Change in other assets and liabilities:   |                              |            |
| Accrued interest receivable   | (118 )                       | (47 )      |
| Other assets  | (440 )                       | (1,240 )   |
| Accrued interest payable  | (137 )                       | (15 )      |
| Other liabilities   | (2,423 )                     | (2,477 )   |
| Net cash provided by operating activities   | 3,856                        | 35,529     |
| Investing activities:   |                              |            |
| Proceeds from maturities, calls and sales of securities available for sale        | 21,074                       | 15,311     |
| Purchases of securities available for sale  | (16,682 )                    | (22,219 )  |
| Redemption of Federal Home Loan Bank stock  | 18                           | --         |
| Net increase in customer loans  | (23,660 )                    | (24,034 )  |
| Other real estate owned improvements  | (205 )                       | --         |
| Proceeds from sales of other real estate owned                                    | 1,103                        | 5,894      |
| Purchases of corporate premises and equipment, net                                | (660 )                       | (1,181 )   |
| Net cash used in investing activities   | (19,012 )                    | (26,229 )  |
| Financing activities:   |                              |            |
| Net increase in demand, interest-bearing demand and savings deposits              | 26,717                       | 7,196      |
| Net decrease in time deposits   | (15,686 )                    | (6,485 )   |
| Net increase (decrease) in borrowings   | 14,839                       | (2,649 )   |
| Issuance of common stock  | 582                          | 142        |
| Redemption of preferred stock   | (10,000 )                    | --         |
| Cash dividends  | (1,871 )                     | (2,064 )   |
| Net cash provided by (used in) financing activities                               | 14,581                       | (3,860 )   |
| Net (decrease) increase in cash and cash equivalents                              | (575 )                       | 5,440      |
| Cash and cash equivalents at beginning of period                                  | 11,507                       | 9,680      |
| Cash and cash equivalents at end of period  | \$10,932                     | \$15,120   |

| Supplemental disclosure   |         |          |
|---|---------|----------|
| Interest paid   | \$5,572 | \$6,047  |
| Income taxes paid   | 4,918   | 4,261    |
| Supplemental disclosure of noncash investing and financing activities |         |          |
| Unrealized gains on securities available for sale                     | \$1,393 | \$3,300  |
| Loans transferred to other real estate owned                          | (438 )  | (3,621 ) |
| Pension adjustment  | 18      | 11       |
| Unrealized loss on cash flow hedging instrument                       | (28 )   | (138 )   |

The accompanying notes are an integral part of the consolidated financial statements.

Table of Contents

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

NOTE 1: Summary of Significant Accounting Policies

**Principles of Consolidation:** The accompanying unaudited consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America (U.S. GAAP) for interim financial reporting and with applicable quarterly reporting regulations of the Securities and Exchange Commission (the SEC). They do not include all of the information and notes required by U.S. GAAP for complete financial statements. Therefore, these consolidated financial statements should be read in conjunction with the consolidated financial statements and notes thereto included in the C&F Financial Corporation Annual Report on Form 10-K for the year ended December 31, 2011.

The unaudited consolidated financial statements include the accounts of C&F Financial Corporation (the Corporation) and its wholly-owned subsidiary, Citizens and Farmers Bank (the Bank or C&F Bank). All significant intercompany accounts and transactions have been eliminated in consolidation. In addition, C&F Financial Corporation owns C&F Financial Statutory Trust I and C&F Financial Statutory Trust II, which are unconsolidated subsidiaries. The subordinated debt owed to these trusts is reported as a liability of the Corporation.

**Nature of Operations:** The Corporation is a bank holding company incorporated under the laws of the Commonwealth of Virginia. The Corporation owns all of the stock of its subsidiary, C&F Bank, which is an independent commercial bank chartered under the laws of the Commonwealth of Virginia. The Bank and its subsidiaries offer a wide range of banking and related financial services to both individuals and businesses.

The Bank has five wholly-owned subsidiaries: C&F Mortgage Corporation and Subsidiaries (C&F Mortgage), C&F Finance Company (C&F Finance), C&F Title Agency, Inc., C&F Investment Services, Inc. and C&F Insurance Services, Inc., all incorporated under the laws of the Commonwealth of Virginia. C&F Mortgage, organized in September 1995, was formed to originate and sell residential mortgages and through its subsidiaries, Hometown Settlement Services LLC and Certified Appraisals LLC, provides ancillary mortgage loan production services, such as loan settlements, title searches and residential appraisals. C&F Finance, acquired on September 1, 2002, is a regional finance company providing automobile loans. C&F Title Agency, Inc., organized in October 1992, primarily sells title insurance to the mortgage loan customers of the Bank and C&F Mortgage. C&F Investment Services, Inc., organized in April 1995, is a full-service brokerage firm offering a comprehensive range of investment services. C&F Insurance Services, Inc., organized in July 1999, owns an equity interest in an insurance agency that sells insurance products to customers of the Bank, C&F Mortgage and other financial institutions that have an equity interest in the agency. Business segment data is presented in Note 8.

**Basis of Presentation:** The preparation of financial statements in conformity with U.S. GAAP 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 period. Actual results could differ from those estimates. Material estimates that are particularly susceptible to significant change in the near term relate to the determination of the allowance for loan losses, the allowance for indemnifications, impairment of loans, impairment of securities, the valuation of other real estate owned, the projected benefit obligation under the defined benefit pension plan, the valuation of deferred taxes, the valuation of derivative financial instruments and goodwill impairment. In the opinion of management, all adjustments, consisting only of normal recurring adjustments, which are necessary for a fair presentation of the results of operations in these financial statements, have been made. Certain reclassifications have been made to prior period amounts to conform to the current period presentation.

Derivative Financial Instruments: The Corporation recognizes derivative financial instruments at fair value as either an other asset or other liability in the consolidated balance sheets. The derivative financial instruments have been designated as and qualify as cash flow hedges. The effective portion of the gain or loss on cash flow hedges is reported as a component of other comprehensive income, net of deferred income taxes, and reclassified into earnings in the same period or periods during which the hedged transaction affects earnings.

Share-Based Compensation: Compensation expense for the second quarter and first six months of 2012 included net expense of \$122,000 (\$76,000 after tax) and \$242,000 (\$150,000 after tax), respectively, for restricted stock granted since 2007. As of June 30, 2012, there was \$1.35 million of total unrecognized compensation expense related to unvested restricted stock that will be recognized over the remaining requisite service periods.

Table of Contents

Stock option activity during the six months ended June 30, 2012 and stock options outstanding as of June 30, 2012 are summarized below:

|  | Shares    | Exercise Price* | Remaining Contractual Life (in years)* | Intrinsic Value of Unexercised In-The Money Options (in 000's) |
|--|-----------|-----------------|--|--|
| Options outstanding at January 1, 2012               | 325,067   | \$36.68         | 3.0                                    |  |
| Exercised  | (22,167 ) | 22.60           |  |  |
| Options outstanding and exercisable at June 30, 2012 | 302,900   | \$37.71         | 2.6                                    | \$ 460   |

\* Weighted average

A summary of activity for restricted stock awards during the first six months of 2012 is presented below:

|                           | Shares   | Weighted-Average Grant Date Fair Value |
|---------------------------|----------|--|
| Unvested, January 1, 2012 | 87,125   | \$ 22.59                               |
| Granted                   | 11,775   | \$ 29.81                               |
| Vested                    | (3,650 ) | \$ 19.82                               |
| Cancelled                 | (950 )   | \$ 22.26                               |
| Unvested, June 30, 2012   | 94,300   | \$ 23.60                               |

## Recent Significant Accounting Pronouncements:

In April 2011, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2011-03, Transfers and Servicing – Reconsideration of Effective Control for Repurchase Agreements. The amendments in this ASU remove from the assessment of effective control (1) the criterion requiring the transferor to have the ability to repurchase or redeem the financial assets on substantially the agreed terms, even in the event of default by the transferee and (2) the collateral maintenance implementation guidance related to that criterion. The amendments in this ASU are effective for the first interim or annual period beginning on or after December 15, 2011. The guidance should be applied prospectively to transactions or modifications of existing transactions that occur on or after the effective date. Early adoption was not permitted. The adoption of the new guidance did not have a material effect on the Corporation's financial statements.

In May 2011, the FASB issued ASU 2011-04, Fair Value Measurement – Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs. This ASU is the result of joint efforts by the FASB and the International Accounting Standards Board to develop a single, converged fair value framework on how (not when) to measure fair value and what disclosures to provide about fair value measurements. The ASU is largely consistent with existing fair value measurement principles in U.S. GAAP (Topic 820), with many of the amendments made to eliminate unnecessary wording differences between U.S. GAAP and International Financial Reporting Standards. The amendments are effective for interim and annual periods beginning after December 15, 2011 with prospective application. Early application was not permitted. The Corporation has included the required

disclosures in its consolidated financial statements.

In June 2011, the FASB issued ASU 2011-05, Comprehensive Income – Presentation of Comprehensive Income. The objective of this ASU is to improve the comparability, consistency and transparency of financial reporting and to increase the prominence of items reported in other comprehensive income by eliminating the option to present components of other comprehensive income as part of the statement of changes in stockholders' equity. The amendments require that all non-owner changes in stockholders' equity be presented either in a single continuous statement of comprehensive income or in two separate but consecutive statements. The amendments do not change the items that must be reported in other comprehensive income, the option for an entity to present components of other comprehensive income either net of related tax effects or before related tax effects, or the calculation or reporting of earnings per share. The amendments in this ASU should be applied retrospectively. The amendments are effective for fiscal years and interim periods within those years beginning after December 15, 2011. The amendments do not require transition disclosures. The Corporation has included the required disclosures in its consolidated financial statements.



Table of Contents

In September 2011, the FASB issued ASU 2011-08, Intangible – Goodwill and Other – Testing Goodwill for Impairment. The amendments in this ASU permit an entity to first assess qualitative factors related to goodwill to determine whether it is more likely than not that the fair value of the reporting unit is less than its carrying amount as a basis for determining whether it is necessary to perform the two-step goodwill test described in Topic 350. The more-likely-than-not threshold is defined as having a likelihood of more than 50 percent. Under the amendments in this ASU, an entity is not required to calculate the fair value of a reporting unit unless the entity determines that it is more likely than not that its fair value is less than its carrying amount. The amendments in this ASU are effective for annual and interim goodwill impairment tests performed for fiscal years beginning after December 15, 2011. Early adoption is permitted, including for annual and interim goodwill impairment tests performed as of a date before September 15, 2011, if an entity's financial statements for the most recent annual or interim period have not yet been issued. The adoption of the new guidance did not have a material effect on the Corporation's consolidated financial statements.

In December 2011, the FASB issued ASU 2011-12, Comprehensive Income - Deferral of the Effective Date for Amendments to the Presentation of Reclassifications of Items Out of Accumulated Other Comprehensive Income in ASU 2011-05. The amendments are being made to allow the FASB time to redeliberate whether to present on the face of the financial statements the effects of reclassifications out of accumulated other comprehensive income on the components of net income and other comprehensive income for all periods presented. While the FASB is considering the operational concerns about the presentation requirements for reclassification adjustments and the needs of financial statement users for additional information about reclassification adjustments, entities should continue to report reclassifications out of accumulated other comprehensive income consistent with the presentation requirements in effect before ASU 2011-05. All other requirements in ASU 2011-05 are not affected by ASU 2011-12, including the requirement to report comprehensive income either in a single continuous financial statement or in two separate but consecutive financial statements. Public entities should apply these requirements for fiscal years, and interim periods within those years, beginning after December 15, 2011. The Corporation has included the required disclosures in its consolidated financial statements.

## NOTE 2: Securities

Debt and equity securities, all of which were classified as available for sale, are summarized as follows:

|  | June 30, 2012     |                              |                               |                         |
|--|-------------------|------------------------------|-------------------------------|-------------------------|
|  | Amortized<br>Cost | Gross<br>Unrealized<br>Gains | Gross<br>Unrealized<br>Losses | Estimated<br>Fair Value |
| (Dollars in thousands)                           |                   |                              |                               |                         |
| U.S. government agencies and corporations        | \$13,530          | \$15                         | \$(13)                        | \$13,532                |
| Mortgage-backed securities                       | 2,635             | 73                           | (1)                           | 2,707                   |
| Obligations of states and political subdivisions | 116,633           | 8,392                        | (70)                          | 124,955                 |
| Preferred stock                                  | 27                | 68                           | —                             | 95                      |
|  | \$132,825         | \$8,548                      | \$(84)                        | \$141,289               |

|  | December 31, 2011 |                              |                               |                         |
|--|-------------------|------------------------------|-------------------------------|-------------------------|
|  | Amortized<br>Cost | Gross<br>Unrealized<br>Gains | Gross<br>Unrealized<br>Losses | Estimated<br>Fair Value |
| (Dollars in thousands)                           |                   |                              |                               |                         |
| U.S. government agencies and corporations        | \$15,248          | \$39                         | \$(4)                         | \$15,283                |
| Mortgage-backed securities                       | 2,135             | 81                           | —                             | 2,216                   |
| Obligations of states and political subdivisions | 120,165           | 6,998                        | (84)                          | 127,079                 |
| Preferred stock                                  | 27                | 41                           | —                             | 68                      |

\$137,575    \$7,159    \$(88    ) \$144,646

9

---

Table of Contents

The amortized cost and estimated fair value of securities, all of which were classified as available for sale, at June 30, 2012, by the earlier of contractual maturity or expected maturity, are shown below. Expected maturities will differ from contractual maturities because borrowers may have the right to prepay obligations with or without call or prepayment penalties.

| (Dollars in thousands)                 | June 30, 2012  |                      |
|--|----------------|----------------------|
|  | Amortized Cost | Estimated Fair Value |
| Due in one year or less                | \$ 22,574      | \$ 22,712            |
| Due after one year through five years  | 37,385         | 39,103               |
| Due after five years through ten years | 47,837         | 51,840               |
| Due after ten years                    | 25,002         | 27,539               |
| Preferred stock                        | 27             | 95                   |
|  | \$ 132,825     | \$ 141,289           |

Proceeds from the maturities, calls and sales of securities available for sale for the six months ended June 30, 2012 were \$21.07 million.

The Corporation pledges securities primarily as collateral for public deposits and repurchase agreements. Securities with an aggregate amortized cost of \$92.57 million and an aggregate fair value of \$99.39 million were pledged at June 30, 2012. Securities with an aggregate amortized cost of \$106.97 million and an aggregate fair value of \$112.66 million were pledged at December 31, 2011.

Securities in an unrealized loss position at June 30, 2012, by duration of the period of the unrealized loss, are shown below.

| (Dollars in thousands)                           | Less Than 12 Months |                 | 12 Months or More |                 | Total      |                 |
|--|---------------------|-----------------|-------------------|-----------------|------------|-----------------|
|  | Fair Value          | Unrealized Loss | Fair Value        | Unrealized Loss | Fair Value | Unrealized Loss |
| U.S. government agencies and corporations        | \$5,677             | \$13            | \$—               | \$—             | \$5,677    | \$13            |
| Mortgage-backed securities                       | 910                 | 1               | —                 | —               | 910        | 1               |
| Obligations of states and political subdivisions | 4,309               | 37              | 675               | 33              | 4,984      | 70              |
| Total temporarily impaired securities            | \$10,896            | \$51            | \$675             | \$33            | \$11,571   | \$84            |

There are 35 debt securities with fair values totaling \$11.57 million considered temporarily impaired at June 30, 2012. The primary cause of the temporary impairments in the Corporation's investments in debt securities was fluctuations in interest rates. During the second quarter of 2012, the municipal bond sector, which is included in the Corporation's obligations of states and political subdivisions category of securities, experienced rising securities prices due to declining interest rates over the quarter, gradual fundamental municipal credit improvement, and strong demand trends for municipal securities. The vast majority of the Corporation's municipal bond portfolio is made up of securities where the issuing municipalities have unlimited taxing authority to support their debt service obligations. At June 30, 2012, approximately 96 percent of the Corporation's obligations of states and political subdivisions, as measured by market value, were rated "A" or better by Standard & Poor's or Moody's Investors Service. Of those in a net unrealized loss position, approximately 83 percent were rated, as measured by market value, "A" or better at June 30, 2012. Because the Corporation intends to hold these investments in debt securities to maturity and it is more likely than not that the Corporation will not be required to sell these investments before a recovery of unrealized losses, the

Edgar Filing: C & F FINANCIAL CORP - Form 10-Q

Corporation does not consider these investments to be other-than-temporarily impaired at June 30, 2012 and no other-than-temporary impairment has been recognized.

Securities in an unrealized loss position at December 31, 2011, by duration of the period of the unrealized loss, are shown below.

| (Dollars in thousands)                           | Less Than 12 Months |                 | 12 Months or More |                 | Total      |                 |
|--|---------------------|-----------------|-------------------|-----------------|------------|-----------------|
|  | Fair Value          | Unrealized Loss | Fair Value        | Unrealized Loss | Fair Value | Unrealized Loss |
| U.S. government agencies and corporations        | \$2,064             | \$4             | \$—               | \$—             | \$2,064    | \$4             |
| Obligations of states and political subdivisions | 3,305               | 35              | 1,328             | 49              | 4,633      | 84              |
| Total temporarily impaired securities            | \$5,369             | \$39            | \$1,328           | \$49            | \$6,697    | \$88            |

Table of Contents

The Corporation's investment in Federal Home Loan Bank (FHLB) stock totaled \$3.75 million at June 30, 2012 and \$3.77 million at December 31, 2011. FHLB stock is generally viewed as a long-term investment and as a restricted investment security, which is carried at cost, because there is no market for the stock, other than the FHLBs or member institutions. Therefore, when evaluating FHLB stock for impairment, its value is based on the ultimate recoverability of the par value rather than by recognizing temporary declines in value. The Corporation does not consider this investment to be other-than-temporarily impaired at June 30, 2012 and no impairment has been recognized. FHLB stock is shown as a separate line item on the balance sheet and is not a part of the available for sale securities portfolio.

## NOTE 3: Loans

Major classifications of loans are summarized as follows:

| (Dollars in thousands)                   | June 30,<br>2012 | December<br>31, 2011 |
|--|------------------|----------------------|
| Real estate – residential mortgage       | \$ 146,256       | \$ 147,135           |
| Real estate – construction 1             | 4,983            | 5,737                |
| Commercial, financial and agricultural 2 | 215,419          | 212,235              |
| Equity lines                             | 33,490           | 33,192               |
| Consumer                                 | 6,148            | 6,057                |
| Consumer finance                         | 263,782          | 246,305              |
|  | 670,078          | 650,661              |
| Less allowance for loan losses           | (35,457 )        | (33,677 )            |
| Loans, net                               | \$ 634,621       | \$ 616,984           |

1 Includes the Corporation's real estate construction lending and consumer real estate lot lending.

2 Includes the Corporation's commercial real estate lending, land acquisition and development lending, builder line lending and commercial business lending.

Consumer loans included \$504,000 and \$299,000 of demand deposit overdrafts at June 30, 2012 and December 31, 2011, respectively.

Loans on nonaccrual status were as follows:

| (Dollars in thousands)                   | June 30,<br>2012 | December<br>31, 2011 |
|--|------------------|----------------------|
| Real estate – residential mortgage       | \$ 1,412         | \$ 2,440             |
| Real estate – construction:              |                  |                      |
| Construction lending                     | —                | —                    |
| Consumer lot lending                     | —                | —                    |
| Commercial, financial and agricultural:  |                  |                      |
| Commercial real estate lending           | 4,435            | 5,093                |
| Land acquisition and development lending | 2,756            | —                    |
| Builder line lending                     | 1,936            | 2,303                |
| Commercial business lending              | 768              | 673                  |
| Equity lines                             | 9                | 123                  |
| Consumer                                 | —                | —                    |
| Consumer finance                         | 259              | 381                  |

|                                  |           |           |
|----------------------------------|-----------|-----------|
| Total loans on nonaccrual status | \$ 11,575 | \$ 11,013 |
|----------------------------------|-----------|-----------|

Table of Contents

The past due status of loans as of June 30, 2012 was as follows:

| (Dollars in thousands)                   | 30-59 Days Past Due | 60-89 Days Past Due | 90+ Days Past Due | Total Past Due  | Current          | Total Loans      | 90+ Days Past Due and Accruing |
|--|---------------------|---------------------|-------------------|-----------------|------------------|------------------|--------------------------------|
| Real estate – residential mortgage       | \$1,189             | \$198               | \$366             | \$1,753         | \$144,503        | \$146,256        | \$13                           |
| Real estate – construction:              |                     |                     |                   |                 |                  |                  |                                |
| Construction lending                     | —                   | —                   | —                 | —               | 3,079            | 3,079            | —                              |
| Consumer lot lending                     | —                   | —                   | —                 | —               | 1,904            | 1,904            | —                              |
| Commercial, financial and agricultural:  |                     |                     |                   |                 |                  |                  |                                |
| Commercial real estate lending           | 272                 | —                   | 129               | 401             | 125,106          | 125,507          | —                              |
| Land acquisition and development lending | —                   | —                   | 2,756             | 2,756           | 30,806           | 33,562           | —                              |
| Builder line lending                     | —                   | —                   | —                 | —               | 17,718           | 17,718           | —                              |
| Commercial business lending              | 23                  | —                   | 551               | 574             | 38,058           | 38,632           | 281                            |
| Equity lines                             | 130                 | 40                  | —                 | 170             | 33,320           | 33,490           | —                              |
| Consumer                                 | —                   | —                   | 2                 | 2               | 6,146            | 6,148            | 2                              |
| Consumer finance                         | 5,431               | 1,260               | 259               | 6,950           | 256,832          | 263,782          | —                              |
| <b>Total</b>                             | <b>\$7,045</b>      | <b>\$1,498</b>      | <b>\$4,063</b>    | <b>\$12,606</b> | <b>\$657,472</b> | <b>\$670,078</b> | <b>\$296</b>                   |

For the purposes of the above table, “Current” includes loans that are 1-29 days past due.

The past due status of loans as of December 31, 2011 was as follows:

| (Dollars in thousands)             | 30-59 Days Past Due | 60-89 Days Past Due | 90+ Days Past Due | Total Past Due | Current   | Total Loans | 90+ Days Past Due and Accruing |
|------------------------------------|---------------------|---------------------|-------------------|----------------|-----------|-------------|--------------------------------|
| Real estate – residential mortgage | \$1,270             | \$1,445             | \$533             | \$3,248        | \$143,887 | \$147,135   | \$65                           |
| Real estate – construction:        |                     |                     |                   |                |           |             |                                |
| Construction lending               | —                   | —                   | —                 | —              | 5,084     | 5,084       | —                              |
| Consumer lot lending               | —                   | —                   | —                 | —              | 653       | 653         | —                              |

|  |         |         |       |          |           |           |      |
|--|---------|---------|-------|----------|-----------|-----------|------|
| Commercial, financial and agricultural:  |         |         |       |          |           |           |      |
| Commercial real estate lending           | 986     | 1,311   | —     | 2,297    | 114,475   | 116,772   | —    |
| Land acquisition and development lending | —       | —       | —     | —        | 32,645    | 32,645    | —    |
| Builder line lending                     | —       | —       | —     | —        | 17,637    | 17,637    | —    |
| Commercial business lending              | 480     | —       | —     | 480      | 44,701    | 45,181    | —    |
| Equity lines                             | 69      | 90      | 33    | 192      | 33,000    | 33,192    | —    |
| Consumer                                 | 13      | —       | —     | 13       | 6,044     | 6,057     | 3    |
| Consumer finance                         | 5,327   | 1,041   | 381   | 6,749    | 239,556   | 246,305   | —    |
| Total                                    | \$8,145 | \$1,445 | \$947 | \$12,979 | \$637,682 | \$650,661 | \$68 |

For the purposes of the above table, “Current” includes loans that are 1-29 days past due.



Table of Contents

Impaired loans, which included troubled debt restructurings (TDRs) of \$15.77 million, and the related allowance at June 30, 2012, were as follows:

| (Dollars in thousands)                   | Recorded<br>Investment<br>in<br>Loans | Unpaid<br>Principal<br>Balance | Related<br>Allowance | Average<br>Balance-Impaired<br>Loans | Interest<br>Income<br>Recognized |
|--|---------------------------------------|--------------------------------|----------------------|--------------------------------------|----------------------------------|
| Real estate – residential mortgage       | \$2,272                               | \$2,309                        | \$426                | \$ 2,298                             | \$66                             |
| Real estate – construction:              |                                       |                                |                      |                                      |                                  |
| Construction lending                     | —                                     | —                              | —                    | —                                    | —                                |
| Consumer lot lending                     | —                                     | —                              | —                    | —                                    | —                                |
| Commercial, financial and agricultural:  |                                       |                                |                      |                                      |                                  |
| Commercial real estate lending           | 5,084                                 | 5,329                          | 1,447                | 5,409                                | 74                               |
| Land acquisition and development lending | 8,185                                 | 8,185                          | 2,031                | 8,290                                | 176                              |
| Builder line lending                     | 1,919                                 | 1,919                          | 455                  | 1,920                                | —                                |
| Commercial business lending              | 636                                   | 639                            | 145                  | 642                                  | 6                                |
| Equity lines                             | —                                     | —                              | —                    | —                                    | —                                |
| Consumer                                 | 432                                   | 432                            | 65                   | 432                                  | 8                                |
| Total                                    | \$18,528                              | \$18,813                       | \$4,569              | \$ 18,991                            | \$330                            |

The Corporation has no obligation to fund additional advances on its impaired loans.

Impaired loans, which included TDRs of \$17.09 million, and the related allowance at December 31, 2011 were as follows:

| (Dollars in thousands)                   | Recorded<br>Investment<br>in<br>Loans | Unpaid<br>Principal<br>Balance | Related<br>Allowance | Average<br>Balance<br>Impaired<br>Loans | Interest<br>Income<br>Recognized |
|--|---------------------------------------|--------------------------------|----------------------|---|----------------------------------|
| Real estate – residential mortgage       | \$3,482                               | \$3,698                        | \$657                | \$ 3,723                                | \$137                            |
| Real estate – construction:              |                                       |                                |                      |   |                                  |
| Construction lending                     | —                                     | —                              | —                    | —                                       | —                                |
| Consumer lot lending                     | —                                     | —                              | —                    | —                                       | —                                |
| Commercial, financial and agricultural:  |                                       |                                |                      |   |                                  |
| Commercial real estate lending           | 5,861                                 | 5,957                          | 1,464                | 6,195                                   | 102                              |
| Land acquisition and development lending | 5,490                                 | 5,814                          | 1,331                | 6,116                                   | 372                              |
| Builder line lending                     | 2,285                                 | 2,285                          | 318                  | 2,397                                   | —                                |
| Commercial business lending              | 652                                   | 654                            | 161                  | 663                                     | 6                                |
| Equity lines                             | —                                     | —                              | —                    | —                                       | —                                |
| Consumer                                 | 324                                   | 324                            | 49                   | 324                                     | 14                               |
| Total                                    | \$18,094                              | \$18,732                       | \$3,980              | \$ 19,418                               | \$631                            |

Loan modifications that were classified as TDRs during the three and six months ended June 30, 2012 and 2011 were as follows:

| (Dollars in thousands) | Three Months<br>Ended June 30, |        | Six Months Ended<br>June 30, |        |
|------------------------|--------------------------------|--------|------------------------------|--------|
|                        | 2012                           | 2011   | 2012                         | 2011   |
|                        | \$ 122                         | \$ 230 | \$ 122                       | \$ 352 |

|   |        |          |        |          |
|---|--------|----------|--------|----------|
| Real estate-residential mortgage-interest reduction       |        |          |        |          |
| Real estate-residential mortgage-interest rate concession | --     | 96       | --     | 96       |
| Commercial, financial and agricultural:                   |        |          |        |          |
| Builder line lending-interest rate concession             | --     | 2,285    | --     | 2,285    |
| Commercial business lending-interest reduction            | --     | 186      | --     | 186      |
| Commercial business lending-interest rate concession      | 373    | 277      | 373    | 363      |
| Consumer-interest reduction                               | --     | --       | 108    | --       |
| Total   | \$ 495 | \$ 3,074 | \$ 603 | \$ 3,282 |

Table of Contents

TDR payment defaults during three and six months ended June 30, 2012 and 2011 were as follows:

| (Dollars in thousands)                     | Three Months<br>Ended June 30, |       | Six Months Ended<br>June 30, |        |
|--|--------------------------------|-------|------------------------------|--------|
|  | 2012                           | 2011  | 2012                         | 2011   |
| Real estate-residential mortgage           | \$ --                          | \$ 70 | \$ --                        | \$ 154 |
| Commercial, financial and<br>agricultural: |                                |       |                              |        |
| Builder line lending                       | 88                             | --    | 88                           | --     |
| Commercial business lending                | 363                            | --    | 363                          | --     |
| Consumer                                   | --                             | --    | --                           | 4      |
| Total                                      | \$ 451                         | \$ 70 | \$ 451                       | \$ 158 |

For purposes of this disclosure, a TDR payment default occurs when, within 12 months of the original TDR modification, either a full or partial charge-off occurs or a TDR becomes 90 days or more past due.

## NOTE 4: Allowance for Loan Losses

The following table presents the changes in the allowance for loan losses by major classification during the six months ended June 30, 2012.

| (Dollars in thousands)                           | Real Estate<br>Residential<br>Mortgage | Real Estate<br>Construction | Commercial,<br>Financial<br>and<br>Agricultural | Equity<br>Lines | Consumer | Consumer<br>Finance | Total    |
|--|--|-----------------------------|---|-----------------|----------|---------------------|----------|
| Allowance for<br>loan losses:                    |  |                             |   |                 |          |                     |          |
| Balance at<br>December 31,<br>2011               | \$2,379                                | \$ 480                      | \$ 10,040                                       | \$912           | \$319    | \$19,547            | \$33,677 |
| Provision charged<br>to operations               | 576                                    | (94 )                       | 917   | 130             | 76       | 3,980               | 5,585    |
| Loans charged off                                | (638 )                                 | —                           | (402 )  | (121 )          | (171 )   | (4,102 )            | (5,434 ) |
| Recoveries of<br>loans previously<br>charged off | 23                                     | —                           | 36  | —               | 99       | 1,471               | 1,629    |
| Balance at June<br>30, 2012                      | \$2,340                                | \$ 386                      | \$ 10,591                                       | \$921           | \$323    | \$20,896            | \$35,457 |

The following table presents the changes in the allowance for loan losses by major classification during the six months ended June 30, 2011.

| (Dollars in thousands)        | Real Estate<br>Residential<br>Mortgage | Real Estate<br>Construction | Commercial,<br>Financial<br>and<br>Agricultural | Equity<br>Lines | Consumer | Consumer<br>Finance | Total    |
|-------------------------------|--|-----------------------------|---|-----------------|----------|---------------------|----------|
| Allowance for<br>loan losses: |  |                             |   |                 |          |                     |          |
|                               | \$1,442                                | \$ 581                      | \$ 8,688  | \$380           | \$307    | \$17,442            | \$28,840 |

|  |         |        |          |       |        |          |          |  |
|--|---------|--------|----------|-------|--------|----------|----------|--|
| Balance<br>December 31,<br>2010                  |         |        |          |       |        |          |          |  |
| Provision charged<br>to operations               | 811     | 147    | 1,376    | 177   | 74     | 3,625    | 6,210    |  |
| Loans charged off                                | (283 )  | —      | (2,530 ) | (9 )  | (167 ) | (3,115 ) | (6,104 ) |  |
| Recoveries of<br>loans previously<br>charged off | 14      | —      | 21       | —     | 41     | 1,189    | 1,265    |  |
| Balance June 30,<br>2011                         | \$1,984 | \$ 728 | \$ 7,555 | \$548 | \$255  | \$19,141 | \$30,211 |  |

Table of Contents

The following table presents, as of June 30, 2012, the total allowance for loan losses the allowance by impairment methodology (individually evaluated for impairment or collectively evaluated for impairment), total loans, and loans by impairment methodology (individually evaluated for impairment or collectively evaluated for impairment).

| (Dollars in thousands)                                | Real Estate Residential Mortgage | Real Estate Construction | Commercial, Financial and Agricultural | Equity Lines | Consumer | Consumer Finance | Total     |
|---|----------------------------------|--------------------------|--|--------------|----------|------------------|-----------|
| Allowance for loan losses:                            |                                  |                          |  |              |          |                  |           |
| Balance at June 30, 2012                              | \$2,340                          | \$ 386                   | \$ 10,591                              | \$921        | \$323    | \$20,896         | \$35,457  |
| Ending balance: individually evaluated for impairment | \$426                            | \$ —                     | \$ 4,078                               | \$—          | \$65     | \$—              | \$4,569   |
| Ending balance: collectively evaluated for impairment | \$1,914                          | \$ 386                   | \$ 6,513                               | \$921        | \$258    | \$20,896         | \$30,888  |
| Loans:  |                                  |                          |  |              |          |                  |           |
| Balance June 30, 2012                                 | \$146,256                        | \$ 4,983                 | \$ 215,419                             | \$33,490     | \$6,148  | \$263,782        | \$670,078 |
| Ending balance: individually evaluated for impairment | \$2,272                          | \$ —                     | \$ 15,824                              | \$—          | \$432    | \$—              | \$18,528  |
| Ending balance: collectively evaluated for impairment | \$143,984                        | \$ 4,983                 | \$ 199,595                             | \$33,490     | \$5,716  | \$263,782        | \$651,550 |

The following table presents, as of December 31, 2011, the total allowance for loan losses, the allowance by impairment methodology (individually evaluated for impairment or collectively evaluated for impairment), total loans, and loans by impairment methodology (individually evaluated for impairment or collectively evaluated for impairment).

| (Dollars in thousands)                     | Real Estate Residential Mortgage | Real Estate Construction | Commercial, Financial and Agricultural | Equity Lines | Consumer | Consumer Finance | Total    |
|--|----------------------------------|--------------------------|--|--------------|----------|------------------|----------|
| Allowance for loan losses:                 |                                  |                          |  |              |          |                  |          |
| Balance at December 31, 2011               | \$2,379                          | \$ 480                   | \$ 10,040                              | \$912        | \$319    | \$19,547         | \$33,677 |
| Ending balance: individually evaluated for | \$657                            | \$ —                     | \$ 3,274                               | \$—          | \$49     | \$—              | \$3,980  |

|                 |            |          |            |           |          |            |            |
|-----------------|------------|----------|------------|-----------|----------|------------|------------|
| impairment      |            |          |            |           |          |            |            |
| Ending balance: |            |          |            |           |          |            |            |
| collectively    |            |          |            |           |          |            |            |
| evaluated for   |            |          |            |           |          |            |            |
| impairment      | \$ 1,722   | \$ 480   | \$ 6,766   | \$ 912    | \$ 270   | \$ 19,547  | \$ 29,697  |
| Loans:          |            |          |            |           |          |            |            |
| Balance at      |            |          |            |           |          |            |            |
| December 31,    |            |          |            |           |          |            |            |
| 2011            | \$ 147,135 | \$ 5,737 | \$ 212,235 | \$ 33,192 | \$ 6,057 | \$ 246,305 | \$ 650,661 |
| Ending balance: |            |          |            |           |          |            |            |
| individually    |            |          |            |           |          |            |            |
| evaluated       |            |          |            |           |          |            |            |
| for impairment  | \$ 3,482   | \$ —     | \$ 14,288  | \$ —      | \$ 324   | \$ —       | \$ 18,094  |
| Ending balance: |            |          |            |           |          |            |            |
| collectively    |            |          |            |           |          |            |            |
| evaluated for   |            |          |            |           |          |            |            |
| impairment      | \$ 143,653 | \$ 5,737 | \$ 197,947 | \$ 33,192 | \$ 5,733 | \$ 246,305 | \$ 632,567 |

Table of Contents

Loans by credit quality indicators as of June 30, 2012 were as follows:

| (Dollars in thousands)                   | Pass       | Special<br>Mention | Substandard | Substandard<br>Nonaccrual | Total1     |
|--|------------|--------------------|-------------|---------------------------|------------|
| Real estate – residential mortgage       | \$ 140,665 | \$ 2,110           | \$ 2,437    | \$ 1,044                  | \$ 146,256 |
| Real estate – construction:              |            |                    |             |                           |            |
| Construction lending                     | 212        | —                  | 2,867       | —                         | 3,079      |
| Consumer lot lending                     | 1,904      | —                  | —           | —                         | 1,904      |
| Commercial, financial and agricultural:  |            |                    |             |                           |            |
| Commercial real estate lending           | 104,722    | 7,036              | 9,314       | 4,435                     | 125,507    |
| Land acquisition and development lending | 15,257     | 9,468              | 6,081       | 2,756                     | 33,562     |
| Builder line lending                     | 13,222     | 1,484              | 1,076       | 1,936                     | 17,718     |
| Commercial business lending              | 35,165     | 1,819              | 880         | 768                       | 38,632     |
| Equity lines                             | 31,204     | 1,436              | 841         | 9                         | 33,490     |
| Consumer                                 | 5,270      | 26                 | 852         | —                         | 6,148      |
|  | \$ 347,621 | \$ 23,379          | \$ 24,348   | \$ 10,948                 | \$ 406,296 |

| (Dollars in thousands) | Performing | Non-Performing | Total      |
|------------------------|------------|----------------|------------|
| Consumer finance       | \$ 263,523 | \$ 259         | \$ 263,782 |

1 At June 30, 2012, the Corporation did not have any loans classified as Doubtful or Loss.

Loans by credit quality indicators as of December 31, 2011 were as follows:

| (Dollars in thousands)                   | Pass       | Special<br>Mention | Substandard | Substandard<br>Nonaccrual | Total1     |
|--|------------|--------------------|-------------|---------------------------|------------|
| Real estate – residential mortgage       | \$ 140,304 | \$ 1,261           | \$ 3,130    | \$ 2,440                  | \$ 147,135 |
| Real estate – construction:              |            |                    |             |                           |            |
| Construction lending                     | 2,214      | —                  | 2,870       | —                         | 5,084      |
| Consumer lot lending                     | 653        | —                  | —           | —                         | 653        |
| Commercial, financial and agricultural:  |            |                    |             |                           |            |
| Commercial real estate lending           | 96,773     | 5,413              | 9,493       | 5,093                     | 116,772    |
| Land acquisition and development lending | 13,605     | 9,939              | 9,101       | —                         | 32,645     |
| Builder line lending                     | 12,480     | 1,434              | 1,420       | 2,303                     | 17,637     |
| Commercial business lending              | 41,590     | 2,001              | 917         | 673                       | 45,181     |
| Equity lines                             | 31,935     | 298                | 836         | 123                       | 33,192     |
| Consumer                                 | 5,271      | 10                 | 776         | —                         | 6,057      |
|  | \$ 344,825 | \$ 20,356          | \$ 28,543   | \$ 10,632                 | \$ 404,356 |

| (Dollars in thousands) | Performing | Non-Performing | Total      |
|------------------------|------------|----------------|------------|
| Consumer finance       | \$ 245,924 | \$ 381         | \$ 246,305 |

1 At December 31, 2011, the Corporation did not have any loans classified as Doubtful or Loss.





Table of Contents

## NOTE 5: Stockholders' Equity and Earnings Per Common Share

## Stockholders' Equity - Other Comprehensive Income

The following table presents the cumulative balances of the components of other comprehensive income, net of deferred tax assets of \$2.27 million and \$1.13 million as of June 30, 2012 and 2011, respectively.

| (Dollars in thousands)                                  | June 30, |          |
|---|----------|----------|
|   | 2012     | 2011     |
| Net unrealized gains on securities                      | \$ 5,501 | \$ 2,646 |
| Net unrecognized loss on cash flow hedges               | (330 )   | (174 )   |
| Net unrecognized losses on defined benefit pension plan | (886 )   | (332 )   |
| Total cumulative other comprehensive income             | \$ 4,285 | \$ 2,140 |

The following tables present the changes in accumulated other comprehensive income, by category, net of tax.

| (Dollars in thousands)              | Unrealized   | Unrealized | Defined      | Total    |
|-------------------------------------|--------------|------------|--------------|----------|
|                                     | Loss on Cash | Holding    | Pension Plan |          |
|                                     | Flow         | Gains on   | Assets and   |          |
|                                     | Hedging      | Securities | Benefit      |          |
|                                     | Instruments  |            | Obligations  |          |
| Balance December 31, 2011           | \$ (314 )    | \$ 4,596   | \$ (898 )    | \$ 3,384 |
| Net change for the six months ended |              |            |              |          |
| June 30, 2012                       | (16 )        | 905        | 12           | 901      |
| Balance at June 30, 2012            | \$ (330 )    | \$ 5,501   | \$ (886 )    | \$ 4,285 |

| (Dollars in thousands)              | Unrealized   | Unrealized | Defined      | Total    |
|-------------------------------------|--------------|------------|--------------|----------|
|                                     | Loss on Cash | Holding    | Pension Plan |          |
|                                     | Flow         | Gains on   | Assets and   |          |
|                                     | Hedging      | Securities | Benefit      |          |
|                                     | Instruments  |            | Obligations  |          |
| Balance December 31, 2010           | \$ (90 )     | \$ 500     | \$ (339 )    | \$ 71    |
| Net change for the six months ended |              |            |              |          |
| June 30, 2011                       | (84 )        | 2,146      | 7            | 2,069    |
| Balance at June 30, 2011            | \$ (174 )    | \$ 2,646   | \$ (332 )    | \$ 2,140 |

The following tables present the change in each component of other comprehensive income on a pre-tax and after-tax basis for the six months ended June 30, 2012 and 2011.

| (Dollars in thousands)   | Six Months Ended June 30, 2012 |                          |            |
|--|--------------------------------|--------------------------|------------|
|  | Pre-Tax                        | Tax Expense<br>(Benefit) | Net-of-Tax |
| Defined benefit pension plan:                                    |                                |                          |            |
| Net loss   | \$ 53                          | \$ 19                    | \$ 34      |
| Amortization of prior service costs                              | (35 )                          | (13 )                    | (22 )      |
| Defined benefit pension plan assets and benefit obligations, net | 18                             | 6                        | 12         |

Edgar Filing: C & F FINANCIAL CORP - Form 10-Q

|  |          |        |        |
|--|----------|--------|--------|
| Unrealized gain on cash flow hedging instruments | (28 )    | (12 )  | (16 )  |
| Unrealized holding gains on securities           | 1,393    | 488    | 905    |
| Total increase in other comprehensive income     | \$ 1,383 | \$ 482 | \$ 901 |

Table of Contents

| (Dollars in thousands)   | Six Months Ended June 30, 2011 |                          |            |
|--|--------------------------------|--------------------------|------------|
|  | Pre-Tax                        | Tax Expense<br>(Benefit) | Net-of-Tax |
| Defined benefit pension plan:                                    |                                |                          |            |
| Net loss   | \$ 47                          | \$ 17                    | \$ 30      |
| Amortization of prior service costs                              | (34 )                          | (12 )                    | (22 )      |
| Amortization of net obligation at transition                     | (2 )                           | (1 )                     | (1 )       |
| Defined benefit pension plan assets and benefit obligations, net | 11                             | 4                        | 7          |
| Unrealized gain on cash flow hedging instruments                 | (138 )                         | (54 )                    | (84 )      |
| Unrealized holding gains on securities                           | 3,300                          | 1,155                    | 2,146      |
| Total increase in other comprehensive income                     | \$ 3,173                       | \$ 1,105                 | \$ 2,069   |

The Corporation had \$8,000 and \$0 of net gains from securities reclassified from other comprehensive income to earnings for the six months ended June 30, 2012 and 2011.

## Earnings Per Common Share

The components of the Corporation's earnings per common share calculations are as follows:

| (Dollars in thousands)   | Three Months Ended June 30, |           |
|--|-----------------------------|-----------|
|  | 2012                        | 2011      |
| Net income   | \$ 4,181                    | \$ 3,083  |
| Accumulated dividends on Series A Preferred Stock  | (14 )                       | (250 )    |
| Accretion of Series A Preferred Stock discount   | (151 )                      | (40 )     |
| Net income available to common shareholders  | \$ 4,016                    | \$ 2,793  |
| Weighted average number of common shares used in earnings per common share – basic             | 3,208,792                   | 3,131,203 |
| Effect of dilutive securities:   |                             |           |
| Stock option awards and Warrant  | 87,353                      | 28,057    |
| Weighted average number of common shares used in earnings per common share – assuming dilution | 3,296,145                   | 3,159,260 |

| (Dollars in thousands)   | Six Months Ended June 30, |           |
|--|---------------------------|-----------|
|  | 2012                      | 2011      |
| Net income   | \$ 7,961                  | \$ 6,052  |
| Accumulated dividends on Series A Preferred Stock  | (139 )                    | (500 )    |
| Accretion of Series A Preferred Stock discount   | (172 )                    | (79 )     |
| Net income available to common shareholders  | \$ 7,650                  | \$ 5,473  |
| Weighted average number of common shares used in earnings per common share – basic             | 3,199,655                 | 3,127,536 |
| Effect of dilutive securities:   |                           |           |
| Stock option awards and Warrant  | 80,905                    | 35,674    |
| Weighted average number of common shares used in earnings per common share – assuming dilution | 3,280,560                 | 3,163,210 |

Potential common shares that may be issued by the Corporation for its stock option awards and Warrant (defined below) are determined using the treasury stock method. Approximately 276,500 and 354,000 shares issuable upon exercise of options were not included in computing diluted earnings per common share for the three months ended

June 30, 2012 and 2011, respectively, and approximately 276,500 and 328,000 shares issuable upon exercise of options were not included in computing diluted earnings per common share for the six months ended June 30, 2012 and 2011, respectively, because they were anti-dilutive.

Table of Contents

In January 2009, the Corporation issued to the United States Department of the Treasury (Treasury) under the Capital Purchase Program (CPP) \$20.00 million of its Fixed Rate Cumulative Perpetual Preferred Stock, Series A (the Preferred Stock) and a warrant to purchase 167,504 shares of the Corporation's common stock (the Warrant). On July 27, 2011 the Corporation redeemed \$10.00 million of the Preferred Stock, and on April 12, 2012 the Corporation redeemed the remaining \$10.00 million of the Preferred Stock. As a result of this redemption, the Corporation will pay no future dividends on the Preferred Stock. Further, in connection with this redemption, the Corporation accelerated the accretion of the remaining preferred stock discount during April 2012, which reduced net income available to common shareholders by approximately \$151,000.

## NOTE 6: Employee Benefit Plans

The Bank has a non-contributory defined benefit plan for which the components of net periodic benefit cost are as follows:

| (Dollars in thousands)                       | Three Months<br>Ended June 30, |        | Six Months Ended<br>June 30, |        |
|--|--------------------------------|--------|------------------------------|--------|
|  | 2012                           | 2011   | 2012                         | 2011   |
| Service cost                                 | \$ 159                         | \$ 153 | \$ 318                       | \$ 306 |
| Interest cost                                | 99                             | 109    | 198                          | 218    |
| Expected return on plan assets               | (158 )                         | (145 ) | (316 )                       | (290 ) |
| Amortization of net obligation at transition | —                              | (1 )   | —                            | (2 )   |
| Amortization of prior service cost           | (17 )                          | (17 )  | (34 )                        | (34 )  |
| Amortization of net loss                     | 26                             | 16     | 52                           | 32     |
| Net periodic benefit cost                    | \$ 109                         | \$ 115 | \$ 218                       | \$ 230 |

The Bank made a \$500,000 contribution to this plan during the second quarter of 2012.

## NOTE 7: Fair Value of Assets and Liabilities

Fair value is defined as the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. U.S. GAAP requires that valuation techniques maximize the use of observable inputs and minimize the use of unobservable inputs. U.S. GAAP also establishes a fair value hierarchy which prioritizes the valuation inputs into three broad levels. Based on the underlying inputs, each fair value measurement in its entirety is reported in one of the three levels. These levels are:

Level 1—Valuation is based upon quoted prices for identical instruments traded in active markets. Level 1 assets and liabilities include debt and equity securities traded in an active exchange market, as well as U.S. Treasury securities.

Level 2—Valuation is based upon quoted prices for similar instruments in active markets, quoted prices for identical or similar instruments in markets that are not active, and model based valuation techniques for which all significant assumptions are observable in the market or can be corroborated by observable market data for substantially the full term of the assets or liabilities. Valuations of other real estate owned are based upon appraisals by independent, licensed appraisers, general market conditions and recent sales of like properties.

Level 3—Valuation is determined using model-based techniques with significant assumptions not observable in the market.

U.S. GAAP allows an entity the irrevocable option to elect fair value (the fair value option) for the initial and subsequent measurement for certain financial assets and liabilities on a contract-by-contract basis. The Corporation has not made any fair value option elections as of June 30, 2012.

Table of Contents

## Assets and Liabilities Measured at Fair Value on a Recurring Basis

The following tables present the balances of financial assets measured at fair value on a recurring basis.

| (Dollars in thousands)                           | June 30, 2012                 |           |         | Assets at Fair Value |
|--|-------------------------------|-----------|---------|----------------------|
|  | Fair Value Measurements Using |           |         |                      |
|  | Level 1                       | Level 2   | Level 3 |                      |
| Assets:  |                               |           |         |                      |
| Securities available for sale                    |                               |           |         |                      |
| U.S. government agencies and corporations        | —                             | \$13,532  | —       | \$13,532             |
| Mortgage-backed securities                       | —                             | 2,707     | —       | 2,707                |
| Obligations of states and political subdivisions | —                             | 124,955   | —       | 124,955              |
| Preferred stock                                  | —                             | 95        | —       | 95                   |
| Total securities available for sale              | —                             | \$141,289 | —       | \$141,289            |
| Liabilities:                                     |                               |           |         |                      |
| Derivative payable                               | —                             | \$542     | —       | \$542                |

| (Dollars in thousands)                           | December 31, 2011             |           |         | Assets at Fair Value |
|--|-------------------------------|-----------|---------|----------------------|
|  | Fair Value Measurements Using |           |         |                      |
|  | Level 1                       | Level 2   | Level 3 |                      |
| Assets:  |                               |           |         |                      |
| Securities available for sale                    |                               |           |         |                      |
| U.S. government agencies and corporations        | —                             | \$15,283  | —       | \$15,283             |
| Mortgage-backed securities                       | —                             | 2,216     | —       | 2,216                |
| Obligations of states and political subdivisions | —                             | 127,079   | —       | 127,079              |
| Preferred stock                                  | —                             | 68        | —       | 68                   |
| Total securities available for sale              | —                             | \$144,646 | —       | \$144,646            |
| Liabilities:                                     |                               |           |         |                      |
| Derivative payable                               | —                             | \$515     | —       | \$515                |

## Assets and Liabilities Measured at Fair Value on a Nonrecurring Basis

The Corporation is also required to measure and recognize certain other financial assets at fair value on a nonrecurring basis in the consolidated balance sheets. For assets measured at fair value on a nonrecurring basis and still held on the consolidated balance sheets, the following table provides the fair value measures by level of valuation assumptions used. Fair value adjustments for other real estate owned (OREO) are recorded in other noninterest expense and fair value adjustments for impaired loans are recorded in the provision for loan losses, in the consolidated statements of income.

| (Dollars in thousands) | June 30, 2012                 |          |         | Assets at Fair Value |
|------------------------|-------------------------------|----------|---------|----------------------|
|                        | Fair Value Measurements Using |          |         |                      |
|                        | Level 1                       | Level 2  | Level 3 |                      |
| Impaired loans, net    | —                             | \$13,959 | —       | \$13,959             |
| OREO, net              | —                             | 5,236    | —       | 5,236                |
| Total                  | —                             | \$19,195 | —       | \$19,195             |

Edgar Filing: C & F FINANCIAL CORP - Form 10-Q

| (Dollars in thousands) | December 31, 2011             |                 |         | Assets<br>at Fair<br>Value |
|------------------------|-------------------------------|-----------------|---------|----------------------------|
|                        | Fair Value Measurements Using |                 |         |                            |
|                        | Level 1                       | Level 2         | Level 3 |                            |
| Impaired loans, net    | —                             | \$14,114        | —       | \$14,114                   |
| OREO, net              | —                             | 6,059           | —       | 6,059                      |
| <b>Total</b>           | —                             | <b>\$20,173</b> | —       | <b>\$20,173</b>            |

20

---



Table of Contents

## Fair Value of Financial Instruments

The carrying values and estimated fair values of the Corporation's financial instruments, whether or not recognized on the consolidated balance sheets at fair value, as of June 30, 2012 are as follows:

| (Dollars in thousands)          | Carrying Value | Fair Value Measurements at June 30, 2012 Using       |                                     |                                 | Balance   |
|---------------------------------|----------------|--|-------------------------------------|---------------------------------|-----------|
|                                 |                | Quoted Prices in Active Markets for Identical Assets | Significant Other Observable Inputs | Significant Unobservable Inputs |           |
|                                 |                | Level 1  | Level 2                             | Level 3                         |           |
| Financial assets:               |                |  |                                     |                                 |           |
| Cash and short-term investments | \$ 10,932      | \$10,232   | \$—                                 | \$ —                            | \$10,932  |
| Securities                      | 141,289        | —  | 141,289                             | —                               | 141,289   |
| Loans, net                      | 634,621        | —  | 645,645                             | —                               | 645,645   |
| Loans held for sale, net        | 79,171         | —  | 81,776                              | —                               | 81,776    |
| Accrued interest receivable     | 5,360          | —  | 5,360                               | —                               | 5,360     |
| Financial liabilities:          |                |  |                                     |                                 |           |
| Demand deposits                 | \$ 365,190     | \$—  | \$365,190                           | \$ —                            | \$365,190 |
| Time deposits                   | 292,257        | —  | 295,920                             | —                               | 295,920   |
| Borrowings                      | 175,990        | —  | 172,004                             | —                               | 172,004   |
| Derivative payable              | 542            | —  | 542                                 | —                               | 542       |
| Accrued interest payable        | 974            | —  | 974                                 | —                               | 974       |

The carrying values and estimated fair values of the Corporation's financial instruments, whether or not recognized on the consolidated balance sheets at fair value, as of December 31, 2011 are as follows:

| (Dollars in thousands)          | December 31, 2011 |                      |
|---------------------------------|-------------------|----------------------|
|                                 | Carrying Amount   | Estimated Fair Value |
| Financial assets:               |                   |                      |
| Cash and short-term investments | \$ 11,507         | \$ 11,507            |
| Securities                      | 144,646           | 144,646              |
| Loans, net                      | 616,984           | 624,219              |
| Loans held for sale, net        | 70,062            | 72,859               |
| Accrued interest receivable     | 5,242             | 5,242                |
| Financial liabilities:          |                   |                      |
| Demand deposits                 | 338,473           | 338,473              |
| Time deposits                   | 307,943           | 312,095              |
| Borrowings                      | 161,151           | 157,863              |
| Derivative payable              | 515               | 515                  |
| Accrued interest payable        | 1,111             | 1,111                |

T

The following describes the valuation techniques used by the Corporation to measure financial assets and financial liabilities at fair value as of June 30, 2012 and December 31, 2011.

Cash and short-term investments. The nature of these instruments and their relatively short maturities provide for the reporting of fair value equal to the historical cost.

Securities available for sale. Securities available for sale are recorded at fair value on a recurring basis using a third-party model based on valuation techniques for which all significant assumptions are observable in the market or can be corroborated by observable market data.

Loans, net. The estimated fair value of the loan portfolio is based on present values using discount rates equal to the market rates currently charged on similar products.

Table of Contents

Certain loans are accounted for under ASC Topic 310 - Receivables, including impaired loans measured at an observable market price (if available), or at the fair value of the loan's collateral (if the loan is collateral dependent). Collateral may be in the form of real estate or business assets including equipment, inventory and accounts receivable. A significant portion of the collateral securing the Corporation's impaired loans is real estate. The fair value of real estate collateral is determined utilizing an income or market valuation approach based on an appraisal conducted by an independent, licensed appraiser outside of the Corporation using observable market data, which in some cases may be adjusted to reflect current trends, including sales prices, expenses, absorption periods and other current relevant factors (Level 2). The value of business equipment is based upon an outside appraisal if deemed significant, or the net book value on the applicable business's financial statements, if not considered significant, using observable market data (Level 2).

**Loans Held for Sale.** Loans held for sale are required to be measured at the lower of cost or fair value. These loans currently consist of residential loans originated for sale in the secondary market. Fair value is based on the price secondary markets are currently offering for similar loans using observable market data (Level 2). As such, the Corporation records any fair value adjustments on a nonrecurring basis. No nonrecurring fair value adjustments were recorded on loans held for sale during the six months ended June 30, 2012.

**Accrued interest receivable.** The carrying amount of accrued interest receivable approximates fair value.

**Deposits.** The fair value of all demand deposit accounts is the amount payable at the report date. For all other deposits, the fair value is determined using the discounted cash flow method. The discount rate was equal to the rate currently offered on similar products.

**Borrowings.** The fair value of borrowings is determined using the discounted cash flow method. The discount rate was equal to the rate currently offered on similar products.

**Derivative payable.** The fair value of derivatives is determined using the discounted cash flow method.

**Accrued interest payable.** The carrying amount of accrued interest payable approximates fair value.

**Letters of credit.** The estimated fair value of letters of credit is based on estimated fees the Corporation would pay to have another entity assume its obligation under the outstanding arrangements. These fees are not considered material.

**Unused portions of lines of credit.** The estimated fair value of unused portions of lines of credit is based on estimated fees the Corporation would pay to have another entity assume its obligation under the outstanding arrangements. These fees are not considered material.

The Corporation assumes interest rate risk (the risk that general interest rate levels will change) as a result of its normal operations. As a result, the fair values of the Corporation's financial instruments will change when interest rate levels change and that change may be either favorable or unfavorable to the Corporation. Management attempts to match maturities of assets and liabilities to the extent believed necessary to balance minimizing interest rate risk and increasing net interest income in current market conditions. However, borrowers with fixed rate obligations are less likely to prepay in a rising rate environment and more likely to prepay in a falling rate environment. Conversely, depositors who are receiving fixed rates are more likely to withdraw funds before maturity in a rising rate environment and less likely to do so in a falling rate environment. Management monitors interest rates, maturities and repricing dates of assets and liabilities and attempts to manage interest rate risk by adjusting terms of new loans, deposits and borrowings and by investing in securities with terms that mitigate the Corporation's overall interest rate risk.



Table of Contents

## NOTE 8: Business Segments

The Corporation operates in a decentralized fashion in three principal business segments: Retail Banking, Mortgage Banking and Consumer Finance. Revenues from Retail Banking operations consist primarily of interest earned on loans and investment securities and service charges on deposit accounts. Mortgage Banking operating revenues consist principally of gains on sales of loans in the secondary market, loan origination fee income and interest earned on mortgage loans held for sale. Revenues from Consumer Finance consist primarily of interest earned on automobile retail installment sales contracts.

The Corporation's other segment includes an investment company that derives revenues from brokerage services, an insurance company that derives revenues from insurance services, and a title company that derives revenues from title insurance services. The results of the other segment are not significant to the Corporation as a whole and have been included in "Other." Certain expenses of the Corporation are also included in "Other," and consist primarily of interest expense associated with the Corporation's trust preferred capital notes and other general corporate expenses.

| (Dollars in thousands)                    | Three Months Ended June 30, 2012 |                  |                  |         |              |              |
|---|----------------------------------|------------------|------------------|---------|--------------|--------------|
|   | Retail Banking                   | Mortgage Banking | Consumer Finance | Other   | Eliminations | Consolidated |
| <b>Revenues:</b>                          |                                  |                  |                  |         |              |              |
| Interest income                           | \$8,096                          | \$566            | \$11,695         | \$—     | \$(1,259)    | \$19,098     |
| Gains on sales of loans                   | —                                | 4,718            | —                | —       | —            | 4,718        |
| Other noninterest income                  | 1,464                            | 979              | 234              | 336     | (2)          | 3,011        |
| Total operating income                    | 9,560                            | 6,263            | 11,929           | 336     | (1,261)      | 26,827       |
| <b>Expenses:</b>                          |                                  |                  |                  |         |              |              |
| Interest expense                          | 1,920                            | 113              | 1,574            | 248     | (1,259)      | 2,596        |
| Provision for loan losses                 | 750                              | 30               | 2,080            | —       | —            | 2,860        |
| Salaries and employee benefits            | 3,742                            | 3,810            | 1,846            | 198     | —            | 9,596        |
| Other noninterest expenses                | 2,862                            | 1,613            | 1,051            | 105     | —            | 5,631        |
| Total operating expenses                  | 9,274                            | 5,566            | 6,551            | 551     | (1,259)      | 20,683       |
|   | >                                | >                | >                | >       | >            | >            |
| Income (loss) before income taxes         | 286                              | 697              | 5,378            | (215)   | (2)          | 6,144        |
| Provision for (benefit from) income taxes | (332)                            | 278              | 2,098            | (81)    | —            | 1,963        |
| Net income (loss)                         | \$618                            | \$419            | \$3,280          | \$(134) | \$(2)        | \$4,181      |
| Total assets                              | \$791,327                        | \$91,025         | \$265,995        | \$2,974 | \$(201,607)  | \$949,714    |
| Capital expenditures                      | \$173                            | \$158            | \$41             | \$—     | \$—          | \$372        |

| (Dollars in thousands)   | Three Months Ended June 30, 2011 |                  |                  |       |              |              |
|--------------------------|----------------------------------|------------------|------------------|-------|--------------|--------------|
|                          | Retail Banking                   | Mortgage Banking | Consumer Finance | Other | Eliminations | Consolidated |
| <b>Revenues:</b>         |                                  |                  |                  |       |              |              |
| Interest income          | \$8,174                          | \$386            | \$10,877         | \$—   | \$(1,068)    | \$18,369     |
| Gains on sales of loans  | —                                | 3,696            | —                | —     | —            | 3,696        |
| Other noninterest income | 1,501                            | 703              | 157              | 301   | —            | 2,662        |
| Total operating income   | 9,675                            | 4,785            | 11,034           | 301   | (1,068)      | 24,727       |
| <b>Expenses:</b>         |                                  |                  |                  |       |              |              |

Edgar Filing: C & F FINANCIAL CORP - Form 10-Q

|   |           |          |           |          |              |            |
|---|-----------|----------|-----------|----------|--------------|------------|
| Interest expense                          | 2,290     | 50       | 1,442     | 254      | (1,068 )     | 2,968      |
| Provision for loan losses                 | 1,500     | 15       | 1,875     | —        | —            | 3,390      |
| Salaries and employee benefits            | 3,586     | 2,978    | 1,674     | 192      | —            | 8,430      |
| Other noninterest expenses                | 3,217     | 1,356    | 878       | 88       | —            | 5,539      |
| Total operating expenses                  | 10,593    | 4,399    | 5,869     | 534      | (1,068 )     | 20,327     |
|   | >         | >        | >         | >        | >            | >          |
| Income (loss) before income taxes         | (918 )    | 386      | 5,165     | (233 )   | —            | 4,400      |
| Provision for (benefit from) income taxes | (764 )    | 154      | 2,015     | (87 )    | (1 )         | 1,317      |
| Net income (loss)                         | \$(154 )  | \$232    | \$3,150   | \$(146 ) | \$1          | \$ 3,083   |
| Total assets                              | \$752,252 | \$53,119 | \$246,730 | \$2,778  | \$(148,308 ) | \$ 906,571 |
| Capital expenditures                      | \$237     | \$(8 )   | \$415     | \$1      | \$—          | \$ 645     |

Edgar Filing: C & F FINANCIAL CORP - Form 10-Q

Table of Contents

Six Months Ended June 30, 2012

| (Dollars in thousands)                    | Retail<br>Banking | Mortgage<br>Banking | Consumer<br>Finance | Other   | Eliminations | Consolidated |
|---|-------------------|---------------------|---------------------|---------|--------------|--------------|
| <b>Revenues:</b>                          |                   |                     |                     |         |              |              |
| Interest income                           | \$16,163          | \$1,140             | \$23,034            | \$—     | \$(2,483)    | \$37,854     |
| Gains on sales of loans                   | —                 | 8,821               | —                   | —       | —            | 8,821        |
| Other noninterest income                  | 3,030             | 2,095               | 494                 | 672     | —            | 6,291        |
| Total operating income                    | 19,193            | 12,056              | 23,528              | 672     | (2,483)      | 52,966       |
| <b>Expenses:</b>                          |                   |                     |                     |         |              |              |
| Interest expense                          | 4,078             | 219                 | 3,124               | 497     | (2,483)      | 5,435        |
| Provision for loan losses                 | 1,500             | 105                 | 3,980               | —       | —            | 5,585        |
| Salaries and employee benefits            | 7,748             | 7,393               | 3,722               | 475     | —            | 19,338       |
| Other noninterest expenses                | 5,771             | 2,945               | 1,974               | 256     | —            | 10,946       |
| Total operating expenses                  | 19,097            | 10,662              | 12,800              | 1,228   | (2,483)      | 41,304       |
|   | >                 | >                   | >                   | >       | >            | >            |
| Income (loss) before income taxes         | 96                | 1,394               | 10,728              | (556)   | —            | 11,662       |
| Provision for (benefit from) income taxes | (829)             | 557                 | 4,184               | (211)   | —            | 3,701        |
| Net income (loss)                         | \$925             | \$837               | \$6,544             | \$(345) | \$—          | \$7,961      |
| Total assets                              | \$791,327         | \$91,025            | \$265,995           | \$2,974 | \$(201,607)  | \$949,714    |
| Capital expenditures                      | \$352             | \$209               | \$99                | \$—     | \$—          | \$660        |

Six Months Ended June 30, 2011

| (Dollars in thousands)                    | Retail<br>Banking | Mortgage<br>Banking | Consumer<br>Finance | Other   | Eliminations | Consolidated |
|---|-------------------|---------------------|---------------------|---------|--------------|--------------|
| <b>Revenues:</b>                          |                   |                     |                     |         |              |              |
| Interest income                           | \$16,204          | \$787               | \$21,086            | \$—     | \$(2,076)    | \$36,001     |
| Gains on sales of loans                   | —                 | 7,496               | —                   | —       | —            | 7,496        |
| Other noninterest income                  | 2,975             | 1,442               | 339                 | 563     | —            | 5,319        |
| Total operating income                    | 19,179            | 9,725               | 21,425              | 563     | (2,076)      | 48,816       |
| <b>Expenses:</b>                          |                   |                     |                     |         |              |              |
| Interest expense                          | 4,677             | 112                 | 2,815               | 506     | (2,078)      | 6,032        |
| Provision for loan losses                 | 2,550             | 35                  | 3,625               | —       | —            | 6,210        |
| Salaries and employee benefits            | 7,486             | 5,723               | 3,329               | 384     | —            | 16,922       |
| Other noninterest expenses                | 6,213             | 2,907               | 1,639               | 237     | —            | 10,996       |
| Total operating expenses                  | 20,926            | 8,777               | 11,408              | 1,127   | (2,078)      | 40,160       |
|   | >                 | >                   | >                   | >       | >            | >            |
| Income (loss) before income taxes         | (1,747)           | 948                 | 10,017              | (564)   | 2            | 8,656        |
| Provision for (benefit from) income taxes | (1,469)           | 379                 | 3,907               | (214)   | 1            | 2,604        |
| Net income (loss)                         | \$(278)           | \$569               | \$6,110             | \$(350) | \$1          | \$6,052      |
| Total assets                              | \$752,252         | \$53,119            | \$246,730           | \$2,778 | \$(148,308)  | \$906,571    |
| Capital expenditures                      | \$486             | \$69                | \$623               | \$3     | \$—          | \$1,181      |

The Retail Banking segment extends a warehouse line of credit to the Mortgage Banking segment, providing a portion of the funds needed to originate mortgage loans. The Retail Banking segment charges the Mortgage Banking segment interest at the daily FHLB advance rate plus 50 basis points. The Retail Banking segment also provides the Consumer Finance segment with a portion of the funds needed to originate loans by means of a variable rate line of credit that carries interest at one-month LIBOR plus 200 basis points and fixed rate loans that carry interest rates ranging from 5.4 percent to 8.0 percent. The Retail Banking segment acquires certain residential real estate loans from the Mortgage Banking segment at prices similar to those paid by third-party investors. These transactions are eliminated to reach consolidated totals. Certain corporate overhead costs incurred by the Retail Banking segment are not allocated to the Mortgage Banking, Consumer Finance and Other segments.



Table of Contents

## NOTE 9: Commitments and Financial Instruments with Off-Balance-Sheet Risk

C&F Mortgage sells substantially all of the residential mortgage loans it originates to third-party investors, some of whom may require the repurchase of loans in the event of loss due to borrower misrepresentation, fraud or early default. Mortgage loans and their related servicing rights are sold under agreements that define certain eligibility criteria for the mortgage loans. Recourse periods for early payment default vary from 90 days up to one year. Recourse periods for borrower misrepresentation or fraud, or underwriting error do not have a stated time limit. C&F Mortgage maintains an indemnification reserve for potential claims made under these recourse provisions. Risks also arise from the possible inability of counterparties to meet the terms of their contracts. C&F Mortgage has procedures in place to evaluate the credit risk of investors and does not expect any counterparty to fail to meet its obligations. The following table presents the changes in the allowance for indemnification losses for the periods presented:

| (Dollars in thousands)               | Three Months<br>Ended June 30, |          | Six Months Ended<br>June 30, |          |
|--------------------------------------|--------------------------------|----------|------------------------------|----------|
|                                      | 2012                           | 2011     | 2012                         | 2011     |
| Allowance, beginning of period       | \$ 1,827                       | \$ 1,522 | \$ 1,702                     | \$ 1,291 |
| Provision for indemnification losses | 330                            | 175      | 455                          | 406      |
| Payments                             | (500 )                         | (161 )   | (500 )                       | (161 )   |
| Allowance, end of period             | \$ 1,657                       | \$ 1,536 | \$ 1,657                     | \$ 1,536 |

## NOTE 10: Derivatives

The Corporation uses derivatives to manage exposure to interest rate risk through the use of interest rate swaps. Interest rate swaps involve the exchange of fixed and variable rate interest payments between two parties, based on a common notional principal amount and maturity date with no exchange of underlying principal amounts. The Corporation's interest rate swaps qualify as cash flow hedges. The Corporation's cash flow hedges effectively modify a portion of the Corporation's exposure to interest rate risk by converting variable rates of interest on \$10.00 million of the Corporation's trust preferred capital notes to fixed rates of interest until September 2015.

The cash flow hedges total notional amount is \$10.00 million. At June 30, 2012, the cash flow hedges had a fair value of (\$542,000), which is recorded in other liabilities. The cash flow hedges were fully effective at June 30, 2012 and therefore the loss on the cash flow hedges was recognized as a component of other comprehensive income (loss), net of deferred income taxes.

## NOTE 11: Other Noninterest Expenses

The following table presents the significant components in the consolidated statements of income line "Noninterest Expenses – Other Expenses."

| (Dollars in thousands)               | Three Months<br>Ended June 30, |        | Six Months Ended<br>June 30, |        |
|--------------------------------------|--------------------------------|--------|------------------------------|--------|
|                                      | 2012                           | 2011   | 2012                         | 2011   |
| Provision for indemnification losses | \$ 330                         | \$ 175 | \$ 455                       | \$ 406 |
| Loan and OREO expenses               | 306                            | 717    | 655                          | 1,187  |
| Data processing fees                 | 563                            | 580    | 1,059                        | 1,131  |
| Telecommunication expenses           | 303                            | 284    | 587                          | 547    |
| FDIC expenses                        | 168                            | 248    | 327                          | 496    |
| Professional fees                    | 398                            | 475    | 854                          | 1,028  |
| All other noninterest expenses       | 1,886                          | 1,449  | 3,611                        | 3,064  |

Edgar Filing: C & F FINANCIAL CORP - Form 10-Q

|                                  |          |          |          |          |
|----------------------------------|----------|----------|----------|----------|
| Total Other Noninterest Expenses | \$ 3,954 | \$ 3,928 | \$ 7,548 | \$ 7,859 |
|----------------------------------|----------|----------|----------|----------|

Table of Contents

ITEM 2.MANAGEMENT’S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

CAUTIONARY STATEMENT REGARDING FORWARD-LOOKING STATEMENTS

This report contains statements concerning the Corporation’s expectations, plans, objectives, future financial performance and other statements that are not historical facts. These statements may constitute “forward-looking statements” as defined by federal securities laws and may include, but are not limited to, statements regarding profitability, liquidity, the Corporation’s and each business segment’s loan portfolio, allowance for loan losses, trends regarding the provision for loan losses, trends regarding net loan charge-offs, trends regarding levels of nonperforming assets and troubled debt restructurings and expenses associated with nonperforming assets, provision for indemnification losses, levels of noninterest income and expense, interest rates and yields, the deposit portfolio, including trends in deposit maturities and rates, interest rate sensitivity, market risk, regulatory developments, capital requirements, growth strategy and financial and other goals. These statements may address issues that involve estimates and assumptions made by management and risks and uncertainties. Actual results could differ materially from historical results or those anticipated by such statements. Factors that could have a material adverse effect on the operations and future prospects of the Corporation include, but are not limited to, changes in:

interest rates

general business conditions, as well as conditions within the financial markets

general economic conditions, including unemployment levels

the legislative/regulatory climate, including the Dodd-Frank Act and regulations promulgated thereunder and the Consumer Financial Protection Bureau (CFPB) and the regulatory and enforcement activities of the CFPB

monetary and fiscal policies of the U.S. Government, including policies of the Treasury and the Federal Reserve Board

the value of securities held in the Corporation’s investment portfolios

the quality or composition of the loan portfolios and the value of the collateral securing those loans

the inventory level and pricing of used automobiles

the level of net charge-offs on loans and the adequacy of our allowance for loan losses

the level of indemnification losses related to mortgage loans sold

demand for loan products

deposit flows

the strength of the Corporation’s counterparties

competition from both banks and non-banks

demand for financial services in the Corporation’s market area

technology

reliance on third parties for key services

the commercial and residential real estate markets

demand in the secondary residential mortgage loan markets

the Corporation's expansion and technology initiatives

accounting principles, policies and guidelines

Any forward-looking statements should be considered in context with the various disclosures made by us about our businesses in our public filings with the Securities and Exchange Commission, including without limitation the risks identified above and those more specifically described in Item 1A. "Risk Factors" of our Annual Report on Form 10-K for the year ended December 31, 2011.

The following discussion supplements and provides information about the major components of the results of operations, financial condition, liquidity and capital resources of the Corporation. This discussion and analysis should be read in conjunction with the accompanying consolidated financial statements.

#### CRITICAL ACCOUNTING POLICIES

The preparation of financial statements requires us to make estimates and assumptions. Those accounting policies with the greatest uncertainty and that require our most difficult, subjective or complex judgments affecting the application of these policies, and the likelihood that materially different amounts would be reported under different conditions, or using different assumptions, are described below.

Table of Contents

**Allowance for Loan Losses:** We establish the allowance for loan losses through charges to earnings in the form of a provision for loan losses. Loan losses are charged against the allowance when we believe that the collection of the principal is unlikely. Subsequent recoveries of losses previously charged against the allowance are credited to the allowance. The allowance represents an amount that, in our judgment, will be adequate to absorb any losses on existing loans that may become uncollectible. Our judgment in determining the level of the allowance is based on evaluations of the collectibility of loans while taking into consideration such factors as trends in delinquencies and charge-offs, changes in the nature and volume of the loan portfolio, current economic conditions that may affect a borrower's ability to repay and the value of collateral, overall portfolio quality and review of specific potential losses. This evaluation is inherently subjective because it requires estimates that are susceptible to significant revision as more information becomes available.

**Allowance for Indemnifications:** The allowance for indemnifications is established through charges to earnings in the form of a provision for indemnifications, which is included in other noninterest expenses. A loss is charged against the allowance for indemnifications under certain conditions when a purchaser of a loan (investor) sold by C&F Mortgage incurs a loss due to borrower misrepresentation, fraud, early default, or underwriting error. The allowance represents an amount that, in management's judgment, will be adequate to absorb any losses arising from indemnification requests. Management's judgment in determining the level of the allowance is based on the volume of loans sold, current economic conditions and information provided by investors. This evaluation is inherently subjective, as it requires estimates that are susceptible to significant revision as more information becomes available.

**Impairment of Loans:** We consider a loan impaired when it is probable that the Corporation will be unable to collect all interest and principal payments as scheduled in the loan agreement. We do not consider a loan impaired during a period of delay in payment if we expect the ultimate collection of all amounts due. We measure impairment on a loan-by-loan basis for commercial, construction and residential loans in excess of \$500,000 by either the present value of expected future cash flows discounted at the loan's effective interest rate, the loan's obtainable market price, or the fair value of the collateral if the loan is collateral dependent. Large groups of smaller balance homogeneous loans are collectively evaluated for impairment. We maintain a valuation allowance to the extent that the measure of the impaired loan is less than the recorded investment. Troubled debt restructurings (TDRs) are also considered impaired loans, even if the loan balance is less than \$500,000. A TDR occurs when we agree to significantly modify the original terms of a loan due to the deterioration in the financial condition of the borrower.

**Impairment of Securities:** Impairment of securities occurs when the fair value of a security is less than its amortized cost. For debt securities, impairment is considered other-than-temporary and recognized in its entirety in net income if either (i) we intend to sell the security or (ii) it is more-likely-than-not that we will be required to sell the security before recovery of its amortized cost basis. If, however, we do not intend to sell the security and it is not more-likely-than-not that we will be required to sell the security before recovery, we must determine what portion of the impairment is attributable to a credit loss, which occurs when the amortized cost basis of the security exceeds the present value of the cash flows expected to be collected from the security. If there is no credit loss, there is no other-than-temporary impairment. If there is a credit loss, other-than-temporary impairment exists, and the credit loss must be recognized in net income and the remaining portion of impairment must be recognized in other comprehensive income. For equity securities, impairment is considered to be other-than-temporary based on our ability and intent to hold the investment until a recovery of fair value. Other-than-temporary impairment of an equity security results in a write-down that must be included in net income. We regularly review each investment security for other-than-temporary impairment based on criteria that includes the extent to which cost exceeds market price, the duration of that market decline, the financial health of and specific prospects for the issuer, our best estimate of the present value of cash flows expected to be collected from debt securities, our intention with regard to holding the security to maturity and the likelihood that we would be required to sell the security before recovery.

Other Real Estate Owned (OREO): Assets acquired through, or in lieu of, loan foreclosure are held for sale and are initially recorded at the lower of the loan balance or the fair value less costs to sell at the date of foreclosure. Subsequent to foreclosure, management periodically performs valuations of the foreclosed assets based on updated appraisals, general market conditions, recent sales of like properties, length of time the properties have been held, and our ability and intention with regard to continued ownership of the properties. The Corporation may incur additional write-downs of foreclosed assets to fair value less costs to sell if valuations indicate a further other-than-temporary deterioration in market conditions.

Goodwill: Goodwill is no longer subject to amortization over its estimated useful life. In assessing the recoverability of the Corporation's goodwill, all of which was recognized in connection with the Bank's acquisition of C&F Finance Company in September 2002, we must make assumptions in order to determine the fair value of the respective assets. Major assumptions used in determining if goodwill is impaired were increases in future income, sales multiples in determining terminal value and the discount rate applied to future cash flows. As part of the impairment test, we performed a sensitivity analysis by increasing the discount rate, lowering sales multiples and reducing increases in future income. We completed the annual test for impairment during the fourth quarter of 2011 and determined there was no impairment to be recognized in 2011. With the adoption of Accounting Standards Update 2011-08, Intangible-Goodwill and Other-Testing Goodwill for Impairment, in 2012, the Corporation will no longer be required to complete a test for impairment unless, based on an assessment of qualitative factors related to goodwill, we determine that it is more likely than not that the fair value of C&F Finance Company is less than its carrying amount. If the likelihood of impairment is more than 50 percent, the Corporation will perform a test for impairment and we may be required to record impairment charges.

## Table of Contents

**Retirement Plan:** The Bank maintains a non-contributory, defined benefit pension plan for eligible full-time employees as specified by the plan. Plan assets, which consist primarily of mutual funds invested in marketable equity securities and corporate and government fixed income securities, are valued using market quotations. The Bank's actuary determines plan obligations and annual pension expense using a number of key assumptions. Key assumptions may include the discount rate, the interest crediting rate, the estimated future return on plan assets and the anticipated rate of future salary increases. Changes in these assumptions in the future, if any, or in the method under which benefits are calculated may impact pension assets, liabilities or expense.

**Derivative Financial Instruments:** The Corporation recognizes derivative financial instruments at fair value as either an other asset or an other liability in the consolidated balance sheets. The derivative financial instruments have been designated as and qualify as cash flow hedges. The effective portion of the gain or loss on the cash flow hedges is reported as a component of other comprehensive income, net of deferred taxes, and reclassified into earnings in the same period or periods during which the hedged transaction affects earnings.

**Accounting for Income Taxes:** Determining the Corporation's effective tax rate requires judgment. In the ordinary course of business, there are transactions and calculations for which the ultimate tax outcomes are uncertain. In addition, the Corporation's tax returns are subject to audit by various tax authorities. Although we believe that the estimates are reasonable, no assurance can be given that the final tax outcome will not be materially different than that which is reflected in the income tax provision and accrual.

For further information concerning accounting policies, refer to Item 8 "Financial Statements and Supplementary Data" under the heading "Note 1: Summary of Significant Accounting Policies" in the Corporation's Annual Report on Form 10-K for the year ended December 31, 2011.

## OVERVIEW

Our primary financial goals are to maximize the Corporation's earnings and to deploy capital in profitable growth initiatives that will enhance long-term shareholder value. We track three primary financial performance measures in order to assess the level of success in achieving these goals: (i) return on average assets (ROA), (ii) return on average common equity (ROE), and (iii) growth in earnings. In addition to these financial performance measures, we track the performance of the Corporation's three principal business activities: retail banking, mortgage banking, and consumer finance. We also actively manage our capital through growth and dividends, while considering the need to maintain a strong regulatory capital position.

### Financial Performance Measures

Net income for the Corporation was \$4.2 million for the three months ended June 30, 2012, compared with \$3.1 million for the three months ended June 30, 2011. Net income for the Corporation was \$8.0 million for the first six months of 2012, compared with \$6.1 million for the first six months of 2011. Net income available to common shareholders was \$4.0 million, or \$1.22 per common share assuming dilution, for the three months ended June 30, 2012, compared with \$2.8 million, or \$0.88 per common share assuming dilution, for the three months ended June 30, 2012. Net income available to common shareholders was \$7.7 million, or \$2.33 per common share assuming dilution for the first half of 2012, compared with \$5.5 million, or \$1.73 per common share assuming dilution for the first half of 2011. The difference between reported net income and net income available to common shareholders is a result of the Preferred Stock dividends and amortization of the Warrant related to the Corporation's participation in the CPP. The Corporation's earnings for the second quarter and first half of 2012 were primarily a result of the strong earnings in the Consumer Finance segment, which continues to benefit from (1) sustained loan growth and (2) the low funding costs on its variable-rate borrowings. The Mortgage Banking segment benefited from (1) higher gains on loans sold as a result of higher loan production and correspondingly higher sales volume during 2012 and (2) lower legal and

consulting expenses. The Retail Banking segment benefited from the effects of (1) the continued low interest rate environment on the cost of deposits, (2) lower provisions for loan losses, (3) higher interchange activity fee income and (4) lower expenses associated with FDIC deposit insurance and foreclosed properties.

The Corporation's ROE and ROA were 17.96 percent and 1.77 percent, respectively, on an annualized basis for the second quarter of 2012, compared with 14.41 percent and 1.24 percent, respectively, for the second quarter of 2011. For the first six months of 2012, on an annualized basis, the Corporation's ROE and ROA were 17.35 percent and 1.69 percent, respectively, compared with 14.46 percent and 1.21 percent, respectively, for the first six months of 2011. The increase in these ratios during 2012 was primarily due to the earnings improvement of each of the Corporation's significant business segments. In addition, the effect of dividends on the Corporation's Preferred Stock on net income available to common shareholders was lessened for the second quarter and first half of 2012 by the redemptions of Preferred Stock in July 2011 and in April 2012.

**Principal Business Activities.** An overview of the financial results for each of the Corporation's principal business segments is presented below. A more detailed discussion is included in "Results of Operations."



Table of Contents

Retail Banking: C&F Bank reported net income of \$618,000 for the second quarter of 2012, compared to a net loss of \$154,000 for the second quarter of 2011. For the first six months of 2012, C&F Bank reported net income of \$925,000, compared to a net loss of \$278,000 for the first six months of 2011. Factors contributing to the improvement in financial results for the three and six months ended June 30, 2012, relative to the same periods of 2011, were higher activity-based interchange income, the effects of the continued low interest rate environment on the cost of deposits, lower provisions for loan losses, lower expenses associated with holding costs of foreclosed properties, and lower FDIC deposit insurance premiums. Partially offsetting these positive factors were the negative effects of the following: (1) a decrease in average loans to nonaffiliates resulting from weak demand in the current economic environment and intensified competition for loans in our markets, (2) a decline in overdraft fees and (3) higher occupancy expenses associated with depreciation and maintenance of technology related to expanding the banking services we offer to customers and improving operational efficiency and security.

The Bank's nonperforming assets were \$16.2 million at June 30, 2012, compared to \$16.1 million at December 31, 2011. Nonperforming assets at June 30, 2012 included \$11.0 million in nonaccrual loans, compared to \$10.0 million at December 31, 2011, and \$5.2 million in foreclosed properties, compared to \$6.1 million at December 31, 2011. Troubled debt restructurings were \$15.8 million at June 30, 2012, of which \$7.5 million were included in nonaccrual loans, as compared to \$17.1 million of troubled debt restructurings at December 31, 2011, of which \$8.4 million were included in nonaccrual loans. The increase in nonaccrual loans primarily resulted from one commercial relationship secured by undeveloped residential property, which was partially offset by nonaccrual loan pay-offs, charge-offs and transfers to foreclosed properties. Management believes it has provided adequate loan loss reserves for the retail banking segment's loans. Foreclosed properties at June 30, 2012 consist of both residential and non-residential properties. These properties are evaluated regularly and have been written down to their estimated fair values less selling costs.

Mortgage Banking: C&F Mortgage Corporation reported net income of \$419,000 for the second quarter of 2012, compared to \$232,000 for the second quarter of 2011. For the first six months of 2012, C&F Mortgage Corporation reported net income of \$837,000, compared to \$569,000 for the first six months of 2011. Factors contributing to the improvements in financial results for the three months and six months ended June 30, 2012, relative to the same periods of 2011, were (1) higher gains on sales of loans and ancillary loan production fees, (2) higher interest income on loans held for sale and (3) lower legal and consulting fees. Loan origination volume increased to \$206.7 million in the second quarter of 2012, a 38.7 percent increase as compared to \$149.0 million in the second quarter of 2011, and to \$379.9 million in the first half of 2012, a 39.1 percent increase as compared to \$273.1 million in the first half of 2011. For the second quarter of 2012, the amount of loan originations for refinancings and home purchases were \$55.8 million and \$150.9 million, respectively, compared to \$21.5 million and \$127.5 million, respectively, for the second quarter of 2011. For the first half of 2012, the amount of loan originations for refinancings and home purchases were \$135.5 million and \$244.5 million, respectively, compared to \$60.1 million and \$213.0 million, respectively, for the first half of 2011. The increases in loan originations are a result of the continued low interest rate environment that has led to increased mortgage borrowing and refinancing activity. These increases have led to correspondingly higher sales volume, which increased to \$191.2 million for the second quarter of 2012, compared to \$134.7 million during the second quarter of 2011, and which increased to \$370.8 million for the first half of 2012, compared to \$297.8 million during the first half of 2011. In connection with the higher sales volumes in 2012, the mortgage banking segment incurred higher production and income based compensation expense.

Consumer Finance: C&F Finance Company reported net income of \$3.3 million for the second quarter of 2012, compared to net income of \$3.2 million for the second quarter of 2011. For the first six months of 2012, C&F Finance reported net income of \$6.5 million, compared to net income of \$6.1 million for the first six months of 2011. The improvements in financial results for 2012 resulted from a 9.5 percent and a 10.7 increase in average loans outstanding and the sustained low cost of the consumer finance segment's variable-rate borrowings. These items were partially offset by (1) increases of \$205,000 and \$355,000 in the provision for loan losses for the three and six months

ended June 30, 2012, respectively, resulting from loan growth and higher net charge-offs, (2) increases of \$166,000 and \$387,000 in personnel costs for the three and six months ended June 30, 2012, respectively, resulting from an increase in the number of personnel to support loan growth and (3) increases of \$49,000 and \$149,000 in occupancy expenses for the three and six months ended June 30, 2012, respectively, resulting from C&F Finance Company's relocation in April 2011 to a larger leased headquarters building and depreciation and maintenance of technology to support growth. The allowance for loan losses as a percentage of consumer finance loans at June 30, 2012 was 7.92 percent, as compared with 7.94 percent at December 31, 2011. Management believes that the current allowance for loan losses is adequate to absorb probable losses in the Consumer Finance segment's loan portfolio.

Other and Eliminations: The net loss for the three months ended June 30, 2012 for this combined segment was \$136,000, compared to a net loss of \$145,000 for the three months ended June 30, 2011. The net loss for the first half of 2012 for this combined segment was \$345,000, compared to a net loss of \$349,000 for the first half of 2011. Revenue and expense of this combined segment include the results of operations of our investment, insurance and title subsidiaries, interest expense associated with the Corporation's trust preferred capital notes, other general corporate expenses and the effects of intercompany eliminations.

Capital Management. Total shareholders' equity was \$93.9 million at June 30, 2012, compared to \$96.1 million at December 31, 2011, which was a decrease of \$2.2 million primarily attributable to the redemption of the Corporation's Preferred Stock, as described below, which was offset in part by earnings in 2012. The Corporation paid cash dividends of 26 cents and 52 cents per common share during the second quarter and first half of 2012, respectively, which was a 20.8 percent and a 21.8 percent payout ratio of net income available to common shareholders for the second quarter and first half of 2012, respectively.

Table of Contents

On April 11, 2012, the Corporation redeemed the remaining 10,000 shares of its Preferred Stock issued to Treasury in January 2009 under the CPP. The redemption consisted of \$10.0 million in liquidation value and \$78,000 of accrued and unpaid dividends associated with the Preferred Stock. As a result of this redemption, the Corporation will pay no future dividends on the Preferred Stock. The Corporation funded this redemption without raising additional capital because of its strong capital position and financial performance. The redemption results in no dilution to common shareholders because no new capital was issued. In connection with this redemption, the Corporation accelerated the accretion of the remaining Preferred Stock discount, which reduced net income available to common shareholders by approximately \$151,000 in the second quarter of 2012, but eliminated any future accretion.

## RESULTS OF OPERATIONS

The following table presents the average balance sheets, the amounts of interest earned on earning assets, with related yields, and interest expense on interest-bearing liabilities, with related rates, for the three and six months ended June 30, 2012 and 2011. Loans include loans held for sale. Loans placed on nonaccrual status are included in the balances and are included in the computation of yields, but had no material effect. Interest on tax-exempt loans and securities is presented on a taxable-equivalent basis (which converts the income on loans and investments for which no income taxes are paid to the equivalent yield as if income taxes were paid using the federal corporate income tax rate of 34 percent).

TABLE 1: Average Balances, Income and Expense, Yields and Rates

| (Dollars in thousands)   | Average<br>Balance | Three Months Ended June 30, |                | Average<br>Balance | 2011               |                |  |
|--|--------------------|-----------------------------|----------------|--------------------|--------------------|----------------|--|
|  |                    | 2012<br>Income/<br>Expense  | Yield/<br>Rate |                    | Income/<br>Expense | Yield/<br>Rate |  |
| <b>Assets</b>  |                    |                             |                |                    |                    |                |  |
| <b>Securities:</b>   |                    |                             |                |                    |                    |                |  |
| Taxable  | \$ 19,856          | \$ 82                       | 1.65 %         | \$ 19,909          | \$ 85              | 1.71 %         |  |
| Tax-exempt   | 118,709            | 1,797                       | 6.06           | 119,086            | 1,856              | 6.26           |  |
| Total securities   | 138,565            | 1,879                       | 5.42           | 138,995            | 1,941              | 5.59           |  |
| Loans, net   | 720,881            | 17,837                      | 9.92           | 672,925            | 17,058             | 10.17          |  |
| <b>Interest-bearing deposits in other banks and Federal funds sold</b> |                    |                             |                |                    |                    |                |  |
|  | 10,558             | 5                           | 0.19           | 22,465             | 16                 | 0.29           |  |
| Total earning assets   | 870,004            | 19,721                      | 9.07           | 834,385            | 19,015             | 9.14           |  |
| Allowance for loan losses  | (35,180 )          |                             |                | (29,195 )          |                    |                |  |
| Total non-earning assets   | 91,591             |                             |                | 97,676             |                    |                |  |
| Total assets   | \$ 926,415         |                             |                | \$ 902,866         |                    |                |  |
| <b>Liabilities and Shareholders' Equity</b>                            |                    |                             |                |                    |                    |                |  |
| <b>Time and savings deposits:</b>                                      |                    |                             |                |                    |                    |                |  |
| Interest-bearing deposits  | \$ 109,039         | \$ 97                       | 0.36 %         | \$ 109,228         | \$ 129             | 0.48 %         |  |
| Money market deposit accounts  | 92,975             | 90                          | 0.39           | 75,521             | 135                | 0.71           |  |
| Savings accounts   | 45,316             | 12                          | 0.11           | 42,413             | 10                 | 0.09           |  |
| Certificates of deposit, \$100 or more                                 | 138,831            | 546                         | 1.58           | 131,495            | 663                | 2.02           |  |
| Other certificates of deposit  | 164,072            | 637                         | 1.56           | 173,644            | 819                | 1.89           |  |
| Total time and savings deposits  | 550,233            | 1,382                       | 1.00           | 532,301            | 1,756              | 1.32           |  |

Edgar Filing: C & F FINANCIAL CORP - Form 10-Q

|   |           |          |      |           |          |      |
|---|-----------|----------|------|-----------|----------|------|
| Borrowings  | 159,961   | 1,215    | 3.04 | 159,332   | 1,212    | 3.04 |
| Total interest-bearing liabilities                      | 710,194   | 2,597    | 1.46 | 691,633   | 2,968    | 1.72 |
|   | >         | >        | >    | >         | >        | >    |
| Demand deposits   | 103,450   |          |      | 94,209    |          |      |
| Other liabilities                                       | 20,275    |          |      | 19,472    |          |      |
| Total liabilities                                       | 833,919   |          |      | 805,314   |          |      |
| Shareholders' equity                                    | 92,496    |          |      | 97,552    |          |      |
| Total liabilities and shareholders' equity              | \$926,415 |          |      | \$902,866 |          |      |
| Net interest income                                     |           | \$17,124 |      |           | \$16,047 |      |
|   |           | >        |      |           | >        |      |
| Interest rate spread                                    |           |          | 7.60 | %         |          | 7.42 |
| Interest expense to average earning assets (annualized) |           |          | 1.19 | %         |          | 1.43 |
| Net interest margin (annualized)                        |           |          | 7.87 | %         |          | 7.71 |

Table of Contents

| (Dollars in thousands)  | Six Months Ended June 30, |                     |            |   |                 |                     |            |   |
|---|---------------------------|---------------------|------------|---|-----------------|---------------------|------------|---|
|   | Average Balance           | 2012 Income/Expense | Yield/Rate |   | Average Balance | 2011 Income/Expense | Yield/Rate |   |
| <b>Assets</b>   |                           |                     |            |   |                 |                     |            |   |
| <b>Securities:</b>  |                           |                     |            |   |                 |                     |            |   |
| Taxable   | \$20,610                  | \$168               | 1.63       | % | \$20,316        | \$162               | 1.60       | % |
| Tax-exempt  | 118,652                   | 3,595               | 6.06       |   | 117,133         | 3,665               | 6.26       |   |
| Total securities  | 139,262                   | 3,763               | 5.40       |   | 137,449         | 3,827               | 5.57       |   |
| Loans, net  | 716,166                   | 35,327              | 9.94       |   | 671,034         | 33,418              | 10.04      |   |
| Interest-bearing deposits in other banks and Federal funds sold | 12,971                    | 13                  | 0.20       |   | 25,772          | 31                  | 0.24       |   |
| Total earning assets  | 868,399                   | 39,103              | 9.01       |   | 834,255         | 37,276              | 9.00       |   |
| Allowance for loan losses                                       | (34,648 )                 |                     |            |   | (29,206 )       |                     |            |   |
| Total non-earning assets  | 92,318                    |                     |            |   | 96,342          |                     |            |   |
| Total assets  | \$926,069                 |                     |            |   | \$901,391       |                     |            |   |
| <b>Liabilities and Shareholders' Equity</b>                     |                           |                     |            |   |                 |                     |            |   |
| <b>Time and savings deposits:</b>                               |                           |                     |            |   |                 |                     |            |   |
| Interest-bearing deposits                                       | \$110,953                 | \$239               | 0.43       | % | \$112,457       | \$321               | 0.58       | % |
| Money market deposit accounts                                   | 89,745                    | 190                 | 0.43       |   | 73,416          | 265                 | 0.73       |   |
| Savings accounts  | 44,687                    | 22                  | 0.10       |   | 42,112          | 20                  | 0.10       |   |
| Certificates of deposit, \$100 or more                          | 139,025                   | 1,187               | 1.72       |   | 132,559         | 1,336               | 2.03       |   |
| Other certificates of deposit                                   | 166,293                   | 1,361               | 1.65       |   | 174,805         | 1,669               | 1.93       |   |
| Total time and savings deposits                                 | 550,703                   | 2,999               | 1.09       |   | 535,349         | 3,611               | 1.36       |   |
| Borrowings  | 159,489                   | 2,437               | 3.06       |   | 159,708         | 2,421               | 3.03       |   |
| Total interest-bearing liabilities                              | 710,192                   | 5,436               | 1.53       |   | 695,057         | 6,032               | 1.74       |   |
|   | >                         | >                   | >          |   | >               | >                   | >          |   |
| Demand deposits   | 98,922                    |                     |            |   | 90,741          |                     |            |   |
| Other liabilities   | 21,450                    |                     |            |   | 19,879          |                     |            |   |
| Total liabilities   | 830,564                   |                     |            |   | 805,677         |                     |            |   |
| Shareholders' equity  | 95,505                    |                     |            |   | 95,714          |                     |            |   |
| Total liabilities and shareholders' equity                      | \$926,069                 |                     |            |   | \$901,391       |                     |            |   |
| Net interest income   |                           | \$33,667            |            |   |                 | \$31,244            |            |   |
|   |                           | >                   |            |   |                 | >                   |            |   |
| Interest rate spread  |                           |                     | 7.47       | % |                 |                     | 7.26       | % |
| Interest expense to average earning assets (annualized)         |                           |                     | 1.25       | % |                 |                     | 1.45       | % |
| Net interest margin (annualized)                                |                           |                     | 7.75       | % |                 |                     | 7.55       | % |

Interest income and expense are affected by fluctuations in interest rates, by changes in the volume of earning assets and interest-bearing liabilities, and by the interaction of rate and volume factors. The following table presents the direct causes of the period-to-period changes in the components of net interest income on a taxable-equivalent basis. We calculated the rate and volume variances using a formula prescribed by the Securities and Exchange Commission

(SEC). Rate/volume variances, the third element in the calculation, are not shown separately in the table, but are allocated to the rate and volume variances in proportion to the relationship of the absolute dollar amounts of the change in each. Loans include both nonaccrual loans and loans held for sale.

Table of Contents

TABLE 2: Rate-Volume Recap

| (Dollars in thousands)  | Three Months Ended June 30,<br>2012 from 2011 |                  |                                 |
|---|---|------------------|---------------------------------|
|   | Increase (Decrease)                           |                  | Total<br>Increase<br>(Decrease) |
|   | Rate  | Due to<br>Volume |                                 |
| Interest income:  |   |                  |                                 |
| Loans   | \$(415 )                                      | \$1,194          | \$779                           |
| Securities:   |   |                  |                                 |
| Taxable   | (3 )  | —                | (3 )                            |
| Tax-exempt  | (53 )   | (6 )             | (59 )                           |
| Interest-bearing deposits in other banks and Federal funds sold | —   | (11 )            | (11 )                           |
| Total interest income   | (471 )  | 1,177            | 706                             |
| Interest expense:   |   |                  |                                 |
| Time and savings deposits:                                      |   |                  |                                 |
| Interest-bearing deposits                                       | (31 )   | (1 )             | (32 )                           |
| Money market deposit accounts                                   | (71 )   | 26               | (45 )                           |
| Savings accounts  | 1   | 1                | 2                               |
| Certificates of deposit, \$100 or more                          | (152 )  | 35               | (117 )                          |
| Other certificates of deposit                                   | (139 )  | (43 )            | (182 )                          |
| Total time and savings deposits                                 | (392 )  | 18               | (374 )                          |
| Borrowings (including Trust preferred capital notes)            | —   | 3                | 3                               |
| Total interest expense  | (392 )  | 21               | (371 )                          |
| Change in net interest income                                   | \$(79 )                                       | \$1,156          | \$1,077                         |

| (Dollars in thousands)  | Six Months Ended June 30,<br>2012 from 2011 |                  |                                 |
|---|---|------------------|---------------------------------|
|   | Increase (Decrease)                         |                  | Total<br>Increase<br>(Decrease) |
|   | Rate  | Due to<br>Volume |                                 |
| Interest income:  |   |                  |                                 |
| Loans   | \$(1,361 )                                  | \$3,270          | \$1,909                         |
| Securities:   |   |                  |                                 |
| Taxable   | 3   | 3                | 6                               |
| Tax-exempt  | (117 )                                      | 47               | (70 )                           |
| Interest-bearing deposits in other banks and Federal funds sold | —   | (18 )            | (18 )                           |
| Total interest income   | (1,475 )                                    | 3,302            | \$1,827                         |
| Interest expense:   |   |                  |                                 |
| Time and savings deposits:                                      |   |                  |                                 |
| Interest-bearing deposits                                       | (78 )                                       | (4 )             | (82 )                           |
| Money market deposit accounts                                   | (125 )                                      | 50               | (75 )                           |
| Savings accounts  | 1   | 1                | 2                               |
| Certificates of deposit, \$100 or more                          | (212 )                                      | 63               | (149 )                          |
| Other certificates of deposit                                   | (230 )                                      | (78 )            | (308 )                          |
| Total time and savings deposits                                 | (644 )                                      | 32               | (612 )                          |
| Borrowings (including Trust preferred capital notes)            | (157 )                                      | 173              | 16                              |

Edgar Filing: C & F FINANCIAL CORP - Form 10-Q

|                               |        |   |         |         |   |
|-------------------------------|--------|---|---------|---------|---|
| Total interest expense        | (801   | ) | 205     | (596    | ) |
| Change in net interest income | \$(674 | ) | \$3,097 | \$2,423 |   |

32

---



Table of Contents

Net interest income, on a taxable-equivalent basis, for the three months ended June 30, 2012 was \$17.1 million, compared to \$16.0 million for the three months ended June 30, 2011. Net interest income, on a taxable-equivalent basis, for the first half of 2012 was \$33.7 million, compared to \$31.2 million for the first half of 2011. The higher net interest income during the second quarter of 2012, as compared to the same period of 2011, resulted from a 16 basis point increase in net interest margin to 7.87 percent, coupled with a 4.3 percent increase in average earning assets. The higher net interest income during the first half of 2012, as compared to the same period of 2011, resulted from a 20 basis point increase in net interest margin to 7.75 percent, coupled with a 4.1 percent increase in average earning assets. The increases in net interest margin for the three and six months ended June 30, 2012, compared to the same periods in 2011, were principally a result of decreases in the rates paid on savings and time deposits, partially offset by lower yields on loans and municipal securities. The decreases in rates paid on time and savings deposits were primarily a result of the sustained low interest rate environment, and the repricing of higher rate certificates of deposit as they matured to lower rates. In addition, the mix in interest-bearing deposits has shifted to shorter-term deposit accounts. The decreases in the yields on loans resulted primarily from higher average loans held for sale at the Mortgage Banking segment, which typically are lower yielding than loans held for investment. The increases in average loans held for sale offset the favorable effects of a changes in the mix of loans held for investment, namely increases in higher yielding average loans at the Consumer Finance segment and declines in lower yielding average loans at the Retail Banking segment resulted in higher yields on loans held for investment. The decline in the yields on securities resulted from calls and maturities of higher-yielding securities and purchases of municipal securities with lower yields in the current low interest rate environment.

Average loans, which includes both loans held for investment and loans held for sale, increased \$48.0 million to \$720.9 million for the quarter ended June 30, 2012 from \$672.9 million for the second quarter of 2011. Likewise average loans increased \$45.1 million to \$716.2 million for the first half of 2012 from \$671.0 million for the first half of 2011. A portion of the increase occurred in the Mortgage Banking segment's portfolio of loans held for sale, the average balance of which increased \$28.0 million during the second quarter of 2012 and \$27.2 million during the first half of 2012. This increase is indicative of the higher loan production due to the continued low interest rate environment that has led to increased mortgage borrowing and refinancing activity. In total, average loans to non-affiliates held for investment increased \$19.9 million during the second quarter of 2012 and \$17.9 million during the first six months of 2012, compared to the same respective periods of 2011. The Consumer Finance segment's average loan portfolio, which increased \$22.4 million during the second quarter of 2012 and \$23.2 million during the first six months of 2012 increased as a result of robust demand in existing and new markets. The increases in average loans at the Consumer Finance segment were offset in part by decreases of \$2.5 million during the second quarter of 2012 and \$5.3 million during the first half of 2012 in the Retail Banking and Mortgage Banking segments' portfolios of average loans held for investment. Loan production at the Retail Banking segment has been negatively affected by weak demand for new loans in the current economic environment and intensified competition for loans in our markets.

The overall yields on average loans decreased 25 basis points to 9.92 percent for the second quarter of 2012 and 10 basis points to 9.94 percent for the for the first half of 2012, when compared to the same periods in 2011, principally as a result of higher levels of lower-yielding Mortgage Banking loans held for sale as a percentage of total loans, as well as a slight decrease in the yield for the three months and six months ended June 30, 2012 on the Consumer Finance segment loans as a result of increased competition from institutions re-entering the automobile financing market.

Average securities available for sale decreased \$430,000 in the second quarter of 2012 and increased \$1.8 million in the first half of 2012 as compared to the same periods in 2011. The second quarter decrease in average securities available for sale and the slight increase in average securities available for sale during the first half of 2012, as compared to the same periods in 2011, reflect the effect of the lower interest rate environment on call activity, as well as on the availability of reinvestment opportunities that satisfy the investment portfolio's role in managing interest rate sensitivity, providing liquidity and serving as an additional source of interest income. The lower yields on the

available-for-sale securities portfolio during the second quarter and first half of 2012, compared to the same periods in 2011, resulted from the calls and maturities of higher-yielding securities and purchases of lower-yielding securities in the current low interest rate environment, as well as purchases of shorter-term securities with lower yields throughout 2011 and continuing into 2012.

Average interest-bearing deposits in other banks and Federal funds sold decreased \$11.9 million and \$12.8 million during the second quarter and first half of 2012, respectively, compared to the same periods in 2011, as a result of deploying excess liquidity to partially fund loan demand at the Mortgage Banking and Consumer Finance segments. The average yield on these overnight funds declined 10 basis points and 4 basis points during the second quarter and first half of 2012, respectively, compared to the same periods in 2011, as a result of the continuing low interest rate environment.

Average interest-bearing time and savings deposits increased \$17.9 million in the second quarter of 2012 and \$15.4 million in the first half of 2012, compared to the same periods in 2011, mainly due to a shift to shorter-term interest-bearing demand and money market deposit accounts, which allows depositors greater flexibility for funds management and investing decisions in this low interest rate environment. The average cost of deposits declined 32 basis points for the second quarter of 2012 and 27 basis points for the first half of 2012, compared to the same periods in 2011, because time deposits that matured throughout 2011 and into 2012 repriced at lower interest rates or were not renewed, interest rates paid on interest-bearing demand and money market deposit accounts decreased as a result of the sustained low interest rate environment, and the balances of shorter-term savings and money market deposits, which pay a lower interest rate, increased.

Table of Contents

Average borrowings increased \$629,000 in the second quarter of 2012 and decreased \$219,000 in the first half of 2012, compared to the same periods in 2011. These minimal changes in average borrowings reflect that funding needs for the growth in average earning assets during 2012 have been met through the utilization of excess liquidity and the growth in average deposits during 2012. There were minimal changes in the average cost of borrowings because of the stable low interest rate environment.

It will be challenging to maintain the Retail Banking segment's net interest margin at its current level if funds obtained from loan repayments and from deposit growth cannot be fully used to originate new loans and instead are reinvested in lower-yielding earning assets, and if the reduction in earning asset yields exceeds interest rate declines in interest-bearing liabilities. With the expectation that short-term interest rates will not change significantly during 2012 and the current low rate environment will be relatively unchanged, the net interest margin at the Consumer Finance segment will be most affected by competition from institutions re-entering the automobile financing market and loan pricing strategies that these competitors may use to grow market share.

## Noninterest Income

TABLE 3: Noninterest Income

(Dollars in thousands)

|   | Three Months Ended June 30, 2012 |                     |                     |                           |         |
|---|----------------------------------|---------------------|---------------------|---------------------------|---------|
|   | Retail<br>Banking                | Mortgage<br>Banking | Consumer<br>Finance | Other and<br>Eliminations | Total   |
| Gains on sales of loans                         | \$—                              | \$4,718             | \$—                 | \$—                       | \$4,718 |
| Service charges on deposit accounts             | 825                              | —                   | —                   | —                         | 825     |
| Other service charges and fees                  | 608                              | 941                 | 2                   | 57                        | 1,608   |
| Gains on calls of available for sale securities | 8                                | —                   | —                   | —                         | 8       |
| Other income                                    | 23                               | 38                  | 232                 | 277                       | 570     |
| Total noninterest income                        | \$1,464                          | \$5,697             | \$234               | \$334                     | \$7,729 |

(Dollars in thousands)

|   | Three Months Ended June 30, 2011 |                     |                     |                           |         |
|---|----------------------------------|---------------------|---------------------|---------------------------|---------|
|   | Retail<br>Banking                | Mortgage<br>Banking | Consumer<br>Finance | Other and<br>Eliminations | Total   |
| Gains on sales of loans                         | \$—                              | \$3,696             | \$—                 | \$—                       | \$3,696 |
| Service charges on deposit accounts             | 846                              | —                   | —                   | —                         | 846     |
| Other service charges and fees                  | 576                              | 699                 | 2                   | 37                        | 1,314   |
| Gains on calls of available for sale securities | —                                | —                   | —                   | —                         | —       |
| Other income                                    | 79                               | 4                   | 155                 | 264                       | 502     |
| Total noninterest income                        | \$1,501                          | \$4,399             | \$157               | \$301                     | \$6,358 |

(Dollars in thousands)

|   | Six Months Ended June 30, 2012 |                     |                     |                           |          |
|---|--------------------------------|---------------------|---------------------|---------------------------|----------|
|   | Retail<br>Banking              | Mortgage<br>Banking | Consumer<br>Finance | Other and<br>Eliminations | Total    |
| Gains on sales of loans                         | \$—                            | \$8,821             | \$—                 | \$—                       | \$8,821  |
| Service charges on deposit accounts             | 1,626                          | —                   | —                   | —                         | 1,626    |
| Other service charges and fees                  | 1,178                          | 1,701               | 6                   | 91                        | 2,976    |
| Gains on calls of available for sale securities | 8                              | —                   | —                   | —                         | 8        |
| Other income                                    | 218                            | 394                 | 488                 | 581                       | 1,681    |
| Total noninterest income                        | \$3,030                        | \$10,916            | \$494               | \$672                     | \$15,112 |



Table of Contents

(Dollars in thousands)

|   | Six Months Ended June 30, 2011 |                     |                     |                           |          |
|---|--------------------------------|---------------------|---------------------|---------------------------|----------|
|   | Retail<br>Banking              | Mortgage<br>Banking | Consumer<br>Finance | Other and<br>Eliminations | Total    |
| Gains on sales of loans                         | \$—                            | \$7,496             | \$—                 | \$—                       | \$7,496  |
| Service charges on deposit accounts             | 1,694                          | —                   | —                   | —                         | 1,694    |
| Other service charges and fees                  | 1,095                          | 1,228               | 4                   | 79                        | 2,406    |
| Gains on calls of available for sale securities | —                              | —                   | —                   | —                         | —        |
| Other income                                    | 186                            | 214                 | 335                 | 484                       | 1,219    |
| Total noninterest income                        | \$2,975                        | \$8,938             | \$339               | \$ 563                    | \$12,815 |

Total noninterest income increased \$1.4 million, or 21.6 percent, in the second quarter of 2012 and \$2.3 million, or 17.9 percent, in the first half of 2012, compared to the same periods in 2011. These increases resulted from higher gains on sales of loans and ancillary loan production fees at the Mortgage Banking segment due to the increase in loan originations and sales, coupled with increases in other income from higher activity-based debit card interchange fees at the Retail Banking segment and higher investment services fees at C&F Investment Services. Partially offsetting these increases was a decline in the Retail Banking segment's service charges on deposit accounts, which resulted from lower overdraft fees during the second quarter and first half of 2012.

## Noninterest Expense

TABLE 4: Noninterest Expenses

(Dollars in thousands)

|                                      | Three Months Ended June 30, 2012 |                     |                     |                           |          |
|--------------------------------------|----------------------------------|---------------------|---------------------|---------------------------|----------|
|                                      | Retail<br>Banking                | Mortgage<br>Banking | Consumer<br>Finance | Other and<br>Eliminations | Total    |
| Salaries and employee benefits       | \$3,742                          | \$3,810             | \$1,846             | \$ 198                    | \$9,596  |
| Occupancy expenses                   | 974                              | 485                 | 213                 | 5                         | 1,677    |
| Other expenses:                      |                                  |                     |                     |                           |          |
| OREO expenses                        | 200                              | —                   | —                   | —                         | 200      |
| Provision for indemnification losses | —                                | 330                 | —                   | —                         | 330      |
| Other expenses                       | 1,688                            | 798                 | 838                 | 100                       | 3,424    |
| Total other expenses                 | 1,888                            | 1,128               | 838                 | 100                       | 3,954    |
| Total noninterest expenses           | \$6,604                          | \$5,423             | \$2,897             | \$ 303                    | \$15,227 |

(Dollars in thousands)

|                                      | Three Months Ended June 30, 2011 |                     |                     |                           |          |
|--------------------------------------|----------------------------------|---------------------|---------------------|---------------------------|----------|
|                                      | Retail<br>Banking                | Mortgage<br>Banking | Consumer<br>Finance | Other and<br>Eliminations | Total    |
| Salaries and employee benefits       | \$3,586                          | \$2,978             | \$1,674             | \$ 192                    | \$8,430  |
| Occupancy expenses                   | 979                              | 461                 | 164                 | 7                         | 1,611    |
| Other expenses:                      |                                  |                     |                     |                           |          |
| OREO expenses                        | 419                              | 11                  | —                   | —                         | 430      |
| Provision for indemnification losses | —                                | 175                 | —                   | —                         | 175      |
| Other expenses                       | 1,819                            | 709                 | 714                 | 81                        | 3,323    |
| Total other expenses                 | 2,238                            | 895                 | 714                 | 81                        | 3,928    |
| Total noninterest expenses           | \$6,803                          | \$4,334             | \$2,552             | \$ 280                    | \$13,969 |

Table of Contents

(Dollars in thousands)

Six Months Ended June 30, 2012

|                                      | Retail<br>Banking | Mortgage<br>Banking | Consume<br>Finance | Other and<br>Eliminations | Total    |
|--------------------------------------|-------------------|---------------------|--------------------|---------------------------|----------|
| Salaries and employee benefits       | \$7,748           | \$7,393             | \$3,722            | \$ 475                    | \$19,338 |
| Occupancy expenses                   | 2,006             | 961                 | 418                | 13                        | 3,398    |
| Other expenses:                      |                   |                     |                    |                           |          |
| OREO expenses                        | 442               | —                   | —                  | —                         | 442      |
| Provision for indemnification losses | —                 | 455                 | —                  | —                         | 455      |
| Other expenses                       | 3,324             | 1,529               | 1,556              | 242                       | 6,651    |
| Total other expenses                 | 3,766             | 1,984               | 1,556              | 242                       | 7,548    |
| Total noninterest expenses           | \$13,519          | \$10,338            | \$5,696            | \$ 731                    | \$30,284 |

(Dollars in thousands)

Six Months Ended June 30, 2011

|                                      | Retail<br>Banking | Mortgage<br>Banking | Consumer<br>Finance | Other and<br>Eliminations | Total    |
|--------------------------------------|-------------------|---------------------|---------------------|---------------------------|----------|
| Salaries and employee benefits       | \$7,486           | \$5,723             | \$3,329             | \$ 384                    | \$16,922 |
| Occupancy expenses                   | 1,908             | 947                 | 269                 | 13                        | 3,137    |
| Other expenses:                      |                   |                     |                     |                           |          |
| OREO expenses                        | 776               | 11                  | —                   | —                         | 787      |
| Provision for indemnification losses | —                 | 406                 | —                   | —                         | 406      |
| Other expenses                       | 3,529             | 1,543               | 1,370               | 224                       | 6,666    |
| Total other expenses                 | 4,305             | 1,960               | 1,370               | 224                       | 7,859    |
| Total noninterest expenses           | \$13,699          | \$8,630             | \$4,968             | \$ 621                    | \$27,918 |

Total noninterest expenses increased \$1.3 million, or 9.0 percent, in the second quarter of 2012 and \$2.4 million, or 8.5 percent, in the first half of 2012, compared to the same periods in 2011. These increases resulted primarily from higher personnel costs at (1) the Retail Banking segment due to increased staffing in the branch network to support customer service initiatives, (2) the Mortgage Banking segment due to higher production and income based compensation, which resulted from the increase in loan production and sales during the second quarter and first half of 2012, as well as higher non-production compensation in order to manage the increasingly complex regulatory environment in which the mortgage banking segment operates and (3) the Consumer Finance segment due to an increase in the number of personnel to support loan growth. In addition, there were increases in occupancy expense during the second quarter and first half of 2012 as compared to the same periods of 2011 at the Consumer Finance segment due to the relocation in April 2011 to a larger leased headquarters building and depreciation and maintenance of technology to support growth. The Mortgage Banking segment recognized higher provisions for indemnification losses during the second quarter and first half of 2012 as compared to the same periods of 2011 as a result of higher sales volumes during both periods of 2012. These increases were partially offset by lower (1) FDIC insurance premiums and loan and OREO expenses at the Retail Banking segment and (2) legal and consulting fees at the Mortgage Banking segment.

## Income Taxes

Income tax expense for the second quarter of 2012 totaled \$2.0 million, resulting in an effective tax rate of 31.9 percent, compared to \$1.3 million and 29.9 percent for the second quarter of 2011. Income tax expense for the first half of 2012 totaled \$3.7 million, resulting in an effective tax rate of 31.7 percent, compared to \$2.6 million and 30.1 percent for the first half of 2011. The increases in the effective tax rates during the second quarter and first half of 2012 were a result of higher pre-tax earnings at the non-bank business segments, which are not exempt from state income taxes and do not generate tax-exempt income.



Table of Contents

## ASSET QUALITY

## Allowance for Loan Losses

The allowance for loan losses represents an amount that, in our judgment, will be adequate to absorb any losses on existing loans that may become uncollectible. The provision for loan losses increases the allowance, and loans charged off, net of recoveries, reduce the allowance. The following tables summarize the allowance activity for the periods indicated:

TABLE 5: Allowance for Loan Losses

| (Dollars in thousands)   | Three Months Ended June |          |      |   |
|--|-------------------------|----------|------|---|
|  | 30,                     |          |      |   |
|  | 2012                    | 2011     |      |   |
| Allowance, beginning of period   | \$34,757                | \$28,765 |      |   |
| Provision for loan losses:   |                         |          |      |   |
| Retail Banking segment   | 750                     | 1,500    |      |   |
| Mortgage Banking segment   | 30                      | 15       |      |   |
| Consumer Finance segment   | 2,080                   | 1,875    |      |   |
| Total provision for loan losses  | 2,860                   | 3,390    |      |   |
| Loans charged off:   |                         |          |      |   |
| Real estate—residential mortgage   | 516                     | 138      |      |   |
| Real estate—construction 1   | —                       | —        |      |   |
| Commercial, financial and agricultural 2   | 402                     | 949      |      |   |
| Equity lines   | —                       | —        |      |   |
| Consumer   | 81                      | 97       |      |   |
| Consumer finance   | 1,902                   | 1,426    |      |   |
| Total loans charged off  | 2,901                   | 2,610    |      |   |
| Recoveries of loans previously charged off:  |                         |          |      |   |
| Real estate—residential mortgage   | 13                      | 3        |      |   |
| Real estate—construction 1   | —                       | —        |      |   |
| Commercial, financial and agricultural 2   | 1                       | 4        |      |   |
| Equity lines   | —                       | —        |      |   |
| Consumer   | 50                      | 19       |      |   |
| Consumer finance   | 677                     | 640      |      |   |
| Total recoveries   | 741                     | 666      |      |   |
| Net loans charged off  | 2,160                   | 1,944    |      |   |
| Allowance, end of period   | \$35,457                | \$30,211 |      |   |
| Ratio of annualized net charge-offs to average total loans outstanding during period for Retail Banking and Mortgage Banking | 0.92                    | %        | 1.14 | % |
| Ratio of annualized net charge-offs to average total loans outstanding during period for Consumer Finance                    | 1.90                    | %        | 1.34 | % |



Table of Contents

| (Dollars in thousands)   | Six Months Ended June 30, |   |          |   |
|--|---------------------------|---|----------|---|
|  | 2012                      |   | 2011     |   |
| Allowance, beginning of period   | \$33,677                  |   | \$28,840 |   |
| Provision for loan losses:   |                           |   |          |   |
| Retail Banking segment   | 1,500                     |   | 2,550    |   |
| Mortgage Banking segment   | 105                       |   | 35       |   |
| Consumer Finance segment   | 3,980                     |   | 3,625    |   |
| Total provision for loan losses  | 5,585                     |   | 6,210    |   |
| Loans charged off:   |                           |   |          |   |
| Real estate—residential mortgage   | 638                       |   | 283      |   |
| Real estate—construction 1   | —                         |   | —        |   |
| Commercial, financial and agricultural 2   | 402                       |   | 2,530    |   |
| Equity lines   | 121                       |   | 9        |   |
| Consumer   | 171                       |   | 167      |   |
| Consumer finance   | 4,102                     |   | 3,115    |   |
| Total loans charged off  | 5,434                     |   | 6,104    |   |
| Recoveries of loans previously charged off:  |                           |   |          |   |
| Real estate—residential mortgage   | 23                        |   | 14       |   |
| Real estate—construction 1   | —                         |   | —        |   |
| Commercial, financial and agricultural 2   | 36                        |   | 21       |   |
| Equity lines   | —                         |   | —        |   |
| Consumer   | 99                        |   | 41       |   |
| Consumer finance   | 1,471                     |   | 1,189    |   |
| Total recoveries   | 1,629                     |   | 1,265    |   |
| Net loans charged off  | 3,805                     |   | 4,839    |   |
| Allowance, end of period   | \$35,457                  |   | \$30,211 |   |
| Ratio of annualized net charge-offs to average total loans outstanding during period for Retail Banking and Mortgage Banking | 0.58                      | % | 1.42     | % |
| Ratio of annualized net charge-offs to average total loans outstanding during period for Consumer Finance                    | 2.08                      | % | 1.67     | % |

1 Includes the Corporation's real estate construction lending and consumer real estate lot lending.

2 Includes the Corporation's commercial real estate lending, land acquisition and development lending, builder line lending and commercial business lending.

Table 6 discloses the allocation of the allowance for loan losses at June 30, 2012 and December 31, 2011.

TABLE 6: Allocation of Allowance for Loan Losses

| (Dollars in thousands)                   | June 30,<br>2012 | December 31,<br>2011 |
|--|------------------|----------------------|
| Allocation of allowance for loan losses: |                  |                      |
| Real estate—residential mortgage         | \$ 2,340         | \$ 2,379             |
| Real estate—construction 1               | 386              | 480                  |
| Commercial, financial and agricultural 2 | 10,591           | 10,040               |
| Equity lines                             | 921              | 912                  |
| Consumer                                 | 323              | 319                  |
| Consumer finance                         | 20,896           | 19,547               |

|         |    |        |    |        |
|---------|----|--------|----|--------|
| Balance | \$ | 35,457 | \$ | 33,677 |
|---------|----|--------|----|--------|

---

1 Includes the Corporation's real estate construction lending and consumer real estate lot lending.

2 Includes the Corporation's commercial real estate lending, land acquisition and development lending, builder line lending and commercial business lending.

Table of Contents

Loans by credit quality ratings are presented in Table 7 below. The characteristics of these loan ratings are as follows:

Pass rated loans are to persons or business entities with an acceptable financial condition, appropriate collateral margins, appropriate cash flow to service the existing loan, and an appropriate leverage ratio. The borrower has paid all obligations as agreed and it is expected that this type of payment history will continue. When necessary, acceptable personal guarantors support the loan.

Special mention loans have a specifically identified weakness in the borrower's operations and in the borrower's ability to generate positive cash flow on a sustained basis. The borrower's recent payment history is characterized by late payments. The Corporation's risk exposure is mitigated by collateral supporting the loan. The collateral is considered to be well-margined, well maintained, accessible and readily marketable.

Substandard loans are considered to have specific and well-defined weaknesses that jeopardize the viability of the Corporation's credit extension. The payment history for the loan has been inconsistent and the expected or projected primary repayment source may be inadequate to service the loan. The estimated net liquidation value of the collateral pledged and/or ability of the personal guarantor(s) to pay the loan may not adequately protect the Corporation. There is a distinct possibility that the Corporation will sustain some loss if the deficiencies associated with the loan are not corrected in the near term. A substandard loan would not automatically meet our definition of impaired unless the loan is significantly past due and the borrower's performance and financial condition provide evidence that it is probable that the Corporation will be unable to collect all amounts due.

Substandard nonaccrual loans have the same characteristics as substandard loans; however, they have a nonaccrual classification because it is probable that the Corporation will not be able to collect all amounts due.

Doubtful loans have all the weaknesses inherent in a loan that is classified substandard but with the added characteristic that the weaknesses make collection or liquidation in full, on the basis of currently existing facts, conditions, and values, highly questionable and improbable. The possibility of loss is extremely high.

Loss loans are not considered collectible under normal circumstances and there is no realistic expectation for any future payment on the loan. Loss rated loans are fully charged off.

TABLE 7: Credit Quality Indicators

Loans by credit quality indicators as of June 30, 2012 were as follows:

| (Dollars in thousands)                              | Pass       | Special<br>Mention | Substandard | Substandard<br>Nonaccrual | Total <sup>1</sup> |
|---|------------|--------------------|-------------|---------------------------|--------------------|
| Real estate—residential mortgage                    | \$ 140,665 | \$ 2,110           | \$ 2,437    | \$ 1,044                  | \$ 146,256         |
| Real estate—construction <sup>2</sup>               | 2,116      | —                  | 2,867       | —                         | 4,983              |
| Commercial, financial and agricultural <sup>3</sup> | 168,366    | 19,807             | 17,351      | 9,895                     | 215,419            |
| Equity lines  | 31,204     | 1,436              | 841         | 9                         | 33,490             |
| Consumer  | 5,270      | 26                 | 852         | —                         | 6,148              |
|   | \$ 347,621 | \$ 23,379          | \$ 24,348   | \$ 10,948                 | \$ 406,296         |

| (Dollars in thousands) | Performing | Nonperforming | Total      |
|------------------------|------------|---------------|------------|
| Consumer finance       | \$ 263,523 | \$ 259        | \$ 263,782 |

1 At June 30, 2012, the Corporation did not have any loans classified as Doubtful or Loss.

2 Includes the Corporation's real estate construction lending and consumer real estate lot lending.

3 Includes the Corporation's commercial real estate lending, land acquisition and development lending, builder line lending and commercial business lending.

39

---

Table of Contents

Loans by credit quality indicators as of December 31, 2011 were as follows:

| (Dollars in thousands)                   | Pass       | Special<br>Mention | Substandard | Substandard<br>Nonaccrual | Total      |
|--|------------|--------------------|-------------|---------------------------|------------|
| Real estate—residential mortgage         | \$ 140,304 | \$ 1,261           | \$ 3,130    | \$ 2,440                  | \$ 147,135 |
| Real estate—construction 2               | 2,867      | —                  | 2,870       | —                         | 5,737      |
| Commercial, financial and agricultural 3 | 164,448    | 18,787             | 20,931      | 8,069                     | 212,235    |
| Equity lines                             | 31,935     | 298                | 836         | 123                       | 33,192     |
| Consumer                                 | 5,271      | 10                 | 776         | —                         | 6,057      |
|  | \$ 344,825 | \$ 20,356          | \$ 28,543   | \$ 10,632                 | \$ 404,356 |

| (Dollars in thousands) | Performing | Non-performing | Total      |
|------------------------|------------|----------------|------------|
| Consumer finance       | \$ 245,924 | \$ 381         | \$ 246,305 |

1 At December 31, 2011, the Corporation did not have any loans classified as Doubtful or Loss.

2 Includes the Corporation's real estate construction lending and consumer real estate lot lending.

3 Includes the Corporation's commercial real estate lending, land acquisition and development lending, builder line lending and commercial business lending.

The combined Retail Banking and Mortgage Banking segments' allowance for loan losses increased \$431,000 since December 31, 2011, and the provision for loan losses at these combined segments decreased \$980,000 during the first half of 2012, compared to the same period in 2011. The allowance for loan losses to total loans for these combined segments increased to 3.58 percent at June 30, 2012, compared to 3.49 percent at December 31, 2011. The increase in this ratio since 2011 year end was a function of lower net charge-offs during the first six months of 2012, loan growth in the higher-risk commercial, financial and agricultural loans segment of the Retail Banking segment's loan portfolio, and the increase in substandard nonaccrual loans. Substandard nonaccrual loans increased slightly to \$10.9 million at June 30, 2012 from \$10.6 million at December 31, 2011; however, substandard nonaccrual loans decreased \$3.4 million during the second quarter from \$14.0 million at March 31, 2012. The increase from December 31, 2011 to March 31, 2012 was concentrated in the commercial sector of the Retail Banking segment's loan portfolio to which we have allocated the largest portion of the Retail Banking segment's loan loss allowance, and was attributable to one commercial relationship secured by undeveloped residential property, which had been classified as substandard at December 31, 2011 and was placed on substandard nonaccrual status during the first quarter of 2012. This commercial relationship remains in substandard nonaccrual status at June 30, 2012, and the decline since March 31, 2012 was attributable to other nonperforming loan pay-offs, charge-offs and transfers to foreclosed properties. We believe that the current level of the allowance for loan losses at the combined Retail Banking and Mortgage Banking segments is adequate to absorb any losses on existing loans that may become uncollectible. If current economic conditions continue or worsen, a higher level of nonperforming loans may be experienced in future periods, which may then require a higher provision for loan losses.

The Consumer Finance segment's allowance for loan losses increased to \$20.9 million at June 30, 2012 from \$19.5 million at December 31, 2011, and its provision for loan losses increased \$355,000 during the first half of 2012, compared to the same period in 2011. The allowance for loan losses as a percentage of loans at June 30, 2012 was 7.92 percent, as compared with 7.94 percent at December 31, 2011. The increase in the provision for loan losses during the first six months of 2012 was primarily attributable to higher net charge-offs, the level of which was slightly higher than the historically lower levels we had been experiencing. We believe that the current level of the allowance for loan losses at the Consumer Finance segment is adequate to absorb any losses on existing loans that may become uncollectible. However, if unemployment levels remain elevated or increase in the future, or if consumer demand for automobiles falls and results in declining values of automobiles securing outstanding loans, a higher provision for loan losses may become necessary.



Table of Contents

## Nonperforming Assets

Table 8 summarizes nonperforming assets at June 30, 2012 and December 31, 2011.

TABLE 8: Nonperforming Assets

## Retail Banking and Mortgage Banking Segments

|   | June 30,<br>2012 | December<br>31,<br>2011 |        |   |
|---|------------------|-------------------------|--------|---|
| (Dollars in thousands)                        |                  |                         |        |   |
| Nonaccrual loans* - Retail Banking            | \$ 10,948        | \$ 10,011               |        |   |
| Nonaccrual loans - Mortgage Banking           | 369              | 621                     |        |   |
| OREO** - Retail Banking                       | 5,236            | 6,059                   |        |   |
| OREO** - Mortgage Banking                     | —                | —                       |        |   |
| Total nonperforming assets                    | \$ 16,553        | \$ 16,691               |        |   |
| Accruing loans past due for 90 days or more   | \$ 296           | \$ 68                   |        |   |
| Troubled debt restructurings                  | \$ 15,772        | \$ 17,094               |        |   |
| Total loans                                   | \$ 406,296       | \$ 404,356              |        |   |
| Allowance for loan losses                     | \$ 14,561        | \$ 14,130               |        |   |
| Nonperforming assets to total loans and OREO* | 4.02             | %                       | 4.07   | % |
| Allowance for loan losses to total loans      | 3.58             |                         | 3.49   |   |
| Allowance for loan losses to nonaccrual loans | 128.67           |                         | 132.90 |   |

\*Nonaccrual loans include nonaccrual TDRs of \$7.5 million at June 30, 2012 and \$8.44 million at December 31, 2011.

\*\* OREO is recorded at its estimated fair value less cost to sell.

## Consumer Finance Segment

|  | June 30,<br>2012 | December<br>31,<br>2011 |      |   |
|--|------------------|-------------------------|------|---|
| (Dollars in thousands)   |                  |                         |      |   |
| Nonaccrual loans   | \$ 259           | \$ 381                  |      |   |
| Accruing loans past due for 90 days or more                          | \$ —             | \$ —                    |      |   |
| Total loans  | \$ 263,782       | \$ 246,305              |      |   |
| Allowance for loan losses  | \$ 20,896        | \$ 19,547               |      |   |
| Nonaccrual consumer finance loans to total<br>consumer finance loans | 0.10             | %                       | 0.15 | % |
| Allowance for loan losses to total consumer finance<br>loans         | 7.92             |                         | 7.94 |   |

Nonperforming assets of the combined Retail Banking and Mortgage Banking segments totaled \$16.6 million at June 30, 2012, compared to \$16.7 million at December 31, 2011. Nonperforming assets at June 30, 2012 included \$10.9 million of nonaccrual loans at the Retail Banking segment, compared to \$10.0 million at December 31, 2011, and \$5.2 million of foreclosed, or OREO, properties, compared to \$6.1 million at December 31, 2011. Nonaccrual loans primarily consisted of loans for residential real estate secured by residential properties and commercial loans secured by non-residential properties. The increase in nonaccrual loans from December 31, 2011 to June 30, 2012 was

attributable to one \$2.8 million commercial relationship secured by undeveloped residential property, which had been classified as substandard at December 31, 2011 and was placed on substandard nonaccrual status during the first quarter of 2012. The increase in nonaccrual loans attributable to this relationship was partially offset by loan pay-offs, charge-offs and transfers to foreclosed properties. Specific reserves of \$2.7 million have been established for nonaccrual loans. We believe we have provided adequate loan loss reserves based on current appraisals or evaluations of the collateral. In some cases, appraisals have been adjusted to reflect current trends including sales prices, expenses, absorption periods and other current relevant factors. OREO properties at June 30, 2012 primarily consisted of residential and non-residential properties associated with commercial relationships. These properties have been written down to their estimated fair values less cost to sell. The decline in OREO properties since December 31, 2011 resulted from sales during the first half of 2012 as the Corporation continues to focus efforts on disposing of OREO property, offset in part by transfers from loans to OREO.

Nonaccrual loans at the Consumer Finance segment decreased to \$259,000 at June 30, 2012 from \$381,000 at December 31, 2011. As noted above, the allowance for loan losses at the Consumer Finance segment increased from \$19.5 million at December 31, 2011 to \$20.9 million at June 30, 2012, and the ratio of the allowance for loan losses to total consumer finance loans was 7.92 percent as of June 30, 2012, as compared with 7.94 percent at December 31, 2011. Nonaccrual consumer finance loans remain relatively low compared to the allowance for loan losses and total consumer finance loan portfolio because the Consumer Finance segment generally initiates repossession of loan collateral once a loan is 60 days or more past due but before the loan reaches 90 days or more past due and is evaluated for nonaccrual status.



Table of Contents

We measure impaired loans based on the present value of expected future cash flows discounted at the effective interest rate of the loan or, as a practical expedient, at the loan's observable market price or the fair value of the collateral if the loan is collateral dependent. We maintain a valuation allowance to the extent that the measure of the impaired loan is less than the recorded investment. TDRs occur when we agree to significantly modify the original terms of a loan by granting a concession due to the deterioration in the financial condition of the borrower. These concessions typically are made for loss mitigation purposes and could include reductions in the interest rate, payment extensions, forgiveness of principal, forbearance or other actions. TDRs are considered impaired loans.

TABLE 9: Impaired Loans

Impaired loans, which include TDRs of \$15.8 million, and the related allowance at June 30, 2012, were as follows:

| (Dollars in thousands)                   | Recorded<br>Investment<br>in<br>Loans | Unpaid<br>Principal<br>Balance | Related<br>Allowance | Average<br>Balance-Impaired<br>Loans | Interest<br>Income<br>Recognized |
|--|---------------------------------------|--------------------------------|----------------------|--------------------------------------|----------------------------------|
| Real estate – residential mortgage       | \$2,272                               | \$2,309                        | \$426                | \$ 2,298                             | \$66                             |
| Real estate – construction:              |                                       |                                |                      |                                      |                                  |
| Construction lending                     | —                                     | —                              | —                    | —                                    | —                                |
| Consumer lot lending                     | —                                     | —                              | —                    | —                                    | —                                |
| Commercial, financial and agricultural:  |                                       |                                |                      |                                      |                                  |
| Commercial real estate lending           | 5,084                                 | 5,329                          | 1,447                | 5,409                                | 74                               |
| Land acquisition and development lending | 8,185                                 | 8,185                          | 2,031                | 8,290                                | 176                              |
| Builder line lending                     | 1,919                                 | 1,919                          | 455                  | 1,920                                | —                                |
| Commercial business lending              | 636                                   | 639                            | 145                  | 642                                  | 6                                |
| Equity lines                             | —                                     | —                              | —                    | —                                    | —                                |
| Consumer                                 | 432                                   | 432                            | 65                   | 432                                  | 8                                |
| Total                                    | \$18,528                              | \$18,813                       | \$4,569              | \$ 18,991                            | \$330                            |

Impaired loans, which include TDRs of \$17.1 million, and the related allowance at December 31, 2011, were as follows:

| (Dollars in thousands)                   | Recorded<br>Investment<br>in<br>Loans | Unpaid<br>Principal<br>Balance | Related<br>Allowance | Average<br>Balance-Impaired<br>Loans | Interest<br>Income<br>Recognized |
|--|---------------------------------------|--------------------------------|----------------------|--------------------------------------|----------------------------------|
| Real estate – residential mortgage       | \$3,482                               | \$3,698                        | \$657                | \$ 3,723                             | \$137                            |
| Commercial, financial and agricultural:  |                                       |                                |                      |                                      |                                  |
| Commercial real estate lending           | 5,861                                 | 5,957                          | 1,464                | 6,195                                | 102                              |
| Land acquisition and development lending | 5,490                                 | 5,814                          | 1,331                | 6,116                                | 372                              |
| Builder line lending                     | 2,285                                 | 2,285                          | 318                  | 2,397                                | —                                |
| Commercial business lending              | 652                                   | 654                            | 161                  | 663                                  | 6                                |
| Equity lines                             | —                                     | —                              | —                    | —                                    | —                                |
| Consumer                                 | 324                                   | 324                            | 49                   | 324                                  | 14                               |
| Total                                    | \$18,094                              | \$18,732                       | \$3,980              | \$ 19,418                            | \$631                            |

The balance of impaired loans was \$18.5 million, including \$15.8 million of TDRs at June 30, 2012, for which there were specific valuation allowances of \$4.6 million. At December 31, 2011, the balance of impaired loans was \$18.1 million, including \$17.1 million of TDRs, for which there were specific valuation allowances of \$4.0 million. The

Corporation has no obligation to fund additional advances on its impaired loans. The increase in impaired loans from December 31, 2011 to June 30, 2012 was primarily due to one commercial relationship secured by undeveloped residential property, which was transferred to substandard nonaccrual status in the first quarter of 2012.

TDRs declined from \$17.1 million at December 31, 2011 to \$15.8 million at June 30, 2012 as a result of scheduled payments, pay-offs and charge-offs. As the Retail Banking segment's loan portfolio remains under credit quality pressure, the Corporation may use loan modifications as a responsible approach to managing asset quality when working with borrowers who are experiencing financial difficulty, which may result in additional TDRs.

Table of Contents

TDRs at June 30, 2012 and December 31, 2011 were as follows:

TABLE 10: Troubled Debt Restructurings

| (Dollars in thousands)       | June 30,<br>2012 | December<br>31,<br>2011 |
|------------------------------|------------------|-------------------------|
| Accruing TDRs                | \$ 8,267         | \$ 8,653                |
| Nonaccrual TDRs <sup>1</sup> | 7,505            | 8,441                   |
| Total TDRs <sup>2</sup>      | \$ 15,772        | \$ 17,094               |

1 Included in nonaccrual loans in Table 8: Nonperforming Assets.

2 Included in impaired loans in Table 9: Impaired Loans.

While TDRs are considered impaired loans, not all TDRs are on nonaccrual status. If a loan was on nonaccrual status at the time of the TDR modification, the loan will remain on nonaccrual status following the modification and may be returned to accrual status based on the Corporation's policy for returning loans to accrual status. If a loan was accruing prior to being modified as a TDR and if the Corporation concludes that the borrower is able to make such modified payments, and there are no other factors or circumstances that would cause it to conclude otherwise, the TDR will remain on an accruing status.

## FINANCIAL CONDITION

At June 30, 2012, the Corporation had total assets of \$949.7 million compared to \$928.1 million at December 31, 2011. The increase was principally a result of loan growth at the Consumer Finance segment and an increase in loans held for sale at the Mortgage Banking segment, which were offset in part by a decline in the Retail Banking segment's securities portfolio resulting from maturities and calls during the first half of 2012.

## Loan Portfolio

The following table sets forth the composition of the Corporation's loans held for investment in dollar amounts and as a percentage of the Corporation's total gross loans held for investment at the dates indicated.

TABLE 11: Summary of Loans Held for Investment

| (Dollars in thousands)                              | June 30, 2012 |         | December 31, 2011 |         |   |
|---|---------------|---------|-------------------|---------|---|
|   | Amount        | Percent | Amount            | Percent |   |
| Real estate – residential mortgage                  | \$146,256     | 22      | % \$147,135       | 22      | % |
| Real estate – construction <sup>1</sup>             | 4,983         | 1       | 5,737             | 1       |   |
| Commercial, financial and agricultural <sup>2</sup> | 215,419       | 32      | 212,235           | 33      |   |
| Equity lines  | 33,490        | 5       | 33,192            | 5       |   |
| Consumer  | 6,148         | 1       | 6,057             | 1       |   |
| Consumer finance                                    | 263,782       | 39      | 246,305           | 38      |   |
| Total loans   | 670,078       | 100     | % 650,661         | 100     | % |
| Less allowance for loan losses                      | (35,457 )     |         | (33,677 )         |         |   |
| Total loans, net                                    | \$634,621     |         | \$616,984         |         |   |

1 Includes the Corporation's real estate construction lending and consumer real estate lot lending.

3 Includes the Corporation's commercial real estate lending, land acquisition and development lending, builder line lending and commercial business lending.

The increase in total loans held for investment occurred in the commercial, financial and agricultural segment as a result of growth in commercial real estate loans and in the consumer finance category as a result of increased demand for automobiles and increased market penetration.

#### Investment Securities

The investment portfolio plays a primary role in the management of the Corporation's interest rate sensitivity. In addition, the portfolio serves as a source of liquidity and is used as needed to meet collateral requirements. The investment portfolio consists of securities available for sale, which may be sold in response to changes in market interest rates, changes in prepayment risk, increases in loan demand, general liquidity needs and other similar factors. These securities are carried at estimated fair value. At June 30, 2012 and December 31, 2011, all securities in the Corporation's investment portfolio were classified as available for sale.

Table of Contents

The following table sets forth the composition of the Corporation's securities available for sale at fair value and as a percentage of the Corporation's total securities available for sale at the dates indicated.

TABLE 12: Securities Available for Sale

| (Dollars in thousands)                            | June 30, 2012 |         | December 31, 2011 |         |   |
|---|---------------|---------|-------------------|---------|---|
|   | Amount        | Percent | Amount            | Percent |   |
| U.S. government agencies and corporations         | \$ 13,532     | 10      | % \$ 15,283       | 10      | % |
| Mortgage-backed securities                        | 2,707         | 2       | 2,216             | 2       |   |
| Obligations of states and political subdivisions  | 124,955       | 88      | 127,079           | 88      |   |
| Total debt securities                             | 141,194       | 100     | 144,578           | 100     |   |
| Preferred stock                                   | 95            | *       | 68                | *       |   |
| Total available for sale securities at fair value | \$ 141,289    | 100     | % \$ 144,646      | 100     | % |

\* Less than one percent.

## Deposits

The Corporation's predominant source of funds is depository accounts, which consist of demand deposits, savings and money market accounts, and time deposits. The Corporation's deposits are principally provided by individuals and businesses located within the communities served.

Deposits totaled \$657.4 million at June 30, 2012, compared to \$646.4 million at December 31, 2011. The increase from December 31, 2011 occurred primarily in noninterest-bearing demand deposits, which increased \$13.9 million, or 14.5 percent, from December 31, 2011 to June 30, 2012, due to higher account balances for both personal and business depositors. Savings and interest-bearing demand deposits increased \$12.9 million, or 5.3 percent, since December 31, 2011, while time deposits declined \$15.7 million, or 5.1 percent, since December 31, 2011. This shift in the mix of deposits to shorter-term, lower rate interest-bearing demand deposits has occurred as depositors are positioning for flexibility in the availability of their funds in the event of an upward shift in interest rates. The Corporation had \$1.7 million in brokered money market deposits outstanding at June 30, 2012, compared to no brokered deposits at December 31, 2011. The source of these brokered deposits is uninvested cash balances held in third-party brokerage sweep accounts. The Corporation uses brokered deposits as a means of diversifying liquidity sources, as opposed to a long-term deposit gathering strategy.

## Borrowings

Borrowings totaled \$176.0 million at June 30, 2012, compared to \$161.2 million at December 31, 2011, as the Corporation used short-term borrowings to meet the short-term funding needs at the Mortgage Banking segment.

## Off-Balance Sheet Arrangements

As of June 30, 2012, there have been no material changes to the off-balance sheet arrangements disclosed in "Management's Discussion and Analysis" in the Corporation's Annual Report on Form 10-K for the year ended December 31, 2011.

## Contractual Obligations

As of June 30, 2012, there have been no material changes outside the ordinary course of business to the contractual obligations disclosed in "Management's Discussion and Analysis" in the Corporation's Annual Report on Form 10-K for

the year ended December 31, 2011.

### Liquidity

The objective of the Corporation's liquidity management is to ensure the continuous availability of funds to satisfy the credit needs of our customers and the demands of our depositors, creditors and investors. Stable core deposits and a strong capital position are the foundation for the Corporation's liquidity position. Additional sources of liquidity available to the Corporation include cash flows from operations, loan payments and payoffs, deposit growth, sales of securities, the issuance of brokered certificates of deposit and the capacity to borrow additional funds.

Liquid assets, which include cash and due from banks, interest-bearing deposits at other banks, federal funds sold and nonpledged securities available for sale, at June 30, 2012 totaled \$52.8 million, compared to \$49.2 million at December 31, 2011. The Corporation's funding sources, including the capacity, amount outstanding and amount available at June 30, 2012 are presented in Table 13: Funding Sources.

Table of Contents

TABLE 13: Funding Sources

| (Dollars in thousands)               | Capacity  | June 30, 2012 |            |
|--------------------------------------|-----------|---------------|------------|
|                                      |           | Outstanding   | Available  |
| Federal funds purchased              | \$59,000  | \$ 16,627     | \$42,373   |
| Repurchase agreements                | 5,000     | 5,000         | —          |
| Borrowings from FHLB                 | 111,194   | 52,500        | 58,694     |
| Borrowings from Federal Reserve Bank | 48,648    | —             | 48,648     |
| Revolving line of credit             | 120,000   | 75,487        | 44,513     |
| Total                                | \$343,842 | \$ 149,614    | \$ 194,228 |

We have no reason to believe these arrangements will not be renewed at maturity. Additional loans and securities are also available that can be pledged as collateral for future borrowings from the Federal Reserve Bank and the FHLB above the current lendable collateral value. From December 31, 2011 to June 30, 2012, the Corporation's available funding from the sources identified in Table 13 decreased from \$221.9 million to \$194.2 million. This decline resulted primarily from the utilization of federal funds purchased to meet the short-term funding needs of the Mortgage Banking segment. We do not believe this decrease represents a material change to our liquidity position.

As a result of the Corporation's management of liquid assets and the ability to generate liquidity through liability funding, management believes that the Corporation maintains overall liquidity sufficient to satisfy its operational requirements and contractual obligations.

## Capital Resources

The Corporation's and the Bank's actual capital amounts and ratios are presented in the following table.

TABLE 14: Capital Ratios

| (Dollars in thousands)                   | Actual     |       | Minimum Capital Requirements |       | Minimum To Be Well Capitalized Under Prompt Corrective Action Provisions |       |
|--|------------|-------|------------------------------|-------|--|-------|
|  | Amount     | Ratio | Amount                       | Ratio | Amount   | Ratio |
| As of June 30, 2012:                     |            |       |                              |       |  |       |
| Total Capital (to Risk-Weighted Assets)  |            |       |                              |       |  |       |
| Corporation                              | \$ 110,584 | 15.6  | % \$56,646                   | 8.0   | % N/A  | N/A   |
| Bank                                     | 108,372    | 15.4  | 56,455                       | 8.0   | \$70,569   | 10.0  |
| Tier 1 Capital (to Risk-Weighted Assets) |            |       |                              |       |  |       |
| Corporation                              | 101,405    | 14.3  | 28,323                       | 4.0   | N/A  | N/A   |
| Bank                                     | 99,222     | 14.1  | 28,228                       | 4.0   | 42,341   | 6.0   |
| Tier 1 Capital (to Average Assets)       |            |       |                              |       |  |       |
| Corporation                              | 101,405    | 11.0  | 36,728                       | 4.0   | N/A  | N/A   |
| Bank                                     | 99,222     | 10.8  | 36,708                       | 4.0   | 45,885   | 5.0   |

As of December 31, 2011:

|  |           |      |            |     |   |          |      |   |
|--|-----------|------|------------|-----|---|----------|------|---|
| Total Capital (to Risk-Weighted Assets)  |           |      |            |     |   |          |      |   |
| Corporation                              | \$113,427 | 16.4 | % \$55,205 | 8.0 | % | N/A      | N/A  |   |
| Bank                                     | 111,029   | 16.2 | 54,999     | 8.0 |   | \$68,749 | 10.0 | % |
| Tier 1 Capital (to Risk-Weighted Assets) |           |      |            |     |   |          |      |   |
| Corporation                              | 104,492   | 15.1 | 27,603     | 4.0 |   | N/A      | N/A  |   |
| Bank                                     | 102,126   | 14.9 | 27,500     | 4.0 |   | 41,249   | 6.0  |   |
| Tier 1 Capital (to Average Assets)       |           |      |            |     |   |          |      |   |
| Corporation                              | 104,492   | 11.5 | 36,362     | 4.0 |   | N/A      | N/A  |   |
| Bank                                     | 102,126   | 11.3 | 36,252     | 4.0 |   | 45,315   | 5.0  |   |

On April 11, 2012, the Corporation redeemed the remaining 10,000 shares of its Preferred Stock issued to Treasury in January 2009 under the CPP. The redemption consisted of \$10.0 million in liquidation value and \$78,000 of accrued and unpaid dividends associated with the Preferred Stock. As a result of this redemption, the Corporation will pay no future dividends on the Preferred Stock. Further, in connection with this redemption, the Corporation accelerated the accretion of the remaining preferred stock discount, which reduced net income available to common shareholders by approximately \$151,000 in the second quarter of 2012, but eliminated any future accretion.



## Table of Contents

The Corporation's Tier One Capital and Total Capital presented in Table 14 include \$20.0 million of trust preferred securities. The Federal Reserve Board, acting in concert with the other federal banking regulatory agencies, has published proposed rules that, if adopted, would generally implement the Basel III capital standards and impose upon bank holding companies with under \$15 billion in total consolidated assets a ten-year phase-out period for trust preferred securities from Tier 1 capital. The Corporation anticipates that the Federal Reserve Board will adopt a final version of these proposed rules in the near future.

### Effects of Inflation and Changing Prices

The Corporation's financial statements included herein have been prepared in accordance with accounting principles generally accepted in the United States (GAAP). GAAP presently requires the Corporation to measure financial position and operating results primarily in terms of historic dollars. Changes in the relative value of money due to inflation or recession are generally not considered. The primary effect of inflation on the operations of the Corporation is reflected in increased operating costs. In management's opinion, changes in interest rates affect the financial condition of a financial institution to a far greater degree than changes in the inflation rate. While interest rates are greatly influenced by changes in the inflation rate, they do not necessarily change at the same rate or in the same magnitude as the inflation rate. Interest rates are highly sensitive to many factors that are beyond the control of the Corporation, including changes in the expected rate of inflation, the influence of general and local economic conditions and the monetary and fiscal policies of the United States government, its agencies and various other governmental regulatory authorities.

### ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

There have been no significant changes from the quantitative and qualitative disclosures made in the Corporation's Annual Report on Form 10-K for the year ended December 31, 2011.

### ITEM 4. CONTROLS AND PROCEDURES

The Corporation's management, including the Corporation's Chief Executive Officer and the Chief Financial Officer, has evaluated the effectiveness of the Corporation's disclosure controls and procedures (as defined in Rule 13a-15(e) under the Securities Exchange Act of 1934, as amended (the Exchange Act)) as of the end of the period covered by this report. Based on that evaluation, the Chief Executive Officer and the Chief Financial Officer have concluded that the Corporation's disclosure controls and procedures were effective as of June 30, 2012 to ensure that information required to be disclosed by the Corporation in reports that it files or submits under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in SEC rules and forms and that such information is accumulated and communicated to the Corporation's management, including the Corporation's Chief Executive Officer and Chief Financial Officer, as appropriate to allow timely decisions regarding required disclosure. Because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that the Corporation's disclosure controls and procedures will detect or uncover every situation involving the failure of persons within the Corporation or its subsidiary to disclose material information required to be set forth in the Corporation's periodic reports.

Management of the Corporation is also responsible for establishing and maintaining adequate internal control over financial reporting (as defined in Rule 13a-15(f) under the Exchange Act). There were no changes in the Corporation's internal control over financial reporting during the Corporation's second quarter ended June 30, 2012 that have materially affected, or are reasonably likely to materially affect, the Corporation's internal control over financial reporting.

## PART II - OTHER INFORMATION

ITEM 1A.

RISK FACTORS

There have been no material changes in the risk factors faced by the Corporation from those disclosed in the Corporation's Annual Report on Form 10-K for the year ended December 31, 2011.

ITEM 2.

UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

There have been no purchases of the Corporation's Common Stock during 2012.

Table of Contents

ITEM 6.

EXHIBITS

|             |  |
|-------------|--|
| 3.1         | Articles of Incorporation of C&F Financial Corporation (incorporated by reference to Exhibit 3.1 to Form 10-KSB filed March 29, 1996)  |
| 3.1.1       | Amendment to Articles of Incorporation of C&F Financial Corporation establishing Series A Preferred Stock, effective January 8, 2009 (incorporated by reference to Exhibit 3.1.1 to Form 8-K filed January 14, 2009) |
| 3.2         | Amended and Restated Bylaws of C&F Financial Corporation, as adopted October 16, 2007 (incorporated by reference to Exhibit 3.2 to Form 8-K filed October 22, 2007)  |
| 4.1         | Certificate of Designations for 20,000 shares of Fixed Rate Cumulative Perpetual Preferred Stock, Series A (incorporated by reference to Exhibit 3.1.1 to Form 8-K filed January 14, 2009)                           |
| 4.2         | Warrant to Purchase up to 167,504 shares of Common Stock, dated January 9, 2009 (incorporated by reference to Exhibit 4.2 to Form 8-K filed January 14, 2009)  |
| 10.28       | Letter Agreement, dated April 11, 2012, between C&F Financial Corporation and the United States Department of the Treasury (incorporated by reference to Exhibit 10.28 to Form 8-K filed April 12, 2012)             |
| <u>31.1</u> | Certification of CEO pursuant to Rule 13a-14(a)  |
| <u>31.2</u> | Certification of CFO pursuant to Rule 13a-14(a)  |
| <u>32</u>   | Certification of CEO/CFO pursuant to 18 U.S.C. Section 1350  |
| 101.INS     | XBRL Instance Document   |
| 101.SCH     | XBRL Taxonomy Extension Schema Document  |
| 101.CAL     | XBRL Taxonomy Extension Calculation Linkbase Document  |
| 101.DEF     | XBRL Taxonomy Extension Definition Linkbase Document   |
| 101.LAB     | XBRL Taxonomy Extension Label Linkbase Document  |
| 101.PRE     | XBRL Taxonomy Presentation Linkbase Document   |

Table of Contents

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.

C&F FINANCIAL CORPORATION  
(Registrant)

Date August 7, 2012

/s/ Larry G. Dillon  
Larry G. Dillon  
Chairman, President and Chief Executive  
Officer  
(Principal Executive Officer)

Date August 7, 2012

/s/ Thomas F. Cherry  
Thomas F. Cherry  
Executive Vice President,  
Chief Financial Officer and Secretary  
(Principal Financial and Accounting  
Officer)