

C & F FINANCIAL CORP  
Form 10-Q  
November 06, 2009  
Table of Contents

**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 September 30, 2009

**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)

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

**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

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 November 3, 2009, the latest practicable date for determination, 3,047,241 shares of common stock, \$1.00 par value, of the registrant were outstanding.

**Table of Contents**

**TABLE OF CONTENTS**

	<b>Page</b>
<u>Part I - Financial Information</u>	
Item 1. <u>Financial Statements</u>	
<u>Consolidated Balance Sheets - September 30, 2009 (unaudited) and December 31, 2008</u>	1
<u>Consolidated Statements of Income (unaudited) - Three months and nine months ended September 30, 2009 and 2008</u>	2
<u>Consolidated Statements of Shareholders' Equity (unaudited) - Nine months ended September 30, 2009 and 2008</u>	3
<u>Consolidated Statements of Cash Flows (unaudited) - Nine months ended September 30, 2009 and 2008</u>	5
<u>Notes to Consolidated Financial Statements (unaudited)</u>	6
Item 2. <u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	20
Item 3. <u>Quantitative and Qualitative Disclosures About Market Risk</u>	40
Item 4. <u>Controls and Procedures</u>	40
<u>Part II - Other Information</u>	
Item 1A. <u>Risk Factors</u>	41
Item 2. <u>Unregistered Sales of Equity Securities and Use of Proceeds</u>	41
Item 6. <u>Exhibits</u>	42
<u>Signatures</u>	43

**Table of Contents****PART I - FINANCIAL INFORMATION****ITEM 1. FINANCIAL STATEMENTS****CONSOLIDATED BALANCE SHEETS**

(In thousands, except for share and per share amounts)

	September 30, 2009 (Unaudited)	December 31, 2008
<b>ASSETS</b>		
Cash and due from banks	\$ 5,402	\$ 9,727
Interest-earning deposits in other banks	1,800	161
Total cash and cash equivalents	7,202	9,888
Securities-available for sale at fair value, amortized cost of \$115,919 and \$100,778, respectively	119,774	100,603
Loans held for sale, net	48,763	37,042
Loans, net of allowance for loan losses of \$22,916 and \$19,806, respectively	617,573	633,017
Federal Home Loan Bank stock	3,887	5,284
Corporate premises and equipment, net	29,882	31,131
Other real estate owned	12,835	1,967
Accrued interest receivable	5,185	5,096
Goodwill	10,724	10,724
Other assets	19,111	20,905
Total assets	\$ 874,936	\$ 855,657
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
Deposits		
Noninterest-bearing demand deposits	\$ 87,647	\$ 77,634
Savings and interest-bearing demand deposits	185,280	204,193
Time deposits	302,478	268,898
Total deposits	575,405	550,725
Short-term borrowings	43,001	56,024
Long-term borrowings	128,712	142,816
Trust preferred capital notes	20,620	20,620
Accrued interest payable	1,637	1,921
Other liabilities	16,022	18,694
Total liabilities	785,397	790,800
Commitments and contingent liabilities		
Shareholders' equity		
Preferred stock (\$1.00 par value, 3,000,000 shares authorized, 20,000 and 0 issued and outstanding, respectively)	20	
Common stock (\$1.00 par value, 8,000,000 shares authorized, 3,045,741 and 3,037,441 shares issued and outstanding, respectively)	2,994	2,992
Additional paid-in capital	20,719	551

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

Retained earnings	64,111	62,361
Warrant to purchase common stock	792	
Discount on preferred stock	(691)	
Accumulated other comprehensive income (loss), net	1,594	(1,047)
Total shareholders' equity	89,539	64,857
Total liabilities and shareholders' equity	\$ 874,936	\$ 855,657

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)**

	<b>Three Months Ended September 30,</b>		<b>Nine Months Ended September 30,</b>	
	<b>2009</b>	<b>2008</b>	<b>2009</b>	<b>2008</b>
<b>Interest income</b>				
Interest and fees on loans	\$ 15,380	\$ 15,325	\$ 44,598	\$ 45,068
Interest on money market investments	1	6	1	25
Interest and dividends on securities				
U.S. government agencies and corporations	96	154	325	374
Tax-exempt obligations of states and political subdivisions	1,086	769	3,095	2,308
Other	62	132	168	423
<b>Total interest income</b>	<b>16,625</b>	<b>16,386</b>	<b>48,187</b>	<b>48,198</b>
<b>Interest expense</b>				
Savings and interest-bearing deposits	363	644	1,372	2,046
Certificates of deposit, \$100 or more	841	998	2,609	3,099
Other time deposits	1,272	1,598	4,025	5,069
Borrowings	993	1,759	3,075	5,172
Trust preferred capital notes	258	320	819	994
<b>Total interest expense</b>	<b>3,727</b>	<b>5,319</b>	<b>11,900</b>	<b>16,380</b>
<b>Net interest income</b>	<b>12,898</b>	<b>11,067</b>	<b>36,287</b>	<b>31,818</b>
<b>Provision for loan losses</b>	<b>4,363</b>	<b>3,145</b>	<b>12,863</b>	<b>8,717</b>
<b>Net interest income after provision for loan losses</b>	<b>8,535</b>	<b>7,922</b>	<b>23,424</b>	<b>23,101</b>
<b>Noninterest income</b>				
Gains on sales of loans	5,464	4,524	19,381	12,915
Service charges on deposit accounts	866	1,022	2,452	2,939
Other service charges and fees	1,246	959	3,846	2,826
Gains (losses) on calls and sales of available for sale securities	(22)	168	8	221
Other-than-temporary impairment of available for sale securities		(1,522)		(1,522)
Other income	1,006	672	2,072	1,694
<b>Total noninterest income</b>	<b>8,560</b>	<b>5,823</b>	<b>27,759</b>	<b>19,073</b>
<b>Noninterest expenses</b>				
Salaries and employee benefits	8,357	7,823	26,668	23,031
Occupancy expenses	1,418	1,466	4,345	4,553
Other expenses	4,946	3,523	13,499	10,004
<b>Total noninterest expenses</b>	<b>14,721</b>	<b>12,812</b>	<b>44,512</b>	<b>37,588</b>

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

Income before income taxes	2,374	933	6,671	4,586
Income tax expense	716	634	1,755	1,442
Net income	1,658	299	4,916	3,144
Effective dividends on preferred stock	291		839	
Net income available to common shareholders	\$ 1,367	\$ 299	\$ 4,077	\$ 3,144
Per common share data				
Net income basic	\$ 0.45	\$ 0.10	\$ 1.34	\$ 1.04
Net income assuming dilution	\$ 0.45	\$ 0.10	\$ 1.34	\$ 1.03
Cash dividends declared	\$ 0.25	\$ 0.31	\$ 0.81	\$ 0.93
Weighted average number of shares basic	3,044,110	3,030,972	3,041,706	3,026,400
Weighted average number of shares assuming dilution	3,047,263	3,048,760	3,042,757	3,065,891

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

**Table of Contents****CONSOLIDATED STATEMENTS OF SHAREHOLDERS EQUITY****(Unaudited)****(In thousands)**

	Preferred Stock	Common Stock	Additional Paid-In Capital	Comprehensive Income	Retained Earnings	Warrant	Discount on Preferred Stock	Accumulated Other Comprehensive Income (Loss)	Total
December 31, 2008	\$	\$ 2,992	\$ 551		\$ 62,361	\$	\$	\$ (1,047)	\$ 64,857
Comprehensive income:									
Net income				\$ 4,916	4,916				4,916
Other comprehensive income, net of tax:									
Changes in defined benefit plan assets and benefit obligations, net of tax				21				21	21
Unrealized holding gains on securities, net of reclassification adjustment				2,620				2,620	2,620
Comprehensive income				\$ 7,557					
Issuance of preferred stock	20		19,894			792	(792)		19,914
Amortization of preferred stock discount					(101)		101		
Stock options exercised		2	32						34
Share-based compensation			242						242
Cash dividends:									
Preferred stock paid					(600)				(600)
Common stock declared					(2,465)				(2,465)
September 30, 2009	\$ 20	\$ 2,994	\$ 20,719		\$ 64,111	\$ 792	\$ (691)	\$ 1,594	\$ 89,539

**Disclosure of Reclassification Amount:**

Unrealized net holding gains arising during period, net of tax	\$ 2,625
Less: reclassification adjustment for net gains included in net income, net of tax	5
Unrealized holding gains on securities, net of reclassification adjustment	\$ 2,620

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



**Table of Contents****CONSOLIDATED STATEMENTS OF SHAREHOLDERS EQUITY****(Unaudited)****(In thousands)**

	<b>Common Stock</b>	<b>Additional Paid-In Capital</b>	<b>Comprehensive Income</b>	<b>Retained Earnings</b>	<b>Accumulated Other Comprehensive Income (Loss)</b>	<b>Total</b>
December 31, 2007	\$ 2,979	\$		\$ 62,048	\$ 197	\$ 65,224
Comprehensive income:						
Net income			\$ 3,144	3,144		3,144
Other comprehensive income, net of tax:						
Changes in defined benefit plan assets and benefit obligations, net of tax			1		1	1
Unrealized holding losses on securities, net of reclassification adjustment			(1,611)		(1,611)	(1,611)
<b>Comprehensive income</b>			<b>\$ 1,534</b>			
Purchase of common stock	(2)	(38)				(40)
Stock options exercised	14	252				266
Share-based compensation		215				215
Cash dividends declared				(2,814)		(2,814)
September 30, 2008	\$ 2,991	\$ 429		\$ 62,378	\$ (1,413)	\$ 64,385

**Disclosure of Reclassification Amount:**

Unrealized net holding losses arising during period, net of tax	\$ (2,987)
Less: reclassification adjustment for net losses included in net income, net of tax	(1,376)
Unrealized holding losses on securities, net of reclassification adjustment	\$ (1,611)

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

**Table of Contents****CONSOLIDATED STATEMENTS OF CASH FLOWS****(Unaudited)****(In thousands)**

	<b>Nine Months Ended September 30,</b>	
	<b>2009</b>	<b>2008</b>
<b>Operating activities:</b>		
Net income	\$ 4,916	\$ 3,144
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation	1,588	1,836
Provision for loan losses	12,863	8,717
Provision for other real estate owned losses	1,413	141
Share-based compensation	242	215
Amortization of prepaid pension transition costs	21	1
Accretion of discounts and amortization of premiums on investment securities, net	111	60
Net realized gains on calls and sales of securities	(8)	(221)
Net (gains) losses on sales of other real estate owned	(18)	8
Other-than-temporary impairment of securities		1,522
Proceeds from sales of loans	855,231	583,978
Origination of loans held for sale	(866,952)	(590,168)
Gain on sales of corporate premises and equipment	(21)	(16)
Change in other assets and liabilities:		
Accrued interest receivable	(89)	170
Other assets	384	3,141
Accrued interest payable	(284)	21
Other liabilities	(2,672)	(713)
<b>Net cash provided by operating activities</b>	<b>6,725</b>	<b>11,836</b>
<b>Investing activities:</b>		
Proceeds from maturities, calls and sales of securities available for sale	18,542	16,120
Purchases of securities available for sale	(33,786)	(26,261)
Net redemptions of Federal Home Loan Bank stock	1,397	376
Net increase in customer loans	(10,528)	(63,203)
Proceeds from sales of other real estate owned	846	217
Purchases of corporate premises and equipment	(387)	(401)
Disposals of corporate premises and equipment	69	85
<b>Net cash used in investing activities</b>	<b>(23,847)</b>	<b>(73,067)</b>
<b>Financing activities:</b>		
Net (decrease) increase in demand, interest-bearing demand and savings deposits	(8,900)	12,874
Net increase in time deposits	33,580	11,413
Net (decrease) increase in borrowings	(27,127)	38,122
Purchase of common stock		(40)
Proceeds from exercise of stock options	34	266
Net proceeds from issuance of preferred stock	19,914	
Cash dividends	(3,065)	(2,814)
<b>Net cash provided by financing activities</b>	<b>14,436</b>	<b>59,821</b>

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

Net decrease in cash and cash equivalents	(2,686)		(1,410)
Cash and cash equivalents at beginning of period	9,888		12,263
Cash and cash equivalents at end of period	\$ 7,202	\$	10,853
<b>Supplemental disclosure</b>			
Interest paid	\$ 12,184	\$	16,358
Income taxes paid	2,286		2,255
<b>Supplemental disclosure of noncash investing activities and financing activities</b>			
Unrealized gains (losses) on securities available for sale	\$ 4,030	\$	(2,479)
Loans transferred to other real estate owned	13,109		2,961

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

**Table of Contents****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS****(Unaudited)****Note 1**

The accompanying unaudited consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America 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 accounting principles generally accepted in the United States of America 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, 2008.

In the opinion of C&F Financial Corporation's management, all adjustments, consisting only of normal recurring accruals, necessary to present fairly the financial position as of September 30, 2009, the results of operations for the three and nine months ended September 30, 2009 and 2008, and cash flows for the nine months ended September 30, 2009 and 2008 have been made. The results of operations for the interim periods are not necessarily indicative of the results to be expected for the full year.

The consolidated financial statements include the accounts of C&F Financial Corporation (the "Corporation") and its subsidiary, Citizens and Farmers Bank (the "Bank"), with all significant intercompany transactions and accounts being eliminated in consolidation. In addition, the 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.

**Share-Based Compensation:** Compensation expense for the third quarter and first nine months of 2009 included \$82,000 (\$51,000 after tax) and \$242,000 (\$150,000 after tax), respectively, for restricted stock granted during 2006 through 2009. Compensation expense for the third quarter and first nine months of 2008 included \$59,000 (\$37,000 after tax) and \$215,000 (\$133,000 after tax), respectively, for options and restricted stock granted during 2006 through 2008. As of September 30, 2009, there was \$876,000 of total unrecognized compensation expense related to unvested restricted stock that will be recognized over the remaining requisite service periods.

Stock option activity for the nine months ended September 30, 2009 is summarized below:

	Shares	Exercise Price*	Remaining Contractual Life (in years)*	Intrinsic Value of Unexercised In-The Money Options (in 000 s)
Options outstanding, January 1, 2009	455,017	\$ 32.71	5.1	\$
Exercised	(2,000)	17.00		
Expired	(7,500)	19.00		
Options exercisable at September 30, 2009	445,517	\$ 33.01	4.5	\$ 35

\* *Weighted average*

**Table of Contents****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****(Unaudited)****Note 2**

On January 9, 2009, as part of the Capital Purchase Program ( Capital Purchase Program ) established by the U.S. Department of the Treasury ( Treasury ) under the Emergency Economic Stabilization Act of 2008 ( EESA ), the Corporation issued and sold to Treasury for an aggregate purchase price of \$20.0 million in cash (1) 20,000 shares of the Corporation's fixed rate cumulative perpetual preferred stock, Series A, par value \$1.00 per share, having a liquidation preference of \$1,000 per share ( Series A Preferred Stock ) and (2) a ten-year warrant to purchase up to 167,504 shares of the Corporation's common stock, par value \$1.00 per share ( Common Stock ), at an initial exercise price of \$17.91 per share ( Warrant ). The Series A Preferred Stock may be treated as Tier 1 capital for regulatory capital adequacy determination purposes.

Cumulative dividends on the Series A Preferred Stock will accrue on the liquidation preference at a rate of 5% per annum for the first five years, and at a rate of 9% per annum thereafter. The Series A Preferred Stock has no maturity date and ranks senior to the Common Stock with respect to the payment of dividends. Under the terms of the certificate of designations of the Series A Preferred Stock in the Corporation's articles of incorporation, the Corporation may redeem the Series A Preferred Stock at 100% of its liquidation preference (plus any accrued and unpaid dividends) beginning on February 15, 2012. Prior to this date, the Corporation may redeem the Series A Preferred Stock at 100% of its liquidation preference (plus any accrued and unpaid dividends) if (i) the Corporation has raised aggregate gross proceeds in one or more qualified equity offerings of at least \$5.0 million, and (ii) the aggregate redemption price does not exceed the aggregate net proceeds from such qualified equity offerings. The phrase qualified equity offering means the sale and issuance for cash by the Corporation, to persons other than the Corporation or any Corporation subsidiary after January 9, 2009, of shares of perpetual preferred stock, Common Stock or any combination of such stock, that, in each case, qualify as and may be included in Tier 1 capital of the Corporation at the time of issuance under the applicable risk-based capital guidelines of the Federal Deposit Insurance Corporation ( FDIC ) (other than any such sales and issuances made pursuant to agreements or arrangements entered into, or pursuant to financing plans which were publicly announced, on or prior to October 13, 2008). However, the American Recovery and Reinvestment Act of 2009 ( ARRA ) appears to change these provisions to provide that the Corporation may redeem the Series A Preferred Stock at any time, at its option, from any source of funds. Any such redemption would be at 100% of the Series A Preferred Stock liquidation preference, plus any accrued and unpaid dividends. In either event, any redemption is subject to the consent of the FDIC.

The purchase agreement pursuant to which the Series A Preferred Stock and the Warrant were sold contains limitations on the payment of dividends or distributions on the Common Stock (including the payment of cash dividends in excess of the amount per share of the Corporation's last quarterly cash dividend declared before October 14, 2008, which was 31 cents per share) and on the Corporation's ability to repurchase, redeem or acquire its Common Stock or other securities, and subjects the Corporation to certain of the executive compensation limitations included in the EESA, as amended by the ARRA, until such time as Treasury no longer owns any Series A Preferred Stock acquired through the Capital Purchase Program. Accordingly, the Corporation purchased no shares of Common Stock during the first nine months of 2009. During the first nine months of 2008, the Corporation purchased 1,600 shares of Common Stock in open-market transactions at prices from \$20.49 to \$31.06 per share.

**Table of Contents****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****(Unaudited)****Note 3**

The components of the Corporation's earnings per common share (EPS) calculations for the three and nine months ended September 30, 2009 and 2008 are as follows:

(in 000 s, except for share amounts)	Three Months Ended September 30,	
	2009	2008
Net income	\$ 1,658	\$ 299
Accumulated dividends on Series A Preferred Stock	(255)	
Amortization of Series A Preferred Stock discount	(36)	
Net income available to common shareholders	\$ 1,367	\$ 299
Weighted average number of common shares used in earnings per common share - basic	3,044,110	3,030,972
Effect of dilutive securities:		
Stock option awards	3,153	17,788
Weighted average number of common shares used in earnings per common share - assuming dilution	3,047,263	3,048,760
 (in 000 s, except for share amounts)		
	Nine Months Ended September 30,	
	2009	2008
Net income	\$ 4,916	\$ 3,144
Accumulated dividends on Series A Preferred Stock	(738)	
Amortization of Series A Preferred Stock discount	(101)	
Net income available to common shareholders	\$ 4,077	\$ 3,144
Weighted average number of common shares used in earnings per common share - basic	3,041,706	3,026,400
Effect of dilutive securities:		
Stock option awards	1,051	39,491
Weighted average number of common shares used in earnings per common share - assuming dilution	3,042,757	3,065,891

In June 2008, the Financial Accounting Standards Board (FASB) concluded that all outstanding unvested share-based payment awards that contain rights to nonforfeitable dividends participate in undistributed earnings with common shareholders. This conclusion affects entities that accrue cash dividends on share-based payment awards during the awards' service period when the dividends do not need to be returned if the employees forfeit the awards. Because the awards are considered participating securities, the issuing entity is required to apply the two-class method of computing basic and diluted EPS. The transition guidance requires an entity to retroactively adjust all prior-period EPS computations, including EPS computations included in interim financial statements. The Corporation adopted the two-class method of computing basic and

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

diluted EPS effective January 1, 2009, and has applied it to its EPS calculations for the three and nine months ended September 30, 2009 and 2008 because the Corporation's unvested restricted shares outstanding contain rights to nonforfeitable dividends. Accordingly, the weighted average number of common shares used in the calculation of basic and diluted EPS includes both vested and unvested common shares outstanding. The retroactive adjustments made to the EPS computations resulted in no change in basic and diluted EPS for the three months ended September 30, 2008 and reductions of \$0.01 in both basic and diluted EPS for the nine months ended September 30, 2008.

**Table of Contents****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****(Unaudited)**

EPS, assuming dilution, has been calculated on the basis of the weighted average number of shares of common stock and common stock equivalents outstanding for the applicable periods. Potentially-dilutive common stock had no effect on net income available to common shareholders.

**Note 4**

Debt and equity securities are summarized as follows:

(in 000 s)	September 30, 2009			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
<b>Available for Sale</b>				
U.S. government agencies and corporations	\$ 9,139	\$ 82	\$ (23)	\$ 9,198
Mortgage-backed securities	2,956	90		3,046
Obligations of states and political subdivisions	102,450	3,746	(101)	106,095
Preferred stock	1,374	105	(44)	1,435
	<b>\$ 115,919</b>	<b>\$ 4,023</b>	<b>\$ (168)</b>	<b>\$ 119,774</b>

(in 000 s)	December 31, 2008			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
<b>Available for Sale</b>				
U.S. government agencies and corporations	\$ 11,108	\$ 59	\$ (5)	\$ 11,162
Mortgage-backed securities	2,264	54		2,318
Obligations of states and political subdivisions	85,842	858	(1,189)	85,511
Preferred stock	1,564	146	(98)	1,612
	<b>\$ 100,778</b>	<b>\$ 1,117</b>	<b>\$ (1,292)</b>	<b>\$ 100,603</b>

The amortized cost and estimated fair value of securities at September 30, 2009, by contractual 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.

(in 000 s)	September 30, 2009	
	Amortized Cost	Estimated Fair Value
<b>Available for Sale</b>		
Due in one year or less	\$ 11,526	\$ 11,602
Due after one year through five years	29,296	29,905
Due after five years through ten years	43,487	45,319
Due after ten years	30,236	31,513
Preferred stock	1,374	1,435



**\$ 115,919    \$ 119,774**

Proceeds from the maturities, calls and sales of securities available for sale for the first nine months of 2009 were \$18.5 million, resulting in gross realized gains of \$33,000 and gross realized losses of \$25,000. Securities with an aggregate amortized cost of \$40.0 million and an aggregate fair value of \$41.0 million were pledged at September 30, 2009 to secure public deposits, repurchase agreements, Federal Reserve Bank treasury, tax and loan deposits, and borrowings from the Federal Reserve Bank.

**Table of Contents****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****(Unaudited)**

Securities in an unrealized loss position at September 30, 2009, by duration of the period of the unrealized loss, are shown below.

(in 000 s)	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	\$ 1,494	\$ 23	\$	\$	\$ 1,494	\$ 23
Obligations of states and political subdivisions	1,361	41	3,446	60	4,807	101
Subtotal-debt securities	2,855	64	3,446	60	6,301	124
Preferred stock	610	44			610	44
Total temporarily impaired securities	\$ 3,465	\$ 108	\$ 3,446	\$ 60	\$ 6,911	\$ 168

There are 20 debt securities and three equity securities totaling \$6.3 million and \$610,000, respectively, in a loss position at September 30, 2009. The primary cause of the temporary impairments in the Corporation's investments in debt securities was fluctuations in interest rates. Because the Corporation intends to hold these investments 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 Corporation does not consider these investments to be other-than-temporarily impaired at September 30, 2009 and no impairment has been recognized. In April 2009, the FASB issued FASB Staff Position ( FSP ) Financial Accounting Standards ( FAS ) 115-2 and FAS 124-2, *Recognition and Presentation of Other-Than-Temporary Impairments* (Accounting Standards Codification ( ASC ) 320 Investments - Debt and Equity Securities), which amends other-than-temporary impairment guidance for debt securities to make the guidance more operational and to improve the presentation and disclosure of other-than-temporary impairments on debt and equity securities. This FSP does not amend existing recognition and measurement guidance related to other-than-temporary impairments of equity securities. It became effective for interim and annual periods ending after June 15, 2009 and its adoption did not have a material effect on the Corporation's consolidated financial statements.

Securities in an unrealized loss position at December 31, 2008, by duration of the period of the unrealized loss, are shown below.

(in 000 s)	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	\$ 495	\$ 5	\$	\$	\$ 495	\$ 5
Obligations of states and political subdivisions	32,846	1,189			32,846	1,189
Subtotal-debt securities	33,341	1,194			33,341	1,194
Preferred stock	699	88	20	10	719	98
Total temporarily impaired securities	\$ 34,040	\$ 1,282	\$ 20	\$ 10	\$ 34,060	\$ 1,292

The Corporation's investment in Federal Home Loan Bank ( FHLB ) stock totaled \$3.9 million at September 30, 2009. 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. Despite the FHLB's temporary suspension of repurchases of excess

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

capital stock in 2009, the Corporation does not consider this investment to be other-than-temporarily impaired at September 30, 2009 and no impairment has been recognized.

**Table of Contents****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****(Unaudited)****Note 5**

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

(in 000 s)	Three Months Ended	
	September 30,	
	2009	2008
Service cost	\$ 126	\$ 209
Interest cost	93	110
Expected return on plan assets	(103)	(144)
Amortization of net obligation at transition	(1)	(1)
Amortization of prior service cost	(17)	1
Amortization of net loss	29	
<b>Net periodic benefit cost</b>	<b>\$ 127</b>	<b>\$ 175</b>

(in 000 s)	Nine Months Ended	
	September 30,	
	2009	2008
Service cost	\$ 378	\$ 627
Interest cost	279	330
Expected return on plan assets	(309)	(432)
Amortization of net obligation at transition	(3)	(3)
Amortization of prior service cost	(51)	3
Amortization of net loss	87	
<b>Net periodic benefit cost</b>	<b>\$ 381</b>	<b>\$ 525</b>

The Bank made a \$1.0 million contribution to this plan in the first quarter of 2009.

**Note 6**

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 segments include 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 these other segments are not significant to the Corporation as a whole and have been included in Other. Revenue and expenses of the Corporation are also included in Other, and consist primarily of dividends received on the Corporation's investment in equity securities and interest expense associated with the Corporation's trust preferred capital notes.



**Table of Contents****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****(Unaudited)****Three Months Ended September 30, 2009****(in 000 s)**

	<b>Retail Banking</b>	<b>Mortgage Banking</b>	<b>Consumer Finance</b>	<b>Other</b>	<b>Eliminations</b>	<b>Consolidated</b>
<b>Revenues:</b>						
Interest income	\$ 8,589	\$ 546	\$ 8,259	\$ 61	\$ (830)	\$ 16,625
Gains on sales of loans		5,464				5,464
Other	1,578	1,162	143	213		3,096
<b>Total operating income</b>	<b>10,167</b>	<b>7,172</b>	<b>8,402</b>	<b>274</b>	<b>(830)</b>	<b>25,185</b>
<b>Expenses:</b>						
Interest expense	3,037	40	1,219	269	(838)	3,727
Provision for loan losses	1,400	63	2,900			4,363
Personnel expenses	3,546	3,309	1,307	195		8,357
Other	3,273	2,390	631	70		6,364
<b>Total operating expenses</b>	<b>11,256</b>	<b>5,802</b>	<b>6,057</b>	<b>534</b>	<b>(838)</b>	<b>22,811</b>
Income (loss) before income taxes	(1,089)	1,370	2,345	(260)	8	2,374
Provision for (benefit from) income taxes	(742)	615	945	(105)	3	716
<b>Net income (loss)</b>	<b>\$ (347)</b>	<b>\$ 755</b>	<b>\$ 1,400</b>	<b>\$ (155)</b>	<b>\$ 5</b>	<b>\$ 1,658</b>
<b>Total assets</b>	<b>\$ 746,044</b>	<b>\$ 55,214</b>	<b>\$ 188,175</b>	<b>\$ 2,465</b>	<b>\$ (116,962)</b>	<b>\$ 874,936</b>
<b>Capital expenditures</b>	<b>\$ 97</b>	<b>\$ 70</b>	<b>\$ 11</b>	<b>\$</b>	<b>\$</b>	<b>\$ 178</b>

**Three Months Ended September 30, 2008****(in 000 s)**

	<b>Retail Banking</b>	<b>Mortgage Banking</b>	<b>Consumer Finance</b>	<b>Other</b>	<b>Eliminations</b>	<b>Consolidated</b>
<b>Revenues:</b>						
Interest income	\$ 9,228	\$ 510	\$ 7,406	\$ 45	\$ (803)	\$ 16,386
Gains on sales of loans		4,539			(15)	4,524
Other	1,859	543	104	(1,207)		1,299
<b>Total operating income</b>	<b>11,087</b>	<b>5,592</b>	<b>7,510</b>	<b>(1,162)</b>	<b>(818)</b>	<b>22,209</b>
<b>Expenses:</b>						
Interest expense	3,946	85	1,752	356	(820)	5,319
Provision for loan losses	500	75	2,570			3,145
Personnel expenses	3,509	2,903	1,195	202	14	7,823
Other	2,326	1,883	661	119		4,989
<b>Total operating expenses</b>	<b>10,281</b>	<b>4,946</b>	<b>6,178</b>	<b>677</b>	<b>(806)</b>	<b>21,276</b>
Income (loss) before income taxes	806	646	1,332	(1,839)	(12)	933
Provision for (benefit from) income taxes	19	245	506	(131)	(5)	634

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

Net income (loss)	\$ 787	\$ 401	\$ 826	\$ (1,708)	\$ (7)	\$ 299
Total assets	\$ 681,350	\$ 51,172	\$ 179,979	\$ 3,072	\$ (69,099)	\$ 846,474
Capital expenditures	\$ 14	\$ 15	\$	\$	\$	\$ 29

**Table of Contents****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****(Unaudited)****Nine Months Ended September 30, 2009****(in 000 s)**

	<b>Retail Banking</b>	<b>Mortgage Banking</b>	<b>Consumer Finance</b>	<b>Other</b>	<b>Eliminations</b>	<b>Consolidated</b>
<b>Revenues:</b>						
Interest income	\$ 25,343	\$ 1,954	\$ 23,185	\$ 198	\$ (2,493)	\$ 48,187
Gains on sales of loans		19,381				19,381
Other	4,276	2,910	368	824		8,378
<b>Total operating income</b>	<b>29,619</b>	<b>24,245</b>	<b>23,553</b>	<b>1,022</b>	<b>(2,493)</b>	<b>75,946</b>
<b>Expenses:</b>						
Interest expense	9,705	203	3,647	864	(2,519)	11,900
Provision for loan losses	3,500	563	8,800			12,863
Personnel expenses	10,325	12,072	3,781	490		26,668
Other	8,773	6,669	2,067	335		17,844
<b>Total operating expenses</b>	<b>32,303</b>	<b>19,507</b>	<b>18,295</b>	<b>1,689</b>	<b>(2,519)</b>	<b>69,275</b>
Income (loss) before income taxes	(2,684)	4,738	5,258	(667)	26	6,671
Provision for (benefit from) income taxes	(2,029)	1,992	2,055	(272)	9	1,755
<b>Net income (loss)</b>	<b>\$ (655)</b>	<b>\$ 2,746</b>	<b>\$ 3,203</b>	<b>\$ (395)</b>	<b>\$ 17</b>	<b>\$ 4,916</b>
<b>Total assets</b>	<b>\$ 746,044</b>	<b>\$ 55,214</b>	<b>\$ 188,175</b>	<b>\$ 2,465</b>	<b>\$ (116,962)</b>	<b>\$ 874,936</b>
<b>Capital expenditures</b>	<b>\$ 132</b>	<b>\$ 235</b>	<b>\$ 19</b>	<b>\$ 1</b>	<b>\$</b>	<b>\$ 387</b>

**Nine Months Ended September 30, 2008****(in 000 s)**

	<b>Retail Banking</b>	<b>Mortgage Banking</b>	<b>Consumer Finance</b>	<b>Other</b>	<b>Eliminations</b>	<b>Consolidated</b>
<b>Revenues:</b>						
Interest income	\$ 27,366	\$ 1,571	\$ 21,532	\$ 166	\$ (2,437)	\$ 48,198
Gains on sales of loans		12,935			(20)	12,915
Other	4,650	1,647	358	(497)		6,158
<b>Total operating income</b>	<b>32,016</b>	<b>16,153</b>	<b>21,890</b>	<b>(331)</b>	<b>(2,457)</b>	<b>67,271</b>
<b>Expenses:</b>						
Interest expense	12,070	319	5,370	1,113	(2,492)	16,380
Provision for loan losses	1,160	587	6,970			8,717
Personnel expenses	10,697	8,086	3,573	641	34	23,031
Other	6,896	5,324	2,006	331		14,557
<b>Total operating expenses</b>	<b>30,823</b>	<b>14,316</b>	<b>17,919</b>	<b>2,085</b>	<b>(2,458)</b>	<b>62,685</b>
Income (loss) before income taxes	1,193	1,837	3,971	(2,416)	1	4,586
Provision for (benefit from) income taxes	(382)	698	1,509	(383)		1,442



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

Net income (loss)	\$ 1,575	\$ 1,139	\$ 2,462	\$ (2,033)	\$ 1	\$ 3,144
Total assets	\$ 681,350	\$ 51,172	\$ 179,979	\$ 3,072	\$ (69,099)	\$ 846,474
Capital expenditures	\$ 153	\$ 215	\$ 33	\$	\$	\$ 401

**Table of Contents**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**(Unaudited)**

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 175 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.

**Note 7**

In September 2006, the FASB issued Statement of Financial Accounting Standards ( SFAS ) No. 157, *Fair Value Measurements* (ASC 820 Fair Value Measurements and Disclosures), which defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles ( GAAP ), and expands disclosures about fair value measurements. SFAS 157 does not require any new fair value measurements, but rather provides enhanced guidance to other pronouncements that require or permit assets or liabilities to be measured at fair value. The Corporation adopted SFAS 157 on January 1, 2008. The FASB approved a one-year deferral for the implementation of SFAS 157 for nonfinancial assets and liabilities that are recognized or disclosed at fair value in the financial statements on a nonrecurring basis. The Corporation adopted the provisions of SFAS 157 for nonfinancial assets and liabilities as of January 1, 2009 without a material effect on its consolidated financial statements.

In April 2009, the FASB issued FSP FAS 157-4, *Determining Fair Value When the Volume and Level of Activity for the Asset or Liability Have Significantly Decreased and Identifying Transactions That Are Not Orderly* (ASC 820 Fair Value Measurements and Disclosures), which provides additional guidance for estimating fair value in accordance with SFAS 157 when the volume and level of activity for the asset or liability have significantly decreased. This FSP also includes guidance on identifying circumstances that indicate a transaction is not orderly. FSP FAS 157-4 became effective for interim and annual periods ending after June 15, 2009, and shall be applied prospectively. The adoption of FSP FAS 157-4 did not have a material effect on the Corporation's consolidated financial statements.

The fair value hierarchy under SFAS 157 is based upon the transparency of inputs to the valuation of an asset or liability as of the measurement date, and prioritizes the inputs to valuation techniques used to measure fair value in three broad levels (Level 1, Level 2 and Level 3). Level 1 inputs are unadjusted quoted prices in active markets (as defined) for identical assets or liabilities that the reporting entity has the ability to access at the measurement date. Level 2 inputs are inputs that include quoted prices for similar assets and liabilities in active markets, and inputs that are observable for the asset or liability, either directly or indirectly, for substantially the full term of the financial instrument. Level 3 inputs are unobservable inputs for the asset or liability and reflect the reporting entity's own assumptions regarding the inputs that market participants would use in pricing the asset or liability.

The following describes the valuation techniques used by the Corporation to measure certain financial assets recorded at fair value on a recurring basis in the financial statements.

**Table of Contents****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****(Unaudited)**

**Securities Available for Sale:** Securities available for sale are recorded at fair value on a recurring basis. Where quoted prices are available in an active market, securities are classified as Level 1 of the valuation hierarchy. Level 1 securities would include highly liquid government bonds, mortgage products and exchange-traded equities. If quoted market prices are not available, then fair values are estimated by using pricing models, quoted prices of securities with similar characteristics, or discounted cash flow and are classified within Level 2 of the valuation hierarchy. Level 2 securities would include U.S. agency securities, mortgage-backed agency securities, obligations of states and political subdivisions and certain corporate, asset-backed and other securities. In certain cases where there is limited activity or less transparency around inputs to the valuation, securities are classified within Level 3 of the valuation hierarchy.

The following table presents the balances of financial assets measured at fair value on a recurring basis at September 30, 2009. There were no liabilities measured at fair value on a recurring basis at September 30, 2009.

(in 000 s)

**Fair Value Measurements at September 30, 2009 Using**

	<b>Quoted Prices in Active Markets for Identical Assets (Level 1)</b>			<b>Significant Other Observable Inputs (Level 2)</b>	<b>Significant Unobservable Inputs (Level 3)</b>	<b>Balance</b>
Securities available for sale	\$	\$	119,774	\$	\$	119,774

Certain financial assets are measured at fair value on a nonrecurring basis in accordance with GAAP. Adjustments to the fair value of these assets usually result from the application of lower-of-cost-or-market accounting or write-downs of individual assets. The following describes the valuation techniques used by the Corporation to measure certain financial assets recorded at fair value on a nonrecurring basis in the financial statements.

**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, which is not generally materially different than cost due to the short duration between origination and sale (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 three months ended September 30, 2009.

**Impaired Loans:** SFAS 157 applies to loans measured for impairment using the practical expedients permitted by SFAS No. 114, *Accounting by Creditors for Impairment of a Loan* (ASC 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 (Level 2). However, if an appraisal of the real estate property is over two years old, then the fair value is considered Level 3. 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. Likewise, values for inventory and accounts receivable collateral are based on financial statement balances or aging reports (Level 3). No nonrecurring fair value adjustments were recorded on impaired loans during the three months ended September 30, 2009.

Table of Contents

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

**Other Real Estate Owned:** Other real estate owned ( OREO ) is measured at fair value based on an appraisal conducted by an independent, licensed appraiser outside of the Corporation using observable market data (Level 2). However, if an appraisal of the real estate property is over two years old, then the fair value is considered Level 3.

The following table summarizes the Corporation's financial assets that were measured at fair value on a nonrecurring basis during the three months ended September 30, 2009:

(in 000 s)	Fair Value Measurements at September 30, 2009 Using			Balance
	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	
OREO	\$	\$ 12,722	\$	\$ 12,722

In April 2009, the FASB issued FSP FAS 107-1 and Accounting Principles Board ( APB ) 28-1, *Interim Disclosures about Fair Value of Financial Instruments* (ASC 825 Financial Instruments and ASC 270 Interim Reporting), which requires disclosures about fair value of financial instruments for interim reporting periods of publicly traded companies for interim periods ending after June 15, 2009. The Corporation's disclosures are presented below. The following describes the valuation techniques used by the Corporation to measure certain financial assets and financial liabilities not previously described elsewhere in this note that are not recorded at fair value on a recurring basis in the financial statements:

**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.

**Loans.** 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.

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

**Accrued interest.** The carrying amount of accrued interest 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.

**Table of Contents****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****(Unaudited)**

(in 000 s)	September 30, 2009		December 31, 2008	
	Carrying Amount	Estimated Fair Value	Carrying Amount	Estimated Fair Value
<b>Financial assets:</b>				
Cash and short-term investments	\$ 7,202	\$ 7,202	\$ 9,888	\$ 9,888
Securities	119,774	119,774	100,603	100,603
Net loans	617,573	614,577	633,017	634,928
Loans held for sale, net	48,763	50,302	37,042	37,904
Accrued interest receivable	5,185	5,185	5,096	5,096
<b>Financial liabilities:</b>				
Demand deposits	272,927	259,968	281,827	272,164
Time deposits	302,478	307,419	268,898	272,340
Borrowings	192,333	186,570	219,460	210,640
Accrued interest payable	1,637	1,637	1,921	1,921

The Corporation assumes interest rate risk (the risk that general interest rate levels will change) as part 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 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.

**Note 8**

In December 2007, the FASB issued SFAS No. 141(R), *Business Combinations* (ASC 805 Business Combinations), which significantly changed the financial accounting and reporting of business combination transactions. SFAS 141(R) established principles for how an acquirer recognizes and measures the identifiable assets acquired, liabilities assumed, and any noncontrolling interest in the acquiree; recognizes and measures the goodwill acquired in the business combination or a gain from a bargain purchase; and determines what information to disclose to enable users of the financial statements to evaluate the nature and financial effects of the business combination. SFAS 141(R) became effective for acquisition dates on or after the beginning of an entity's first year that began after December 15, 2008. The adoption of SFAS 141(R) did not have a material effect on the Corporation's consolidated financial statements.

In April 2009, the FASB issued FSP FAS 141(R)-1, *Accounting for Assets Acquired and Liabilities Assumed in a Business Combination That Arise from Contingencies* (ASC 805 Business Combinations), which amends and clarifies SFAS 141(R) to address application issues on initial recognition and measurement, subsequent measurement and accounting, and disclosure of assets and liabilities arising from contingencies in a business combination. This FSP is effective for assets and liabilities arising from contingencies in business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after December 15, 2008. The adoption of *Accounting for Assets Acquired and Liabilities Assumed in a Business Combination That Arise from Contingencies* did not have a material effect on the Corporation's consolidated financial statements.

**Table of Contents**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**(Unaudited)**

In April 2009, the SEC issued Staff Accounting Bulletin ( SAB ) No. 111, which amends and replaces SAB Topic 5.M. in the SAB Series entitled Other Than Temporary Impairment of Certain Investments in Debt and Equity Securities. SAB 111 maintains the SEC Staff's previous views related to equity securities and amends SAB Topic 5.M. to exclude debt securities from its scope. The implementation of SAB 111 did not have a material effect on the Corporation's consolidated financial statements.

In May 2009, the FASB issued SFAS No. 165, *Subsequent Events* (ASC 855 Subsequent Events), which establishes general standards of accounting for and disclosure of events that occur after the balance sheet date but before financial statements are issued or are available to be issued. SFAS 165 became effective for interim and annual periods ending after June 15, 2009. The adoption of SFAS 165 did not have a material effect on the Corporation's consolidated financial statements.

In June 2009, the FASB issued SFAS No. 166, *Accounting for Transfers of Financial Assets – an Amendment of FASB Statement No. 140* (ASC 860 Transfers and Servicing), which provides guidance to improve the relevance, representational faithfulness, and comparability of the information that a reporting entity provides in its financial statements about a transfer of financial assets; the effects of a transfer on its financial position, financial performance, and cash flows; and a transferor's continuing involvement, if any, in transferred financial assets. SFAS 166 must be applied as of the beginning of the first annual reporting period that begins after November 15, 2009 and for interim periods within that first annual reporting period. Earlier application is prohibited. The Corporation does not expect the adoption of SFAS 166 to have a material effect on its consolidated financial statements.

In June 2009, the FASB issued SFAS No. 167, *Amendments to FASB Interpretation No. 46(R)* (ASC 810 Consolidation), which improves financial reporting by enterprises involved with variable interest entities. SFAS 167 will be effective as of the first annual reporting period that begins after November 15, 2009 and for interim periods within that first annual reporting period. Earlier application is prohibited. The Corporation does not expect the adoption of SFAS 166 to have a material effect on its consolidated financial statements.

In June 2009, the FASB issued SFAS No. 168, *The FASB Accounting Standards Codification and the Hierarchy of Generally Accepted Accounting Principles – a Replacement of FASB Statement No. 162* (ASC 105 Generally Accepted Accounting Principles), which establishes the FASB Accounting Standards Codification ( Codification ), which will become the source of authoritative U.S. GAAP recognized by the FASB to be applied by nongovernmental entities. Rules and interpretive releases of the SEC under authority of federal securities laws are also sources of authoritative GAAP for SEC registrants. On the effective date, the Codification will supersede all then-existing non-SEC accounting and reporting standards. All other non-grandfathered non-SEC accounting literature not included in the Codification will become nonauthoritative. SFAS 168 is effective for financial statements issued for interim and annual periods ending after September 15, 2009. The adoption of SFAS 168 did not have a material effect on the Corporation's consolidated financial statements.

In June 2009, the FASB issued Emerging Issues Task Force ( EITF ) Issue No. 09-1, *Accounting for Own-Share Lending Arrangements in Contemplation of Convertible Debt Issuance of other Financing* (ASC 470 Debt), which clarifies how an entity should account for an own-share lending arrangement that is entered into in contemplation of a convertible debt offering. EITF Issue

**Table of Contents**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**(Unaudited)**

No. 09-1 became effective for arrangements entered into on or after June 15, 2009 and early adoption was prohibited. The adoption of EITF Issue No. 09-1 did not have a material effect on the Corporation's consolidated financial statements.

In June 2009, the SEC issued SAB No. 112, which revises or rescinds portions of the interpretative guidance included in the codification of SABs in order to make the interpretive guidance consistent with current U.S. GAAP. The implementation of SAB 112 did not have a material effect on the Corporation's consolidated financial statements.

In August 2009, the FASB issued Accounting Standard Update (ASU) No. 2009-05, *Fair Value Measurements and Disclosures - Measuring Liabilities at Fair Value*. ASU 2009-05 amended Subtopic 820-10, Fair Value Measurements and Disclosures - Overall, and provided clarification for the fair value measurement of liabilities. ASU 2009-05 became effective for the first reporting period, including interim periods, beginning after issuance. The adoption of ASU 2009-05 did not have a material effect on the Corporation's consolidated financial statements.

In September 2009, the FASB issued ASU No. 2009-12, *Fair Value Measurements and Disclosures (Topic 820): Investments in Certain Entities That Calculate Net Asset Value per Share (or Its Equivalent)*. ASU 2009-12 is effective for interim and annual periods ending after December 15, 2009. The Corporation does not expect the adoption of ASU 2009-12 to have a material effect on its consolidated financial statements.

In October 2009, the FASB issued ASU No. 2009-15, *Accounting for Own-Share Lending Arrangements in Contemplation of Convertible Debt Issuance or Other Financing*. ASU 2009-15 amends Subtopic 470-20 to expand accounting and reporting guidance for own-share lending arrangements issued in contemplation of convertible debt issuance. ASU 2009-15 is effective for fiscal years beginning on or after December 15, 2009 and interim periods within those fiscal years for arrangements outstanding as of the beginning of those fiscal years. The Corporation does not expect the adoption of ASU 2009-15 to have a material effect on its consolidated financial statements.

**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. Statements which express belief, intention, expectation, and similar expressions identify forward-looking statements. These forward-looking statements are based on the beliefs of the Corporation's management, as well as assumptions made by, and information currently available to, the Corporation's management. These statements are inherently uncertain, and there can be no assurance that the underlying assumptions will prove to be accurate. Actual results could differ materially from 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:

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

general economic conditions, including unemployment levels

the commercial and residential real estate markets

the legislative/regulatory climate, including policies of the FDIC

continued increases in FDIC premiums and/or additional FDIC special assessments

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

interest rates

demand for loan products

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

the level of net charge-offs on loans

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

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 Corporation's expansion and technology initiatives

accounting principles, policies and guidelines

These risks are exacerbated by the turbulence during 2008 and 2009 in significant portions of the global financial markets, which if it worsens, could impact the Corporation's performance, both directly by affecting the Corporation's revenues and the value of its assets and liabilities, and indirectly by affecting the Corporation's counterparties and the economy generally. During 2008 and thus far in 2009, the capital and credit markets have experienced extended volatility and disruption. There can be no assurance that these unprecedented recent developments will not continue to materially and adversely affect our business, financial condition and results of operations, as well as our ability to raise capital for other funding for liquidity and business purposes.

Although the Corporation currently has diverse sources of liquidity and its capital ratios exceed the minimum levels required for well-capitalized status, the Corporation issued and sold its Series A Preferred Stock and Warrant for a \$20.0 million investment from Treasury under the Capital Purchase Program on January 9, 2009. The Corporation also elected to participate in the FDIC Temporary Liquidity Guarantee Program; however, the Corporation currently has no unsecured

## Table of Contents

borrowings to which this program applies. The Bank is participating in the FDIC Transaction Account Guarantee Program, under which all noninterest-bearing transaction accounts (as defined within the program) are fully guaranteed by the FDIC for the entire amount in the account through June 30, 2010.

Our ability to engage in routine funding transactions could be adversely affected by the actions and commercial soundness of other financial institutions. Financial services institutions are interrelated as a result of trading, clearing, counterparty or other relationships, and we routinely execute transactions with counterparties in the financial industry, including brokers and dealers, commercial banks, and other institutional clients. As a result, defaults by, or even rumors or questions about, one or more financial services institutions, or the financial services industry generally, could exacerbate the market-wide liquidity crisis and could lead to losses or defaults by us or by other institutions. There is no assurance that any such losses would not materially adversely affect the Corporation's results of operations.

Further, there can be no assurance that the actions taken by the federal government and regulatory agencies will stabilize the U.S. financial system or alleviate the industry or economic factors that may adversely affect the Corporation's business and financial performance.

These risks and uncertainties should be considered in evaluating the forward-looking statements contained herein. We caution readers not to place undue reliance on those statements, which speak only as of the date of this report.

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 unaudited 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.

**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 appropriate 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 specific potential losses. This evaluation is inherently subjective because it requires estimates that are susceptible to significant revision as more information becomes available.

## Table of Contents

**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 Corporation incurs a loss due to borrower misrepresentation or early default. 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 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 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 maintain a valuation allowance to the extent that the measure of the impaired loan is less than the recorded investment.

**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 include 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:** 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, 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.

## Table of Contents

**Goodwill:** Goodwill is no longer subject to amortization over its estimated useful life, but is subject to at least an annual assessment for impairment using a two-step process that begins with an estimation of the fair value of the reporting unit. 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 impairment 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 2008 and determined there was no impairment to be recognized in 2008. The annual test for impairment for 2009 will be completed in the fourth quarter of 2009. If the underlying estimates and related assumptions change in the future, we may be required to record impairment charges.

**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 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.

**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 Note 1 of the Corporation's Consolidated Financial Statements in the Corporation's Annual Report on Form 10-K for the year ended December 31, 2008.

## *OVERVIEW*

Our primary financial goals are to maximize the Corporation's earnings and to deploy capital in profitable growth initiatives that will enhance shareholder value. We track three primary 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 segments: Retail Banking, Mortgage Banking and Consumer Finance. We also manage our capital through growth, dividends, and historically, stock purchases.

**Financial Performance Measures.** Net income for the Corporation was \$1.7 million for the third quarter of 2009, compared with \$299,000 for the third quarter of 2008 (\$1.8 million, adjusted to exclude the impairment charge taken in the third quarter of 2008 related to the Corporation's investments in perpetual preferred stock of the Federal National Mortgage Association ( Fannie Mae ) and the Federal Home Loan Mortgage Corporation ( Freddie Mac ). Net income available to common shareholders for the third quarter of 2009 was \$1.4 million, or 45 cents per common share assuming

**Table of Contents**

dilution, compared with \$299,000, or 10 cents per common share assuming dilution, (\$1.8 million, or 60 cents per common share assuming dilution, adjusted to exclude the effect of the impairment charge) for the third quarter of 2008. The Corporation's net income was \$4.9 million for the first nine months of 2009, compared with \$3.1 million for the first nine months of 2008 (\$4.7 million, adjusted to exclude the effect of the impairment charge). Net income available to common shareholders for the first nine months of 2009 was \$4.1 million, or \$1.34 per common share assuming dilution, compared with \$3.1 million, or \$1.03 per common share assuming dilution (\$4.7 million, or \$1.52 per common share assuming dilution, adjusted to exclude the effect of the impairment charge), for the first nine months of 2008. The difference between reported net income and net income available to common shareholders in 2009 is a result of the Series A Preferred Stock dividends and amortization of the Warrant related to the Corporation's participation in the Capital Purchase Program. The Series A Preferred Stock and Warrant were issued in the first quarter of 2009 and, therefore, did not affect net income available to common shareholders for 2008. Financial results for the third quarter and first nine months of 2009 were affected by the positive effects of the lower interest rate environment on loan production at our Mortgage Banking segment and on the net interest margin at our Consumer Finance segment. The favorable performance of these segments in 2009 offset the quarterly and year-to-date 2009 losses at our Retail Banking segment, which principally resulted from the effect of nonperforming loans on interest income, lower overdraft charges on deposit accounts, higher expenses associated with nonaccrual loans and foreclosed properties for which loan loss provisions or write downs to fair market value were necessary, and higher assessments for FDIC deposit insurance, including the special assessment recognized in the second quarter of 2009 to help replenish the Deposit Insurance Fund.

For the third quarter of 2009, the Corporation's ROE and ROA, on an annualized basis, were 8.14 percent and 0.63 percent, respectively, compared to 1.82 percent and 0.14 percent (11.07 percent and 0.87 percent, adjusted to exclude the effect of the impairment charge) for the third quarter of 2008. For the first nine months of 2009, the Corporation's ROE and ROA, on an annualized basis, were 8.21 percent and 0.62 percent, respectively, compared to 6.38 percent and 0.52 percent (9.47 percent and 0.77 percent, adjusted to exclude the effect of the impairment charge) for the first nine months of 2008. In 2009, these ratios reflect the effects of Series A Preferred Stock dividends and amortization of the Warrant on net income available to common shareholders, as well as asset growth since the end of the third quarter of 2008.

**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.

*Retail Banking:* The Retail Banking segment, which consists of the Bank, reported a net loss of \$347,000 for the third quarter of 2009, compared to net income of \$787,000 for the third quarter of 2008. The Bank's net loss was \$655,000 for the first nine months of 2009, compared to net income of \$1.6 million for the first nine months of 2008. The decline in 2009 earnings included the effects of (1) margin compression and competition for loans and deposits on net interest income, (2) a higher provision for loan losses attributable to the continued slow down in the economy and an increase in nonperforming assets, (3) lower overdraft charges on deposit accounts, (4) higher assessments for deposit insurance resulting from the FDIC's special assessment in the second quarter of 2009 to help restore the Deposit Insurance Fund, coupled with the effects of its amended risk-based assessment system and (5) higher nonaccrual loan and foreclosed properties expenses primarily resulting from the work-out of several commercial relationships. The Bank's net interest margin began compressing as a result of the combination of rapidly declining short-term interest rates and increased competition for deposits during 2008. With interest rates stabilizing more recently, deposit repricing in the lower interest rate environment and the implementation of interest rate floors on adjustable rate loans at the Bank upon origination or renewal have begun to mitigate the effects of the lower interest rate environment, and margins at the Bank have begun to improve and rebound from their lows.

---

**Table of Contents**

General economic trends, particularly the economic recession that we are experiencing in the Bank's markets, can affect the quality of the loan portfolio and, therefore, our provision for loan losses, as well as the level of our nonperforming assets. Managing the risks inherent in our loan portfolio and expenses associated with nonperforming assets will influence the Bank's performance during the remainder of 2009 and in future periods. In addition, increases in FDIC insurance premiums, if any, and special assessments will continue to affect the Bank's noninterest expenses in future periods.

*Mortgage Banking:* Third quarter net income for the Mortgage Banking segment, which consists of C&F Mortgage Corporation (the Mortgage Company), was \$755,000 in 2009, compared to \$401,000 in the third quarter of 2008. Net income for the first nine months of 2009 was \$2.8 million, compared to \$1.1 million for the first nine months of 2008. Earnings in 2009 included the effects of lower interest rates on loan origination volume, which increased 8.4 percent and 46.9 percent for the third quarter and first nine months of 2009, respectively. For the third quarter of 2009, the amount of loan originations at the Mortgage Company for refinancings was \$51.5 million compared to \$37.6 million for the third quarter of 2008. Loan originations for home purchases for these two periods were \$163.1 million and \$160.4 million, respectively. For the first nine months of 2009, the amount of loan originations at the Mortgage Company for refinancings was \$442.9 million compared to \$155.3 million for the first nine months of 2008. Loan originations for home purchases for these two time periods were \$424.0 million and \$434.9 million, respectively. Higher loan production in 2009 resulted in gains on sales of loans of \$5.5 million and \$19.4 million for the three months and nine months ended September 30, 2009, respectively, compared to \$4.5 million and \$12.9 million for the three months and nine months ended September 30, 2008, respectively. This increase in revenue was offset in part by (1) increases of \$224,000 and \$1.1 million in the combined provisions for indemnification and foreclosed property losses in the third quarter and first nine months of 2009, respectively, and (2) increases of \$406,000 and \$4.0 million in personnel costs in the third quarter and first nine months of 2009, respectively, resulting principally from higher variable compensation associated with the increase in loan production and net income. The increases in the provisions for indemnification and foreclosed property losses resulted from increased nonperforming loans due to recourse resulting from borrower fraud and the continued deterioration of the U.S. economy, especially in the housing markets, together with higher unemployment. While we mitigate the risk of loan repurchase and indemnification liability by underwriting to the purchasers' guidelines, we cannot eliminate the possibility that a prolonged period of payment defaults and foreclosures will result in an increase in requests for repurchases or indemnifications and the need for additional indemnification and foreclosed property loss provisions in the future.

*Consumer Finance:* Third quarter net income for the Consumer Finance segment, which consists of C&F Finance Company (the Finance Company), was \$1.4 million in 2009, compared to \$826,000 in 2008. Net income was \$3.2 million for the first nine months of 2009, compared to \$2.5 million for the first nine months of 2008. The Finance Company has benefited from growth in average consumer finance loans outstanding since the end of the third quarter of 2008, as well as the decline in its costs of borrowings throughout 2009 compared to 2008. Its fixed-rate loan portfolio is partially funded by a variable-rate line of credit indexed to LIBOR, which has resulted in an increase in its net interest margin during 2009 as short term interest rates fell throughout 2008. However, the Finance Company has experienced higher loan charge-offs in 2009 compared to 2008, which, in combination with loan growth, has resulted in increases in the provision for loan losses of \$330,000 in the third quarter of 2009 and \$1.8 million in the first nine months of 2009, compared to the same periods in 2008. We expect the ongoing effects of the economic recession will result in more delinquencies and

**Table of Contents**

repossessions at the Finance Company. Depending on the severity of any further downturn in the economy, decreased consumer demand for automobiles and declining values of automobiles securing outstanding loans could result. This could weaken collateral coverage and increase the amount of loss in the event of default.

**Capital Management.** Total shareholders' equity increased \$24.7 million to \$89.5 million at September 30, 2009, compared to \$64.9 million at December 31, 2008. This increase primarily occurred in connection with the Corporation's participation in the Treasury's Capital Purchase Program, as previously described. One means by which we manage our capital is through dividends. The Corporation maintained its quarterly dividend for the third quarter of 2009 at 25 cents per common share, which resulted in a common dividend payout ratio of 56 percent based on net income available to common shareholders for the third quarter of 2009. The board of directors will continue to evaluate the Corporation's dividends in light of changes in economic conditions, the Corporation's capital levels and its future levels of earnings. Another means by which we historically have managed our capital is through purchases of the Corporation's Common Stock. However, as a participant in the Capital Purchase Program there are limitations on the Corporation's ability to repurchase Common Stock prior to the earlier of January 9, 2012 or the date on which Treasury no longer holds any of the Corporation's Series A Preferred Stock.

*RESULTS OF OPERATIONS**Net Interest Income***Selected Average Balance Sheet Data and Net Interest Margin**

(in 000's)

	Three Months Ended			
	September 30, 2009		September 30, 2008	
	Average Balance	Yield/Cost	Average Balance	Yield/Cost
Securities	\$ 117,678	6.16%	\$ 94,282	6.23%
Loans, net	683,167	9.01	683,652	8.98
Interest-earning deposits in other banks	2,345	0.22	673	1.76
Federal funds sold			696	1.77
<b>Total earning assets</b>	<b>\$ 803,190</b>	<b>8.57%</b>	<b>\$ 779,303</b>	<b>8.63%</b>
Time and savings deposits	\$ 488,761	2.03%	\$ 463,413	2.80%
Borrowings	182,432	2.74	206,402	4.03
<b>Total interest-bearing liabilities</b>	<b>\$ 671,193</b>	<b>2.22%</b>	<b>\$ 669,815</b>	<b>3.18%</b>
<b>Net interest margin</b>		<b>6.71%</b>		<b>5.90%</b>

**Table of Contents**

(in 000 s)

	Nine Months Ended			
	September 30, 2009 Average Balance	Yield/ Cost	September 30, 2008 Average Balance	Yield/ Cost
Securities	\$ 112,507	6.17%	\$ 91,482	6.35%
Loans, net	701,542	8.48	658,577	9.13
Interest-earnings deposits in other banks	1,097	0.17	770	2.47
Federal funds sold			636	2.24
<b>Total earning assets</b>	<b>\$ 815,146</b>	<b>8.15%</b>	<b>\$ 751,465</b>	<b>8.78%</b>
Time and savings deposits	\$ 486,577	2.19%	\$ 457,684	2.98%
Borrowings	196,266	2.65	188,960	4.35
<b>Total interest-bearing liabilities</b>	<b>\$ 682,843</b>	<b>2.32%</b>	<b>\$ 646,644</b>	<b>3.38%</b>
<b>Net interest margin</b>		<b>6.21%</b>		<b>5.88%</b>

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 shows the direct causes of the changes in the components of net interest income on a taxable-equivalent basis from the third quarter of 2008 to the third quarter of 2009 and from the first nine months of 2008 to the first nine months 2009. 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.

(in 000 s)	From the Third Quarter of 2008 to the Third Quarter of 2009		
	Increase(Decrease) Due to Changes in		Total Increase (Decrease)
	Rate	Volume	
<b>Interest income:</b>			
Securities	\$ (52)	\$ 395	\$ 343
Loans	66	(11)	55
Interest-bearing deposits in other banks and federal funds sold	(5)		(5)
<b>Total interest income</b>	<b>9</b>	<b>384</b>	<b>393</b>
<b>Interest expense:</b>			
Time and savings deposits	(1,008)	244	(764)
Borrowings	(607)	(221)	(828)
<b>Total interest expense</b>	<b>(1,615)</b>	<b>23</b>	<b>(1592)</b>
<b>Change in net interest income</b>	<b>\$ 1,624</b>	<b>\$ 361</b>	<b>\$ 1985</b>



**Table of Contents**

(in 000 s)	From the First Nine Months of 2008 to the First Nine Months of 2009		
	Increase(Decrease) Due to Changes in		Total
	Rate	Volume	Increase (Decrease)
<b>Interest income:</b>			
Securities	\$ (186)	\$ 1,039	\$ 853
Loans	(3,317)	2,843	(474)
Interest-bearing deposits in other banks and federal funds sold	(17)	(7)	(24)
<b>Total interest income</b>	<b>(3,520)</b>	<b>3,875</b>	<b>355</b>
<b>Interest expense:</b>			
Time and savings deposits	(3,002)	794	(2,208)
Borrowings	(2,502)	230	(2,272)
<b>Total interest expense</b>	<b>(5,504)</b>	<b>1,024</b>	<b>(4,480)</b>
<b>Change in net interest income</b>	<b>\$ 1,984</b>	<b>\$ 2,851</b>	<b>\$ 4,835</b>

Net interest income, on a taxable-equivalent basis, for the third quarter of 2009 was \$13.5 million, compared to \$11.5 million for the third quarter of 2008. Net interest income, on a taxable-equivalent basis, for the first nine months of 2009 was \$38.0 million, compared to \$33.1 million for the first nine months of 2008. The higher net interest income resulted from increases of 3.1 percent and 8.5 percent in the average balance of interest-earning assets for the third quarter and first nine months of 2009, respectively, compared with the same periods in 2008, coupled with increases of 81 basis points and 33 basis points in the net interest margin for the third quarter and first nine months of 2009, respectively, compared with the same periods in 2008. The increase in the net interest margin occurred primarily at the Finance Company because its fixed-rate loan portfolio is partially funded by a variable-rate line of credit indexed to LIBOR, which has been significantly lower throughout 2009. The Bank's net interest margin began compressing as a result of the combination of rapidly declining short-term interest rates and increased competition for deposits during 2008. With interest rates stabilizing more recently, deposit repricing in the lower interest rate environment and the implementation of interest rate floors on adjustable rate loans at the Bank upon origination or renewal have begun to mitigate the effects of the lower interest rate environment, and margins at the Bank have begun to improve and rebound from their lows.

Average loans held for investment decreased \$12.8 million in the third quarter of 2009, while increasing \$17.9 million in the first nine months of 2009, compared to the same periods in 2008. The Retail Banking segment's average loan portfolio decreased \$18.0 million in the third quarter of 2009, compared to the same period in 2008, primarily as a result of transfers to foreclosed properties. However, the Retail Banking segment's average loan portfolio increased \$11.3 million in the first nine months of 2009, compared to the same periods in 2008, primarily as a result of residential mortgage loan growth, which was offset in part by transfers to foreclosed properties. The Consumer Finance segment's average loan portfolio increased \$7.1 million in the third quarter of 2009 and \$7.9 million in the first nine months of 2009, compared to the same periods in 2008, as result of the purchase of a portfolio of seasoned loans in the Virginia market from an unrelated finance company, as well as increased production within existing markets. Average loans held for sale at the Mortgage Banking segment increased \$12.3 million in the third quarter of 2009 and \$25.1 million in the first nine months of 2009, compared to the same periods in 2008, as a result of higher loan demand in the lower interest rate environment in 2009. The overall yield on loans held for investment at our Retail Banking segment and loans held for sale at the Mortgage Banking segment decreased in the third quarter and first nine months of 2009 in relation to the same periods in 2008 as a result of a general decrease in interest rates. The yield on the Consumer Finance segment's average loan portfolio increased in the third quarter and first nine months of 2009 in relation to the same periods in 2008 as a result of higher rates on loans originated in 2009 and higher loan origination fee income.

**Table of Contents**

Average securities available for sale increased \$23.4 million in the third quarter of 2009 and \$21.0 million in the first nine months of 2009, compared to the same periods in 2008. The increase in securities available for sale occurred predominantly in the Retail Banking segment's municipal bond portfolio. This resulted from a strategy to increase the Bank's securities portfolio as a percentage of total assets. The lower investment portfolio yields in the third quarter and first nine months of 2009 in relation to the same periods in 2008 resulted from the current interest rate environment in which portfolio growth has occurred at lower yields, coupled with a decline in dividends on FHLB stock in 2009.

Average interest-earning deposits at other banks, primarily the Federal Reserve Bank in 2009 and the FHLB in 2008, and federal funds sold increased \$976,000 in the third quarter of 2009, while decreasing \$309,000 in the first nine months of 2009, compared to the same periods in 2008. Fluctuations in the average balance of these low-yielding assets occurred in response to loan demand and an increase in the securities portfolio. The lower average yield on interest-earning deposits at other banks in the third quarter and first nine months of 2009 relative to the same periods in 2008 resulted from the decline in short-term interest rates during 2008.

Average interest-bearing time and savings deposits increased \$25.3 million in the third quarter of 2009 and \$28.9 million in the first nine months of 2009, compared to the same periods in 2008. Growth in lower-rate retail transaction accounts resulted from our deposit strategies that emphasize retention of multi-service customer relationships. Growth in time deposits occurred in deposits of municipalities in our market areas and retail depositors who are maintaining flexibility in their investing options due to the unpredictability in the stock market. The average cost of deposits declined 77 basis points in the third quarter of 2009 and 79 basis points in the first nine months of 2009 in relation to the same periods in 2008. The lower average cost of deposits resulted from the repricing of transaction accounts as interest rates declined throughout 2008 and the more gradual repricing of time deposits to interest rates that are lower than their maturing rates.

Average borrowings decreased \$24.0 million in the third quarter of 2009, while increasing \$7.3 million in the first nine months of 2009, compared to the same periods in 2008. The decline in the third quarter of 2009 reflected the utilization of deposits, rather than borrowings, to fund increased production at the Mortgage Banking segment. The increase during the first nine months of 2009 was attributable to increased use of borrowings from the FHLB and the Federal Reserve Bank to fund loan growth at the Retail Banking and Consumer Finance segments and increased production at the Mortgage Banking segment of loans to be sold in the secondary market, particularly in the first half of 2009. The average cost of borrowings decreased 129 basis points in the third quarter of 2009 and 170 basis points in the first nine months of 2009 in relation to the same periods in 2008 because a portion of the Corporation's borrowings is indexed to short-term interest rates and reprices as short-term interest rates change.

Interest rates and economic conditions will be significant factors influencing the performance of all of the Corporation's business segments during 2009. The net interest margin may be negatively affected if nonperforming loans continue to increase and if deteriorating economic conditions result in lower-yielding loan growth. However, the continued repricing of time deposits to lower interest rates should reduce funding costs and relieve some pressure on the net interest margin, unless competition for deposits hinders a decline in rates paid for deposits.

**Table of Contents****Noninterest Income**

(in 000 s)	Three Months Ended September 30, 2009				
	Retail Banking	Mortgage Banking	Consumer Finance	Other and Eliminations	Total
Gains on sales of loans	\$	\$ 5,464	\$	\$	\$ 5,464
Service charges on deposit accounts	866				866
Other service charges and fees	495	749	2		1,246
Gains (losses) on calls and sales of available for sale securities	3			(25)	(22)
Other income	214	413	141	238	1,006
Total noninterest income	\$ 1,578	\$ 6,626	\$ 143	\$ 213	\$ 8,560

(in 000 s)	Three Months Ended September 30, 2008				
	Retail Banking	Mortgage Banking	Consumer Finance	Other and Eliminations	Total
Gains on sales of loans	\$	\$ 4,539	\$	\$ (15)	\$ 4,524
Service charges on deposit accounts	1,022				1,022
Other service charges and fees	414	542	3		959
Gains on calls and sales of available for sale securities	156			12	168
Impairment of Fannie Mae and Freddie Mac preferred stock				(1,522)	(1,522)
Other income	267	1	101	303	672
Total noninterest income	\$ 1,859	\$ 5,082	\$ 104	\$ (1,222)	\$ 5,823

(in 000 s)	Nine Months Ended September 30, 2009				
	Retail Banking	Mortgage Banking	Consumer Finance	Other and Eliminations	Total
Gains on sales of loans	\$	\$ 19,381	\$	\$	\$ 19,381
Service charges on deposit accounts	2,452				2,452
Other service charges and fees	1,247	2,593	6		3,846
Gains on calls and sales of available for sale securities	33			(25)	8
Other income	544	317	362	849	2,072
Total noninterest income	\$ 4,276	\$ 22,291	\$ 368	\$ 824	\$ 27,759

(in 000 s)	Nine Months Ended September 30, 2008				
	Retail Banking	Mortgage Banking	Consumer Finance	Other and Eliminations	Total
Gains on sales of loans	\$	\$ 12,935	\$	\$ (20)	\$ 12,915
Service charges on deposit accounts	2,939				2,939
Other service charges and fees	1,175	1,645	6		2,826
Gains on calls and sales of available for sale securities	209			12	221
Impairment of Fannie Mae and Freddie Mac preferred stock				(1,522)	(1,522)
Other income	327	2	352	1,013	1,694
Total noninterest income	\$ 4,650	\$ 14,582	\$ 358	\$ (517)	\$ 19,073



**Table of Contents**

Total noninterest income increased \$2.7 million in the third quarter of 2009 and \$8.7 million in the first nine months of 2009, compared to the same periods in 2008. These increases primarily resulted (1) at the Mortgage Banking segment in 2009 from the effect of increased loan production on gains on sale of loans and ancillary fees associated with loan originations, (2) at the Bank in 2009 from higher bank card interchange fees and a fee received in connection with a change in its debit card processor and (3) at the holding company from the \$1.5 million other-than-temporary impairment in the Corporation's holdings of perpetual preferred stock of Fannie Mae and Freddie Mac in the third quarter of 2008. These increases were offset by a lower volume of overdraft charges at the Bank as a result of economic conditions over the past year, which have caused a decrease in the use of this product.

**Noninterest Expense**

(in 000 \$)	Three Months Ended September 30, 2009				
	Retail Banking	Mortgage Banking	Consumer Finance	Other and Eliminations	Total
Salaries and employee benefits	\$ 3,546	\$ 3,309	\$ 1,307	\$ 195	\$ 8,357
Occupancy expense	877	440	95	6	1,418
Other expenses	2,396	1,950	536	64	4,946
Total noninterest expense	\$ 6,819	\$ 5,699	\$ 1,938	\$ 265	\$ 14,721

(in 000 \$)	Three Months Ended September 30, 2008				
	Retail Banking	Mortgage Banking	Consumer Finance	Other and Eliminations	Total
Salaries and employee benefits	\$ 3,509	\$ 2,903	\$ 1,195	\$ 216	\$ 7,823
Occupancy expense	858	507	95	6	1,466
Other expenses	1,468	1,376	566	113	3,523
Total noninterest expense	\$ 5,835	\$ 4,786	\$ 1,856	\$ 335	\$ 12,812

(in 000 \$)	Nine Months Ended September 30, 2009				
	Retail Banking	Mortgage Banking	Consumer Finance	Other and Eliminations	Total
Salaries and employee benefits	\$ 10,325	\$ 12,072	\$ 3,781	\$ 490	\$ 26,668
Occupancy expense	2,656	1,359	310	20	4,345
Other expenses	6,117	5,310	1,757	315	13,499
Total noninterest expense	\$ 19,098	\$ 18,741	\$ 5,848	\$ 825	\$ 44,512

(in 000 \$)	Nine Months Ended September 30, 2008				
	Retail Banking	Mortgage Banking	Consumer Finance	Other and Eliminations	Total
Salaries and employee benefits	\$ 10,697	\$ 8,086	\$ 3,573	\$ 675	\$ 23,031
Occupancy expense	2,741	1,491	303	18	4,553
Other expenses	4,155	3,833	1,703	313	10,004
Total noninterest expense	\$ 17,593	\$ 13,410	\$ 5,579	\$ 1,006	\$ 37,588



**Table of Contents**

Total noninterest expense increased \$1.9 million in the third quarter of 2009 and \$6.9 million in the first nine months of 2009, compared to the same periods in 2008. The Mortgage Banking segment reported higher variable personnel and operating expenses as a result of the increase in loan production in 2009. The Retail Banking segment reported higher operating expenses arising from higher FDIC deposit insurance premiums and the special assessment in the second quarter of 2009 to help replenish the Deposit Insurance Fund, bank card processing expenses, expenses associated with loan work-outs, and foreclosed property expenses and write-downs. Increases in personnel costs and operating expenses at the Consumer Finance segment during 2009 resulted from staff additions to support loan growth and operating expenses associated with loan production.

**Income Taxes**

Income tax expense for the third quarter of 2009 totaled \$716,000, resulting in an effective tax rate of 30.2 percent, compared to \$634,000, or 68.0 percent, for the third quarter of 2008. Income tax expense during the third quarter of 2008 did not include the tax benefit associated with the other-than-temporary impairment charge in preferred stock of Fannie Mae and Freddie Mac because of its designation as a capital loss for income tax purposes. The EESA, enacted on October 3, 2008, provided tax relief to banking organizations that suffered losses on preferred holdings of Fannie Mae and Freddie Mac by changing the character of these losses from capital to ordinary for federal income tax purposes. Therefore, the Corporation did not recognize the \$578,000 tax benefit of the loss until the fourth quarter of 2008, the period of enactment of the new law. Income tax expense for the first nine months of 2009 was \$1.8 million, resulting in an effective tax rate of 26.3 percent, compared to \$1.4 million, resulting in an effective tax rate of 31.4 percent, for the first nine months of 2008. This decrease in the effective rate in 2009 resulted from higher tax-exempt securities income resulting from growth in the Bank's municipal bond portfolio, the effects of which were offset in part by higher pre-tax earnings at the non-bank business segments, which are not exempt from state income taxes.

**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:

(in 000 s)	Three Months Ended September 30, 2009		
	Retail and Mortgage Banking	Consumer Finance	Total
Allowance, beginning of period	\$ 7,913	\$ 13,619	\$ 21,532
Provision for loan losses	1,463	2,900	4,363
	9,376	16,519	25,895
Loans charged off	(600)	(2,846)	(3,446)
Recoveries of loans previously charged off	21	446	467
Net loans charged off	(579)	(2,400)	(2,979)
Allowance, end of period	\$ 8,797	\$ 14,119	\$ 22,916

**Table of Contents**

(in 000 s)	Three Months Ended September 30, 2008		
	Retail and Mortgage Banking	Consumer Finance	Total
Allowance, beginning of period	\$ 5,598	\$ 11,929	\$ 17,527
Provision for loan losses	575	2,570	3,145
	6,173	14,499	20,672
Loans charged off	(297)	(2,706)	(3,003)
Recoveries of loans previously charged off	21	396	417
Net loans charged off	(276)	(2,310)	(2,586)
Allowance, end of period	\$ 5,897	\$ 12,189	\$ 18,086
(in 000 s)	Nine Months Ended September 30, 2009		
	Retail and Mortgage Banking	Consumer Finance	Total
Allowance, beginning of period	\$ 7,198	\$ 12,608	\$ 19,806
Provision for loan losses	4,063	8,800	12,863
	11,261	21,408	32,669
Loans charged off	(2,538)	(8,590)	(11,128)
Recoveries of loans previously charged off	74	1,301	1,375
Net loans charged off	(2,464)	(7,289)	(9,753)
Allowance, end of period	\$ 8,797	\$ 14,119	\$ 22,916
(in 000 s)	Nine Months Ended September 30, 2008		
	Retail and Mortgage Banking	Consumer Finance	Total
Allowance, beginning of period	\$ 4,743	\$ 11,220	\$ 15,963
Provision for loan losses	1,747	6,970	8,717
	6,490	18,190	24,680
Loans charged off	(672)	(7,138)	(7,810)
Recoveries of loans previously charged off	79	1,137	1,216
Net loans charged off	(593)	(6,001)	(6,594)
Allowance, end of period	\$ 5,897	\$ 12,189	\$ 18,086

There has been a \$1.6 million increase in the allowance for loan losses at the combined Retail Banking and Mortgage Banking segments since December 31, 2008, and the provision for loan losses at these combined segments increased \$888,000 and \$2.3 million in the third quarter and



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

first nine months of 2009, respectively, compared to the same periods in 2008. These increases were attributable to the sustained level of nonperforming assets of the combined Retail Banking and Mortgage Banking segments as discussed below. Net charge-offs for these combined segments for the first nine months of 2009 included write downs at the Bank of three collateral-dependent commercial relationships based on an impairment analysis, which indicated that their respective carrying values exceeded the fair market value of the underlying real estate collateral. We believe that the current level of the

**Table of Contents**

allowance for loan losses 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 \$14.1 million since December 31, 2008, and its provision for loan losses increased \$330,000 and \$1.8 million in the third quarter and first nine months of 2009, respectively, compared to the same periods in 2008. The increase in the provision for loan losses was primarily attributable to higher net charge-offs in 2009 and loan growth. We believe that the current level of the allowance for loan losses at C&F Finance is adequate to absorb any losses on existing loans that may become uncollectible. However, if unemployment continues to rise for the remainder of 2009 and if weakening consumer demand for automobiles results in declining values of automobiles securing outstanding loans, a higher provision for loan losses may become necessary.

**Nonperforming Assets**

<b>Retail and Mortgage Banking</b> (in 000 \$)	<b>September 30, 2009</b>	<b>December 31, 2008</b>
Nonaccrual loans*-Retail Banking	\$ 8,232	\$ 17,222
Nonaccrual loans*-Mortgage Banking	253	1,460
OREO**-Retail Banking	12,116	1,370
OREO**-Mortgage Banking	719	596
<b>Total nonperforming assets</b>	<b>\$ 21,320</b>	<b>\$ 20,648</b>
Accruing loans* past due for 90 days or more	\$ 231	\$ 3,517
<b>Total loans*</b>	<b>\$ 456,691</b>	<b>\$ 480,438</b>
Allowance for loan losses	\$ 8,797	\$ 7,198
<b>Nonperforming assets to total loans* and OREO**</b>	<b>4.54%</b>	<b>4.28%</b>
Allowance for loan losses to total loans*	1.93	1.50
Allowance for loan losses to nonaccrual loans*	103.68	38.53

\* Loans exclude Consumer Finance segment loans presented below.

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

<b>Consumer Finance</b> (in 000 \$)	<b>September 30, 2009</b>	<b>December 31, 2008</b>
Nonaccrual loans	\$ 386	\$ 798
Accruing loans past due for 90 days or more		\$
<b>Total loans</b>	<b>\$ 183,798</b>	<b>\$ 172,385</b>
Allowance for loan losses	\$ 14,119	\$ 12,608
<b>Nonaccrual consumer finance loans to total consumer finance loans</b>	<b>0.21%</b>	<b>0.46%</b>
Allowance for loan losses to total consumer finance loans	7.68	7.31

Nonperforming assets at the combined Retail Banking and Mortgage Banking segments increased to \$21.3 million at September 30, 2009 and consist of \$8.5 million of nonaccrual loans and \$12.8 million of foreclosed properties. The largest components of the Bank's nonaccrual loans are three commercial relationships aggregating \$5.8 million, which are secured by residential real estate. The largest components of the Bank's foreclosed properties are \$12.0 million of residential properties associated with three commercial relationships, \$10.7 million of which was in nonaccrual loan status as of December 31, 2008. These properties have been written down to their estimated fair market values based upon current appraisals less selling costs. Nonaccrual loans and foreclosed properties of



**Table of Contents**

the Mortgage Banking segment totaled \$253,000 and \$719,000, respectively, at September 30, 2009, and resulted primarily from loans that were repurchased from investors because of documentation issues. In addition, loans past due for 90 days or more and still accruing interest totaled \$231,000 at the combined Retail and Mortgage Banking segment at September 30, 2009, and consist primarily of a small number of loans secured by real estate. We have increased our allowance as a percentage of total loans at the combined Retail and Mortgage Banking segment largely as a result of the sustained level of nonperforming loans and the continued deterioration in the economy, in particular the housing market. We may continue to make adjustments to the allowance level in the future based upon changes in our loan portfolios and general economic conditions.

Nonaccrual loans at the Consumer Finance segment have declined from \$798,000 at December 31, 2008 to \$386,000 at September 30, 2009. Nonetheless, the allowance for loan losses increased from \$12.6 million at December 31, 2008 to \$14.1 million at September 30, 2009, and the ratio of the allowance for loan losses to total consumer finance loans increased 37 basis points, as a result of our concern about general employment levels and economic conditions. The Finance Company's loan portfolio could be immediately adversely affected by the ongoing effects of the economic recession. Increasing unemployment levels, decreased consumer demand for automobiles and declining values of automobiles securing outstanding loans could increase the level of charge-offs. We may make adjustments to our allowance level in the future based upon changes in our loan portfolio and general economic conditions.

*FINANCIAL CONDITION*

At September 30, 2009, the Corporation had total assets of \$874.9 million compared to \$855.7 million at December 31, 2008. The increase was principally a result of increases in investment securities at the Bank, loans held for investment at the Finance Company, and loans held for sale at the Mortgage Company, which were offset in part by a decline in loans held for investment at the Bank. Asset growth was primarily funded with increased deposits.

**Table of Contents****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:

(in 000 s)	September 30, 2009		December 31, 2008	
	Amount	Percent	Amount	Percent
Real estate - residential mortgage	\$ 146,470	23%	\$ 141,341	22%
Real estate - construction	14,006	2	28,286	4
Commercial, financial and agricultural <sup>1</sup>	255,745	40	272,164	42
Equity lines	31,774	5	29,136	4
Consumer	8,696	1	9,511	1
Consumer - Consumer Finance	183,798	29	172,385	27
<b>Total loans</b>	<b>640,489</b>	<b>100%</b>	<b>652,823</b>	<b>100%</b>
Less allowance for loan losses				
Retail and Mortgage Banking	(8,797)		(7,198)	
Consumer Finance	(14,119)		(12,608)	
<b>Total loans, net</b>	<b>\$ 617,573</b>		<b>\$ 633,017</b>	

<sup>1</sup> Includes loans secured by real estate for builder lines, acquisition and development and commercial development, as well as commercial loans secured by personal property.

The decline in total loans occurred primarily in the consumer real estate-construction and commercial categories as a result of the slowdown in new residential construction, coupled with the foreclosure of residential real estate securing three commercial relationships.

**Investment Securities**

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:

(in 000 s)	September 30, 2009		December 31, 2008	
	Amount	Percent	Amount	Percent
U.S. government agencies and corporations	\$ 9,198	8%	\$ 11,162	11%
Mortgage-backed securities	3,046	2	2,318	2
Obligations of states and political subdivisions	106,095	89	85,511	85
<b>Total debt securities</b>	<b>118,339</b>	<b>99</b>	<b>98,991</b>	<b>98</b>
Preferred stock	1,435	1	1,612	2
<b>Total available for sale securities</b>	<b>\$ 119,774</b>	<b>100%</b>	<b>\$ 100,603</b>	<b>100%</b>

## **Table of Contents**

### ***Deposits***

Deposits totaled \$575.4 million at September 30, 2009, compared to \$550.7 million at December 31, 2008, which is an increase of \$24.7 million. Growth in time deposits, which increased \$33.6 million, occurred in the shorter-term time deposits of municipalities in our market areas and in the no-penalty time deposits of retail depositors who are maintaining flexibility in their investing options due to the unpredictability in the stock market.

### ***Borrowings***

Borrowings totaled \$171.7 million at September 30, 2009, compared to \$198.8 million at December 31, 2008. This decrease was attributable to growth in deposits, which replaced borrowings as a funding source for lending activities at the Mortgage Banking segment, and the liquidity created by the sale of the Series A Preferred Stock and Warrant.

### ***Off-Balance Sheet Arrangements***

As of September 30, 2009, there have been no material changes to the off-balance sheet arrangements disclosed in Management's Discussion and Analysis of Financial Condition and Results of Operations in the Corporation's Annual Report on Form 10-K for the year ended December 31, 2008.

### ***Contractual Obligations***

As of September 30, 2009, there have been no material changes outside the ordinary course of business to the contractual obligations disclosed in Management's Discussion and Analysis of Financial Condition and Results of Operations in the Corporation's Annual Report on Form 10-K for the year ended December 31, 2008.

### ***Liquidity***

Liquid assets, which include cash and due from banks, interest-earning deposits at other banks, federal funds sold and nonpledged securities available for sale, at September 30, 2009, totaled \$85.9 million. The Corporation's funding sources consist of: (1) established federal funds lines with third-party financial institutions that had \$26.6 million outstanding under lines totaling \$32.0 million as of September 30, 2009, (2) a \$5.0 million repurchase agreement outstanding with a third-party broker as of September 30, 2009, (3) an established line with the FHLB that had \$52.5 million outstanding under a total line of \$90.3 million as of September 30, 2009, (4) an established line with the Federal Reserve Bank that had \$10.0 million outstanding under a total line of \$79.0 million as of September 30, 2009 and (5) a revolving line of credit with a third-party bank that had \$71.2 million outstanding under a total line of \$120.0 million as of September 30, 2009. We have no reason to believe these arrangements will not be renewed at maturity. The decrease in availability from the FHLB since December 31, 2008 resulted from the release of a portion of the blanket lien securing FHLB advances in order to pledge additional loans for future borrowings from the Federal Reserve Bank.

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.

**Table of Contents****Capital Resources**

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

(in 000 \$)	Actual		Minimum Capital Requirements		Minimum To Be Well Capitalized Under Prompt Corrective Action Provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
<b>As of September 30, 2009:</b>						
Total Capital (to Risk-Weighted Assets)						
Corporation	\$ 107,593	15.7%	\$ 54,887	8.0%	N/A	N/A
Bank	102,877	15.1	54,475	8.0	\$ 68,094	10.0%
Tier 1 Capital (to Risk-Weighted Assets)						
Corporation	98,840	14.4	27,443	4.0	N/A	N/A
Bank	94,188	13.8	27,237	4.0	40,856	6.0
Tier 1 Capital (to Average Tangible Assets)						
Corporation	98,840	11.5	34,342	4.0	N/A	N/A
Bank	94,188	11.0	34,189	4.0	42,736	5.0
<b>As of December 31, 2008:</b>						
Total Capital (to Risk-Weighted Assets)						
Corporation	\$ 83,836	12.3%	\$ 54,500	8.0%	N/A	N/A
Bank	81,174	12.0	54,109	8.0	\$ 67,637	10.0%
Tier 1 Capital (to Risk-Weighted Assets)						
Corporation	73,575	10.8	27,250	4.0	N/A	N/A
Bank	72,579	10.7	27,055	4.0	40,582	6.0
Tier 1 Capital (to Average Tangible Assets)						
Corporation	73,575	8.9	33,263	4.0	N/A	N/A
Bank	72,579	8.7	33,217	4.0	41,521	5.0

On January 9, 2009, as part of the Capital Purchase Program, the Corporation issued and sold to Treasury 20,000 shares of the Corporation's Series A Preferred Stock having a liquidation preference of \$1,000 per share and a Warrant for the purchase of up to 167,504 shares of the Corporation's Common Stock, for a total price of \$20.0 million. The Series A Preferred Stock has been treated as Tier 1 capital for regulatory capital adequacy determination purposes as of September 30, 2009.

**Effects of Inflation**

The effect of changing prices on financial institutions is typically different from other industries as the Corporation's assets and liabilities are monetary in nature. Interest rates are significantly impacted by inflation, but neither the timing nor the magnitude of the changes is directly related to price level indices. Impacts of inflation on interest rates, loan demand and deposits are reflected in the consolidated financial statements.

**Table of Contents***USE OF CERTAIN NON-GAAP FINANCIAL MEASURES*

In addition to results presented in accordance with United States GAAP, we have presented certain non-GAAP financial measures for the three and nine months ended September 30, 2008 throughout this Form 10-Q, which are reconciled to their equivalent GAAP financial measures below. We believe these non-GAAP financial measures provide information useful to investors in understanding the Corporation's performance trends and facilitate comparisons with its peers. Specifically, we believe the exclusion of a significant impairment charge recognized in a single accounting period in 2008 permits a comparison of results for ongoing business operations, and it is on this basis that we internally assess the Corporation's performance and establish goals for future periods. Although we believe the non-GAAP financial measures presented in this Form 10-Q enhance investors' understandings of the Corporation's performance, these non-GAAP financial measures should not be considered a substitute for GAAP financial measures.

**Reconciliation of Non-GAAP Financial Measures**

(dollars in thousands, except for per share data)

		For the Quarter		For the Nine Months	
		Ended September 30,		Ended September 30,	
	*	2009	2008	2009	2008
<b>Net Income and Earnings Per Share</b>					
Net income (GAAP)		\$ 1,658	299	\$ 4,916	\$ 3,144
Effective dividends on Treasury preferred stock		(291)		(839)	
Net income available to common shareholders (GAAP)	A	1,367	299	4,077	3,144
Other-than-temporary impairment on Fannie Mae and Freddie Mac preferred stock (GAAP)			1,522		1,522
Net income available to common shareholders, excluding other-than-temporary impairment on Fannie Mae and Freddie Mac preferred stock	B	\$ 1,367	\$ 1,821	\$ 4,077	\$ 4,666
Weighted average common shares assuming dilution (GAAP)	C	3,047	3,049	3,043	3,066
Weighted average common shares basic (GAAP)	D	3,044	3,031	3,042	3,026
Earnings per common share assuming dilution GAAP	A/C	\$ 0.45	\$ 0.10	\$ 1.34	\$ 1.03
Excluding other-than-temporary impairment on Fannie Mae and Freddie Mac preferred stock	B/C	\$ 0.45	\$ 0.60	\$ 1.34	\$ 1.52
Earnings per common share basic GAAP	A/D	\$ 0.45	\$ 0.10	\$ 1.34	\$ 1.04
Excluding other-than-temporary impairment on Fannie Mae and Freddie Mac preferred stock	B/D	\$ 0.45	\$ 0.60	\$ 1.34	\$ 1.54



**Table of Contents****Reconciliation of Non-GAAP Financial Measures**

(dollars in thousands, except for per share data)

	*	For the Quarter Ended September 30,		For the Nine Months Ended September 30,	
		2009	2008	2009	2008
<b>Annualized Return on Average Assets</b>					
Average assets (GAAP)	E	\$ 867,654	\$ 838,458	877,958	\$ 812,499
Annualized return on average assets					
GAAP	(A/E)*4	0.63%	0.14%		
GAAP	(A/E)/.75			0.62%	0.52%
Excluding other-than-temporary impairment on Fannie Mae and Freddie Mac preferred stock	(B/E)*4	0.63%	0.87%		
Excluding other-than-temporary impairment on Fannie Mae and Freddie Mac preferred stock	(B/E)/.75			0.62%	0.77%
<b>Annualized Return on Average Common Equity</b>					
Average equity (GAAP)	F	\$ 67,625	\$ 65,819	\$ 66,080	\$ 65,701
Annualized return on average equity					
GAAP	(A/F)*4	8.14%	1.82%		
GAAP	(A/F)/.75			8.21%	6.38%
Excluding other-than-temporary impairment on Fannie Mae and Freddie Mac preferred stock	(B/F)*4	8.14%	11.07%		
Excluding other-than-temporary impairment on Fannie Mae and Freddie Mac preferred stock	(B/F)/.75			8.21%	9.47%

\* The letters included in this column are provided to show how the various ratios presented in the Reconciliation of Non-GAAP Financial Measures are calculated.

**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, 2008.

**ITEM 4. CONTROLS AND PROCEDURES**

The Corporation's management, with the participation of 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 September 30, 2009 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

## **Table of Contents**

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 third quarter ended September 30, 2009 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, 2008.

### **ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS**

There have been no purchases of the Corporation's Common Stock during 2009 as part of the board-approved authorization on July 24, 2008, which expired in July 2009. Further, in connection with the Corporation's sale to Treasury of its Series A Preferred Stock and Warrant under the Capital Purchase Program, as previously described, there are limitations on the Corporation's ability to purchase Common Stock prior to the earlier of January 9, 2012 or the date on which Treasury no longer holds any of the Series A Preferred Stock. Prior to such time, the Corporation generally may not purchase any Common Stock without the consent of the Treasury, subject to certain exceptions such as certain repurchases in connection with the administration of employee benefit plans.

As noted earlier, the purchase agreement pursuant to which the Series A Preferred Stock and the Warrant were sold contains limitations on the Corporation's payment of dividends or distributions on the Common Stock (including the payment of cash dividends in excess of the amount per share of the Corporation's last quarterly cash dividend declared before October 14, 2008, which was 31 cents per share) until the earlier of January 9, 2012 or such time as Treasury no longer owns any Series A Preferred Stock acquired through the Capital Purchase Program. In addition, as is typical with cumulative preferred stocks, dividend payments on the Series A Preferred Stock must be paid before dividends can be paid on junior shares, such as the Corporation's Common Stock.

**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)
- 31.1 Certification of CEO pursuant to Rule 13a-14(a)
- 31.2 Certification of CFO pursuant to Rule 13a-14(a)
- 32 Certification of CEO/CFO pursuant to 18 U.S.C. Section 1350

**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 November 3, 2009

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

Date November 3, 2009

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