

C & F FINANCIAL CORP  
Form 10-Q  
November 10, 2014  
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, 2014**

**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)**

---

<b>Virginia</b> <b>(State or other jurisdiction of incorporation or organization)</b>	<b>54-1680165</b> <b>(I.R.S. Employer Identification No.)</b>
<b>802 Main Street West Point, VA</b> <b>(Address of principal executive offices)</b>	<b>23181</b> <b>(Zip Code)</b>

**(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, 2014, the latest practicable date for determination, 3,404,167 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>	3
Item 1. <u>Financial Statements</u>	3
<u>Consolidated Balance Sheets - September 30, 2014 (unaudited) and December 31, 2013</u>	3
<u>Consolidated Statements of Income (unaudited) - Three and nine months ended September 30, 2014 and 2013</u>	4
<u>Consolidated Statements of Comprehensive Income (unaudited) - Three and nine months ended September 30, 2014 and 2013</u>	5
<u>Consolidated Statements of Shareholders' Equity (unaudited) - Nine months ended September 30, 2014 and 2013</u>	6
<u>Consolidated Statements of Cash Flows (unaudited) - Nine months ended September 30, 2014 and 2013</u>	7
<u>Notes to Consolidated Financial Statements (unaudited)</u>	8
Item 2. <u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	35
Item 3. <u>Quantitative and Qualitative Disclosures About Market Risk</u>	62
Item 4. <u>Controls and Procedures</u>	62
<u>Part II - Other Information</u>	63
Item 1A. <u>Risk Factors</u>	63
Item 2. <u>Unregistered Sales of Equity Securities and Use of Proceeds</u>	63
Item 6. <u>Exhibits</u>	64
<u>Signatures</u>	65

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

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

	<b>September 30, 2014</b>	<b>December 31, 2013</b>
	<b>(Unaudited)</b>	
<b><u>ASSETS</u></b>		
Cash and due from banks	<b>\$ 10,357</b>	\$ 14,666
Interest-bearing deposits in other banks	<b>134,972</b>	41,750
Federal funds sold	<b>—</b>	91,723
Total cash and cash equivalents	<b>145,329</b>	148,139
Securities-available for sale at fair value, amortized cost of \$214,000 and \$217,708, respectively	<b>220,093</b>	218,110
Loans held for sale, at fair value	<b>35,910</b>	35,879
Loans, net of allowance for loan losses of \$35,573 and \$34,852, respectively	<b>792,117</b>	785,532
Restricted stocks, at cost	<b>3,690</b>	4,336
Corporate premises and equipment, net	<b>37,735</b>	38,232
Other real estate owned, net of valuation allowance of \$578 and \$4,135, respectively	<b>1,087</b>	2,769
Accrued interest receivable	<b>6,243</b>	6,360
Goodwill	<b>14,425</b>	14,425
Core deposit intangible, net	<b>2,860</b>	3,774
Bank-owned life insurance	<b>14,275</b>	13,988
Other assets	<b>42,231</b>	40,753
Total assets	<b>\$ 1,315,995</b>	\$ 1,312,297
<b><u>LIABILITIES AND SHAREHOLDERS' EQUITY</u></b>		
Deposits		
Noninterest-bearing demand deposits	<b>\$ 171,434</b>	\$ 147,520
Savings and interest-bearing demand deposits	<b>462,856</b>	460,889
Time deposits	<b>367,142</b>	399,883
Total deposits	<b>1,001,432</b>	1,008,292
Short-term borrowings	<b>12,431</b>	11,780
Long-term borrowings	<b>132,987</b>	132,987
Trust preferred capital notes	<b>25,095</b>	25,068
Accrued interest payable	<b>791</b>	843
Other liabilities	<b>21,228</b>	20,386
Total liabilities	<b>1,193,964</b>	1,199,356

Commitments and contingent liabilities	—	—
Shareholders' equity		
Common stock (\$1.00 par value, 8,000,000 shares authorized, 3,402,691 and 3,388,793 shares issued and outstanding, respectively)	<b>3,276</b>	3,269
Additional paid-in capital	<b>9,095</b>	10,686
Retained earnings	<b>106,152</b>	99,252
Accumulated other comprehensive income (loss), net	<b>3,508</b>	(266 )
Total shareholders' equity	<b>122,031</b>	112,941
Total liabilities and shareholders' equity	<b>\$ 1,315,995</b>	\$ 1,312,297

*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>2014</b>	<b>2013</b>	<b>2014</b>	<b>2013</b>
Interest income				
Interest and fees on loans	<b>\$20,050</b>	\$18,325	<b>\$59,366</b>	\$54,062
Interest on money market investments and federal funds sold	<b>92</b>	28	<b>288</b>	89
Interest and dividends on securities				
U.S. government agencies and corporations	<b>172</b>	111	<b>556</b>	317
Tax-exempt obligations of states and political subdivisions	<b>1,094</b>	1,149	<b>3,326</b>	3,427
Corporate bonds and other	<b>430</b>	41	<b>1,308</b>	112
Total interest income	<b>21,838</b>	19,654	<b>64,844</b>	58,007
Interest expense				
Savings and interest-bearing deposits	<b>241</b>	168	<b>761</b>	573
Certificates of deposit, \$100 or more	<b>305</b>	358	<b>975</b>	1,087
Other time deposits	<b>440</b>	458	<b>1,391</b>	1,411
Borrowings	<b>889</b>	896	<b>2,637</b>	2,662
Trust preferred capital notes	<b>241</b>	189	<b>713</b>	566
Total interest expense	<b>2,116</b>	2,069	<b>6,477</b>	6,299
Net interest income	<b>19,722</b>	17,585	<b>58,367</b>	51,708
Provision for loan losses	<b>4,140</b>	3,840	<b>10,915</b>	10,140
Net interest income after provision for loan losses	<b>15,582</b>	13,745	<b>47,452</b>	41,568
Noninterest income				
Gains on sales of loans	<b>1,188</b>	1,790	<b>4,025</b>	7,068
Service charges on deposit accounts	<b>1,179</b>	1,010	<b>3,357</b>	2,930
Other service charges and fees	<b>1,672</b>	1,655	<b>4,668</b>	4,631
Net gains on sales/calls of available for sale securities	<b>23</b>	270	<b>26</b>	276
Other income	<b>561</b>	914	<b>2,625</b>	2,795
Total noninterest income	<b>4,623</b>	5,639	<b>14,701</b>	17,700
Noninterest expenses				
Salaries and employee benefits	<b>8,811</b>	7,862	<b>27,035</b>	23,160
Occupancy expenses	<b>2,188</b>	1,791	<b>6,503</b>	5,329
Other expenses	<b>4,586</b>	4,871	<b>14,657</b>	13,612
Total noninterest expenses	<b>15,585</b>	14,524	<b>48,195</b>	42,101

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

Income before income taxes	<b>4,620</b>	4,860	<b>13,958</b>	17,167
Income tax expense	<b>1,326</b>	1,494	<b>4,029</b>	5,617
Net income	<b>\$3,294</b>	\$3,366	<b>\$9,929</b>	\$11,550
Per common share data				
Net income – basic	<b>\$0.97</b>	\$1.01	<b>\$2.92</b>	\$3.51
Net income – assuming dilution	<b>\$0.97</b>	\$0.97	<b>\$2.88</b>	\$3.37
Weighted average number of shares – basic	<b>3,405,162</b>	3,318,687	<b>3,403,749</b>	3,287,146
Weighted average number of shares – assuming dilution	<b>3,405,308</b>	3,484,961	<b>3,446,472</b>	3,423,097

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



Table Of Contents**CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME**

(Unaudited)

(In thousands)

	<b>Three Months Ended September 30, 2014</b>		<b>Nine Months Ended September 30, 2013</b>	
Net income	<b>\$3,294</b>	\$3,366	<b>\$9,929</b>	\$11,550
Other comprehensive income (loss), net:				
Changes in defined benefit plan assets and benefit obligations				
Changes in net loss arising during the period <sup>1</sup>	<b>40</b>	30	<b>24</b>	91
Tax effect	<b>(14 )</b>	(11 )	<b>(8 )</b>	(32 )
Amortization of prior service cost <sup>1</sup>	<b>(85 )</b>	(17 )	<b>(51 )</b>	(51 )
Tax effect	<b>30</b>	6	<b>18</b>	18
Net of tax amount	<b>(29 )</b>	8	<b>(17 )</b>	26
Unrealized gain on cash flow hedging instruments				
Unrealized holding gain arising during the period	<b>53</b>	25	<b>139</b>	141
Tax effect	<b>(19 )</b>	(10 )	<b>(53 )</b>	(55 )
Net of tax amount	<b>34</b>	15	<b>86</b>	86
Unrealized holding gains (losses) on securities				
Unrealized holding gains (losses) arising during the period	<b>602</b>	(655 )	<b>5,715</b>	(6,440 )
Tax effect	<b>(212 )</b>	222	<b>(1,993 )</b>	2,247
Reclassification adjustment for gains included in net income <sup>2</sup>	<b>(23 )</b>	(270 )	<b>(26 )</b>	(276 )
Tax effect	<b>8</b>	103	<b>9</b>	105
Net of tax amount	<b>375</b>	(600 )	<b>3,705</b>	(4,364 )
Other comprehensive income (loss), net:	<b>380</b>	(577 )	<b>3,774</b>	(4,252 )
Comprehensive income, net	<b>\$3,674</b>	\$2,789	<b>\$13,703</b>	\$7,298

<sup>1</sup> These items are included in the computation of net periodic benefit cost. See Note 7, Employee Benefit Plan, for additional information.

<sup>2</sup> Gains are included in "Net gains on sales/calls of available for sale securities" on the income statement.

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



Table Of Contents**CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY**

(Unaudited)

(In thousands, except per share amounts)

	<b>Common Stock</b>	<b>Additional Paid-In Capital</b>	<b>Retained Earnings</b>	<b>Accumulated Other Comprehensive Income (Loss), Net</b>	<b>Total Shareholders' Equity</b>
Balance December 31, 2013	\$ 3,269	\$ 10,686	\$ 99,252	\$ (266)	) \$ 112,941
Comprehensive income:					
Net income	—	—	9,929	—	9,929
Other comprehensive income, net	—	—	—	3,774	3,774
Common stock warrant repurchased	—	(2,303)	—	—	(2,303)
Share-based compensation	—	721	—	—	721
Restricted stock vested	8	(16)	—	—	(8)
Common stock issued	2	97	—	—	99
Common stock purchased	(3)	(90)	—	—	(93)
Cash dividends paid – common stock (\$0.89 per share)	—	—	(3,029)	—	(3,029)
Balance September 30, 2014	\$ 3,276	\$ 9,095	\$ 106,152	\$ 3,508	\$ 122,031

	<b>Common Stock</b>	<b>Additional Paid-In Capital</b>	<b>Retained Earnings</b>	<b>Accumulated Other Comprehensive Income (Loss), Net</b>	<b>Total Shareholders' Equity</b>
Balance December 31, 2012	\$ 3,162	\$ 5,624	\$ 88,695	\$ 4,716	\$ 102,197
Comprehensive income:					
Net income	—	—	11,550	—	11,550
Other comprehensive (loss), net	—	—	—	(4,252)	(4,252)
Stock options exercised	55	2,157	—	—	2,212
Share-based compensation	—	454	—	—	454
Restricted stock vested	6	(6)	—	—	—
Common stock issued	2	82	—	—	84
	—	—	(2,866)	—	(2,866)

Cash dividends paid – common stock (\$0.87 per share)

Balance September 30, 2013	\$ 3,225	\$ 8,311	\$ 97,379	\$ 464	\$ 109,379
----------------------------	----------	----------	-----------	--------	------------

*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>2014</b>	<b>2013</b>
Operating activities:		
Net income	<b>\$9,929</b>	\$11,550
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation	<b>2,072</b>	1,674
Provision for loan losses	<b>10,915</b>	10,140
Provision for indemnifications	<b>182</b>	492
Provision for other real estate owned losses	<b>—</b>	459
Share-based compensation	<b>713</b>	454
Net accretion of acquisition-related fair value adjustments	<b>(2,166 )</b>	—
Accretion of discounts and amortization of premiums on securities, net	<b>1,075</b>	497
Net realized gains on sales/calls of securities	<b>(26 )</b>	(276 )
Net realized gains on sales of other real estate owned	<b>(206 )</b>	(102 )
Net realized gain on sale of equipment	<b>(59 )</b>	—
Income from bank-owned life insurance	<b>(256 )</b>	—
Proceeds from sales of loans held for sale	<b>363,653</b>	608,458
Origination of loans held for sale	<b>(363,684)</b>	(591,642)
Change in other assets and liabilities:		
Accrued interest receivable	<b>117</b>	64
Other assets	<b>(3,537 )</b>	(112 )
Accrued interest payable	<b>(52 )</b>	(63 )
Other liabilities	<b>629</b>	(4,379 )
Net cash provided by operating activities	<b>19,299</b>	37,214
Investing activities:		
Proceeds from maturities, calls and sales of securities available for sale	<b>31,864</b>	17,566
Purchases of securities available for sale	<b>(28,795 )</b>	(19,116 )
Redemption of restricted stocks	<b>646</b>	219
Net increase in customer loans	<b>(18,302 )</b>	(19,401 )
Proceeds from sales of other real estate owned	<b>4,767</b>	2,367
Purchases of corporate premises and equipment, net	<b>(1,603 )</b>	(3,129 )
Net cash used in investing activities	<b>(11,423 )</b>	(21,494 )
Financing activities:		
Net increase in demand, interest-bearing demand and savings deposits	<b>25,881</b>	8,695
Net decrease in time deposits	<b>(31,892 )</b>	(9,647 )
Net increase in borrowings	<b>651</b>	4,514

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

Proceeds from exercise of stock options	—	2,212
Repurchase of common stock	(93 )	—
Repurchase of common stock warrant	(2,303 )	—
Issuance of common stock	99	84
Cash dividends	(3,029 )	(2,866 )
Net cash (used in) provided by financing activities	(10,686 )	2,992
Net (decrease) increase in cash and cash equivalents	(2,810 )	18,712
Cash and cash equivalents at beginning of period	148,139	25,620
Cash and cash equivalents at end of period	\$ 145,329	\$ 44,332
Supplemental disclosure		
Interest paid	\$ 7,351	\$ 6,362
Income taxes paid	2,399	5,058
Supplemental disclosure of noncash investing and financing activities		
Unrealized gains (losses) on securities available for sale	\$ 5,689	\$(6,716 )
Loans transferred to other real estate owned	2,735	268
Pension adjustment	(27 )	40
Unrealized gain on cash flow hedging instrument	139	141

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

Table Of Contents

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**(Unaudited)**

**NOTE 1: Summary of Significant Accounting Policies**

**Principles of Consolidation:** The accompanying unaudited consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America (U.S. GAAP) for interim financial reporting and with applicable quarterly reporting regulations of the Securities and Exchange Commission (the SEC). They do not include all of the information and notes required by U.S. GAAP for complete financial statements. Therefore, these consolidated financial statements should be read in conjunction with the consolidated financial statements and notes thereto included in the C&F Financial Corporation Annual Report on Form 10-K for the year ended December 31, 2013.

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

**Nature of Operations:** C&F Financial Corporation is a bank holding company incorporated under the laws of the Commonwealth of Virginia. The Corporation owns all of the stock of its subsidiary, Citizens and Farmers Bank, which is an independent commercial bank chartered under the laws of the Commonwealth of Virginia. On October 1, 2013, the Corporation acquired Central Virginia Bankshares, Inc. (CVBK) and its wholly-owned subsidiary, Central Virginia Bank (CVB), which was an independent commercial bank chartered under the laws of the Commonwealth of Virginia. On March 22, 2014, CVBK was merged with and into C&F Financial Corporation and CVB was merged with and into C&F Bank.

The Bank has six wholly-owned subsidiaries: C&F Mortgage Corporation and Subsidiaries (C&F Mortgage), C&F Finance Company (C&F Finance), C&F Title Agency, Inc., C&F Investment Services, Inc., C&F Insurance Services, Inc. and CVB Title Services, Inc., all incorporated under the laws of the Commonwealth of Virginia. C&F Mortgage, organized in September 1995, was formed to originate and sell residential mortgages and through its subsidiaries, Hometown Settlement Services LLC and Certified Appraisals LLC, provides ancillary mortgage loan production services, such as loan settlements, title searches and residential appraisals. C&F Finance, acquired on September 1,

2002, is a finance company providing automobile loans through indirect lending programs. C&F Title Agency, Inc., organized in October 1992, primarily sells title insurance to the mortgage loan customers of the Bank and C&F Mortgage. C&F Investment Services, Inc., organized in April 1995, is a full-service brokerage firm offering a comprehensive range of investment services. C&F Insurance Services, Inc., organized in July 1999, owns an equity interest in an insurance agency that sells insurance products to customers of the Bank, C&F Mortgage and other financial institutions that have an equity interest in the agency. CVB Title Services, Inc. was organized for the primary purpose of owning membership interests in two insurance-related limited liability companies. Business segment data is presented in Note 9.

**Basis of Presentation:** The preparation of financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. Material estimates that are particularly susceptible to significant change in the near term relate to the determination of the allowance for loan losses, the allowance for indemnifications, impairment of loans, impairment of securities, the valuation of other real estate owned, the projected benefit obligation under the defined benefit pension plan, the valuation of deferred taxes, fair value measurements and goodwill impairment. In the opinion of management, all adjustments, consisting only of normal recurring adjustments, which are necessary for a fair presentation of the results of operations in these financial statements, have been made.



Table Of Contents

**Reclassification:** Certain reclassifications have been made to prior period amounts to conform to the current period presentation. None of these reclassifications are considered material.

**Derivative Financial Instruments:** The Corporation recognizes derivative financial instruments at fair value as either an other asset or an other liability in the consolidated balance sheet. The Corporation's derivative financial instruments as of September 30, 2014 and December 31, 2013 consisted of (1) the fair value of interest rate lock commitments (IRLCs) on mortgage loans that will be sold in the secondary market and the related forward commitments to sell mortgage loans and (2) interest rate swaps that qualified as cash flow hedges of a portion of the Corporation's trust preferred capital notes. Derivative financial instruments as of December 31, 2013 additionally included forward commitments related to IRLCs to sell mortgage-backed securities (MBS). Adjustments to reflect unrealized gains and losses resulting from changes in fair value of the Corporation's IRLCs and forward sales commitments and realized gains and losses upon ultimate sale of the loans are classified as noninterest income. The Corporation's IRLCs and forward loan sales commitments are described more fully in Note 8 and Note 10. The effective portion of the gain or loss on the Corporation's cash flow hedges is reported as a component of other comprehensive income, net of deferred income taxes, and reclassified into earnings in the same period(s) during which the hedged transaction affects earnings. The cash flow hedges are described more fully in Note 11.

**Share-Based Compensation:** Compensation expense for the third quarter of 2014 and first nine months of 2014 included expense, net of forfeitures, of \$234,000 (\$145,000 after tax) and \$721,000 (\$447,000 after tax), respectively, for restricted stock granted during 2009 through 2014. As of September 30, 2014, there was \$2.40 million of total unrecognized compensation expense related to unvested restricted stock that will be recognized over the remaining requisite service periods.

A summary of activity for restricted stock awards during the first nine months of 2014 is presented below:

		<b>Weighted- Average</b>
	<b>Shares</b>	<b>Grant Date</b>
		<b>Fair Value</b>
Unvested, January 1, 2014	120,183	\$ 31.18
Granted	15,750	\$ 41.38
Vested	(8,100 )	\$ 18.77
Forfeitures	(1,500 )	\$ 41.25
Unvested, September 30, 2014	126,333	\$ 33.13

Stock option activity during the nine months ended September 30, 2014 and stock options outstanding at September 30, 2014 are summarized below:

	Shares	Exercise Price*	Remaining Contractual Life (in years)*	Intrinsic Value of Unexercised In-The Money Options (in 000's)
Options outstanding at January 1, 2014	164,150	\$ 38.21	1.7	\$ 1,224
Expired	(12,000)	\$ 37.50		
Options outstanding and exercisable at September 30, 2014	152,150	\$ 38.27	1.0	\$ —

\*Weighted average

#### Recent Significant Accounting Pronouncements:

In January 2014, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2014-01, "Investments-Equity Method and Joint Ventures (Topic 323): Accounting for Investments in Qualified Affordable Housing Projects (a consensus of the FASB Emerging Issues Task Force)." The amendments in this ASU permit reporting entities to make an accounting policy election to account for their investments in qualified affordable housing projects using the proportional amortization method if certain conditions are met. Under the proportional amortization method, an entity amortizes the initial cost of the investment in proportion to the tax credits and other tax benefits received and recognizes the net investment performance in the income statement as a component of income tax expense (benefit). The amendments in this ASU should be applied retrospectively to all periods presented. A reporting entity that uses the effective yield method to account for its investments in qualified affordable housing projects before the date of adoption may continue to apply the effective yield method for those preexisting investments. The amendments in this ASU are effective for public business entities for annual periods and interim reporting periods within those annual periods, beginning after December 15, 2014. Early adoption is permitted. The Corporation is currently assessing the effect that ASU 2014-01 will have on its financial statements.



Table Of Contents

In January 2014, the FASB issued ASU 2014-04, “Receivables-Troubled Debt Restructurings by Creditors (Subtopic 310-40): Reclassification of Residential Real Estate Collateralized Consumer Mortgage Loans upon Foreclosure (a consensus of the FASB Emerging Issues Task Force).” The amendments in this ASU clarify that an in substance repossession or foreclosure occurs, and a creditor is considered to have received physical possession of residential real estate property collateralizing a consumer mortgage loan, upon either (1) the creditor obtaining legal title to the residential real estate property upon completion of a foreclosure or (2) the borrower conveying all interest in the residential real estate property to the creditor to satisfy that loan through completion of a deed in lieu of foreclosure or through a similar legal agreement. Additionally, the amendments require interim and annual disclosure of both (1) the amount of foreclosed residential real estate property held by the creditor and (2) the recorded investment in consumer mortgage loans collateralized by residential real estate property that are in the process of foreclosure according to local requirements of the applicable jurisdiction. The amendments in this ASU are effective for public business entities for annual periods, and interim periods within those annual periods, beginning after December 15, 2014. The Corporation is currently assessing the effect that ASU 2014-04 will have on its financial statements.

In April 2014, the FASB issued ASU 2014-08, “Presentation of Financial Statements (Topic 205) and Property, Plant, and Equipment (Topic 360): Reporting Discontinued Operations and Disclosures of Disposals of Components of an Entity.” The amendments in this ASU change the criteria for reporting discontinued operations while enhancing disclosures in this area. Under the new guidance, only disposals representing a strategic shift in operations should be presented as discontinued operations. Those strategic shifts should have a major effect on the organization’s operations and financial results and include disposals of a major geographic area, a major line of business, or a major equity method investment. The new guidance requires expanded disclosures about discontinued operations that will provide financial statement users with more information about the assets, liabilities, income, and expenses of discontinued operations. Additionally, the new guidance requires disclosure of the pre-tax income attributable to a disposal of a significant part of an organization that does not qualify for discontinued operations reporting. The amendments in the ASU are effective for public business entities for annual periods, and interim periods within those annual periods, beginning after December 15, 2014. Early adoption is permitted. The Corporation does not expect the adoption of ASU 2014-08 to have a material effect on its financial statements.

In June 2014, the FASB issued ASU No. 2014-09, “Revenue from Contracts with Customers: Topic 606”. This ASU applies to any entity using U.S. GAAP that either enters into contracts with customers to transfer goods or services or enters into contracts for the transfer of nonfinancial assets unless those contracts are within the scope of other standards. The guidance supersedes the revenue recognition requirements in “Revenue Recognition-Topic 605”, most industry-specific guidance, and some cost guidance included in “Revenue Recognition-Construction-Type and Production-Type Contracts-Subtopic 605-35”. The core principle of the guidance is that an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. To be in alignment with the core principle, an entity must apply a five step process including: identification of the contract(s) with a customer, identification of performance obligations in the contract(s), determination of the transaction price, allocation of the transaction price to the performance obligations, and recognition of revenue when (or as) the entity satisfies a performance obligation. Additionally, the existing requirements for the recognition of a gain or loss on the transfer of nonfinancial assets that are not in a contract with a customer have also been amended to be consistent with the guidance on recognition and measurement. The amendments in this ASU are effective for annual reporting periods beginning after December 15, 2016, including interim periods within that reporting period. Early adoption is not

permitted. The Corporation is currently assessing the effect that ASU 2014-09 will have on its financial statements.

Table Of Contents

In June 2014, the FASB issued ASU No. 2014-11, “Transfers and Servicing (Topic 860): Repurchase-to-Maturity Transactions, Repurchase Financings, and Disclosures”. This ASU aligns the accounting for repurchase-to-maturity transactions and repurchase agreements executed as a repurchase financing with the accounting for other typical repurchase agreements. The new guidance eliminates sale accounting for repurchase-to-maturity transactions and supersedes the guidance under which a transfer of a financial asset and a contemporaneous repurchase financing could be accounted for on a combined basis as a forward agreement. The amendments in the ASU also require a new disclosure for transactions economically similar to repurchase agreements in which the transferor retains substantially all of the exposure to the economic return on the transferred financial assets throughout the term of the transaction. Additional disclosures will be required for the nature of collateral pledged in repurchase agreements and similar transactions accounted for as secured borrowings. The amendments in this ASU are effective for the first interim or annual period beginning after December 15, 2014; however, the disclosure for transactions accounted for as secured borrowings is required to be presented for annual periods beginning after December 15, 2014, and interim periods beginning after March 15, 2015. Early adoption is not permitted. The Corporation is currently assessing the effect that ASU 2014-11 will have on its financial statements.

In June 2014, the FASB issued ASU No. 2014-12, “Compensation - Stock Compensation (Topic 718): Accounting for Share-Based Payments When the Terms of an Award Provide That a Performance Target Could Be Achieved after the Requisite Service Period”. The new guidance applies to reporting entities that grant employees share-based payments in which the terms of the award allow a performance target to be achieved after the requisite service period. The amendments in the ASU require that a performance target that affects vesting and that could be achieved after the requisite service period be treated as a performance condition. Existing guidance in “Compensation - Stock Compensation (Topic 718)”, should be applied to account for these types of awards. The amendments in this ASU are effective for annual periods and interim periods within those annual periods beginning after December 15, 2015. Early adoption is permitted and reporting entities may choose to apply the amendments in the ASU either on a prospective or retrospective basis. The Corporation is currently assessing the effect that ASU 2014-12 will have on its financial statements.

In August 2014, the FASB issued ASU No. 2014-14, “Receivables - Troubled Debt Restructurings by Creditors (Subtopic 310-40): Classification of Certain Government-Guaranteed Mortgage Loans upon Foreclosure”. The amendments in this ASU apply to creditors that hold government-guaranteed mortgage loans and is intended to eliminate the diversity in practice related to the classification of these guaranteed loans upon foreclosure. The new guidance stipulates that a mortgage loan be derecognized and a separate other receivable be recognized upon foreclosure if (1) the loan has a government guarantee that is not separable from the loan prior to foreclosure, (2) at the time of foreclosure, the creditor has the intent to convey the real estate property to the guarantor and make a claim on the guarantee, and the creditor has the ability to recover under that claim, and (3) at the time of foreclosure, any amount of the claim that is determined on the basis of the fair value of the real estate is fixed. Upon foreclosure, the other receivable should be measured on the amount of the loan balance (principal and interest) expected to be recovered from the guarantor. The amendments in this ASU are effective for annual periods and interim periods within those annual periods beginning after December 15, 2014. Entities may adopt the amendments on a prospective basis or modified retrospective basis as of the beginning of the annual period of adoption; however, the entity must apply the same method of transition as elected under ASU 2014-04. Early adoption is permitted provided the entity has already adopted ASU 2014-04. The Corporation is currently assessing the effect that ASU 2014-14 will have on its financial statements.

In August 2014, the FASB issued ASU No. 2014-15, "Presentation of Financial Statements - Going Concern (Subtopic 205-40): Disclosure of Uncertainties about an Entity's Ability to Continue as a Going Concern". This update is intended to provide guidance about management's responsibility to evaluate whether there is substantial doubt about an entity's ability to continue as a going concern and to provide related footnote disclosures. Management is required under the new guidance to evaluate whether there are conditions or events, considered in the aggregate, that raise substantial doubt about the entity's ability to continue as a going concern within one year after the date the financial statements are issued when preparing financial statements for each interim and annual reporting period. If conditions or events are identified, the ASU specifies the process that must be followed by management and also clarifies the timing and content of going concern footnote disclosures in order to reduce diversity in practice. The amendments in this ASU are effective for annual periods and interim periods within those annual periods beginning after December 15, 2016. Early adoption is permitted. The Corporation does not expect the adoption of ASU 2014-15 to have a material effect on its financial statements.

Table Of Contents**NOTE 2: Business Combinations**

On October 1, 2013, the Corporation completed its acquisition of CVBK, the one-bank holding company for CVB. Pursuant to the Agreement and Plan of Merger dated June 10, 2013, CVBK's shareholders received \$0.32 for each share of CVBK common stock they owned, or approximately \$846,000 in the aggregate. In addition, the Corporation purchased from the U.S. Treasury for \$3.35 million all of CVBK's preferred stock and warrants issued to the U.S Treasury under the Capital Purchase Program, including accrued and unpaid dividends on the preferred stock. CVB had seven retail bank branches located in the Virginia counties of Powhatan, Cumberland, Chesterfield and Henrico.

The Corporation accounted for the acquisition using the acquisition method of accounting in accordance with Accounting Standards Codification (ASC) 805, *Business Combinations*. Under the acquisition method of accounting, the assets and liabilities of CVBK were recorded at their respective acquisition date fair values. Determining the fair value of assets and liabilities, particularly related to the loan portfolio, is a complicated process involving significant judgment regarding methods and assumptions used to calculate the estimated fair values. The fair values determined on the acquisition date were preliminary and subject to refinement for up to one year after the acquisition date (the Measurement Period) as additional information relative to the acquisition date fair values became available. Goodwill of \$5.91 million was initially recorded at the time of the acquisition. As a result of retrospective fair value mark refinements during the Measurement Period in accordance with ASC 805 and related guidance, goodwill as indicated below is \$2.21 million less than the goodwill estimated in the Corporation's 2013 audited financial statements.

<i>(Dollars in thousands)</i>	<b>Amounts Previously Recognized as of  October 1, 2013 <sup>(1)</sup></b>	<b>Measurement Period Adjustments</b>	<b>Adjusted Amounts Recognized as of  October 1, 2013</b>
Consideration paid:			
CVBK common stock	\$ 846		\$ 846
CVBK preferred stock and warrants	3,350		3,350
Total consideration paid	4,196		4,196
Identifiable assets acquired:			
Cash and cash equivalents	\$ 59,775	\$ —	\$ 59,775
Securities available for sale, at fair value	120,097	—	120,097
Loans, net of allowance and unearned income	147,066	—	147,066
Corporate premises and equipment, net <sup>(2)</sup>	10,948	(910 )	10,038
Other real estate owned, net	395	—	395
Core deposit intangibles	4,107	—	4,107
Deferred tax asset, net <sup>(3)</sup>	6,029	3,235	9,264
Other assets <sup>(4)</sup>	16,624	(119 )	16,505



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

Total identifiable assets acquired	365,041	2,206	367,247
Identifiable liabilities assumed:			
Deposits	315,421	—	315,421
Borrowings	42,124	—	42,124
Trust preferred capital notes	4,439	—	4,439
Other liabilities	4,768	—	4,768
Total identifiable liabilities assumed	366,752	—	366,752
Net identifiable assets (liabilities) assumed	(1,711	) \$ 2,206	495
Goodwill resulting from acquisition	\$ 5,907		\$ 3,701

(1) As previously reported in the Corporation's 2013 Form 10-K

(2) The fair value of CVBK's premises, including land, buildings and improvements, was determined based upon appraisal by licensed appraisers. Based on information as of the acquisition date that became available during the Measurement Period, the fair value of CVBK's premises was reduced by \$910,000.

(3) The additional \$3.23 million in deferred tax assets resulted primarily from improvement in the purchased credit impaired loan portfolio, which resulted in significantly fewer loan charge-offs during the Measurement Period.

(4) The \$119,000 reduction in other assets resulted primarily from lower accrued interest receivable.

Table Of Contents

The following table illustrates the unaudited pro forma revenue and net income of the combined entities had the acquisition taken place on January 1, 2013. The unaudited combined pro forma revenue and net income combines the historical results of CVBK with the Corporation's consolidated statement of income for the three and nine months ended September 30, 2013 and, while certain adjustments were made for the estimated effect of certain fair value adjustments and other acquisition-related activity, they are not indicative of what would have occurred had the acquisition actually taken place on January 1, 2013. Expenses related to systems conversions and other integration related expenses were incurred during the first nine months of 2014 in connection with merging CVBK into the Corporation and CVB into C&F Bank. Additionally, the Corporation expects to achieve further operational cost savings and other efficiencies as a result of the acquisition which are not reflected in the unaudited pro forma amounts below.

	<b>Unaudited Unaudited</b>	
	<b>Pro Forma Three Months Ended</b>	<b>Pro Forma Nine Months Ended</b>
<i>(Dollars in thousands)</i>	<b>September 30, 2013</b>	<b>September 30, 2013</b>
Total revenues, net of interest expense	\$ 26,954	\$ 81,113
Net income	2,432	11,469

**NOTE 3: Securities**

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

	<b>September 30, 2014</b>			<b>Estimated Fair Value</b>
	<b>Amortized Cost</b>	<b>Gross Unrealized Gains</b>	<b>Gross Unrealized Losses</b>	
U.S. government agencies and corporations	\$26,127	\$ 1	\$ (908)	) \$ 25,220
Mortgage-backed securities	63,346	422	(222)	) 63,546
Obligations of states and political subdivisions	124,527	7,006	(206)	) 131,327
	<b>\$214,000</b>	<b>\$ 7,429</b>	<b>\$ (1,336)</b>	<b>) \$ 220,093</b>

	<b>December 31, 2013</b>			
	<b>Amortized</b>	<b>Gross</b>	<b>Gross</b>	<b>Estimated</b>
<i>(Dollars in thousands)</i>	<b>Cost</b>	<b>Unrealized</b>	<b>Unrealized</b>	<b>Fair</b>
		<b>Gains</b>	<b>Losses</b>	<b>Value</b>
U.S. Treasury securities	\$10,000	\$ —	\$ —	\$ 10,000
U.S. government agencies and corporations	32,503	4	(2,557 )	29,950
Mortgage-backed securities	51,318	100	(555 )	50,863
Obligations of states and political subdivisions	123,729	4,223	(813 )	127,139
Corporate and other debt securities	158	—	—	158
	\$217,708	\$ 4,327	\$ (3,925 )	\$ 218,110

Table Of Contents

The amortized cost and estimated fair value of securities, all of which were classified as available for sale, at September 30, 2014, by the earlier of contractual maturity or expected maturity, are shown below. Expected maturities will differ from contractual maturities because borrowers may have the right to prepay obligations with or without call or prepayment penalties.

<i>(Dollars in thousands)</i>	<b>September 30, 2014</b>	
	<b>Amortized</b>	<b>Estimated</b>
	<b>Cost</b>	<b>Fair Value</b>
Due in one year or less	<b>\$31,414</b>	<b>\$ 31,154</b>
Due after one year through five years	<b>112,686</b>	<b>116,300</b>
Due after five years through ten years	<b>43,616</b>	<b>44,748</b>
Due after ten years	<b>26,284</b>	<b>27,891</b>
	<b>\$214,000</b>	<b>\$ 220,093</b>

Proceeds from the maturities, calls and sales of securities available for sale for the nine months ended September 30, 2014 were \$31.86 million.

The Corporation pledges securities primarily as collateral for public deposits and repurchase agreements. Securities with an aggregate amortized cost of \$100.50 million and an aggregate fair value of \$103.68 million were pledged at September 30, 2014. Securities with an aggregate amortized cost of \$149.22 million and an aggregate fair value of \$149.83 million were pledged at December 31, 2013.

Securities in an unrealized loss position at September 30, 2014, by duration of the period of the unrealized loss, are shown below.

<i>(Dollars in thousands)</i>	<b>Less Than 12 Months</b>		<b>12 Months or More</b>		<b>Total</b>	
	<b>Fair</b>	<b>Unrealized</b>	<b>Fair</b>	<b>Unrealized</b>	<b>Fair</b>	<b>Unrealized</b>
	<b>Value</b>	<b>Loss</b>	<b>Value</b>	<b>Loss</b>	<b>Value</b>	<b>Loss</b>
U.S. government agencies and corporations	<b>\$3,674</b>	<b>\$ 42</b>	<b>\$21,043</b>	<b>\$ 866</b>	<b>\$24,717</b>	<b>\$ 908</b>
Mortgage backed securities	<b>12,516</b>	<b>155</b>	<b>1,433</b>	<b>67</b>	<b>13,949</b>	<b>222</b>
Obligations of states and political subdivisions	<b>7,822</b>	<b>82</b>	<b>7,392</b>	<b>124</b>	<b>15,214</b>	<b>206</b>
Total temporarily impaired securities	<b>\$24,012</b>	<b>\$ 279</b>	<b>\$29,868</b>	<b>\$ 1,057</b>	<b>\$53,880</b>	<b>\$ 1,336</b>

There are 84 debt securities totaling \$53.88 million considered temporarily impaired at September 30, 2014. The Corporation's unrealized loss position improved slightly since June 30, 2014 as long-term interest rates fell during the third quarter of 2014, thereby increasing market values of the Corporation's portfolio of securities of obligations of states and political subdivisions. Long-term interest rates have generally declined in 2014 as weaker global growth dampened inflation and increased demand for debt securities, even with some signs of improved economic conditions in the United States. The municipal bond sector, which includes the Corporation's obligations of states and political subdivisions, has continued to benefit from technical factors, as investor demand has remained stable while the supply of new municipal bonds has fallen as compared to last year. At September 30, 2014, approximately 97 percent of the Corporation's obligations of states and political subdivisions, as measured by market value, were rated "A" or better by Standard & Poor's or Moody's Investors Service. Of those in a net unrealized loss position, approximately 93 percent were rated "A" or better, as measured by market value, at September 30, 2014. For the approximately seven percent not rated "A" or better, as measured by market value at September 30, 2014, the Corporation considers these to meet regulatory credit quality standards, such that the securities have low risk of default by the obligor, and the full and timely repayment of principal and interest is expected over the expected life of the investment. Because the Corporation intends to hold these investments in debt securities to maturity and it is more likely than not that the Corporation will not be required to sell these investments before a recovery of unrealized losses, the Corporation does not consider these investments to be other-than-temporarily impaired at September 30, 2014 and no other-than-temporary impairment has been recognized.

Table Of Contents

Securities in an unrealized loss position at December 31, 2013, by duration of the period of the unrealized loss, are shown below.

	<b>Less Than 12 Months</b>		<b>12 Months or More</b>		<b>Total</b>	
	<b>Fair</b>	<b>Unrealized</b>	<b>Fair</b>	<b>Unrealized</b>	<b>Fair</b>	<b>Unrealized</b>
<i>(Dollars in thousands)</i>	<b>Value</b>	<b>Loss</b>	<b>Value</b>	<b>Loss</b>	<b>Value</b>	<b>Loss</b>
U.S. government agencies and corporations	\$29,430	\$ 1,385	\$8,948	\$ 1,172	\$38,378	\$ 2,557
Mortgage-backed securities	40,090	555	—	—	40,090	555
Obligations of states and political subdivisions	21,260	656	3,078	157	24,338	813
Total temporarily impaired securities	\$90,780	\$ 2,596	\$12,026	\$ 1,329	\$102,806	\$ 3,925

The Corporation's investment in restricted stocks includes membership stock in the Federal Home Loan Bank (FHLB) and the Community Bankers Bank at September 30, 2014, and additionally included stock in the Federal Reserve Bank at December 31, 2013. Restricted stocks totaled \$3.69 million at September 30, 2014 and \$4.34 million at December 31, 2013. These membership stocks are generally viewed as long-term investments and as a restricted investment securities, which are carried at cost, because there is no market for the stock, other than member institutions. Therefore, when evaluating these investments for impairment, their value is based on the ultimate recoverability of the par value rather than by recognizing temporary declines in value. The Corporation does not consider these investments to be other-than-temporarily impaired at September 30, 2014 and no impairment has been recognized. These stocks are shown as a separate line item on the balance sheet and are not a part of the available for sale securities portfolio.

**NOTE 4: Loans**

Major classifications of loans are summarized as follows:

<i>(Dollars in thousands)</i>	<b>September 30, 2014</b>	<b>December 31, 2013</b>
Real estate – residential mortgage	<b>\$ 179,222</b>	\$ 188,455
Real estate – construction <sup>1</sup>	<b>6,689</b>	5,810
Commercial, financial and agricultural <sup>2</sup>	<b>294,359</b>	288,593
Equity lines	<b>50,799</b>	50,795
Consumer	<b>8,755</b>	9,007
Consumer finance	<b>287,866</b>	277,724

	<b>827,690</b>	820,384
Less allowance for loan losses	<b>(35,573 )</b>	(34,852 )
Loans, net	<b>\$ 792,117</b>	\$ 785,532

---

<sup>1</sup>Includes the Corporation's real estate construction lending and consumer real estate lot lending.

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

Consumer loans included \$311,000 and \$354,000 of demand deposit overdrafts at September 30, 2014 and December 31, 2013, respectively.

Table Of Contents

The outstanding principal balance and the carrying amount of loans acquired pursuant to the Corporation's acquisition of CVBK (or acquired loans) that were recorded at fair value at the acquisition date and are included in the consolidated balance sheet at September 30, 2014 and December 31, 2013 were as follows:

<i>(Dollars in thousands)</i>	September 30, 2014		Acquired Loans - Total	December 31, 2013		Acquired Loans - Total
	Acquired Loans -Purchased Credit Impaired (PCI)	Acquired Loans -Purchased Performing		Acquired Loans -Purchased Credit Impaired	Acquired Loans -Purchased Performing	
Outstanding principal balance	\$39,114	\$ 90,811	\$129,925	\$49,041	\$ 110,977	\$160,018
Carrying amount						
Real estate – residential mortgage	\$1,992	\$ 19,221	\$21,213	\$2,694	\$ 29,285	\$31,979
Real estate – construction	287	—	287	771	917	1,688
Commercial, financial and agricultural <sup>2</sup>	20,945	49,226	70,171	28,602	55,204	83,806
Equity lines	318	16,034	16,352	332	16,909	17,241
Consumer	18	1,162	1,180	121	2,156	2,277
Total acquired loans	\$23,560	\$ 85,643	\$109,203	\$32,520	\$ 104,471	\$136,991

<sup>1</sup> Includes the Corporation's real estate construction lending and consumer real estate lot lending.

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

Loans on nonaccrual status were as follows:

<i>(Dollars in thousands)</i>	September 30, 2014	December 31, 2013
Real estate – residential mortgage	\$ 2,517	\$ 1,996
Commercial, financial and agricultural:		
Commercial real estate lending	2,167	1,486
Land acquisition and development lending	—	—
Builder line lending	—	13
Commercial business lending	374	374
Equity lines	409	291
Consumer	232	231
Consumer finance	1,196	1,187



Total loans on nonaccrual status            **\$ 6,895**     \$ 5,578

Table Of Contents

The past due status of loans as of September 30, 2014 was as follows:

<i>(Dollars in thousands)</i>	30-59	60-89	90+	Total Past Due	Current <sup>1</sup>	Total Loans	90+ Days
	Days	Days	Days				Past Due and Accruing
Real estate – residential mortgage	\$1,313	\$363	\$1,238	\$2,914	\$176,308	\$179,222	\$ —
Real estate – construction:							
Construction lending	—	—	—	—	3,245	3,245	—
Consumer lot lending	—	190	—	190	3,254	3,444	—
Commercial, financial and agricultural:							
Commercial real estate lending	2,108	839	407	3,354	179,905	183,259	48
Land acquisition and development lending	—	—	208	208	33,387	33,595	—
Builder line lending	—	—	—	—	19,823	19,823	—
Commercial business lending	159	8	390	557	57,125	57,682	—
Equity lines	259	49	158	466	50,333	50,799	—
Consumer	45	1	194	240	8,515	8,755	—
Consumer finance	12,205	2,964	1,196	16,365	271,501	287,866	—
Total	\$16,089	\$4,414	\$3,791	\$24,294	\$803,396	\$827,690	\$ 48

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

The table above includes the following:

• nonaccrual loans that are current of \$3.10 million, 30-59 days past due of \$134,000, 60-89 days past due of \$120,000 and 90+ days past due of \$3.54 million and

• loans purchased (both performing and PCI) in the acquisition of CVBK that are current of \$104.49 million, 30-59 days past due of \$1.13 million, 60-89 days past due of \$1.03 million and 90+ days past due of \$2.55 million.

Table Of Contents

The past due status of loans as of December 31, 2013 was as follows:

<i>(Dollars in thousands)</i>	30-59	60-89	90+	Total Past Due	Current <sup>1</sup>	Total Loans	90+ Days
	Days	Days	Days				Past Due and Accruing
	Past Due	Past Due	Past Due				
Real estate – residential mortgage	\$ 1,547	\$ 952	\$ 1,547	\$ 4,046	\$ 184,409	\$ 188,455	\$ —
Real estate – construction:							
Construction lending	—	—	—	—	3,728	3,728	—
Consumer lot lending	—	—	—	—	2,082	2,082	—
Commercial, financial and agricultural:							
Commercial real estate lending	5,567	228	72	5,867	162,255	168,122	72
Land acquisition and development lending	—	—	272	272	25,368	25,640	—
Builder line lending	—	—	—	—	13,426	13,426	—
Commercial business lending	306	368	2,033	2,707	78,698	81,405	—
Equity lines	264	45	173	482	50,313	50,795	—
Consumer	54	46	195	295	8,712	9,007	3
Consumer finance	14,174	2,998	1,187	18,359	259,365	277,724	—
Total	\$ 21,912	\$ 4,637	\$ 5,479	\$ 32,028	\$ 788,356	\$ 820,384	\$ 75

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

The table above includes the following:

nonaccrual loans that are current of \$2.15 million, 30-59 days past due of \$7,000, 60-89 days past due of \$306,000 and 90+ days past due of \$3.11 million and loans purchased (both performing and PCI) in the acquisition of CVBK that are current of \$131.82 million, 30-59 days past due of \$1.35 million, 60-89 days past due of \$841,000 and 90+ days past due of \$2.98 million of which \$3,000 are 90+ days past due and accruing.

Loan modifications that were classified as TDRs during the three and nine months ended September 30, 2014 and 2013 were as follows:

<i>(Dollars in thousands)</i>	Three Months Ended September 30,	
	2014	2013
	Number of Post-Modification of Recorded	Number of Post-Modification of Recorded

	<b>Loansvestment</b>		<b>Loansvestment</b>	
Commercial, financial and agricultural:				
Commercial real estate lending - interest reduction	<b>1</b>	<b>\$ 103</b>	—	\$ —
Commercial real estate lending - interest rate concession	—	—	2	1,350
	<b>1</b>	<b>\$ 103</b>	2	\$ 1,350

Table Of Contents

<i>(Dollars in thousands)</i>	Nine Months Ended September 30, 2014		2013	
	Number of Recorded Loans	Post-Modification Investment	Number of Recorded Loans	Post-Modification Investment
Real estate - residential mortgage - interest rate concession	1	\$ 328	1	\$ 89
Commercial, financial and agricultural:				
Commercial real estate lending - interest reduction	1	103	—	—
Commercial real estate lending - interest rate concession	—	—	4	1,829
Builder line lending - interest rate concession	—	—	1	17
Total	2	\$ 431	6	\$ 1,935

A TDR payment default occurs when, within 12 months of the original TDR modification, either a full or partial charge-off occurs or a TDR becomes 90 days or more past due. There were no TDR defaults during the three and nine months ended September 30, 2014. There was one \$3,000 commercial real estate TDR that defaulted during the nine months ended September 30, 2013.

Impaired loans, which consisted solely of TDRs, and the related allowance at September 30, 2014 were as follows. There has been no impairment to the PCI loan portfolio since acquisition.

<i>(Dollars in thousands)</i>	Recorded Investment in Loans	Unpaid Principal Balance	Related Allowance	Average Balance- Impaired Loans	Interest Income Recognized
Real estate – residential mortgage	\$ 2,326	\$ 2,448	\$ 397	\$ 2,213	\$ 96
Commercial, financial and agricultural:					
Commercial real estate lending	2,676	2,774	423	2,670	101
Builder line lending	—	—	—	—	—
Commercial business lending	482	483	128	492	5
Equity lines	30	32	1	22	1
Consumer	92	92	14	93	3
Total	\$ 5,606	\$ 5,829	\$ 963	\$ 5,490	\$ 206

Impaired loans, which included TDR loans of \$5.62 million, and the related allowance at December 31, 2013 were as follows:

<i>(Dollars in thousands)</i>	Recorded	Unpaid	Related	Average	Interest
-------------------------------	----------	--------	---------	---------	----------

	<b>Investment in Loans</b>	<b>Principal Balance</b>	<b>Allowance</b>	<b>Balance-Impaired Loans</b>	<b>Income Recognized</b>
Real estate – residential mortgage	\$ 2,601	\$ 2,694	\$ 390	\$ 2,090	\$ 99
Commercial, financial and agricultural:					
Commercial real estate lending	2,729	2,780	504	2,748	99
Builder line lending	13	16	4	14	1
Commercial business lending	695	756	131	562	11
Equity lines	131	132	—	33	—
Consumer	93	93	14	95	9
<b>Total</b>	<b>\$ 6,262</b>	<b>\$ 6,471</b>	<b>\$ 1,043</b>	<b>\$ 5,542</b>	<b>\$ 219</b>

PCI loans had an unpaid principal balance of \$39.1 million and a carrying value of \$23.6 million at September 30, 2014. Determining the fair value of purchased credit impaired loans required the Corporation to estimate cash flows expected to result from those loans and to discount those cash flows at appropriate rates of interest. For such loans, the excess of the cash flows expected at acquisition over the estimated fair value is recognized as interest income over the remaining lives of the loans and is called the accretable yield. The difference between contractually required payments at acquisition and the cash flows expected to be collected at acquisition reflects the effect of estimated credit losses and is called the nonaccretable difference. In accordance with GAAP, there was no carry-over of previously established allowance for loan losses from acquired loans.

Table Of Contents

The PCI loan portfolio related to the CVBK acquisition was accounted for at fair value on the date of acquisition as follows:

<i>(Dollars in thousands)</i>	<b>October 1, 2013</b>
Contractual principal and interest due	\$70,390
Nonaccretable difference	(26,621)
Expected cash flows	43,769
Accretable yield	(8,454 )
Purchase credit impaired loans - estimated fair value	\$35,315

The following table presents a summary of the change in the accretable yield of the PCI loan portfolio for the period from December 31, 2013 to September 30, 2014:

<i>(Dollars in thousands)</i>	<b>Accretable Yield</b>
Accretable yield, December 31, 2013	\$ 7,776
Accretion	(2,446 )
Reclassification of nonaccretable difference due to improvement in expected cash flows	1,959
Changes in expected cash flows <sup>1</sup>	6,760
Accretable yield, September 30, 2014	\$ 14,049

<sup>1</sup> Represents changes in cash flows expected to be collected due to the effects of changes in recovery approach and prepayment assumptions.

Table Of Contents**NOTE 5: Allowance for Loan Losses**

The following table presents the changes in the allowance for loan losses by major classification during the nine months ended September 30, 2014.

<i>(Dollars in thousands)</i>	Real Estate	Real Estate	Commercial,		Consumer	Consumer Finance	Total
	Residential	Construction	Financial and	Equity Lines			
	Mortgage		Agricultural				
<b>Allowance for loan losses:</b>							
Balance at December 31, 2013	\$ 2,355	\$ 434	\$ 7,805	\$ 892	\$ 273	\$ 23,093	\$ 34,852
Provision charged to operations	45	—	—	—	—	10,870	10,915
Loans charged off	(147 )	—	(224 )	(47 )	(242 )	(12,717 )	(13,377)
Recoveries of loans previously charged off	37	—	111	—	210	2,825	3,183
Balance at September 30, 2014	\$ 2,290	\$ 434	\$ 7,692	\$ 845	\$ 241	\$ 24,071	\$ 35,573

The following table presents the changes in the allowance for loan losses by major classification during the nine months ended September 30, 2013.

<i>(Dollars in thousands)</i>	Real Estate	Real Estate	Commercial,		Consumer	Consumer Finance	Total
	Residential	Construction	Financial and	Equity Lines			
	Mortgage		Agricultural				
<b>Allowance for loan losses:</b>							
Balance at December 31, 2012	\$ 2,358	\$ 424	\$ 9,824	\$ 885	\$ 283	\$ 22,133	\$ 35,907
Provision charged to operations	537	50	328	11	149	9,065	10,140
Loans charged off	(744 )	—	(2,297 )	(126 )	(287 )	(10,656 )	(14,110)
Recoveries of loans previously charged off	99	—	170	27	103	2,525	2,924
Balance at September 30, 2013	\$ 2,250	\$ 474	\$ 8,025	\$ 797	\$ 248	\$ 23,067	\$ 34,861



Table Of Contents

The following table presents, as of September 30, 2014, the total allowance for loan losses, the allowance by impairment methodology (individually evaluated for impairment or collectively evaluated for impairment or PCI loans), the total loans, and loans by impairment methodology (individually evaluated for impairment, collectively evaluated for impairment, or PCI loans).

<i>(Dollars in thousands)</i>	<b>Real Estate Residential Mortgage</b>	<b>Real Estate Construction</b>	<b>Commercial, Financial and Agricultural</b>	<b>Equity Lines</b>	<b>Consumer</b>	<b>Consumer Finance</b>	<b>Total</b>
<b>Allowance for loan losses:</b>							
Balance at September 30, 2014	\$ 2,290	\$ 434	\$ 7,692	\$ 845	\$ 241	\$ 24,071	\$ 35,573
Ending balance: individually evaluated for impairment	\$ 397	\$ —	\$ 551	\$ 1	\$ 14	\$ —	\$ 963
Ending balance: collectively evaluated for impairment	\$ 1,893	\$ 434	\$ 7,141	\$ 844	\$ 227	\$ 24,071	\$ 34,610
Ending balance: PCI loans	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —
<b>Loans:</b>							
Balance at September 30, 2014	\$ 179,222	\$ 6,689	\$ 294,359	\$ 50,799	\$ 8,755	\$ 287,866	\$ 827,690
Ending balance: individually evaluated for impairment	\$ 2,326	\$ —	\$ 3,158	\$ 30	\$ 92	\$ —	\$ 5,606
Ending balance: collectively evaluated for impairment	\$ 174,904	\$ 6,402	\$ 270,256	\$ 50,451	\$ 8,645	\$ 287,866	\$ 798,524
Ending balance: PCI loans	\$ 1,992	\$ 287	\$ 20,945	\$ 318	\$ 18	\$ —	\$ 23,560

The following table presents, as of December 31, 2013, the total allowance for loan losses, the allowance by impairment methodology (individually evaluated for impairment, collectively evaluated for impairment or PCI loans), the total loans and loans by impairment methodology (individually evaluated for impairment, collectively evaluated for impairment or PCI loans).

<i>(Dollars in thousands)</i>	<b>Real Estate</b>	<b>Real Estate</b>	<b>Commercial, Equity Lines</b>	<b>Consumer</b>	<b>Consumer</b>	<b>Total</b>
-------------------------------	------------------------	------------------------	-------------------------------------	-----------------	-----------------	--------------

	<b>Residential Construction</b>		<b>Financial and</b>			<b>Finance</b>	
	<b>Mortgage</b>		<b>Agricultural</b>				
<b>Allowance for loan losses:</b>							
Ending balance	\$ 2,355	\$ 434	\$ 7,805	\$ 892	\$ 273	\$ 23,093	\$ 34,852
Ending balance: individually evaluated for impairment	\$ 390	\$ —	\$ 639	\$ —	\$ 14	\$ —	\$ 1,043
Ending balance: collectively evaluated for impairment	\$ 1,965	\$ 434	\$ 7,166	\$ 892	\$ 259	\$ 23,093	\$ 33,809
Ending balance: PCI loans	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —
<b>Loans:</b>							
Ending balance	\$ 188,455	\$ 5,810	\$ 288,593	\$ 50,795	\$ 9,007	\$ 277,724	\$ 820,384
Ending balance: individually evaluated for impairment	\$ 2,601	\$ —	\$ 3,437	\$ 131	\$ 93	\$ —	\$ 6,262
Ending balance: collectively evaluated for impairment	\$ 183,160	\$ 5,039	\$ 256,554	\$ 50,332	\$ 8,793	\$ 277,724	\$ 781,602
Ending balance: PCI loans	\$ 2,694	\$ 771	\$ 28,602	\$ 332	\$ 121	\$ —	\$ 32,520

Table Of Contents

Loans by credit quality indicators as of September 30, 2014 were as follows:

<i>(Dollars in thousands)</i>	Pass	Special Mention	Substandard	Substandard Nonaccrual	Total <sup>1</sup>
Real estate – residential mortgage	\$171,109	\$2,597	\$3,202	\$2,314	\$179,222
Real estate – construction:					
Construction lending	537	—	2,708	—	3,245
Consumer lot lending	3,372	72	—	—	3,444
Commercial, financial and agricultural:					
Commercial real estate lending	163,868	4,571	12,654	2,166	183,259
Land acquisition and development lending	29,696	1,296	2,603	—	33,595
Builder line lending	18,316	970	537	—	19,823
Commercial business lending	45,448	1,053	10,840	341	57,682
Equity lines	48,608	998	784	409	50,799
Consumer	8,402	15	107	231	8,755
	\$489,356	\$11,572	\$33,435	\$5,461	\$539,824

<sup>1</sup> At September 30, 2014, the Corporation did not have any loans classified as Doubtful or Loss.

Included in the table above are loans purchased in connection with the acquisition of CVBK of \$93.8 million pass rated, \$3.7 million special mention, \$10.9 million substandard and \$738,000 substandard nonaccrual.

<i>(Dollars in thousands)</i>	Performing	Non-Performing	Total
Consumer finance	\$286,670	\$1,196	\$287,866

Loans by credit quality indicators as of December 31, 2013 were as follows:

<i>(Dollars in thousands)</i>	Pass	Special Mention	Substandard	Substandard Nonaccrual	Total <sup>1</sup>
Real estate – residential mortgage	\$180,670	\$2,209	\$3,580	\$1,996	\$188,455
Real estate – construction:					
Construction lending	1,068	11	2,649	—	3,728
Consumer lot lending	1,831	105	146	—	2,082
Commercial, financial and agricultural:					
Commercial real estate lending	152,017	2,934	11,685	1,486	168,122

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

Land acquisition and development lending	18,236	1,601	5,803	—	25,640
Builder line lending	11,608	1,278	527	13	13,426
Commercial business lending	61,715	2,758	16,558	374	81,405
Equity lines	48,603	1,003	898	291	50,795
Consumer	8,616	2	158	231	9,007
	\$484,364	\$ 11,901	\$ 42,004	\$ 4,391	\$542,660

<sup>1</sup> At December 31, 2013, the Corporation did not have any loans classified as Doubtful or Loss.

Included in the table above are loans purchased in connection with the acquisition of CVBK of \$115.27 million pass rated, \$3.30 million special mention, \$17.77 million substandard and \$652,000 substandard nonaccrual.

Table Of Contents

<i>(Dollars in thousands)</i>	<b>Performing</b>	<b>Non-Performing</b>	<b>Total</b>
Consumer finance	\$ 276,537	\$ 1,187	\$277,724

**NOTE 6: Shareholders' Equity and Earnings Per Common Share****Accumulated Other Comprehensive Income (Loss)**

The following table presents the cumulative balances of the components of accumulated other comprehensive income (loss), net of deferred tax of \$1.22 million and \$163,000 as of September 30, 2014 and December 31, 2013, respectively.

<i>(Dollars in thousands)</i>	<b>September 30, 2014</b>	<b>December 31, 2013</b>
Net unrealized gains on securities	\$ 3,968	\$ 261
Net unrecognized loss on cash flow hedges	(117 )	(202 )
Net unrecognized losses on defined benefit plan	(343 )	(325 )
Total accumulated other comprehensive income (loss)	\$ 3,508	\$ (266 )

**Common Shares**

During the third quarter and first nine months of 2014, the Corporation purchased 2,800 and 3,025 shares of its common stock, respectively. During the third quarter of 2014, 2,800 shares were purchased under a share repurchase program authorized by the Corporation's Board of Directors for the purchase of up to \$5.0 million of the Corporation's common stock through May 2015. During the first quarter of 2014, 225 shares were purchased from employees to satisfy tax withholding obligations arising upon the vesting of restricted shares. There were no common stock purchases by the Corporation during the first nine months of 2013.

**Earnings Per Common Share**

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

<i>(Dollars in thousands)</i>	<b>Three Months Ended</b>	
	<b>September 30,</b>	
	<b>2014</b>	<b>2013</b>
Net income	<b>\$3,294</b>	\$3,366
Weighted average number of common shares used in earnings per common share – basic	<b>3,405,162</b>	3,318,687
Effect of dilutive securities:		
Stock option awards and Warrant	<b>146</b>	166,274
Weighted average number of common shares used in earnings per common share – assuming dilution	<b>3,405,308</b>	3,484,961

Table Of Contents

<i>(Dollars in thousands)</i>	Nine Months Ended	
	September 30, 2014	2013
Net income available to common shareholders	\$9,929	\$11,550
Weighted average number of common shares used in earnings per common share – basic	3,403,749	3,287,146
Effect of dilutive securities:		
Stock option awards and Warrant	42,723	135,951
Weighted average number of common shares used in earnings per common share – assuming dilution	3,446,472	3,423,097

Potential common shares that may be issued by the Corporation for its stock option awards and, when it was outstanding, the warrant to purchase common stock of the Corporation originally issued to the United States Department of the Treasury as part of the Corporation's participation in the Capital Purchase Program (the Warrant), are determined using the treasury stock method. Approximately 164,150 shares issuable upon exercise of options were not included in computing diluted earnings per common share for the three months ended September 30, 2014, and approximately 145,470 and 23,400 shares issuable upon exercise of options were not included in computing earnings per common share for the nine months ended September 30, 2014 and 2013, respectively, because they were anti-dilutive.

**NOTE 7: Employee Benefit Plan**

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

<i>(Dollars in thousands)</i>	Three Months Ended		Nine Months Ended	
	September 30, 2014	2013	September 30, 2014	2013
Service cost	\$190	\$194	\$572	\$582
Interest cost	113	106	339	319
Expected return on plan assets	(208)	(187)	(624)	(561)
Amortization of prior service cost	(85 )	(17 )	(51 )	(51 )
Amortization of net loss	40	30	24	91
Net periodic benefit cost	\$50	\$126	\$260	\$380

**NOTE 8: Fair Value of Assets and Liabilities**

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

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

Level 2—Valuation is based upon quoted prices for similar instruments in active markets, quoted prices for identical or similar instruments in markets that are not active, and model based valuation techniques for which all significant assumptions are observable in the market or can be corroborated by observable market data for substantially the full term of the assets or liabilities.



Table Of Contents

Level 3—Valuation is determined using model-based techniques that use at least one significant assumption not observable in the market. These unobservable assumptions reflect the Corporation's estimates of assumptions that market participants would use in pricing the respective asset or liability. Valuation techniques may include the use of pricing models, discounted cash flow models and similar techniques.

U.S. GAAP allows an entity the irrevocable option to elect fair value (the fair value option) for the initial and subsequent measurement for certain financial assets and liabilities on a contract-by-contract basis. During the second quarter of 2013, the Corporation elected to begin using fair value accounting for its entire portfolio of loans held for sale (LHFS).

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

The following describes the valuation techniques and inputs used by the Corporation in determining the fair value of certain assets recorded at fair value on a recurring basis in the financial statements.

**Securities available for sale.** The Corporation primarily values its investment portfolio using Level 2 fair value measurements, but may also use Level 1 or Level 3 measurements if required by the composition of the portfolio. At September 30, 2014 and December 31, 2013, the Corporation's entire investment securities portfolio was comprised of securities available for sale, which were valued using Level 2 fair value measurements. The Corporation has contracted with third party portfolio accounting service vendors for valuation of its securities portfolio. The vendors' sources for security valuation are Standard & Poor's Securities Evaluations Inc. (SPSE), Thomson Reuters Pricing Service (TRPS) and Interactive Data Pricing and Reference Data LLC (IDC). Each source provides opinions, known as evaluated prices, as to the value of individual securities based on model-based pricing techniques that are partially based on available market data, including prices for similar instruments in active markets and prices for identical assets in markets that are not active. SPSE and IDC provide evaluated prices for the Corporation's obligations of states and political subdivisions category of securities. Both sources use proprietary pricing models and pricing systems, mathematical tools and judgment to determine an evaluated price for a security based upon a hierarchy of market information regarding that security or securities with similar characteristics. TRPS and IDC provide evaluated prices for the Corporation's U.S. government agencies and corporations and mortgage-backed categories of securities.

Fixed-rate callable securities of the U.S. government agencies and corporations category are individually evaluated on an option adjusted spread basis for callable issues or on a nominal spread basis incorporating the term structure of agency market spreads and the appropriate risk free benchmark curve for non-callable issues. Fixed-rate securities issued by the Small Business Association in the U.S. government agencies and corporations category are individually evaluated based upon a hierarchy of security-specific information and market data regarding that security or securities with similar characteristics. Pass-through mortgage-backed securities in the mortgage-backed category are grouped into aggregate categories defined by issuer program, weighted average coupon, and weighted average maturity. Each aggregate is benchmarked to a relative mortgage-backed to-be-announced (TBA) or other benchmark price. TBA prices are obtained from market makers and live trading systems. Collateralized mortgage obligations in the

mortgage-backed category are individually evaluated based upon a hierarchy of security-specific information and market data regarding that security or securities with similar characteristics. Each evaluation is determined using an option adjusted spread and prepayment model based on volatility-driven, multi-dimensional spread tables.

**Loans held for sale.** Fair value of the Corporation's loans held for sale (LHFS) is based on observable market prices for similar instruments traded in the secondary mortgage loan markets in which the Corporation conducts business. The Corporation's portfolio of LHFS is classified as Level 2.

**IRLCs.** The Corporation recognizes IRLCs at fair value. Fair value of IRLCs is based on either (i) the price of the underlying loans obtained from an investor for loans that will be delivered on a best efforts basis or (ii) the observable price for individual loans traded in the secondary market for loans that will be delivered on a mandatory basis. All of the Corporation's IRLCs are classified as Level 2.

Table Of Contents

**Forward sales commitments.** Forward commitments to sell mortgage loans and TBAs are used to mitigate interest rate risk for residential mortgage loans held for sale and IRLCs. Forward commitments to sell mortgage loans and TBAs are considered derivatives and are recorded at fair value, based on (i) committed sales prices from investors for commitments to sell mortgage loans or (ii) observable market data inputs for commitments to sell TBAs. The Corporation's forward sales commitments are classified as Level 2.

**Derivative liability - cash flow hedges.** The Corporation's derivative financial instruments have been designated as and qualify as cash flow hedges. The fair value of the Corporation's cash flow hedges is determined using the discounted cash flow method. All of the Corporation's cash flow hedges are classified as Level 2.

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

<i>(Dollars in thousands)</i>	<b>September 30, 2014</b>			<b>Assets at Fair Value</b>
	<b>Fair Value Measurements Using</b>			
	<b>Level</b>	<b>Level 2</b>	<b>Level</b>	
	<b>1</b>		<b>3</b>	
<b>Assets:</b>				
Securities available for sale				
U.S. government agencies and corporations	\$—	\$25,220	\$ —	\$25,220
Mortgage-backed securities	—	63,546	—	63,546
Obligations of states and political subdivisions	—	131,327	—	131,327
Total securities available for sale	—	220,093	—	220,093
Loans held for sale	—	35,910	—	35,910
Interest rate lock commitments included in other assets	—	616	—	616
Total assets measured at fair value on a recurring basis	\$—	\$256,619	\$ —	\$256,619
<b>Liabilities:</b>				
Derivative liability - cash flow hedges	\$—	\$192	\$ —	\$192

<i>(Dollars in thousands)</i>	<b>December 31, 2013</b>			<b>Assets at Fair Value</b>
	<b>Fair Value Measurements Using</b>			
	<b>Level</b>	<b>Level 2</b>	<b>Level</b>	
	<b>1</b>		<b>3</b>	
<b>Assets:</b>				

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

Securities available for sale		
U.S. Treasury securities	\$—\$10,000	\$ — \$10,000
U.S. government agencies and corporations	29,950	29,950
Mortgage-backed securities	— 50,863	— 50,863
Obligations of states and political subdivisions	— 127,139	— 127,139
Corporate and other debt securities	— 158	— 158
Total securities available for sale	— 218,110	— 218,110
Loans held for sale	— 35,879	— 35,879
Interest rate lock commitments included in other assets	— 511	— 511
Forward sales commitments included in other assets	— 22	— 22
Total assets	\$—\$254,522	\$ — \$254,522
Liabilities:		
Derivative liability - cash flow hedges	\$—\$331	\$ — \$331

Table Of Contents

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

The Corporation may be required, from time to time, to measure and recognize certain other financial assets at fair value on a nonrecurring basis in accordance with U.S. GAAP. The following describes the valuation techniques and inputs used by the Corporation in determining the fair value of certain assets recorded at fair value on a nonrecurring basis in the financial statements.

**Impaired loans.** The Corporation does not record loans held for investment at fair value on a recurring basis. However, there are instances when a loan is considered impaired and an allowance for loan losses is established. A loan is considered impaired when it is probable that the Corporation will be unable to collect all interest and principal payments as scheduled in the loan agreement. All TDRs are considered impaired loans. The Corporation measures impairment on a loan-by-loan basis for commercial, construction and residential loans in excess of \$500,000 by either the present value of expected future cash flows discounted at the loan's effective interest rate, the loan's obtainable market price, or the fair value of the collateral if the loan is collateral dependent. Additionally, management reviews current market conditions, borrower history, past experience with similar loans and economic conditions. Based on management's review, additional write-downs to fair value may be incurred. The Corporation maintains a valuation allowance to the extent that the measure of the impaired loan is less than the recorded investment. When the fair value of an impaired loan is based solely on observable cash flows, market price or a current appraisal, the Corporation records the impaired loan as nonrecurring Level 2. However, if based on management's review, additional write-downs to fair value are required, the Corporation records the impaired loan as nonrecurring Level 3.

The measurement of impaired loans of less than \$500,000 is based on each loan's future cash flows discounted at the loan's effective interest rate rather than the market rate of interest, which is not a fair value measurement and is therefore excluded from fair value disclosure requirements.

**Other real estate owned (OREO).** Assets acquired through, or in lieu of, loan foreclosure are held for sale and are initially recorded at fair value less costs to sell at the date of foreclosure. Initial fair value is based upon appraisals the Corporation obtains from independent licensed appraisers. Subsequent to foreclosure, management periodically performs valuations of the foreclosed assets based on updated appraisals, general market conditions, recent sales of like properties, length of time the properties have been held, and our ability and intention with regard to continued ownership of the properties. The Corporation may incur additional write-downs of foreclosed assets to fair value less costs to sell if valuations indicate a further other-than-temporary deterioration in market conditions. As such, we record OREO as nonrecurring Level 3.

The following table presents the balances of financial assets measured at fair value on a non-recurring basis.

**September 30, 2014**

<i>(Dollars in thousands)</i>	<b>Fair Value Measurements Using</b>			<b>Assets at Fair Value</b>
	<b>Level 1</b>	<b>Level 2</b>	<b>Level 3</b>	
Impaired loans, net	\$—	\$—	\$2,607	\$2,607
Other real estate owned, net	—	—	1,087	1,087
Total	\$—	\$—	\$3,694	\$3,694

**December 31, 2013**

<i>(Dollars in thousands)</i>	<b>Fair Value Measurements Using</b>			<b>Assets at Fair Value</b>
	<b>Level 1</b>	<b>Level 2</b>	<b>Level 3</b>	
Impaired loans, net	\$—	\$—	\$3,646	\$3,646
Other real estate owned, net	—	—	2,769	2,769
Total	\$—	\$—	\$6,415	\$6,415

Table Of Contents

The following table presents quantitative information about Level 3 fair value measurements for financial assets measured at fair value on a non-recurring basis as of September 30, 2014:

<i>(Dollars in thousands)</i>	<b>Fair Value Measurements at September 30, 2014</b>			<b>Range of Inputs</b>
	<b>Fair Value</b>	<b>Valuation Technique(s)</b>	<b>Unobservable Inputs</b>	
Impaired loans, net	\$2,607	Appraisals	Discount for current market conditions and estimated selling costs	7%-50%
Other real estate owned, net	\$1,087	Appraisals	Discount for current market conditions and estimated selling costs	1.25%-25%
Total	\$3,694			

***Fair Value of Financial Instruments***

ASC 825, *Financial Instruments*, requires disclosure about fair value of financial instruments, including those financial assets and financial liabilities that are not required to be measured and reported at fair value on a recurring or nonrecurring basis. ASC 825 excludes certain financial instruments and all nonfinancial instruments from its disclosure requirements. Accordingly, the aggregate fair value amounts presented may not necessarily represent the underlying fair value of the Corporation.

The following describes the valuation techniques used by the Corporation to measure its financial instruments at fair value as of September 30, 2014 and December 31, 2013.

**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, net.** The fair value of performing loans is estimated using a discounted expected future cash flows analysis based on current rates being offered on similar products in the market. An overall valuation adjustment is made for specific credit risks as well as general portfolio risks. Based on the valuation methodologies used in assessing the fair value of loans and the associated valuation allowance, these loans are considered Level 3.

Loan totals, as listed in the table below, include impaired loans. For valuation techniques used in relation to impaired loans, see the Assets and Liabilities Measured at Fair Value on a Nonrecurring Basis section in this Note 8.

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

**Bank-owned life insurance (BOLI).** The fair value of BOLI is estimated using information provided by insurance carriers. These policies are carried at their cash surrender value, which approximates the fair value.

**Deposits.** The fair value of all demand deposit accounts is the amount payable at the report date. For all other deposits, the fair value is determined using the discounted cash flow method. The discount rate was equal to the rate currently offered on similar products in active markets (Level 2).

**Borrowings.** The fair value of borrowings is determined using the discounted cash flow method. The discount rate was equal to the rate currently offered on similar products in active markets (Level 2).

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

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



Table Of Contents

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

The following tables reflect the carrying amounts and estimated fair values of the Corporation's financial instruments whether or not recognized on the balance sheet at fair value.

<i>(Dollars in thousands)</i>	Carrying Value	Fair Value Measurements at September 30, 2014 Using			Total Fair Value
		Level 1	Level 2	Level 3	
Financial assets:					
Cash and cash equivalents	\$145,329	\$145,329	\$—	\$—	\$145,329
Securities available for sale	220,093	—	220,093	—	220,093
Restricted stocks	3,690	3,690	—	—	3,690
Loans, net	792,117	—	—	804,464	804,464
Loans held for sale	35,910	—	35,910	—	35,910
Accrued interest receivable	6,243	6,243	—	—	6,243
BOLI	14,275	—	14,275	—	14,275
Derivative asset	616	—	616	—	616
Financial liabilities:					
Demand deposits	\$634,290	\$634,290	\$—	\$—	\$634,290
Time deposits	367,142	—	370,367	—	370,367
Borrowings	170,513	—	162,843	—	162,843
Derivative liability	192	—	192	—	192
Accrued interest payable	791	791	—	—	791

<i>(Dollars in thousands)</i>	Carrying Value	Fair Value Measurements at December 31, 2013 Using			Total Fair Value
		Level 1	Level 2	Level 3	
Financial assets:					
Cash and cash equivalents	\$148,139	\$148,139	\$—	\$—	\$148,139
Securities available for sale	218,110	—	218,110	—	218,110
Restricted stocks	4,336	4,336	—	—	4,336
Loans, net	785,532	—	—	800,488	800,488
Loans held for sale	35,879	—	35,879	—	35,879
Accrued interest receivable	6,360	6,360	—	—	6,360
BOLI	13,988	—	13,988	—	13,988
Derivative asset	533	—	533	—	533

## Financial liabilities:

Demand deposits	\$608,409	\$608,409	\$—	\$—	\$608,409
Time deposits	399,883	—	403,291	—	403,291
Borrowings	169,835	—	162,194	—	162,194
Derivative liability	331		331		331
Accrued interest payable	843	843	—	—	843

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

Table Of Contents**NOTE 9: Business Segments**

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

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

<i>(Dollars in thousands)</i>	<b>Three Months Ended September 30, 2014</b>					
	<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	\$10,925	\$ 366	\$ 11,837	\$—	\$ (1,290 )	\$ 21,838
Gains on sales of loans	—	1,188	—	—	—	1,188
Other noninterest income	2,212	597	262	364	—	3,435
Total operating income	13,137	2,151	12,099	364	(1,290 )	26,461
<b>Expenses:</b>						
Interest expense	1,460	57	1,648	241	(1,290 )	2,116
Provision for loan losses	—	15	4,125	—	—	4,140
Salaries and employee benefits	5,420	813	2,382	196	—	8,811
Other noninterest expenses	4,284	1,172	1,224	94	—	6,774
Total operating expenses	11,164	2,057	9,379	531	(1,290 )	21,841
Income (loss) before income taxes	1,973	94	2,720	(167 )	—	4,620
Provision for (benefit from) income taxes	292	37	1,061	(64 )	—	1,326
Net income (loss)	\$1,681	\$ 57	\$ 1,659	\$(103 )	\$ —	\$ 3,294
Total assets	\$1,153,939	\$ 50,439	\$ 288,328	\$3,656	\$ (180,367 )	\$ 1,315,995
Goodwill	\$3,701	\$ —	\$ 10,724	\$ —	\$ —	\$ 14,425
Capital expenditures	\$306	\$ 20	\$ 3	\$ —	\$ —	\$ 329



Table Of Contents

<i>(Dollars in thousands)</i>	<b>Three Months Ended September 30, 2013</b>					
	<b>Retail</b>	<b>Mortgage</b>	<b>Consumer</b>	<b>Other</b>	<b>Eliminations</b>	<b>Consolidated</b>
	<b>Banking</b>	<b>Banking</b>	<b>Finance</b>			
<b>Revenues:</b>						
Interest income	\$8,094	\$ 566	\$ 12,316	\$—	\$ (1,322 )	\$ 19,654
Gains on sales of loans	—	1,790	—	—	—	1,790
Other noninterest income	1,849	1,146	259	594	1	3,849
Total operating income	9,943	3,502	12,575	594	(1,321 )	25,293
<b>Expenses:</b>						
Interest expense	1,458	99	1,645	189	(1,322 )	2,069
Provision for loan losses	—	15	3,825	—	—	3,840
Salaries and employee benefits	4,531	1,086	2,047	198	—	7,862
Other noninterest expenses	3,396	1,799	1,059	408	—	6,662
Total operating expenses	9,385	2,999	8,576	795	(1,322 )	20,433
Income (loss) before income taxes	558	503	3,999	(201 )	1	4,860
Provision for (benefit from) income taxes	(233 )	201	1,559	(33 )	—	1,494
Net income (loss)	\$791	\$ 302	\$ 2,440	\$(168 )	\$ 1	\$ 3,366
Total assets	\$816,906	\$ 70,865	\$ 289,252	\$4,892	\$ (198,284 )	\$ 983,631
Goodwill	\$—	\$—	\$ 10,724	\$—	\$—	\$ 10,724
Capital expenditures	\$1,273	\$ 329	\$ 19	\$—	\$—	\$ 1,621

<i>(Dollars in thousands)</i>	<b>Nine Months Ended September 30, 2014</b>					
	<b>Retail</b>	<b>Mortgage</b>	<b>Consumer</b>	<b>Other</b>	<b>Eliminations</b>	<b>Consolidated</b>
	<b>Banking</b>	<b>Banking</b>	<b>Finance</b>			
<b>Revenues:</b>						
Interest income	\$32,612	\$ 997	\$ 34,959	\$—	\$ (3,724 )	\$ 64,844
Gains on sales of loans	—	4,025	—	—	—	4,025
Other noninterest income	6,720	2,085	824	1,047	—	10,676
Total operating income	39,332	7,107	35,783	1,047	(3,724 )	79,545
<b>Expenses:</b>						
Interest expense	4,530	151	4,807	713	(3,724 )	6,477
Provision for loan losses	—	45	10,870	—	—	10,915
Salaries and employee benefits	16,859	2,912	6,636	628	—	27,035
Other noninterest expenses	13,583	3,506	3,526	545	—	21,160
Total operating expenses	34,972	6,614	25,839	1,886	(3,724 )	65,587
Income (loss) before income taxes	4,360	493	9,944	(839 )	—	13,958
Provision for (benefit from) income taxes	273	197	3,878	(319 )	—	4,029
Net income (loss)	\$4,087	\$ 296	\$ 6,066	\$(520 )	\$—	\$ 9,929

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

Total assets	<b>\$1,153,939</b>	<b>\$ 50,439</b>	<b>\$ 288,328</b>	<b>\$3,656</b>	<b>\$ (180,367 )</b>	<b>\$ 1,315,995</b>
Goodwill	<b>\$3,701</b>	<b>\$ —</b>	<b>\$ 10,724</b>	<b>\$—</b>	<b>\$ —</b>	<b>\$ 14,425</b>
Capital expenditures	<b>\$1,454</b>	<b>\$ 61</b>	<b>\$ 87</b>	<b>\$1</b>	<b>\$ —</b>	<b>\$ 1,603</b>

32

---

Table Of Contents

<i>(Dollars in thousands)</i>	Nine Months Ended September 30, 2013					Consolidated
	Retail	Mortgage	Consumer	Other	Eliminations	
	Banking	Banking	Finance			
<b>Revenues:</b>						
Interest income	\$23,693	\$ 1,409	\$ 36,808	\$1	\$ (3,904)	) \$ 58,007
Gains on sales of loans	—	7,068	—	—	—	7,068
Other noninterest income	5,249	3,310	833	1,239	1	10,632
Total operating income	28,942	11,787	37,641	1,240	(3,903)	) 75,707
<b>Expenses:</b>						
Interest expense	4,475	272	4,889	567	(3,904)	) 6,299
Provision for loan losses	1,000	75	9,065	—	—	10,140
Salaries and employee benefits	12,740	3,840	5,981	599	—	23,160
Other noninterest expenses	9,649	4,543	3,233	1,516	—	18,941
Total operating expenses	27,864	8,730	23,168	2,682	(3,904)	) 58,540
Income (loss) before income taxes	1,078	3,057	14,473	(1,442)	1	17,167
Provision for (benefit from) income taxes	(908)	) 1,223	5,644	(342)	) —	5,617
Net income (loss)	\$1,986	\$ 1,834	\$ 8,829	\$(1,100)	\$ 1	\$ 11,550
Total assets	\$816,906	\$ 70,865	\$ 289,252	\$4,892	\$ (198,284)	) \$ 983,631
Goodwill	\$—	\$ —	\$ 10,724	\$—	\$ —	\$ 10,724
Capital expenditures	\$3,005	\$ 460	\$ 60	\$2	\$ —	\$ 3,527

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 purchase loan contracts by means of a variable rate line of credit that carries interest at one-month LIBOR plus 200-225 basis points and fixed rate loans that carry interest rates ranging from 3.8 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 10: Commitments and Financial Instruments with Off-Balance-Sheet Risk**

C&F Mortgage enters into IRLCs with customers and will sell the underlying loans to investors on either a best efforts or a mandatory delivery basis. Depending on the delivery method, C&F Mortgage mitigates interest rate risk on IRLCs and loans held for sale by (a) entering into forward loan sales contracts with investors for loans to be delivered on a best efforts basis or (b) entering into forward sales contracts of MBS for loans to be delivered on a mandatory

basis. Both the IRLCs with customers and the forward sales contracts are considered derivative financial instruments. At September 30, 2014, the Corporation had derivative financial instruments with a notional value of \$50.10 million. The fair value of these derivative instruments at September 30, 2014 was \$616,000, which was included in other assets.



Table Of Contents

C&F Mortgage sells substantially all of the residential mortgage loans it originates to third-party counterparties. As is customary in the industry, the agreements with these counterparties require C&F Mortgage to extend representations and warranties with respect to program compliance, borrower misrepresentation, fraud, and early payment performance. Under the agreements, the counterparties are entitled to make loss claims and repurchase requests of C&F Mortgage for loans that contain covered deficiencies. C&F Mortgage has obtained early payment default recourse waivers for a significant portion of its business. Recourse periods for early payment default for the remaining counterparties vary from 90 days up to one year. Recourse periods for borrower misrepresentation or fraud, or underwriting error do not have a stated time limit. C&F Mortgage maintains an indemnification reserve for potential claims made under these recourse provisions. The following table presents the changes in the allowance for indemnification losses for the periods presented:

	<b>Three Months</b>		<b>Nine Months</b>	
	<b>Ended</b>		<b>Ended</b>	
	<b>September 30,</b>		<b>September 30,</b>	
<i>(Dollars in thousands)</i>	<b>2014</b>	<b>2013</b>	<b>2014</b>	<b>2013</b>
Allowance, beginning of period	<b>\$2,074</b>	\$2,232	<b>\$2,415</b>	\$2,092
Provision for indemnification losses	<b>73</b>	117	<b>182</b>	492
Payments	<b>(64 )</b>	—	<b>(514 )</b>	(235 )
Allowance, end of period	<b>\$2,083</b>	\$2,349	<b>\$2,083</b>	\$2,349

**NOTE 11: Interest Rate Swaps**

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

The cash flow hedges total notional amount is \$10.00 million. At September 30, 2014, the cash flow hedges had a fair value of (\$192,000), which is recorded in other liabilities. The cash flow hedges were fully effective at September 30, 2014 and therefore the loss on the cash flow hedges was recognized as a component of other comprehensive income (loss), net of deferred income taxes.

**NOTE 12: Other Noninterest Expenses**

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

	<b>Three Months</b>		<b>Nine Months</b>	
	<b>Ended</b>		<b>Ended</b>	
	<b>September 30,</b>		<b>September 30,</b>	
<i>(Dollars in thousands)</i>	<b>2014</b>	<b>2013</b>	<b>2014</b>	<b>2013</b>
FDIC insurance expense	<b>\$193</b>	\$150	<b>\$806</b>	\$474
Data processing fees	<b>806</b>	668	<b>2,758</b>	1,985
Loan and OREO expenses	<b>221</b>	440	<b>305</b>	880
Amortization of core deposit intangible	<b>290</b>	—	<b>914</b>	—
Telecommunication expenses	<b>348</b>	284	<b>1,101</b>	876
Professional fees	<b>442</b>	476	<b>1,634</b>	1,436
Travel and educational expenses	<b>258</b>	248	<b>813</b>	751
Marketing and advertising expenses	<b>362</b>	230	<b>957</b>	670
Acquisition transaction costs	<b>6</b>	279	<b>315</b>	1,061
All other noninterest expenses	<b>1,660</b>	2,096	<b>5,054</b>	5,479
Total other noninterest expenses	<b>\$4,586</b>	\$4,871	<b>\$14,657</b>	\$13,612

Table Of Contents

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

*Cautionary Statement Regarding Forward-Looking Statements*

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

• interest rates, such as the current volatility in yields on U.S. Treasury bonds and mortgage rates

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

• general economic conditions, including unemployment levels

• the legislative/regulatory climate, including the Dodd-Frank Wall Street Reform and Consumer Protection Act (the Dodd-Frank Act) and regulations promulgated thereunder, the Consumer Financial Protection Bureau (CFPB) and the regulatory and enforcement activities of the CFPB and rules promulgated under the Basel III framework

• monetary and fiscal policies of the U.S. Government, including policies of the Treasury and the Federal Reserve Board, including the effect of these policies on interest rates and business in our markets

• the ability to achieve the results expected from the CVB acquisition, including anticipated costs savings, continued relationships with major customers and deposit retention

- the value of securities held in the Corporation's investment portfolios
- the quality or composition of the loan portfolios and the value of the collateral securing those loans
- the commercial and residential real estate markets
- the inventory level and pricing of used automobiles, including sales prices of repossessed vehicles
- the level of net charge-offs on loans and the adequacy of our allowance for loan losses
- demand in the secondary residential mortgage loan markets
- the level of indemnification losses related to mortgage loans sold
- demand for loan products
- deposit flows
- the strength of the Corporation's counterparties
- competition from both banks and non-banks
- demand for financial services in the Corporation's market area
- the Corporation's expansion and technology initiatives
- reliance on third parties for key services
- accounting principles, policies and guidelines and elections by the Corporation thereunder

Table Of Contents

These risks are exacerbated by the turbulence over the past several years in the global and United States financial markets. Continued weakness in the global and United States financial markets could further affect 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 in general. While there are some signs of improvement in the economic environment, there was a prolonged period of volatility and disruption in the markets, and unemployment has risen to, and remains at, high levels. There can be no assurance that these unprecedented 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 liquidity and business purposes.

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 institutions. As a result, defaults by, or even rumors or questions about defaults by, one or more financial services institutions, or the financial services industry generally, could create another market-wide liquidity crisis similar to that experienced in late 2008 and early 2009 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.

There can be no assurance that the actions taken by the federal government and regulatory agencies will alleviate the industry or economic factors that may adversely affect the Corporation's business and financial performance. Further, many aspects of the Dodd-Frank Act remain subject to rulemaking and will take effect over several years, making it difficult to anticipate the overall effect on the Corporation's business and financial performance.

These risks and uncertainties, and the risks discussed in more detail in Item 1A, "Risk Factors" of the Corporation's Annual Report on Form 10-K for the year ended December 31, 2013, 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 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 adequate to absorb any losses on existing loans that may become uncollectible. Our judgment in determining the level of the allowance is based on evaluations of the collectibility of loans while taking into consideration such factors as trends in delinquencies and charge-offs, changes in the nature and volume of the loan portfolio, current economic conditions that may affect a borrower's ability to repay and the value of collateral, overall portfolio quality and review of specific potential losses. This evaluation is inherently subjective because it requires estimates that are susceptible to significant revision as more information becomes available.

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 incurs a loss due to borrower misrepresentation, fraud, early default, or underwriting error. The allowance represents an amount that, in management's judgment, will be adequate to absorb any losses arising from indemnification requests. Management's judgment in determining the level of the allowance is based on the volume of loans sold, historical experience, current economic conditions and information provided by investors. This evaluation is inherently subjective, as it requires estimates that are susceptible to significant revision as more information becomes available.

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

**Loans Acquired in a Business Combination:** Loans acquired in a business combination, such as C&F Financial Corporation's acquisition of CVBK, are recorded at estimated fair value on the date of acquisition without the carryover of the related allowance for loan losses. Purchased credit-impaired (PCI) loans are those for which there is evidence of credit deterioration since origination and for which it is probable at the date of acquisition that the Corporation will not collect all contractually required principal and interest payments. When determining fair value, PCI loans were aggregated into pools of loans based on common risk characteristics as of the date of acquisition such as loan type, date of origination, and evidence of credit quality deterioration such as internal risk grades and past due and nonaccrual status. The difference between contractually required payments at acquisition and the cash flows expected to be collected at acquisition is referred to as the "nonaccretable difference," and is available to absorb future credit losses on those loans. Subsequent decreases to the expected cash flows will generally result in a provision for loan losses. Subsequent significant increases in cash flows may result in a reversal of the provision for loan losses to the extent of prior charges, or a reversal of the nonaccretable difference with a positive effect on future interest income. Further, any excess of cash flows expected at acquisition over the estimated fair value is referred to as the "accretable yield" and is recognized as interest income over the remaining life of the loan when there is a reasonable expectation about the amount and timing such cash flows.

Subsequent to acquisition, we evaluate on a quarterly basis our estimate of cash flows expected to be collected. In the current economic environment, estimates of cash flows for PCI loans require significant judgment. Subsequent decreases to the expected cash flows will generally result in a provision for loan losses resulting in an increase to the allowance for loan losses. Subsequent increases in cash flows will generally result in an increase in interest income

over the remaining life of the loan, or pool(s) of loans. Disposals of loans, which may include sale of loans to third parties, receipt of payments in full or in part from the borrower or foreclosure of the collateral, result in removal of the loan from the PCI loan portfolio at its carrying amount. The Corporation's PCI loans currently consist of loans acquired in connection with the acquisition of CVBK. PCI loans that were classified as nonperforming loans by CVBK are no longer classified as nonperforming so long as, at quarterly re-estimation periods, we believe we will fully collect the new carrying value of the pools of loans.

Loans not designated PCI loans as of the acquisition date are designated purchased performing loans. The Corporation accounts for purchased performing loans using the contractual cash flows method of recognizing discount accretion based on the acquired loans' contractual cash flows. Purchased performing loans are recorded at fair value, including a credit discount. The fair value discount is accreted as an adjustment to yield over the estimated lives of the loans. There is no allowance for loan losses established at the acquisition date for purchased performing loans. A provision for loan losses may be required in future periods for any deterioration in these loans subsequent to the acquisition.



Table Of Contents

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

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

**Goodwill:** The Corporation's goodwill was recognized in connection with the Corporation's acquisition of CVBK in October 2013, subject to later adjustment as discussed in Part I, Item 1, "Financial Statements: under the heading "Note 2: Business Combinations" in this Quarterly Report on Form 10-Q, and C&F Bank's acquisition of C&F Finance Company in September 2002. With the adoption of ASU 2011-08, *Intangible-Goodwill and Other-Testing Goodwill for Impairment*, in 2012, the Corporation is no longer required to perform a test for impairment unless, based on an assessment of qualitative factors related to goodwill, we determine that it is more likely than not that the fair value of goodwill is less than its carrying amount. If the likelihood of impairment is more than 50 percent, the Corporation must perform a test for impairment and we may be required to record impairment charges. In assessing the recoverability of the Corporation's goodwill, major assumptions used in determining impairment are increases in future income, sales multiples in determining terminal value and the discount rate applied to future cash flows. If an impairment test is performed, we will prepare a sensitivity analysis by increasing the discount rate, lowering sales multiples and reducing increases in future income.

**Retirement Plan:** The Bank maintains a non-contributory, defined benefit pension plan for eligible full-time employees as specified by the plan. Plan assets, which consist primarily of mutual funds invested in marketable equity securities and corporate and government fixed income securities, are valued using market quotations. The Bank's actuary determines plan obligations and annual pension expense using a number of key assumptions. Key assumptions

may include the discount rate, the interest crediting rate, the estimated future return on plan assets and the anticipated rate of future salary increases. Changes in these assumptions in the future, if any, or in the method under which benefits are calculated may affect pension assets, liabilities or expense.

**Derivative Financial Instruments:** The Corporation recognizes derivative financial instruments at fair value as either an other asset or other liability in the consolidated balance sheet. The Corporation's derivative financial instruments consist of (1) IRLCs on mortgage loans that will be held for sale and related forward sale commitments and (2) interest rate swaps that qualify as cash flow hedges of a portion of the Corporation's trust preferred capital notes. Because the IRLCs and forward sale commitments are not designated as hedging instruments, adjustments to reflect unrealized gains and losses resulting from changes in fair value of the Corporation's IRLCs and forward sales commitments and realized gains and losses upon ultimate sale of the loans are classified as noninterest income. The effective portion of the gain or loss on the Corporation's cash flow hedges is reported as a component of other comprehensive income, net of deferred taxes, and reclassified into earnings in the same period or periods during which the hedged transactions affect earnings. For more information concerning fair value measurements of these instruments, see Part I, Item 1, "Financial Statements" in this Quarterly Report on Form 10-Q under the heading "Note 8: Fair Value of Assets and Liabilities."

Table Of Contents

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

For further information concerning accounting policies, refer to Item 8, "Financial Statements and Supplementary Data," under the heading "Note 1: Summary of Significant Accounting Policies" in the Corporation's Annual Report on Form 10-K for the year ended December 31, 2013.

## OVERVIEW

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

On October 1, 2013, the Corporation acquired all of the outstanding common stock of CVBK. On March 22, 2014, CVBK was merged with and into C&F Financial Corporation and CVB was merged with and into C&F Bank. The Corporation's financial position and results of operations as of and for the three and nine months ended September 30, 2014 and its financial position as of December 31, 2013 include the financial position and results of operations acquired in connection with the Corporation's purchase of CVBK and CVB.

For more information on this acquisition, see Part I, Item I, "Financial Statements" in this Quarterly Report on Form 10-Q under the heading "Note 2: Business Combinations."

## Financial Performance Measures

Net income for the Corporation was \$3.3 million, or \$0.97 per common share assuming dilution, for the three months ended September 30, 2014, compared with \$3.4 million, or \$0.97 per common share assuming dilution, for the three

months ended September 30, 2013. Net income for the Corporation was \$9.9 million, or \$2.88 per common share assuming dilution, for the nine months ended September 30, 2014, compared with \$11.6 million, or \$3.37 per common share assuming dilution, for the nine months ended September 30, 2013. The declines in net income for the third quarter and first nine months of 2014, compared to the same periods of 2013, were attributable to lower earnings at the Mortgage Banking and the Consumer Finance segments, offset in part by an increase in earnings at the Retail Banking segment. At the Mortgage Banking segment, mortgage interest rate increases since May of 2013 led to significantly reduced refinance activity and slower than expected residential real estate purchases, which has translated into weaker mortgage loan origination volume and correspondingly lower income from gains on sales of loans and ancillary mortgage lending fees. At the Consumer Finance segment, higher net charge-offs attributable to the continued difficult economic environment, reduced sales prices of repossessed vehicles and the effect easing of underwriting standards by our competitors has had on our borrowers' willingness to default on their loans resulted in a higher provision for loan losses during the third quarter and first nine months of 2014, compared to the same periods of 2013. In addition, the average balance and yield on the Consumer Finance segment's loan portfolio have declined as a result of increased competition and loan pricing strategies that competitors have used to grow market share in auto financing. The Retail Banking segment, which reported an increase in earnings during the third quarter and first nine months of 2014, compared to the same periods in 2013, benefited from (1) accounting adjustments associated with the acquisition of CVB, (2) the effects of the continued low interest rate environment on the cost of deposits, (3) a decline in the provision for loan losses as a result of improvement in asset quality and (4) a decline in expenses associated with foreclosed properties as a result of the sale of a majority of these properties since December 31, 2013.

Table Of Contents

The Corporation's ROE and ROA were 10.92 percent and 0.99 percent, respectively, on an annualized basis for the third quarter of 2014, compared with 12.58 percent and 1.37 percent, respectively, for the third quarter of 2013. For the first nine months of 2014, on an annualized basis, the Corporation's ROE and ROA were 11.22 percent and 1.00 percent, respectively, compared with 14.52 percent and 1.56 percent, respectively, for the first nine months of 2013. Both ROE and ROA for the third quarter and first nine months of 2014 were unfavorably affected by lower net income during 2014, compared to the same periods of 2013. The decline in ROE was also affected by internal capital growth of 11.6 percent since September 30, 2013 resulting from earnings and stock option exercises during the fourth quarter of 2013. The decline in ROA was further affected by asset growth of 33.8 percent since September 30, 2013 primarily resulting from the acquisition of CVBK on October 1, 2013.

**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 reported net income of \$1.7 million for the third quarter of 2014, compared to net income of \$791,000 for the third quarter of 2013. For the first nine months of 2014, C&F Bank reported net income of \$4.1 million, compared to net income of \$2.0 million for the first nine months of 2013. Net income of the Retail Banking segment during 2014 includes the results of operations acquired in connection with the Corporation's purchase of CVB on October 1, 2013. The results of both the third quarter and first nine months of 2014 for the Retail Banking segment were significantly affected by fair market value accounting adjustments resulting from the CVB acquisition. Accordingly, yields on loans and investments acquired from CVB increased and the cost of certificates of deposit assumed from CVB decreased, the benefits of which were partially offset by the amortization of the core deposit intangible and higher depreciation associated with the write-up of certain buildings recognized in the acquisition of CVB. The net accretion attributable to these adjustments was \$326,000 and \$1.4 million, net of taxes (\$502,000 and \$2.2 million prior to taxes, respectively) during the third quarter and first nine months of 2014, respectively.

The improvement in net income of the Retail Banking segment for the third quarter and first nine months of 2014, compared to the same periods of 2013, also resulted from (1) the effects of the continued low interest rate environment on the cost of deposits throughout 2014, (2) stability in loan credit quality resulting in a \$1.0 million decrease in the loan loss provision for the first nine months of 2014 compared to the same period in 2013, and (3) a significant decline in OREO during the first nine months of 2014 resulting in lower related holding costs and loss provisions. Partially offsetting these positive factors were the effects of the following: (1) higher personnel costs associated with increased staff levels and support positions associated with the addition of seven branches and the servicing of acquired loans and deposits through the acquisition of CVB and the addition of commercial loan personnel focused on growing the segment's commercial and small business loan portfolios, (2) one-time transaction expenses associated with the merger of CVB into C&F Bank, (3) depreciation of information technology equipment purchased to upgrade CVB's systems and equipment to conform to C&F Bank's technology infrastructure, and (4) higher operating expenses resulting from the effects of combining CVB's operations into the Bank's.

The Bank's nonperforming assets were \$6.6 million at September 30, 2014, compared to \$7.2 million at December 31, 2013. Nonperforming assets at September 30, 2014 included \$5.5 million in total nonaccrual loans, compared to \$4.4 million at December 31, 2013, and \$1.1 in OREO, compared to \$2.8 million at December 31, 2013. The increase in nonaccrual loans since December 31, 2013 was generally attributable to smaller balance residential real estate and commercial loans. Troubled debt restructurings at both September 30, 2014 and December 31, 2013 were \$5.6 million, of which \$2.5 million and \$2.6 million at September 30, 2014 and at December 31, 2013, respectively, were included in nonaccrual loans. The decline in OREO during the first nine months of 2014 resulted from sales of properties that had a total carrying value of \$2.5 million at December 31, 2013.

Table Of Contents

**Mortgage Banking:** The Mortgage Banking segment reported net income of \$57,000 for the third quarter of 2014, compared to net income of \$302,000 for the third quarter of 2013. For the first nine months of 2014, C&F Mortgage reported net income of \$296,000, compared to \$1.8 million for the first nine months of 2013. The entire mortgage industry, including the Corporation's Mortgage Banking segment, is experiencing significantly reduced refinancing and purchase activity, which has translated into weaker mortgage loan volume and correspondingly lower income from gains on sales of loans and ancillary mortgage lending fees. Loan originations at the Corporation's Mortgage Banking segment declined 27.4 percent and 38.5 percent during the third quarter and first nine months of 2014, respectively, compared to the same periods in 2013, which management believes is in line with or lower than industry declines. During the third quarter of 2014, the amount of loan originations for refinancings and new and resale home purchases were \$17.5 million and \$128.7 million, respectively, compared to \$52.3 million and \$149.1 million, respectively, during the third quarter of 2013. During the first nine months of 2014, the amount of loan originations for refinancings and new and resale home purchases were \$48.0 million and \$315.7 million, respectively, compared to \$230.7 million and \$360.9 million, respectively, during the first nine months of 2013. Further contributing to the declines in the Mortgage Banking segment's earnings during the three and nine months ended September 30, 2014, relative to the same periods of 2013, are fixed costs of personnel, facilities and operations that are not fully utilized during the current down cycle in loan production. Partially offsetting the negative effects of these production declines was a decline in production-based compensation.

If conditions influencing the mortgage banking environment, such as interest rates and housing inventories, do not improve, C&F Mortgage may experience a continuation of lower loan demand, particularly for mortgage refinancings, which could negatively affect earnings of the mortgage banking segment in future periods.

**Consumer Finance:** The Consumer Finance segment reported net income of \$1.7 million for the third quarter of 2014, compared to net income of \$2.4 million for the third quarter of 2013. For the first nine months of 2014, C&F Finance reported net income of \$6.1 million, compared to net income of \$8.8 million for the first nine months of 2013. Average loans outstanding during the third quarter of 2014 were essentially level with average loans outstanding during the third quarter of 2013 and average loans during the first nine months of 2014 declined \$1.7 million compared to the same period in 2013. These changes in the average consumer finance loan portfolio, coupled with a 69 basis point and a 75 basis point decline in average yield on the portfolio for the third quarter and first nine months of 2014, respectively, resulted in a \$482,000 decline and a \$1.8 million decline in net interest income during the third quarter and first nine months of 2014, respectively. The average balance of and average yield on the Consumer Finance segment's loan portfolio have declined as a result of increased competition and loan pricing strategies that competitors have used to grow market share.

The results of the Consumer Finance segment also included a \$300,000 and a \$1.8 million increase in the provision for loan losses during the third quarter and first nine months of 2014, compared to the same periods in 2013, as the net charge-off ratio has remained higher through the first nine months of 2014, compared to the first nine months of 2013, as a result of the continued difficult economic environment, reduced sales prices of repossessed vehicles and easing of underwriting standards by our competitors. The increase in the provision for loan losses during the first nine months of 2014 and the lack of significant portfolio growth since December 31, 2013 resulted in an increase in the ratio of the allowance for loan losses to total loans to 8.36 percent at September 30, 2014 from 8.32 percent at December 31,

2013. Management believes that the current allowance for loan losses is adequate to absorb probable losses in the consumer finance loan portfolio. However, if factors influencing the Consumer Finance segment result in a higher net charge-off ratio, C&F Finance may need to continue to increase the level of its allowance for loan losses, which could negatively affect future earnings of the Consumer Finance segment.

**Capital Management.** Total shareholders' equity was \$122.0 million at September 30, 2014, compared to \$112.9 million at December 31, 2013. Capital growth resulted from earnings for the first nine months of 2014 and an increase in unrealized holding gains on securities available for sale, which are a component of accumulated other comprehensive income. These increases were offset in part by dividends declared of 30 cents and 89 cents per share during the third quarter and first nine months of 2014, respectively. The third quarter dividend was paid on October 1, 2014 and equated to a payout ratio of 30.9 percent of third quarter net income.



Table Of Contents

Further affecting capital during 2014 was the Corporation's repurchase from the United States Department of the Treasury (Treasury) of a warrant to purchase 167,504 shares of the Corporation's common stock at an exercise price of \$17.91 per share (Warrant). The Warrant was issued to Treasury in January 2009 in connection with the Corporation's participation in the Troubled Asset Relief Program (TARP) Capital Purchase Program. The Corporation paid an aggregate purchase price of \$2.3 million for the repurchase of the Warrant, which has been cancelled. The repurchase price was based on the fair market value of the Warrant as agreed upon by the Corporation and Treasury. With the repurchase of the Warrant, the Corporation has completely exited the TARP Capital Purchase Program.

During the second quarter of 2014, the Board of Directors of the Corporation authorized a share repurchase program to purchase up to \$5.0 million of the Corporation's common stock. The Corporation purchased 2,800 shares under this repurchase program during the third quarter of 2014 through open-market transactions at a net price of \$33.05 per share. For more information about these repurchases of the Corporation's common stock, see Part II, Item 2, "Unregistered Sales of Equity Securities and Use of Proceeds" under the heading "Issuer Purchases of Equity Securities" in this Quarterly Report on Form 10-Q.

## **RESULTS OF OPERATIONS**

The following table presents the average balance sheets, the amounts of interest earned on earning assets, with related yields, and interest expense on interest-bearing liabilities, with related rates, for the three and nine months ended September 30, 2014 and 2013. Loans include loans held for sale. Loans placed on nonaccrual status are included in the balances and are included in the computation of yields, but had no material effect. Accretion and amortization of fair value purchase adjustments are included in the computation of yields on loans and investments and on the cost of deposits and borrowings acquired in connection with the purchase of CVB. Interest on tax-exempt loans and securities is presented on a taxable-equivalent basis (which converts the income on loans and investments for which no income taxes are paid to the equivalent yield as if income taxes were paid using the federal corporate income tax rate of 34 percent).

Table Of Contents**TABLE 1: Average Balances, Income and Expense, Yields and Rates**

	Three Months Ended September 30,					
	2014			2013		
	Average	Income/	Yield/	Average	Income/	Yield/
	Balance	Expense	Rate	Balance	Expense	Rate
<i>(Dollars in thousands)</i>						
<b>Assets</b>						
Securities:						
Taxable	\$97,842	\$602	2.46 %	\$29,720	\$152	2.05 %
Tax-exempt	118,632	1,657	5.59	118,650	1,740	5.87
Total securities	216,474	2,259	4.17	148,370	1,892	5.10
Total loans	862,214	20,059	9.23	732,924	18,335	9.93
Interest-bearing deposits in other banks and federal funds sold	147,817	92	0.24	48,845	29	0.24
Total earning assets	1,226,505	22,410	7.25	930,139	20,256	8.64
Allowance for loan losses	(35,278 )			(34,731 )		
Total non-earning assets	133,408			90,459		
Total assets	\$1,324,635			\$985,867		
<b>Liabilities and Shareholders' Equity</b>						
Time and savings deposits:						
Interest-bearing demand deposits	\$185,006	\$96	0.21 %	\$116,398	\$71	0.24 %
Money market deposit accounts	184,761	125	0.27	124,099	87	0.28
Savings accounts	98,252	20	0.08	49,667	10	0.08
Certificates of deposit, \$100 or more	142,801	305	0.85	123,285	358	1.15
Other certificates of deposit	230,851	440	0.76	156,512	458	1.16
Total time and savings deposits	841,671	986	0.47	569,961	984	0.68
Borrowings	170,718	1,130	2.59	166,425	1,085	2.55
Total interest-bearing liabilities	1,012,389	2,116	0.82	736,386	2,069	1.10
Demand deposits	170,773			117,987		
Other liabilities	20,814			24,501		
Total liabilities	1,203,976			878,874		
Shareholders' equity	120,659			106,993		
Total liabilities and shareholders' equity	\$1,324,635			\$985,867		
Net interest income		\$20,294			\$18,187	
Interest rate spread			6.43 %			7.54 %
Interest expense to average earning assets (annualized)			0.68 %			0.88 %
Net interest margin (annualized)			6.58 %			7.77 %

Table Of Contents

<i>(Dollars in thousands)</i>	Nine Months Ended September 30,					
	2014			2013		
	Average	Income/ Expense	Yield/ Rate	Average	Income/ Expense	Yield/ Rate
	<b>Balance</b>	<b>Expense</b>	<b>Rate</b>	<b>Balance</b>	<b>Expense</b>	<b>Rate</b>
<b>Assets</b>						
Securities:						
Taxable	\$95,419	\$1,864	2.60 %	\$30,918	\$429	1.85 %
Tax-exempt	118,191	5,039	5.69	116,367	5,192	5.95
Total securities	213,610	6,903	4.31	147,285	5,621	5.09
Total loans	852,406	59,395	9.32	727,548	54,093	9.94
Interest-bearing deposits in other banks and Federal funds sold	159,314	288	0.24	50,872	89	0.23
Total earning assets	1,225,330	66,586	7.26	925,705	59,803	8.64
Allowance for loan losses	(34,994 )			(34,918 )		
Total non-earning assets	133,090			93,679		
Total assets	\$1,323,426			\$984,466		
<b>Liabilities and Shareholders' Equity</b>						
Time and savings deposits:						
Interest-bearing demand deposits	\$184,596	\$332	0.24 %	\$125,284	\$292	0.31 %
Money market deposit accounts	179,223	365	0.27	118,532	250	0.28
Savings accounts	98,042	64	0.09	49,434	31	0.08
Certificates of deposit, \$100 or more	147,919	975	0.88	124,542	1,087	1.17
Other certificates of deposit	237,889	1,391	0.78	158,237	1,411	1.19
Total time and savings deposits	847,669	3,127	0.49	576,029	3,071	0.71
Borrowings	170,663	3,350	2.59	165,474	3,228	2.57
Total interest-bearing liabilities	1,018,332	6,477	0.84	741,503	6,299	1.12
Demand deposits	166,076			112,043		
Other liabilities	20,994			25,094		
Total liabilities	1,205,402			878,640		
Shareholders' equity	118,024			105,826		
Total liabilities and shareholders' equity	\$1,323,426			\$984,466		
Net interest income		\$60,109			\$53,504	
Interest rate spread			6.42 %			7.52 %
Interest expense to average earning assets (annualized)			0.70 %			0.90 %
Net interest margin (annualized)			6.56 %			7.73 %

Interest income and expense are affected by fluctuations in interest rates, by changes in the volume of earning assets and interest-bearing liabilities, and by the interaction of rate and volume factors. The following table presents the direct causes of the period-to-period changes in the components of net interest income on a taxable-equivalent basis. We calculated the rate and volume variances using a formula prescribed by the SEC. Rate/volume variances, the third element in the calculation, are not shown separately in the table, but are allocated to the rate and volume variances in proportion to the relationship of the absolute dollar amounts of the change in each. Loans include both nonaccrual loans and loans held for sale.



Table Of Contents**TABLE 2: Rate-Volume Recap**

	<b>Three Months Ended September 30, 2014 from 2013</b>		
	<b>Increase (Decrease)</b>	<b>Total</b>	
	<b>Due to Rate</b>	<b>Volume</b>	<b>Increase (Decrease)</b>
<i>(Dollars in thousands)</i>			
<b>Interest income:</b>			
Loans	\$ (6,836)	\$ 8,560	\$ 1,724
Securities:			
Taxable	36	414	450
Tax-exempt	(83 )	—	(83 )
Interest-bearing deposits in other banks and federal funds sold	1	62	63
Total interest income	(6,882)	9,036	2,154
<b>Interest expense:</b>			
Time and savings deposits:			
Interest-bearing demand deposits	(59 )	84	25
Money market deposit accounts	(19 )	57	38
Savings accounts	—	10	10
Certificates of deposit, \$100 or more	(313 )	260	(53 )
Other certificates of deposit	(737 )	719	(18 )
Total time and savings deposits	(1,128)	1,130	2
Borrowings (including trust preferred capital notes)	16	29	45
Total interest expense	(1,112)	1,159	47
Change in net interest income	\$ (5,770)	\$ 7,877	\$ 2,107

Table Of Contents

**Nine Months Ended  
September 30, 2014 from  
2013**

**Increase  
(Decrease)                      Total**

**Due to                      Increase  
Rate      Volume      (Decrease)**

*(Dollars in thousands)***Interest income:**

Loans	\$(5,226)	\$10,528	\$ 5,302
Securities:			
Taxable	234	1,201	1,435
Tax-exempt	(273 )	120	(153 )
Interest-bearing deposits in other banks and Federal funds sold	4	195	199
Total interest income	(5,261)	12,044	6,783

**Interest expense:**

Time and savings deposits:			
Interest-bearing demand deposits	(105 )	145	40
Money market deposit accounts	(10 )	125	115
Savings accounts	3	30	33
Certificates of deposit, \$100 or more	(374 )	262	(112 )
Other certificates of deposit	(776 )	756	(20 )
Total time and savings deposits	(1,262)	1,318	56
Borrowings (including Trust preferred capital notes)	22	100	122
Total interest expense	(1,240)	1,418	178
Change in net interest income	\$(4,021)	\$10,626	\$ 6,605

Net interest income, on a taxable-equivalent basis, for the three months ended September 30, 2014 was \$20.3 million, compared to \$18.2 million for the three months ended September 30, 2013. Net interest income, on a taxable-equivalent basis, for the first nine months of 2014 was \$60.1 million, compared to \$53.5 million for the first nine months of 2013. The increase in net interest income for the third quarter and first nine months of 2014, compared to the same periods of 2013, was a result of an increase in average earning assets resulting from the acquisition of CVBK on October 1, 2013, offset in part by a decrease in the net interest margin. The net interest margin decreased 119 basis points to 6.58 percent for the third quarter of 2014, and decreased 117 basis points to 6.56 percent for the first nine months of 2014 relative to the same periods in 2013. The decreases in net interest margin during 2014 can be attributed to a decrease in the yield on interest-earning assets offset in part by decreases in the cost of interest-bearing liabilities and an increase in demand deposits that pay no interest. The decreases in yield on interest-earning assets were primarily attributable to large increases in interest-bearing deposits in other banks and federal funds sold, which category of earning assets provides the lowest yield of all categories of earning assets, and decreases in the yields on the investment and loan portfolios for the three and nine months ended September 30, 2014, as compared to the same periods in 2013. The decreases in the cost of interest bearing liabilities is a result of the sustained low interest rate environment, the repricing of higher-rate certificates of deposit as they mature to lower rates, and a shift in the mix of deposits from higher cost interest-bearing deposits to lower cost deposits, including non-interest-bearing demand deposits and low-cost interest-bearing demand deposits, money market deposits and savings accounts.

Average loans, which includes both loans held for investment and loans held for sale, increased \$129.3 million to \$862.2 million for the third quarter of 2014, compared to the same period of 2013. Average loans increased \$124.9 million to \$852.4 million for the first nine months of 2014, compared to the same period of 2013. In total, average loans held for investment increased \$150.6 million during the third quarter of 2014 and \$146.8 million during the first nine months of 2014, compared to the same periods of 2013. Average loans in the Retail Banking segment increased \$150.2 million and \$148.5 million for the third quarter and first nine months of 2014, compared to the same periods of 2013, primarily as a result of the acquisition of CVBK on October 1, 2013. This increase was offset in part by a \$1.7 million decrease in the Consumer Finance segment's average loan portfolio for the first nine months of 2014, which declined as a result of increased competition, while average loans for the Consumer Finance segment for the third quarter of 2014 increased by \$568,000 compared to the same period of 2013. The Mortgage Banking segment's average portfolio of loans held for sale decreased \$129,000 and \$2,000 during the third quarter and first nine months of 2014, compared to the same periods of 2013. The decline in demand for mortgage loans and refinancing activity during the third quarter and first nine months of 2014 resulted in a \$55.2 million and \$228.0 million decrease in loan originations, respectively, when compared to the same periods of 2013.

Table Of Contents

The overall yield on average loans decreased 70 basis points to 9.23 percent for the third quarter of 2014 and 62 basis points to 9.32 percent for the first nine months of 2014, when compared to the same periods of 2013. These declines include a 69 basis point and a 75 basis point decline in the average yield on the Consumer Finance segment's loan portfolio for the third quarter and first nine months of 2014, respectively, as a result of aggressive pricing strategies by competitive lenders that lowered rates on newly-originated loans during 2013 and 2014. Further contributing to the decline in overall loan yield is the reduction in concentration of the Consumer Finance segment loans, which is the highest yielding component of total loans, as a percentage of total loans held for investment. Partially offsetting these factors in the third quarter and first nine months of 2014 was \$326,000 and \$1.4 million, respectively, of accretion related to the fair value adjustments to CVB's loan portfolio, which contributed approximately 28 basis points and 24 basis points to the yield on loans and 14 basis points and 17 basis points to the yield on interest earnings assets and the net interest margin for the third quarter of 2014 and first nine months of 2014, respectively.

Average securities available for sale increased \$68.1 million for the third quarter of 2014 and \$66.3 million for the first nine months of 2014, compared to the same periods of 2013. These increases occurred primarily in mortgage-backed securities, which were acquired in connection with the acquisition of CVBK. The average yield on the available-for-sale securities portfolio declined 93 basis points and 78 basis points for the third quarter and first nine months of 2014, compared to the same periods of 2013. The lower yield on the securities portfolio resulted from a shift in the mix of the securities portfolio from 80 percent and 79 percent concentration in higher-yielding tax-exempt securities for the third quarter and first nine months of 2013, respectively, to 55 percent concentration in tax-exempt securities for both the third quarter and first nine months of 2014.

Average interest-bearing deposits in other banks and Federal funds sold increased \$99.0 million and \$108.4 million, respectively, for the third quarter and first nine months of 2014, compared to the same periods of 2013, primarily as a result of the acquisition of CVBK, which had excess liquidity as a result of the liquidation of a significant portion of its investment portfolio shortly after the date of acquisition. The average yield on these overnight funds remained stable during the third quarter of 2014 and increased 1 basis point during the first nine months of 2014, compared to the same periods of 2013.

Average interest-bearing time and savings deposits increased \$271.7 million for the third quarter of 2014 and \$271.6 million in the first nine months of 2014, compared to the same periods of 2013, primarily as a result of the acquisition of CVBK. However, the effect on interest expense of the higher volume of interest-bearing deposits was significantly offset by a 21 basis point decline and a 22 basis point decline for the third quarter and first nine months of 2014, respectively, in the average cost of interest-bearing deposits. In particular, time deposits continued to reprice at lower interest rates upon renewal or were not renewed, and deposit interest expense was further reduced by the accretion of the fair value purchase adjustment on time deposits assumed in the CVB acquisition, which approximated \$286,000 and \$849,000 for the third quarter and first nine months of 2014.

Average borrowings increased \$4.3 million and \$5.2 million during the third quarter and first nine months of 2014, compared to the same periods of 2013. These increases were primarily due to the assumption of trust preferred capital



notes in connection with the acquisition of CVBK, which had an average carrying value of \$4.5 million during both the third quarter and first nine months of 2014. In addition, average retail repurchase agreements increased on average by \$645,000 during the first nine months of 2014. The cost of borrowings remained relatively constant during the third quarter and first nine months of 2014, compared to the same periods of 2013.

It will be challenging to maintain the Retail Banking segment's net interest margin at its current level if funds obtained from loan repayments and from deposit growth cannot be fully used to originate new loans and instead are reinvested in lower-yielding earning assets, and if the reduction in earning asset yields exceeds interest rate declines in interest-bearing liabilities, which are approaching their interest rate floors. The Retail Banking segment's net interest margin will benefit in future periods from the net accretion associated with the fair value adjustments to the loans, securities, deposits and borrowings purchased in the CVBK acquisition. If conditions influencing the mortgage banking environment do not improve, the Mortgage Banking segment may experience a continuation of lower loan demand, particularly for refinancings, which could reduce interest income on loans originated for sale, further contributing to a deterioration in net interest margin. The net interest margin at the Consumer Finance segment will be most affected by increasing competition and loan pricing strategies that competitors may use to grow market share in automobile financing and by economic conditions that are negatively affecting borrowers and could increase default rates on the segment's loans. Increased competition may result in (1) lower yields as the Consumer Finance segment responds to competitive pricing pressures and (2) fewer purchases of automobile retail installment sales contracts.

Table Of Contents**Noninterest Income****TABLE 3: Noninterest Income**

*(Dollars in thousands)*

	<b>Three Months Ended September 30, 2014</b>				
	<b>Retail</b>	<b>Mortgage</b>	<b>Consumer</b>	<b>Other and</b>	<b>Total</b>
	<b>Banking</b>	<b>Banking</b>	<b>Finance</b>	<b>Eliminations</b>	
Gains on sales of loans	\$—	\$ 1,188	\$ —	\$ —	\$1,188
Service charges on deposit accounts	1,179	—	—	—	1,179
Other service charges and fees	1,007	661	4	—	1,672
Gains on calls of available for sale securities	23	—	—	—	23
Other income	3	(64 )	258	364	561
Total noninterest income	\$2,212	\$ 1,785	\$ 262	\$ 364	\$4,623

*(Dollars in thousands)*

	<b>Three Months Ended September 30, 2013</b>				
	<b>Retail</b>	<b>Mortgage</b>	<b>Consumer</b>	<b>Other and</b>	<b>Total</b>
	<b>Banking</b>	<b>Banking</b>	<b>Finance</b>	<b>Eliminations</b>	
Gains on sales of loans	\$—	\$ 1,790	\$ —	\$ —	\$1,790
Service charges on deposit accounts	1,010	—	—	—	1,010
Other service charges and fees	682	920	2	51	1,655
Gains on calls of available for sale securities	—	—	—	270	270
Other income	157	226	257	274	914
Total noninterest income	\$1,849	\$ 2,936	\$ 259	\$ 595	\$5,639

*(Dollars in thousands)*

	<b>Nine Months Ended September 30, 2014</b>				
	<b>Retail</b>	<b>Mortgage</b>	<b>Consumer</b>	<b>Other and</b>	<b>Total</b>
	<b>Banking</b>	<b>Banking</b>	<b>Finance</b>	<b>Eliminations</b>	
Gains on sales of loans	\$—	\$ 4,025	\$ —	\$ —	\$4,025
Service charges on deposit accounts	3,357	—	—	—	3,357
Other service charges and fees	2,909	1,731	11	17	4,668
Gains on calls of available for sale securities	26	—	—	—	26
Other income	428	354	813	1,030	2,625
Total noninterest income	\$6,720	\$ 6,110	\$ 824	\$ 1,047	\$14,701



Table Of Contents*(Dollars in thousands)*

	<b>Nine Months Ended September 30, 2013</b>				<b>Total</b>
	<b>Retail Banking</b>	<b>Mortgage Banking</b>	<b>Consumer Finance</b>	<b>Other and Eliminations</b>	
Gains on sales of loans	\$—	\$ 7,068	\$ —	\$ —	\$7,068
Service charges on deposit accounts	2,930	—	—	—	2,930
Other service charges and fees	2,003	2,493	6	129	4,631
Gains on calls of available for sale securities	6	—	—	270	276
Other income	310	817	827	841	2,795
Total noninterest income	\$5,249	\$ 10,378	\$ 833	\$ 1,240	\$17,700

Total noninterest income decreased \$1.0 million, or 18.0 percent, in the third quarter of 2014 and decreased \$3.0 million, or 16.9 percent, in the first nine months of 2014, compared to the same periods in 2013. Declines of \$1.2 million and \$4.3 million in noninterest income for the third quarter and first nine months of 2014, respectively, compared to the same periods of 2013, occurred at the Mortgage Banking segment where gains on sales of loans and ancillary loan origination fees were negatively affected by higher mortgage interest rates, which caused a 27.4 percent decline and a 38.5 percent decline in the Mortgage Banking segment's loan origination volume during the third quarter and first nine months of 2014, respectively, compared to the same periods of 2013. The declines in noninterest income at the Mortgage Banking segment were partially offset by increases of \$363,000 and \$1.5 million for the third quarter and first nine months of 2014, respectively, compared to the same periods of 2013, at the Retail Banking segment, which resulted from the acquisition of CVB on October 1, 2013 and the contribution of CVB's operations to noninterest income generated by the Retail Banking segment.

**Noninterest Expense****TABLE 4: Noninterest Expenses***(Dollars in thousands)*

	<b>Three Months Ended September 30, 2014</b>				<b>Total</b>
	<b>Retail Banking</b>	<b>Mortgage Banking</b>	<b>Consumer Finance</b>	<b>Other and Eliminations</b>	
Salaries and employee benefits	\$5,420	\$ 813	\$ 2,382	\$ 196	\$8,811
Occupancy expenses	1,561	465	160	2	2,188
Other expenses:					
OREO expenses	95	—	—	—	95
Provision for indemnification losses	—	73	—	—	73
Other expenses	2,628	634	1,064	92	4,418
Total other expenses	2,723	707	1,064	92	4,586
Total noninterest expenses	\$9,704	\$ 1,985	\$ 3,606	\$ 290	\$15,585

*(Dollars in thousands)***Three Months Ended September 30, 2013**  
**Retail Mortgage Consumer Other and**

	<b>Banking</b>	<b>Banking</b>	<b>Finance</b>	<b>Eliminations</b>	<b>Total</b>
Salaries and employee benefits	\$4,531	\$ 1,086	\$ 2,047	\$ 198	\$7,862
Occupancy expenses	1,115	463	208	5	1,791
Other expenses:					
OREO expenses	290	—	—	—	290
Provision for indemnification losses	—	117	—	—	117
Other expenses	1,991	1,219	851	403	4,464
Total other expenses	2,281	1,336	851	403	4,871
Total noninterest expenses	\$7,927	\$ 2,885	\$ 3,106	\$ 606	\$14,524

Table Of Contents

<i>(Dollars in thousands)</i>	<b>Nine Months Ended September 30, 2014</b>				<b>Total</b>
	<b>Retail</b>	<b>Mortgage</b>	<b>Consumer</b>	<b>Other and</b>	
	<b>Banking</b>	<b>Banking</b>	<b>Finance</b>	<b>Eliminations</b>	
Salaries and employee benefits	\$16,859	\$ 2,912	\$ 6,636	\$ 628	\$27,035
Occupancy expenses	4,592	1,362	545	4	6,503
Other expenses:					
OREO expenses	17	—	—	—	17
Provision for indemnification losses	—	182	—	—	182
Other expenses	8,974	1,962	2,981	541	14,458
Total other expenses	8,991	2,144	2,981	541	14,657
Total noninterest expenses	\$30,442	\$ 6,418	\$ 10,162	\$ 1,173	\$48,195

<i>(Dollars in thousands)</i>	<b>Nine Months Ended September 30, 2013</b>				<b>Total</b>
	<b>Retail</b>	<b>Mortgage</b>	<b>Consumer</b>	<b>Other and</b>	
	<b>Banking</b>	<b>Banking</b>	<b>Finance</b>	<b>Eliminations</b>	
Salaries and employee benefits	\$12,740	\$ 3,840	\$ 5,981	\$ 599	\$23,160
Occupancy expenses	3,292	1,407	618	12	5,329
Other expenses:					
OREO expenses	674	—	—	—	674
Provision for indemnification losses	—	492	—	—	492
Other expenses	5,683	2,644	2,615	1,504	12,446
Total other expenses	6,357	3,136	2,615	1,504	13,612
Total noninterest expenses	\$22,389	\$ 8,383	\$ 9,214	\$ 2,115	\$42,101

Total noninterest expenses increased \$1.1 million, or 7.1 percent, in the third quarter of 2014 and increased \$6.1 million, or 14.5 percent, in the first nine months of 2014, compared to the same periods in 2013. Noninterest expenses increased at the Retail Banking segment primarily as a result of the acquisition of CVB and the expenses associated with the operation of seven additional branches and the servicing of acquired loans and deposits. Further increases resulted from higher personnel costs during the third quarter and first nine months of 2014 at (1) the Retail Banking segment due to increased staffing in the branch network to support customer service initiatives and the addition of new personnel dedicated to growing C&F Bank's commercial and small business loan portfolio and (2) at the Consumer Finance segment due to an increase in the number of personnel to support expansion into new markets. These increases were partially offset at the Mortgage Banking segment by lower (1) production-based compensation, (2) loan processing expenses and (3) provision for indemnification losses in connection with loans sold to investors; at the Retail Banking segment by lower foreclosed properties expenses as a result of the sale of a majority of these properties since the third quarter of 2013. Additionally, the Corporation recognized approximately \$315,000 in transaction costs during the first nine months of 2014 associated with the acquisition of CVBK, as compared to \$1.1 million in transaction costs during the first nine months of 2013.

**Income Taxes**

Income tax expense for the third quarter of 2014 totaled \$1.3 million, resulting in an effective tax rate of 28.7 percent, compared to \$1.5 million and 30.7 percent for the third quarter of 2013. Income tax expense for the first nine months of 2014 totaled \$4.0 million, resulting in an effective tax rate of 28.9 percent, compared to \$5.6 million and 32.7 percent for the first nine months of 2013. The decline in the effective tax rate during the third quarter and first nine months of 2014 compared to the same periods of 2013 was a result of higher earnings at the Retail Banking segment, which generates significant tax-exempt income on securities issued by states and political subdivisions and is exempt from state income taxes, as well as non-deductible merger expenses incurred during the third quarter and first nine months of 2013.

Table Of Contents**ASSET QUALITY****Allowance for Loan Losses**

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

The following tables summarize the allowance activity for the periods indicated:

**TABLE 5: Allowance for Loan Losses**

	<b>Three Months Ended September 30,</b>	
	<b>2014</b>	<b>2013</b>
<i>(Dollars in thousands)</i>		
Allowance, beginning of period	<b>\$35,258</b>	\$34,769
Provision for loan losses:		
Retail Banking segment	—	—
Mortgage Banking segment	<b>15</b>	15
Consumer Finance segment	<b>4,125</b>	3,825
Total provision for loan losses	<b>4,140</b>	3,840
Loans charged off:		
Real estate—residential mortgage	<b>68</b>	269
Real estate—construction	—	—
Commercial, financial and agricultural <sup>2</sup>	<b>50</b>	27
Equity lines	—	89
Consumer	<b>95</b>	59
Consumer finance	<b>4,619</b>	4,295
Total loans charged off	<b>4,832</b>	4,739
Recoveries of loans previously charged off:		
Real estate—residential mortgage	<b>13</b>	13
Real estate—construction	—	—
Commercial, financial and agricultural <sup>2</sup>	<b>64</b>	110
Equity lines	—	—
Consumer	<b>40</b>	24
Consumer finance	<b>890</b>	844



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

Total recoveries	<b>1,007</b>		991	
Net loans charged off	<b>3,825</b>		3,748	
Allowance, end of period	<b>\$35,573</b>		\$34,861	
Ratio of annualized net charge-offs to average total loans outstanding during period for Retail Banking	<b>0.07</b>	%	0.30	%
Ratio of annualized net charge-offs to average total loans outstanding during period for Consumer Finance	<b>5.18</b>	%	5.17	%

Table Of Contents

<i>(Dollars in thousands)</i>	<b>Nine Months Ended September 30,</b>			
	<b>2014</b>	<b>2013</b>		
Allowance, beginning of period	<b>\$34,852</b>	\$35,907		
Provision for loan losses:				
Retail Banking segment	—	1,000		
Mortgage Banking segment	<b>45</b>	75		
Consumer Finance segment	<b>10,870</b>	9,065		
Total provision for loan losses	<b>10,915</b>	10,140		
Loans charged off:				
Real estate—residential mortgage	<b>147</b>	744		
Real estate—construction	—	—		
Commercial, financial and agricultural <sup>2</sup>	<b>224</b>	2,297		
Equity lines	<b>47</b>	126		
Consumer	<b>242</b>	287		
Consumer finance	<b>12,717</b>	10,656		
Total loans charged off	<b>13,377</b>	14,110		
Recoveries of loans previously charged off:				
Real estate—residential mortgage	<b>37</b>	99		
Real estate—construction	—	—		
Commercial, financial and agricultural <sup>2</sup>	<b>111</b>	170		
Equity lines	—	27		
Consumer	<b>210</b>	103		
Consumer finance	<b>2,825</b>	2,525		
Total recoveries	<b>3,183</b>	2,924		
Net loans charged off	<b>10,194</b>	11,186		
Allowance, end of period	<b>\$35,573</b>	\$34,861		
Ratio of annualized net charge-offs to average total loans outstanding during period for Retail Banking	<b>0.07</b>	%	1.03	%
Ratio of annualized net charge-offs to average total loans outstanding during period for Consumer Finance	<b>4.68</b>	%	3.83	%

<sup>1</sup> Includes the Corporation's real estate construction lending and consumer real estate lot lending.

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

For the nine months ended September 30, 2013, the annualized net charge-off ratio for the Retail Banking segment includes a \$2.1 million charge-off for a single commercial lending relationship.



Table Of Contents

Table 6 discloses the allocation of the allowance for loan losses at September 30, 2014 and December 31, 2013.

**TABLE 6: Allocation of Allowance for Loan Losses**

<i>(Dollars in thousands)</i>	<b>September 30, 2014</b>	<b>December 31, 2013</b>
Allocation of allowance for loan losses:		
Real estate—residential mortgage	<b>\$ 2,290</b>	\$ 2,355
Real estate—construction	<b>434</b>	434
Commercial, financial and agricultural <sup>2</sup>	<b>7,692</b>	7,805
Equity lines	<b>845</b>	892
Consumer	<b>241</b>	273
Consumer finance	<b>24,071</b>	23,093
Total allowance for loan losses	<b>\$ 35,573</b>	\$ 34,852

<sup>1</sup>Includes the Corporation's real estate construction lending and consumer real estate lot lending.

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

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

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

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

Substandard loans are considered to have specific and well-defined weaknesses that jeopardize the viability of the Corporation's credit extension. The payment history for the loan has been inconsistent and the expected or projected

primary repayment source may be inadequate to service the loan. The estimated net liquidation value of the collateral pledged and/or ability of the personal guarantor(s) to pay the loan may not adequately protect the Corporation. There is a distinct possibility that the Corporation will sustain some loss if the deficiencies associated with the loan are not corrected in the near term. A substandard loan would not automatically meet our definition of impaired unless the loan is significantly past due and the borrower's performance and financial condition provide evidence that it is probable that the Corporation will be unable to collect all amounts due.

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

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

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

Table Of Contents**TABLE 7: Credit Quality Indicators**

Loans by credit quality indicators as of September 30, 2014 were as follows:

<i>(Dollars in thousands)</i>	Pass	Special Mention	Substandard	Substandard Nonaccrual	Total <sup>1</sup>
Real estate—residential mortgage	\$171,109	\$2,597	\$ 3,202	\$ 2,314	\$179,222
Real estate—construction	3,909	72	2,708	—	6,689
Commercial, financial and agricultural <sup>3</sup>	257,328	7,890	26,634	2,507	294,359
Equity lines	48,608	998	784	409	50,799
Consumer	8,402	15	107	231	8,755
	\$489,356	\$11,572	\$ 33,435	\$ 5,461	\$539,824

<i>(Dollars in thousands)</i>	Performing	Non-Performing	Total
Consumer finance	\$ 286,670	\$ 1,196	\$287,866

<sup>1</sup> At September 30, 2014, the Corporation did not have any loans classified as Doubtful or Loss.

<sup>2</sup> Includes the Corporation's real estate construction lending and consumer real estate lot lending.

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

Included in the table above are loans purchased in connection with the acquisition of CVBK of \$93.8 million pass rated, \$3.7 million special mention, \$10.9 million substandard and \$738,000 substandard nonaccrual.

Loans by credit quality indicators as of December 31, 2013 were as follows:

<i>(Dollars in thousands)</i>	Pass	Special Mention	Substandard	Substandard Nonaccrual	Total <sup>1</sup>
Real estate – residential mortgage	\$180,670	\$2,209	\$ 3,580	\$ 1,996	\$188,455
Real estate – construction <sup>2</sup>	2,899	116	2,795	—	5,810
Commercial, financial and agricultural <sup>3</sup>	243,576	8,571	34,573	1,873	288,593
Equity lines	48,603	1,003	898	291	50,795

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

Consumer	8,616	2	158	231	9,007
	\$484,364	\$11,901	\$42,004	\$4,391	\$542,660

<sup>1</sup>At December 31, 2013, the Corporation did not have any loans classified as Doubtful or Loss.

<sup>2</sup>Includes the Corporation's real estate construction lending and consumer real estate lot lending.

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

Included in the table above are loans purchased in connection with the acquisition of CVBK of \$115.3 million pass rated, \$3.3 million special mention, \$17.8 million substandard and \$652,000 substandard nonaccrual.

<i>(Dollars in thousands)</i>	<b>Performing</b>	<b>Non-Performing</b>	<b>Total</b>
Consumer finance	\$276,537	\$1,187	\$277,724

The Retail Banking segment's allowance for loan losses as of September 30, 2014 decreased \$302,000 since December 31, 2013 as a result of net charge-offs during 2014 that were provided for in prior periods. While there was a \$1.1 million increase in substandard nonaccrual loans during the first nine months of 2014 for the Retail Banking segment, there was no provision for loan losses during this period because of the overall improvement in the quality of the loan portfolio as indicated by the \$8.6 million decline in substandard loans. The allowance for loan losses as a percentage of total loans, excluding purchased credit impaired loans, was 2.14 percent and 2.22 percent at September 30, 2014 and December 31, 2013, respectively. We believe that the current level of the allowance for loan losses at the Retail Banking segment 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.

Table Of Contents

The Consumer Finance segment's allowance for loan losses increased by \$978,000 since December 31, 2013 to \$24.1 million at September 30, 2014, and its provision for loan losses increased \$300,000 and \$1.8 million for the third quarter and first nine months of 2014, respectively, compared to the same periods of 2013. The increase in the provision for loan losses during the first nine months of 2014 and the lack of significant loan portfolio growth since December 31, 2013 resulted in an increase in the ratio of the allowance for loan losses to total loans to 8.36 percent at September 30, 2014 from 8.32 percent at December 31, 2013. The increase in the provision for loan losses resulted from higher net charge-offs throughout the first nine months of 2014, compared to the first nine months of 2013, attributable to the continued difficult economic environment, reduced sales prices of repossessed vehicles and easing of underwriting standards by our competitors leading to higher default rates. We believe that the current level of the allowance for loan losses at the Consumer Finance segment is adequate to absorb any losses on existing loans that may become uncollectible. However, if factors influencing the Consumer Finance segment result in a higher net charge-off ratio in future periods, the Consumer Finance segment may need to increase the level of its allowance for loan losses, which could negatively affect future earnings of the Consumer Finance segment.

**Nonperforming Assets**

Table 8 summarizes nonperforming assets at September 30, 2014 and December 31, 2013.

**TABLE 8: Nonperforming Assets****Retail Banking Segment**

<i>(Dollars in thousands)</i>	<b>September 30, 2014</b>	<b>December 31, 2013</b>
Loans, excluding purchased loans	<b>\$ 427,862</b>	\$ 402,755
Purchased performing loans <sup>1</sup>	<b>85,643</b>	104,471
Purchased credit impaired loans <sup>1</sup>	<b>23,560</b>	32,520
Total loans	<b>\$ 537,065</b>	\$ 539,746
Nonaccrual loans <sup>2</sup>	<b>\$ 4,774</b>	\$ 3,740
Purchased performing-nonaccrual loans <sup>3</sup>	<b>738</b>	651
Total nonaccrual loans	<b>5,512</b>	4,391
OREO <sup>4</sup>	<b>1,087</b>	2,769
Total nonperforming assets <sup>5</sup>	<b>\$ 6,599</b>	\$ 7,160



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

Accruing loans past due for 90 days or more	<b>\$ 48</b>		\$ 75	
Troubled debt restructurings (TDRs) <sup>2</sup>	<b>\$ 5,326</b>		\$ 5,217	
Purchased performing TDRs <sup>6</sup>	<b>\$ 280</b>		\$ 403	
Allowance for loan losses (ALL)	<b>\$ 10,964</b>		\$ 11,266	
Nonperforming assets to total loans and OREO	<b>1.23</b>	%	1.34	%
ALL to total loans, excluding purchased credit impaired loans <sup>7</sup>	<b>2.14</b>	%	2.22	%
ALL to total nonaccrual loans	<b>198.91</b>	%	256.57	%

---

The loans acquired from CVB are tracked in two separate categories - "purchased performing" and "purchased credit impaired." The fair market value adjustments for the purchased performing loans are \$1.2 million at September 30, 2014 and \$1.3 million at December 31, 2013 for interest and \$4.0 million at September 30, 2014 and \$5.2 million at December 31, 2013 for credit. The fair market value adjustments for the purchased credit impaired loans are \$5.6 million at September 30, 2014 and \$5.0 million at December 31, 2013 for interest and \$10.0 million at September 30, 2014 and \$11.5 million at December 31, 2013 for credit.

Table Of Contents

<sup>2</sup> Nonaccrual loans include nonaccrual TDRs of \$2.5 million at September 30, 2014 and \$2.6 million at December 31, 2013.

<sup>3</sup> Purchased performing-nonaccrual loans are presented net of fair market value interest and credit marks totaling \$253,000 at September 30, 2014 and \$488,000 at December 31, 2013.

<sup>4</sup> OREO is recorded at its estimated fair market value less cost to sell.

<sup>5</sup> As required by acquisition accounting, purchased credit impaired loans that were considered nonaccrual and TDRs prior to the acquisition lose these designations and are not included in post-acquisition nonperforming assets as presented in Table 8.

<sup>6</sup> Purchased performing TDRs are accruing and are presented net of fair market value interest and credit marks totaling \$9,000 at September 30, 2014 and \$11,000 at December 31, 2013.

<sup>7</sup> For the purpose of calculating this ratio, purchased performing loans are included in total loans. Purchased performing loans were marked to fair value on acquisition date; therefore, no allowance for loan losses was recorded for these loans.

**Mortgage Banking Segment**

<i>(Dollars in thousands)</i>	<b>September 30, 2014</b>	<b>December 31, 2013</b>		
Nonaccrual loans	<b>\$ 187</b>	\$ —		
Total loans	<b>\$ 2,759</b>	\$ 2,914		
ALL	<b>\$ 538</b>	\$ 493		
Nonaccrual loans to total loans	<b>6.78</b>	—	%	%
ALL to loans	<b>19.50</b>	16.92	%	%
ALL to nonaccrual loans	<b>287.70</b>	—	%	%

**Consumer Finance Segment**

<i>(Dollars in thousands)</i>	<b>September 30, 2014</b>	<b>December 31, 2013</b>		
Nonaccrual loans	<b>\$ 1,196</b>	\$ 1,187		
Accruing loans past due for 90 days or more	<b>\$ —</b>	\$ —		
Total loans	<b>\$ 287,866</b>	\$ 277,724		
ALL	<b>\$ 24,071</b>	\$ 23,093		
Nonaccrual consumer finance loans to total consumer finance loans	<b>0.42</b>	0.43	%	%
ALL to total consumer finance loans	<b>8.36</b>	8.32	%	%

Total nonperforming assets of the Retail Banking segment totaled \$6.6 million at September 30, 2014, compared to \$7.2 million at December 31, 2013, a 7.8 percent decline during the first nine months of 2014. The Retail Banking Segment's nonperforming assets at September 30, 2014 included \$5.5 million of nonaccrual loans, compared to \$4.4 million at December 31, 2013, and \$1.1 million of OREO, compared to \$2.8 million at December 31, 2013. The increase in nonaccrual loans since December 31, 2013 was generally attributable to smaller balance residential real estate and commercial loans. We believe we have provided adequate loan loss reserves based on current appraisals or evaluations of the collateral. In some cases, appraisals have been adjusted to reflect current trends including sales prices, expenses, absorption periods and other current relevant factors. The 60.7 percent decline in OREO properties since December 31, 2013 resulted from sales of properties that had a total carrying value of \$2.5 million at December 31, 2013.

Nonaccrual loans at the Consumer Finance segment were \$1.2 million at both September 30, 2014 and at December 31, 2013. As noted above, the ratio of the allowance for loan losses to total consumer finance loans was 8.36 percent as of September 30, 2014, compared with 8.32 percent at December 31, 2013. Nonaccrual consumer finance loans remain relatively low compared to the allowance for loan losses and the total consumer finance loan portfolio because the Consumer Finance segment generally initiates repossession of loan collateral once a loan is 60 days or more past due but before the loan reaches 90 days or more past due and is evaluated for nonaccrual status.

Table Of Contents

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

**TABLE 9: Impaired Loans**

Impaired loans, which consisted solely of TDRs, and the related allowance at September 30, 2014, were as follows:

<i>(Dollars in thousands)</i>	<b>Recorded Investment in Loans</b>	<b>Unpaid Principal Balance</b>	<b>Related Allowance</b>	<b>Average Balance-Impaired Loans</b>	<b>Interest Income Recognized</b>
Real estate – residential mortgage	\$ 2,326	\$ 2,448	\$ 397	\$ 2,213	\$ 96
Commercial, financial and agricultural:					
Commercial real estate lending	2,676	2,774	423	2,670	101
Builder line lending	—	—	—	—	—
Commercial business lending	482	483	128	492	5
Equity lines	30	32	1	22	1
Consumer	92	92	14	93	3
Total	\$ 5,606	\$ 5,829	\$ 963	\$ 5,490	\$ 206

Impaired loans, which included \$5.6 million of TDRs, and the related allowance at December 31, 2013, were as follows:

<i>(Dollars in thousands)</i>	<b>Recorded Investment in Loans</b>	<b>Unpaid Principal Balance</b>	<b>Related Allowance</b>	<b>Average Balance-Impaired Loans</b>	<b>Interest Income Recognized</b>
Real estate – residential mortgage	\$ 2,601	\$ 2,694	\$ 390	\$ 2,090	\$ 99
Commercial, financial and agricultural:					

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

Commercial real estate lending	2,729	2,780	504	2,748	99
Builder line lending	13	16	4	14	1
Commercial business lending	695	756	131	562	11
Equity lines	131	132	—	33	—
Consumer	93	93	14	95	9
Total	\$ 6,262	\$ 6,471	\$ 1,043	\$ 5,542	\$ 219

57

---

Table Of Contents

TDRs (including purchased performing TDRs) at September 30, 2014 and December 31, 2013 were as follows:

**TABLE 10: Troubled Debt Restructurings**

<i>(Dollars in thousands)</i>	<b>September 30, 2014</b>	<b>December 31, 2013</b>
Accruing TDRs	<b>\$ 3,110</b>	\$ 3,026
Nonaccrual TDRs <sup>1</sup>	<b>2,496</b>	2,594
Total TDRs <sup>2</sup>	<b>\$ 5,606</b>	\$ 5,620

---

<sup>1</sup>Included in nonaccrual loans in Table 8: Nonperforming Assets.

<sup>2</sup>Included in impaired loans in Table 9: Impaired Loans.

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

**FINANCIAL CONDITION**

At September 30, 2014, the Corporation had total assets of \$1.3 billion, which was an increase of \$3.7 million since December 31, 2013. The increase resulted primarily from a \$7.3 million increase in total loans.

**Loan Portfolio**

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

**TABLE 11: Summary of Loans Held for Investment**

<i>(Dollars in thousands)</i>	<b>September 30,</b>		<b>December 31,</b>			
	<b>2014</b>	<b>Percent</b>	<b>2013</b>	<b>Percent</b>		
Real estate – residential mortgage	<b>\$179,222</b>	<b>22</b>	<b>%</b>	<b>\$188,455</b>	<b>23</b>	<b>%</b>
Real estate – construction <sup>1</sup>	<b>6,689</b>	<b>1</b>		<b>5,810</b>	<b>1</b>	
Commercial, financial and agricultural <sup>2</sup>	<b>294,359</b>	<b>35</b>		<b>288,593</b>	<b>35</b>	
Equity lines	<b>50,799</b>	<b>6</b>		<b>50,795</b>	<b>6</b>	
Consumer	<b>8,755</b>	<b>1</b>		<b>9,007</b>	<b>1</b>	
Consumer finance	<b>287,866</b>	<b>35</b>		<b>277,724</b>	<b>34</b>	
Total loans	<b>827,690</b>	<b>100</b>	<b>%</b>	<b>820,384</b>	<b>100</b>	<b>%</b>
Less allowance for loan losses	<b>(35,573 )</b>			<b>(34,852 )</b>		
Total loans, net	<b>\$792,117</b>			<b>\$785,532</b>		

<sup>1</sup>Includes the Corporation's real estate construction lending and consumer real estate lot lending.

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

Table Of Contents**Investment Securities**

The investment portfolio plays a primary role in the management of the Corporation's interest rate sensitivity. In addition, the portfolio serves as a source of liquidity and is used as needed to meet collateral requirements. The investment portfolio consists of securities available for sale, which may be sold in response to changes in market interest rates, changes in prepayment risk, changes in loan demand, general liquidity needs and other similar factors. These securities are carried at estimated fair value. At September 30, 2014 and December 31, 2013, all securities in the Corporation's investment portfolio were classified as available for sale.

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

**TABLE 12: Securities Available for Sale**

<i>(Dollars in thousands)</i>	<b>September 30, 2014</b>		<b>December 31, 2013</b>		
	<b>Amount</b>	<b>Percent</b>	<b>Amount</b>	<b>Percent</b>	
U.S Treasury securities	\$—	—	% \$10,000	5	%
U.S. government agencies and corporations	<b>25,220</b>	<b>11</b>	29,950	14	
Mortgage-backed securities	<b>63,546</b>	<b>29</b>	50,863	23	
Obligations of states and political subdivisions	<b>131,327</b>	<b>60</b>	127,139	58	
Corporate and other debt securities	—	—	158	—	
Total available for sale securities at fair value	<b>\$220,093</b>	<b>100</b>	% \$218,110	100	%

For more information about the Corporation's securities available for sale, including a description of securities in an unrealized loss position at September 30, 2014 and December 31, 2013, see Part I, Item 1, "Financial Statements" under the heading "Note 3: Investment Securities" in this Quarterly Report on Form 10-Q.

**Deposits**

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



During the first nine months of 2014 deposits decreased \$6.9 million to \$1.00 billion at September 30, 2014, compared to \$1.01 billion at December 31, 2013. This decrease resulted primarily from a \$32.7 million decrease in time deposits, mostly offset by a \$23.9 million increase in non-interest bearing demand deposits of individuals and corporations and a \$2.0 million increase in savings and interest-bearing demand deposits.

The Corporation had \$2.3 million in brokered money market deposits outstanding at September 30, 2014, compared to \$2.4 million at December 31, 2013. The source of these brokered deposits is uninvested cash balances held in third-party brokerage sweep accounts. The Corporation uses brokered deposits as a means of diversifying liquidity sources, as opposed to a long-term deposit gathering strategy.

### **Borrowings**

Borrowings increased to \$170.5 million at September 30, 2014 from \$169.8 million at December 31, 2013 as a result of a \$651,000 increase in retail overnight repurchase agreements with commercial depositors, the level of which is a function of the deposit balances maintained by these depositors.

Table Of Contents

**Off-Balance Sheet Arrangements**

As of September 30, 2014, there have been no material changes to the off-balance sheet arrangements disclosed in Part I, Item 7, "Management's Discussion and Analysis," under the heading "Off-Balance-Sheet Arrangements" in the Corporation's Annual Report on Form 10-K for the year ended December 31, 2013.

**Contractual Obligations**

As of September 30, 2014, there have been no material changes outside the ordinary course of business to the contractual obligations disclosed in Part I, Item 7, "Management's Discussion and Analysis," under the heading "Contractual Obligations" in the Corporation's Annual Report on Form 10-K for the year ended December 31, 2013.

**Liquidity**

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

Liquid assets, which include cash and due from banks, interest-bearing deposits at other banks, federal funds sold and nonpledged securities available for sale, at September 30, 2014 totaled \$261.7 million, compared to \$216.4 million at December 31, 2013. The increase in liquid assets since December 31, 2013 resulted primarily from the Corporation's election in January 2014 to secure public deposits by the pooled method, rather than the dedicated or opt-out method, which reduced the amount of collateral required to secure public deposits and thus increased the amount of unpledged securities. The Corporation's funding sources for borrowings, including the capacity, amount outstanding and amount available at September 30, 2014 are presented in Table 13.

**TABLE 13: Funding Sources**

<i>(Dollars in thousands)</i>	<b>September 30, 2014</b>		
	<b>Capacity</b>	<b>Outstanding</b>	<b>Available</b>
Unsecured federal funds agreements	\$65,000	\$ —	\$65,000
Repurchase agreements	5,000	5,000	—
Repurchase lines of credit	40,000	—	40,000
Borrowings from the FHLB	141,037	52,500	88,537
Borrowings from Federal Reserve Bank	30,586	—	30,586
Revolving line of credit	120,000	75,487	44,513
Total	\$401,623	\$ 132,987	\$268,636

We have no reason to believe these arrangements will not be renewed at maturity. Additional loans and securities are also available that can be pledged as collateral for future borrowings from the Federal Reserve Bank and the FHLB above the current lendable collateral value. Our ability to maintain sufficient liquidity may be affected by numerous factors, including economic conditions nationally and in our markets. Depending on our liquidity levels, our capital position, conditions in the capital markets, our business operations and initiatives, and other factors, we may from time to time consider the issuance of debt, equity or other securities or other possible capital market transactions, the proceeds of which could provide additional liquidity for our operations.

Table Of Contents

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

**Capital Resources**

The Corporation's and the Bank's actual regulatory capital amounts and ratios under currently applicable regulatory capital standards are presented in the following table.

**TABLE 14: Capital Ratios**

	Actual		Minimum Capital Requirements		Minimum To Be Well Capitalized Under Prompt Corrective Action	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
<i>(Dollars in thousands)</i>						
<i>As of September 30, 2014:</i>						
Total Capital (to Risk-Weighted Assets)						
Corporation	\$135,224	15.3 %	\$70,825	8.0 %	N/A	N/A
Bank	133,869	15.2	70,666	8.0	\$88,332	10.0 %
Tier 1 Capital (to Risk-Weighted Assets)						
Corporation	123,869	14.0	35,412	4.0	N/A	N/A
Bank	122,534	13.9	35,333	4.0	52,999	6.0
Tier 1 Capital (to Average Assets)						
Corporation	123,869	9.5	52,193	4.0	N/A	N/A
Bank	122,534	9.4	52,151	4.0	65,189	5.0
<i>As of December 31, 2013:</i>						
Total Capital (to Risk-Weighted Assets)						
Corporation	\$126,202	14.8 %	\$68,137	8.0 %	N/A	N/A
Bank	100,538	14.5	55,400	8.0	\$69,250	10.0 %
CVB	20,632	13.0	12,710	8.0	15,888	10.0
Tier 1 Capital (to Risk-Weighted Assets)						
Corporation	115,257	13.5	34,069	4.0	N/A	N/A

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

Bank	91,559	13.2	27,700	4.0	41,550	6.0
CVB	20,597	13.0	6,355	4.0	9,533	6.0
Tier 1 Capital (to Average Assets)						
Corporation	115,257	8.9	51,664	4.0	N/A	N/A
Bank	91,559	9.4	38,964	4.0	48,706	5.0
CVB	20,597	6.2	13,332	4.0	16,644	5.0

The Corporation's Tier 1 Capital and Total Capital presented in Table 14 include \$25.0 million of trust preferred securities. Under the changes to the regulatory capital framework that were approved on July 9, 2013 by the federal banking agencies (the Basel III Final Rule), the Corporation's trust preferred securities will continue to be included in Tier 1 Capital and Total Capital until they mature, pursuant to a "grandfathering" provision that exempts the Corporation's trust preferred securities from the more stringent regulatory capital treatment contained in the Basel III Final Rule for trust preferred securities. In addition to "grandfathering" certain previously outstanding trust preferred securities for community banks, the Basel III Final Rule introduces a new Common Equity Tier 1 Capital measure, increases the applicable minimum regulatory capital levels and certain prompt corrective action capital levels, and establishes a capital conservation buffer and new risk weights for certain types of assets. The Basel III Final Rule is effective for community banks on January 1, 2015 and has a transition period applicable to certain regulatory capital changes until January 1, 2019.

Table Of Contents

The Corporation's capital resources may be further affected by the Corporation's share repurchase program, which was authorized by the Corporation's Board of Directors during the second quarter of 2014. Under this program the Corporation is authorized to purchase up to \$5.0 million of its common stock. Repurchases under the program may be made through privately-negotiated transactions or open-market transactions, and shares repurchased will be returned to the status of authorized and unissued shares of common stock. The timing, number and purchase price of shares repurchased under the program will be determined by management in its discretion and will depend on a number of factors, including the market price of the shares, general market and economic conditions, applicable legal requirements and other conditions. The share repurchase program is authorized through May 2015. As of September 30, 2014, an additional \$4.9 million of the Corporation's common stock may be purchased under the Corporation's share repurchase program.

**Effects of Inflation and Changing Prices**

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

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

There have been no significant changes from the quantitative and qualitative disclosures about market risk made in the Corporation's Annual Report on Form 10-K for the year ended December 31, 2013.

**ITEM 4. CONTROLS AND PROCEDURES**

The Corporation's management, including the Corporation's Chief Executive Officer and the Chief Financial Officer, has evaluated the effectiveness of the Corporation's disclosure controls and procedures (as defined in Rule 13a-15(e) under the Securities Exchange Act of 1934, as amended (the Exchange Act)) as of the end of the period covered by this report. Based on that evaluation, the Chief Executive Officer and the Chief Financial Officer have concluded that the Corporation's disclosure controls and procedures were effective as of September 30, 2014 to ensure that information required to be disclosed by the Corporation in reports that it files or submits under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in SEC rules and forms and that such information is accumulated and communicated to the Corporation's management, including the Corporation's Chief Executive Officer and Chief Financial Officer, as appropriate to allow timely decisions regarding required disclosure. Because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that the Corporation's disclosure controls and procedures will detect or uncover every situation involving the failure of persons within the Corporation or its subsidiary to disclose material information required to be set forth in the Corporation's periodic reports.

Table Of Contents

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, 2014 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**

Other than as disclosed in this 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, 2013.

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

**Issuer Purchases of Equity Securities**

The Corporation's Board of Directors has authorized a share repurchase program for the Corporation's outstanding common stock through May 2015 (the Repurchase Program). Repurchases under the Repurchase Program may be made through privately-negotiated transactions, or open-market transactions, including pursuant to a trading plan in accordance with Rule 10b5-1 of the Exchange Act and/or Rule 10b-18 of the Exchange Act.

The following table summarizes repurchases of the Corporation's common stock that occurred during the three months ended September 30, 2014.

<i>(Dollars in thousands)</i>	<b>Total Number of</b>	<b>Average Price</b>	<b>Total Number of</b>	<b>Maximum Number (or</b>
-------------------------------	----------------------------	--------------------------	----------------------------	-------------------------------



	<b>Shares Purchased<sup>1</sup></b>	<b>Paid per Share</b>	<b>Shares Purchased as Part of Publicly Announced Plans or Programs</b>	<b>Approximate Dollar Value) of Shares that May Yet Be Purchased Under the Plans or Programs</b>
July 1, 2014 - July 31, 2014	—	\$ —	—	\$ —
August 1, 2014 - August 31, 2014	<b>2,800</b>	<b>33.05</b>	<b>2,800</b>	<b>4,907</b>
September 1, 2014 - September 30, 2014	—	—	—	—
<b>Total</b>	<b>2,800</b>	<b>\$ 33.05</b>	<b>2,800</b>	<b>\$ 4,907</b>

---

<sup>1</sup> These shares were purchased through open-market transactions under the Repurchase Program.

Table Of Contents

**ITEM 6. EXHIBITS**

- 2.1 Agreement and Plan of Merger dated as of June 10, 2013 by and among C&F Financial Corporation, Special Purpose Sub, Inc. and Central Virginia Bankshares, Inc. (incorporated by reference to Exhibit 2.1 to Form 8-K filed June 14, 2013)
- 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)
- 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
- 101.INS XBRL Instance Document
- 101.SCH XBRL Taxonomy Extension Schema Document
- 101.CALXBRL Taxonomy Extension Calculation Linkbase Document
- 101.DEF XBRL Taxonomy Extension Definition Linkbase Document
- 101.LAB XBRL Taxonomy Extension Label Linkbase Document
- 101.PRE XBRL Taxonomy Presentation Linkbase Document

Table Of Contents

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

C&F FINANCIAL CORPORATION  
(Registrant)

Date November 10, 2014 /s/ Larry G. Dillon  
Larry G. Dillon  
Chairman, President and Chief Executive Officer

(Principal Executive Officer)

Date November 10, 2014 /s/ Thomas F. Cherry  
Thomas F. Cherry  
Executive Vice President,

Chief Financial Officer and Secretary

(Principal Financial and Accounting Officer)