C & F FINANCIAL CORP
Form 10-Q
August 07, 2015
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 June 30, 2015

or

Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

For the transition period from _________ to _________

Commission File Number 000-23423

C&F FINANCIAL CORPORATION

(Exact name of registrant as specified in its charter)

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

(804) 843-2360

(Registrant's telephone number, including area code)

N/A

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

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

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

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

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

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

At August 6, 2015, the latest practicable date for determination, 3,394,862 shares of common stock, $1.00 par value, of the registrant were outstanding.

Table of Contents

TABLE OF CONTENTS

Table of Contents

Part I – FINANCIAL INFORMATION

ITEM 1.FINANCIAL STATEMENTS

CONSOLIDATED BALANCE SHEETS

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

Assets	June 30, 2015 (unaudited)	December 31, 2014 *
Cash and due from banks	$ 11,459	$ 10,749
Interest-bearing deposits in other banks	127,856	156,867
Total cash and cash equivalents	139,315	167,616
Securities—available for sale at fair value, amortized cost of $213,163 and $214,437, respectively	218,349	221,897
Loans held for sale, at fair value	65,468	28,279
Loans, net of allowance for loan losses of $35,571 and $35,606, respectively	826,623	800,198
Restricted stocks, at cost	3,345	3,442
Corporate premises and equipment, net	36,525	37,295
Other real estate owned, net of valuation allowance of $90 and $29, respectively	977	786
Accrued interest receivable	6,654	6,421
Goodwill	14,425	14,425
Core deposit intangible, net	2,072	2,583
Bank-owned life insurance	14,681	14,484
Other assets	44,502	40,761
Total assets	$ 1,372,936	$ 1,338,187
Liabilities		
Deposits		
Noninterest-bearing demand deposits	$ 187,814	$ 161,839
Savings and interest-bearing demand deposits	507,235	497,755
Time deposits	347,779	366,507
Total deposits	1,042,828	1,026,101
Short-term borrowings	12,507	14,436
Long-term borrowings	144,029	127,488
Trust preferred capital notes	25,121	25,103

Accrued interest payable	707	740
Other liabilities	21,746	20,709
Total liabilities	1,246,938	1,214,577
Shareholders’ Equity		
Common stock ($1.00 par value, 8,000,000 shares authorized, 3,393,915 and 3,418,750 shares issued and outstanding, respectively, includes, 138,375 and 135,600 of unvested shares, respectively)	3,256	3,283
Additional paid-in capital	8,647	9,456
Retained earnings	112,494	107,785
Accumulated other comprehensive income, net	1,601	3,086
Total shareholders’ equity	125,998	123,610
Total liabilities and shareholders’ equity	$ 1,372,936	$ 1,338,187

* Derived from audited consolidated financial statements.

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

Table of Contents

CONSOLIDATED STATEMENTS OF INCOME

(Unaudited)

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2015	2014	2015	2014
Interest income				
Interest and fees on loans	$ 19,603	$ 19,849	$ 38,621	$ 39,316
Interest on interest-bearing deposits and federal funds sold	86	115	186	196
Interest and dividends on securities				
U.S. government agencies and corporations	118	190	246	384
Tax-exempt obligations of states and political subdivisions	1,047	1,059	2,126	2,140
Taxable obligations of states and political subdivisions	50	46	92	92
Corporate bonds and other	446	453	882	878
Total interest income	21,350	21,712	42,153	43,006
Interest expense				
Savings and interest-bearing deposits	274	248	549	520
Time deposits	790	780	1,471	1,621
Borrowings	817	878	1,603	1,748
Trust preferred capital notes	295	235	584	472
Total interest expense	2,176	2,141	4,207	4,361
Net interest income	19,174	19,571	37,946	38,645
Provision for loan losses	2,155	3,265	5,670	6,775
Net interest income after provision for loan losses	17,019	16,306	32,276	31,870
Noninterest income				
Gains on sales of loans	2,002	1,646	3,647	2,815
Service charges on deposit accounts	1,076	1,116	2,091	2,178
Other service charges and fees	1,759	1,615	3,200	2,996
Net gains on calls and sales of available for sale securities	2	3	3	3
Investment services income	328	323	705	606
Other income	348	642	970	1,398
Total noninterest income	5,515	5,345	10,616	9,996
Noninterest expenses				
Salaries and employee benefits	9,938	9,149	20,102	18,308
Occupancy	2,220	2,183	4,380	4,315
Other	4,496	4,900	8,922	9,699

Total noninterest expenses	16,654	16,232	33,404	32,322
Income before income taxes	5,880	5,419	9,488	9,544
Income tax expense	1,779	1,677	2,742	2,909
Net income	$ 4,101	$ 3,742	$ 6,746	$ 6,635
Net income per share - basic	$ 1.21	$ 1.10	$ 1.98	$ 1.95
Net income per share - assuming dilution	$ 1.21	$ 1.09	$ 1.98	$ 1.91
Weighted average number of shares outstanding - basic	3,394,236	3,405,245	3,404,204	3,403,042
Weighted average number of shares outstanding - assuming dilution	3,394,291	3,442,468	3,404,415	3,467,054

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

4

Table of Contents

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(Unaudited)

(In thousands)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2015	2014	2015	2014
Net income	$ 4,101	$ 3,742	$ 6,746	$ 6,635
Other comprehensive (loss) income:				
Changes in defined benefit plan assets and benefit obligations				
Changes in net loss arising during the period1	(29)	(8)	(58)	(16)
Tax effect	11	3	22	6
Amortization of prior service cost arising during the period1	14	17	28	34
Tax effect	(5)	(6)	(10)	(12)
Net of tax amount	(9)	6	(18)	12
Unrealized gain on cash flow hedging instruments				
Unrealized holding gain arising during the period	166	46	18	86
Tax effect	(59)	(19)	(7)	(34)
Net of tax amount	107	27	11	52
Unrealized holding (losses) gains on securities				
Unrealized holding (losses) gains arising during the period	(2,794)	1,943	(2,271)	5,113
Tax effect	978	(680)	795	(1,781)
Reclassification adjustment for gains included in net income2	(2)	(3)	(3)	(3)
Tax effect	1	1	1	1
Net of tax amount	(1,817)	1,261	(1,478)	3,330
Other comprehensive (loss) income:	(1,719)	1,294	(1,485)	3,394
Comprehensive income	$ 2,382	$ 5,036	$ 5,261	$ 10,029

[1] These items are included in the computation of net periodic benefit cost. See Note 7, Employee Benefit Plans, for additional information.

[2] Gains are included in “Net gains on calls and sales of available for sale securities" on the consolidated statements of income.

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

5

Table of Contents

CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY

(Unaudited)

(In thousands, except per share amounts)

	Common Stock	Additional Paid - In Capital	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total Shareholders' Equity
Balance December 31, 2013	$ 3,269	$ 10,686	$ 99,492	$ (266)	$ 113,181
Comprehensive income:					
Net income	—	—	6,635	—	6,635
Other comprehensive income	—	—	—	3,394	3,394
Common stock warrant repurchased	—	(2,303)	—	—	(2,303)
Share-based compensation	—	487	—	—	487
Restricted stock vested	7	(15)	—	—	(8)
Common stock issued	2	64	—	—	66
Cash dividends declared – common stock ($0.59 per share)	—	—	(2,009)	—	(2,009)
Balance June 30, 2014	$ 3,278	$ 8,919	$ 104,118	$ 3,128	$ 119,443

	Common Stock	Additional Paid - In Capital	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total Shareholders' Equity
Balance December 31, 2014	$ 3,283	$ 9,456	$ 107,785	$ 3,086	$ 123,610
Comprehensive income:					
Net income	—	—	6,746	—	6,746
Other comprehensive loss	—	—	—	(1,485)	(1,485)
Share-based compensation	—	576	—	—	576
Restricted stock vested	13	(13)	—	—	—
Common stock issued	2	65	—	—	67
Common stock repurchased	(42)	(1,437)	—	—	(1,479)
	—	—	(2,037)	—	(2,037)

Cash dividends declared – common stock ($0.60 per share)					
Balance June 30, 2015	$ 3,256	$ 8,647	$ 112,494	$ 1,601	$ 125,998

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

Table of Contents

CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited)

(In thousands)

	Six Months Ended June 30, 2015	2014
Operating activities:		
Net income	$ 6,746	$ 6,635
Adjustments to reconcile net income to net cash (used in) provided by operating activities:		
Depreciation	1,337	1,461
Provision for loan losses	5,670	6,775
Provision for indemnifications	139	109
Provision for other real estate owned losses	90	—
Share-based compensation	576	479
Net accretion of certain acquisition-related fair value adjustments	(1,300)	(1,722)
Accretion of discounts and amortization of premiums on securities, net	747	629
Realized gains on sales and calls of securities	(3)	(3)
Net realized gains on sales of other real estate owned	(226)	(227)
Net realized gains on sale of corporate premises and equipment	(7)	(38)
Increase in bank-owned life insurance cash surrender value	(175)	(188)
Origination of loans held for sale	(277,393)	(217,466)
Proceeds from sales of loans held for sale	243,851	222,557
Gains on sales of loans held for sale	(3,647)	(2,815)
Change in other assets and liabilities:		
Accrued interest receivable	(233)	105
Other assets	(1,185)	(3,590)
Accrued interest payable	(33)	(36)
Other liabilities	1,030	(2,378)
Net cash (used in) provided by operating activities	(24,016)	10,287
Investing activities:		
Proceeds from maturities, calls and sales of securities available for sale	16,891	21,545
Purchases of securities available for sale	(16,130)	(15,981)
Net redemptions of restricted stocks	97	646
Purchase of loans	(16,258)	—
Net increase in loans	(16,872)	(12,870)
Proceeds from sales of other real estate owned	332	4,274
Purchases of corporate premises and equipment, net	(560)	(1,218)
Net cash used in investing activities	(32,500)	(3,604)
Financing activities:		
Net increase in demand, interest-bearing demand and savings deposits	35,455	51,555
Net decrease in time deposits	(18,403)	(19,532)

Net increase (decrease) in borrowings	14,612	(245)
Repurchase of common stock warrant	—	(2,303)
Issuance of common stock	67	66
Repurchase of common stock	(1,479)	—
Cash dividends	(2,037)	(2,009)
Net cash provided by financing activities	28,215	27,532
Net (decrease) increase in cash and cash equivalents	(28,301)	34,215
Cash and cash equivalents at beginning of year	167,616	148,139
Cash and cash equivalents at end of period	$ 139,315	$ 182,354
Supplemental disclosure		
Interest paid	$ 4,547	$ 4,942
Income taxes paid	339	2,041
Supplemental disclosure of noncash investing and financing activities		
Unrealized (losses) gains on securities available for sale	$ (2,274)	$ 5,110
Transfers between loans, other real estate owned and repossessed assets	2,308	1,980
Pension adjustment	(30)	18
Unrealized gain on cash flow hedging instruments	18	86

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

7

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, 2014.

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, the 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: The Corporation is a bank holding company incorporated under the laws of the Commonwealth of Virginia. The Corporation owns all of the stock of its subsidiary, C&F Bank, which is an independent commercial bank chartered under the laws of the Commonwealth of Virginia. 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 five wholly-owned active subsidiaries: C&F Mortgage Corporation and Subsidiary (C&F Mortgage), C&F Finance Company (C&F Finance), C&F Wealth Management Corporation (formerly 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 subsidiary, Certified Appraisals LLC, provides ancillary mortgage loan production services for residential appraisals. C&F Finance, acquired on September 1, 2002, is a finance company providing automobile loans through indirect lending programs. C&F Wealth Management Corporation, organized in April 1995 and renamed in May 2015, 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 C&F 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, projected cash flows of purchased credit impaired 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.

Reclassification: Certain reclassifications have been made to prior period amounts to conform to the current period presentation. None of these reclassifications are considered material. See Note 2 for additional information about reclassifications related to the adoption of new accounting standards.

Table of Contents

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 as of June 30, 2015 and December 31, 2014 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 on the Corporation's trust preferred capital notes. Because the IRLCs and forward sales 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 income taxes, and reclassified into earnings in the same period or period(s) during which the hedged transactions affect earnings.

Share-Based Compensation: Compensation expense for the second quarter of 2015 and the first six months of 2015 included expense, net of forfeitures, of $312,000 ($193,000 after tax) and $576,000 ($357,000 after tax), respectively, for restricted stock granted during 2010 through 2015. As of June 30, 2015, there was $2.79 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 six months of 2015 and 2014 is presented below:

	Shares	Weighted-Average Grant Date Fair Value
Unvested, January 1, 2015	135,600	$ 34.34
Granted	16,650	37.72
Vested	(12,600)	25.78
Forfeitures	(1,275)	37.58
Unvested, June 30, 2015	138,375	$ 35.50

Shares	Weighted-Average Grant Date Fair Value

Unvested, January 1, 2014	120,183	$ 31.18
Granted	15,750	41.38
Vested	(8,100)	18.77
Forfeitures	(700)	33.96
Unvested, June 30, 2014	127,133	$ 33.22

Table of Contents

Stock option activity during the six months ended June 30, 2015 and 2014 and stock options outstanding at June 30, 2015 and 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 and exercisable at January 1, 2015	100,762	$ 37.75	0.9	$ —
Expired	(12,000)	$ 35.20		
Options outstanding and exercisable at June 30, 2015	88,762	$ 38.10	0.7	$ —

* Weighted average

	Shares	Exercise Price*	Remaining Contractual Life (in years)*	Intrinsic Value of Unexercised In-The Money Options (in 000's)
Options outstanding and exercisable at January 1, 2014	164,150	$ 38.21	1.7	$ 1,224
Expired	(12,000)	$ 37.50		
Options outstanding and exercisable at June 30, 2014	152,150	$ 38.27	1.3	$ 9

* 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 - 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 became effective for public business entities for annual periods and interim reporting periods within those annual periods, beginning after December 15, 2014. The adoption of ASU 2014-01 did not have a material effect on the Corporation's financial statements. The adoption of ASU 2014-01 is described further in Note 2.

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:

Table of Contents

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 does not expect the adoption of ASU 2014-09 to have a material effect on its financial statements.

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 became 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 adoption of ASU 2014-11 did not have a material effect on the Corporation’s 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 does not expect the adoption of ASU 2014-12 to have a material effect 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.

In November 2014, the FASB issued ASU No. 2014-16, Derivatives and Hedging (Topic 815): Determining Whether the Host Contract in a Hybrid Financial Instrument Issued in the Form of a Share Is More Akin to Debt or to Equity. The amendments in ASU do not change the current criteria in U.S. GAAP for determining when separation of certain embedded derivative features in a hybrid financial instrument is required. The amendments clarify how current U.S. GAAP should be interpreted in evaluating the economic characteristics and risks of a host contract in a hybrid financial instrument that is issued in the form of a share. Specifically, the amendments clarify that an entity should consider all relevant terms and features, including the embedded derivative feature being evaluated for bifurcation, in evaluating the nature of the host contract. Furthermore, the amendments clarify that no single term or feature would necessarily determine the economic characteristics and risks of the host contract. Rather, the nature of the host contract depends upon the economic characteristics and risks of the entire hybrid financial instrument. The amendments in this ASU also clarify that, in evaluating the nature of a host contract, an entity should assess the substance of the relevant terms and features (i.e., the relative strength of the debt-like or equity-like terms and features given the facts and circumstances) when considering how to weight those terms and features. The amendments in this ASU are effective for public business entities for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2015. Early adoption, including adoption in an interim period, is permitted. The Corporation does not expect the adoption of ASU 2014-16 to have a material effect on its financial statements.

In January 2015, the FASB issued ASU No. 2015-01, Income Statement—Extraordinary and Unusual Items (Subtopic 225-20): Simplifying Income Statement Presentation by Eliminating the Concept of Extraordinary Items. The amendments in this ASU eliminate from U.S. GAAP the concept of extraordinary items. Subtopic 225-20, Income Statement - Extraordinary and Unusual Items, required that an entity separately classify, present, and disclose extraordinary events and transactions. Presently, an event or transaction is presumed to be an ordinary and usual activity of the reporting entity unless evidence clearly supports its classification as an extraordinary item. If an event or transaction meets the criteria for extraordinary classification, an entity is required to segregate the extraordinary item from the results of ordinary operations and show the item separately in the income statement, net of tax, after income from continuing operations. The entity also is required to disclose applicable income taxes and either present or disclose earnings-per-share data applicable to the extraordinary item. The amendments in this ASU are effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2015. Early adoption is permitted provided that the guidance is applied from the beginning of the fiscal year of adoption. The Corporation does not expect the adoption of ASU 2015-01 to have a material effect on its financial statements

In February 2015, the FASB issued ASU No. 2015-02, “Consolidation (Topic 810): Amendments to the Consolidation Analysis.” The amendments in this ASU are intended to improve targeted areas of consolidation guidance for legal entities such as limited partnerships, limited liability corporations, and securitization structures (collateralized debt obligations, collateralized loan obligations, and mortgage-backed security transactions). In addition to reducing the number of consolidation models from four to two, the new standard simplifies the FASB Accounting Standards Codification (ASC) and improves current GAAP by placing more emphasis on risk of loss when determining a controlling financial interest, reducing the frequency of the application of related-party guidance when determining a controlling financial interest in a variable interest entity (VIE), and changing consolidation conclusions for public and private companies in several industries that typically make use of limited partnerships or VIEs. The amendments in this ASU are effective for public business entities for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2015. Early adoption is permitted, including adoption in an interim period. ASU 2015-02 may be applied retrospectively in previously issued financial statements for one or more years with a cumulative-effect adjustment to retained earnings as of the beginning of the first year restated. The Corporation does not expect the adoption of ASU 2015-02 to have a material effect on its financial statements.

In April 2015, the FASB issued ASU No. 2015-03, “Interest – Imputation of Interest (Subtopic 835-30): Simplifying the Presentation of Debt Issuance Costs.” The amendments in this ASU are intended to simplify the presentation of debt issuance costs. These amendments require that debt issuance costs related to a recognized debt liability be presented in the balance sheet as a direct deduction from the carrying amount of that debt liability, consistent with debt discounts. The recognition and measurement guidance for debt issuance costs are not affected by the amendments in this ASU. The amendments in this ASU are effective for public business entities for financial statements issued for fiscal years beginning after December 15, 2015, and interim periods within those fiscal years. Early adoption is permitted for financial statements that have not been previously issued. The Corporation does not expect the adoption of ASU 2015-03 to have a material effect on its financial statements.

In April 2015, the FASB issued ASU No. 2015-05, “Intangibles - Goodwill and Other - Internal-Use Software (Subtopic 350-40): Customer’s Accounting for Fees Paid in a Cloud Computing Arrangement.” The amendments in this ASU provide guidance to customers regarding cloud computing arrangements that include a software license. If a cloud computing arrangement includes a software license, then the customer should account for the software license element of the arrangement consistent with the acquisition of other software licenses. If a cloud computing arrangement does not include a software license, the customer should account for the arrangement as a service contract. The amendments do not change the accounting for a customer's accounting for service contracts. As a result of the amendments, all software licenses within the scope of Subtopic 350-40 will be accounted for consistent with other licenses of intangible assets. The amendments in this ASU are effective for public business entities for annual periods, including interim periods within those annual periods, beginning after December 15, 2015. Early adoption is permitted. An entity can elect to adopt the amendments either: (1) prospectively to all arrangements entered into or materially modified after the effective date; or (2) retrospectively. The Corporation is currently assessing the effect that ASU 2015-05 will have on its financial statements.

In May 2015, the FASB issued ASU No. 2015-08, "Business Combinations (Topic 805): Pushdown Accounting – Amendments to SEC Paragraphs Pursuant to Staff Accounting Bulletin No. 115." The amendments in ASU 2015-08 amend various paragraphs in the ASC regarding positions of the staff of the SEC pursuant to the issuance of Staff Accounting Bulletin No. 115, Topic 5: Miscellaneous Accounting, regarding various pushdown accounting issues, and did not have a material effect on our financial statements.

Other accounting standards that have been issued by the FASB or other standards-setting bodies are not expected to have a material impact on the Corporation's financial position, results of operations or cash flows.

NOTE 2: Adoption of New Accounting Standards

The Corporation adopted ASU 2014-01, Accounting for Investments in Qualified Affordable Housing Projects, as of January 1, 2015. As permitted by the guidance, the Corporation has elected to amortize the initial cost of investments in affordable housing projects over the period in which the Corporation will receive related tax credits, which approximates the proportional amortization method, and the resulting amortization is recognized as a component of income taxes attributable to continuing operations. Historically, the amortization related to these investments were recognized within noninterest expense. The Corporation adopted this guidance in the first quarter of 2015 with retrospective application as required by ASU 2014-01. Prior period results have been restated to conform to this presentation.

As of June 30, 2015, the carrying value of the Corporation's aggregate investment in qualified affordable housing projects was $2.69 million and the aggregate commitment to provide additional capital to these investments was $1.26 million. Amortization recognized as a component of income tax expense for the three and six months ended June 30, 2015 was $65,000 and $203,000, respectively, compared to $103,000 and $207,000 for the three and six months ended June 30, 2014, respectively.

NOTE 3: Securities

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

	June 30, 2015			
(Dollars in thousands)	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
U.S. government agencies and corporations	$ 20,710	$ 1	$ (395)	$ 20,316
Mortgage-backed securities	70,483	701	(480)	70,704
Obligations of states and political subdivisions	121,970	5,618	(259)	127,329
	$ 213,163	$ 6,320	$ (1,134)	$ 218,349

Table of Contents

	December 31, 2014			
(Dollars in thousands)	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
U.S. government agencies and corporations	$ 23,409	$ 1	$ (476)	$ 22,934
Mortgage-backed securities	66,716	935	(32)	67,619
Obligations of states and political subdivisions	124,312	7,158	(126)	131,344
	$ 214,437	$ 8,094	$ (634)	$ 221,897

The amortized cost and estimated fair value of securities at June 30, 2015, 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.

	June 30, 2015	
(Dollars in thousands)	Amortized Cost	Fair Value
Due in one year or less	$ 28,660	$ 28,681
Due after one year through five years	130,184	133,451
Due after five years through ten years	35,698	36,549
Due after ten years	18,621	19,668
	$ 213,163	$ 218,349

Proceeds from the maturities, calls and sales of securities available for sale for the three and six months ended June 30, 2015 were $8.34 million and $16.89 million, respectively, resulting in gross realized gains of $2,000 and $3,000, respectively. Proceeds from the maturities, calls and sales of securities available for sale for the three and six months ended June 30, 2014 were $4.96 million and $21.55 million, respectively, resulting in gross realized gains of $3,000 and $3,000, respectively.

The Corporation pledges securities primarily as collateral for public deposits and repurchase agreements. Securities with an aggregate amortized cost of $83.88 million and an aggregate fair value of $86.75 million were pledged at June 30, 2015. Securities with an aggregate amortized cost of $106.31 million and an aggregate fair value of $110.37 million were pledged at December 31, 2014.

Securities in an unrealized loss position at June 30, 2015, by duration of the period of the unrealized loss, are shown below.

	Less Than 12 Months		12 Months or More		Total	
(Dollars in thousands)	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss
U.S. government agencies and corporations	$ 7,492	$ 58	$ 11,823	$ 337	$ 19,315	$ 395
Mortgage-backed securities	17,206	427	2,375	53	19,581	480
Obligations of states and political subdivisions	14,203	150	5,192	109	19,395	259
Total temporarily impaired securities	$ 38,901	$ 635	$ 19,390	$ 499	$ 58,291	$ 1,134

There were 99 debt securities totaling $58.29 million considered temporarily impaired at June 30, 2015. The primary cause of the temporary impairments in the Corporation's investments in debt securities was fluctuations in interest rates. Interest rates increased during the second quarter of 2015, primarily in the middle and long-end of the United States Treasury yield curve, thereby increasing unrealized losses on certain of the Corporation's debt securities as compared to March 31, 2015. Prices for debt securities were lower as interest rates rose driven by (i) stronger United States economic data, particularly in the labor markets, that reflected the probability of accelerating economic expansion and (ii) anticipated increases in the Federal Funds rate later this year. Interest rates in the municipal bond sector, which includes the Corporation's obligations of states and political subdivisions, were also higher during the second quarter of 2015, albeit to a lesser degree as compared to the overall market, primarily due to improving overall economic conditions and municipal credit concerns in Puerto Rico, offset by continued elevated supply of refunding securities. At June 30, 2015, approximately 97 percent of the

Table of Contents

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 95 percent were rated “A” or better, as measured by market value, at June 30, 2015. For the approximately five percent not rated "A" or better, as measured by market value at June 30, 2015, 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 June 30, 2015 and no other-than-temporary impairment has been recognized.

Securities in an unrealized loss position at December 31, 2014, by duration of the period of the unrealized loss, are shown below.

	Less Than 12 Months		12 Months or More		Total	
(Dollars in thousands)	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss
U.S. government agencies and corporations	$ 1,966	$ 2	$ 21,234	$ 474	$ 23,200	$ 476
Mortgage-backed securities	—	—	4,518	32	4,518	32
Obligations of states and political subdivisions	6,279	51	6,049	75	12,328	126
Total temporarily impaired securities	$ 8,245	$ 53	$ 31,801	$ 581	$ 40,046	$ 634

The Corporation’s investment in restricted stocks totaled $3.35 million at June 30, 2015, and consisted of $3.20 million of Federal Home Loan Bank (FHLB) stock and $145,000 of Community Bankers Bank (CBB) stock. Restricted stock is generally viewed as a long-term investment and as restricted investment securities, which are carried at cost, because there is no market for the stock, other than the FHLBs or member institutions. Therefore, when evaluating restricted stock for impairment, their respective values are based on the ultimate recoverability of the par value rather than by recognizing temporary declines in value. The Corporation does not consider its investment in restricted stocks to be other-than-temporarily impaired at June 30, 2015 and no impairment has been recognized. Total restricted stocks is shown as a separate line item on the balance sheet and is not a part of the available-for-sale securities portfolio. At December 31, 2014, the Corporation’s restricted stocks included $3.30 million of FHLB stock and $145,000 of CBB stock.

NOTE 4: Loans

Major classifications of loans are summarized as follows:

(Dollars in thousands)	June 30, 2015	December 31, 2014
Real estate – residential mortgage	$ 182,052	$ 179,817
Real estate – construction 1	4,001	7,325
Commercial, financial and agricultural 2	328,883	306,845
Equity lines	50,670	50,321
Consumer	8,432	8,163
Consumer finance	288,156	283,333
	862,194	835,804
Less allowance for loan losses	(35,571)	(35,606)
Loans, net	$ 826,623	$ 800,198

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

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

Table of Contents

Consumer loans included $317,000 and $355,000 of demand deposit overdrafts at June 30, 2015 and December 31, 2014, respectively.

The outstanding principal balance and the carrying amount of loans acquired pursuant to the Corporation's acquisition of CVB (or acquired loans) that were recorded at fair value at the acquisition date and are included in the consolidated balance sheet at June 30, 2015 and December 31, 2014 were as follows:

	June 30, 2015			December 31, 2014		
(Dollars in thousands)	Acquired Loans - Purchased Credit Impaired	Acquired Loans - Purchased Performing	Acquired Loans - Total	Acquired Loans - Purchased Credit Impaired	Acquired Loans - Purchased Performing	Acquired Loans - Total
Outstanding principal balance	$ 27,871	$ 78,565	$ 106,436	$ 36,541	$ 85,015	$ 121,556
Carrying amount						
Real estate – residential mortgage	$ 1,620	$ 17,341	$ 18,961	$ 1,723	$ 18,688	$ 20,411
Commercial, financial and agricultural1	13,693	41,512	55,205	19,367	45,015	64,382
Equity lines						