

C & F FINANCIAL CORP  
Form 10-Q  
May 08, 2013

---

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 March 31, 2013

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

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

(§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	<input type="radio"/>	Accelerated filer	<input checked="" type="radio"/>
Non-accelerated filer	<input type="radio"/> (Do not check if a smaller reporting company)	Smaller reporting company	<input type="radio"/>

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

At April 30, 2013, the latest practicable date for determination, 3,269,184 shares of common stock, \$1.00 par value, of the registrant were outstanding.

---

---

---

## TABLE OF CONTENTS

	Page
<b>Part I - Financial Information</b>	
<b>Item 1.</b>	<b>Financial Statements</b>
	Consolidated Balance Sheets – March 31, 2013 (unaudited) and December 31, 2012 2
	Consolidated Statements of Income (unaudited) - Three months ended March 31, 2013 and 2012 3
	Consolidated Statements of Comprehensive Income (unaudited) – Three months ended March 31, 2013 and 2012 4
	Consolidated Statements of Shareholders’ Equity (unaudited) - Three months ended March 31, 2013 and 2012 5
	Consolidated Statements of Cash Flows (unaudited) - Three months ended March 31, 2013 and 2012 6
	Notes to Consolidated Financial Statements (unaudited) 7
<b>Item 2.</b>	<b>Management’s Discussion and Analysis of Financial Condition and Results of Operations 28</b>
<b>Item 3.</b>	<b>Quantitative and Qualitative Disclosures About Market Risk 47</b>
<b>Item 4.</b>	<b>Controls and Procedures 47</b>
<b>Part II - Other Information</b>	
<b>Item 1A.</b>	<b>Risk Factors 47</b>
<b>Item 2.</b>	<b>Unregistered Sales of Equity Securities and Use of Proceeds 47</b>
<b>Item 6.</b>	<b>Exhibits 48</b>
<b>Signatures</b>	<b>49</b>

## PART I - FINANCIAL INFORMATION

## ITEM 1. FINANCIAL STATEMENTS

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

	March 31, 2013 (Unaudited)	December 31, 2012
<b>ASSETS</b>		
Cash and due from banks	\$6,191	\$8,079
Interest-bearing deposits in other banks	64,535	17,541
Total cash and cash equivalents	70,726	25,620
Securities-available for sale at fair value, amortized cost of \$142,192 and \$143,661, respectively	150,521	152,817
Loans held for sale, net	45,432	72,727
Loans, net of allowance for loan losses of \$33,921 and \$35,907, respectively	641,195	640,283
Federal Home Loan Bank stock, at cost	3,525	3,744
Corporate premises and equipment, net	27,839	27,083
Other real estate owned, net of valuation allowance of \$4,086 and \$3,937, respectively	5,297	6,236
Accrued interest receivable	5,566	5,673
Goodwill	10,724	10,724
Other assets	32,552	32,111
<b>Total assets</b>	<b>\$993,377</b>	<b>\$977,018</b>
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
<b>Deposits</b>		
Noninterest-bearing demand deposits	\$115,553	\$105,721
Savings and interest-bearing demand deposits	296,535	293,854
Time deposits	284,376	286,609
<b>Total deposits</b>	<b>696,464</b>	<b>686,184</b>
Short-term borrowings	13,612	9,139
Long-term borrowings	132,987	132,987
Trust preferred capital notes	20,620	20,620
Accrued interest payable	797	837
Other liabilities	23,983	25,054
<b>Total liabilities</b>	<b>888,463</b>	<b>874,821</b>
<b>Shareholders' equity</b>		
Common stock (\$1.00 par value, 8,000,000 shares authorized, 3,268,169 and 3,259,823 shares issued and outstanding, respectively)	3,163	3,162
Additional paid-in capital	5,780	5,624
Retained earnings	91,753	88,695
Accumulated other comprehensive income, net	4,218	4,716
<b>Total shareholders' equity</b>	<b>104,914</b>	<b>102,197</b>
<b>Total liabilities and shareholders' equity</b>	<b>\$993,377</b>	<b>\$977,018</b>

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

## CONSOLIDATED STATEMENTS OF INCOME

(Unaudited)

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

	Three Months Ended March 31,	
	2013	2012
<b>Interest income</b>		
Interest and fees on loans	\$ 17,819	\$ 17,476
Interest on money market investments	23	8
Interest and dividends on securities		
U.S. government agencies and corporations	106	57
Tax-exempt obligations of states and political subdivisions	1,142	1,187
Corporate bonds and other	33	28
Total interest income	19,123	18,756
<b>Interest expense</b>		
Savings and interest-bearing deposits	219	253
Certificates of deposit, \$100 or more	375	640
Other time deposits	485	724
Borrowings	881	973
Trust preferred capital notes	188	249
Total interest expense	2,148	2,839
Net interest income	16,975	15,917
Provision for loan losses	3,180	2,725
Net interest income after provision for loan losses	13,795	13,192
<b>Noninterest income</b>		
Gains on sales of loans	4,797	4,103
Service charges on deposit accounts	924	801
Other service charges and fees	1,504	1,368
Net gains on calls of available for sale securities	2	—
Other income	967	1,111
Total noninterest income	8,194	7,383
<b>Noninterest expenses</b>		
Salaries and employee benefits	10,165	9,742
Occupancy expenses	1,768	1,721
Other expenses	4,192	3,594
Total noninterest expenses	16,125	15,057
Income before income taxes	5,864	5,518
Income tax expense	1,858	1,738
Net income	4,006	3,780
Effective dividends on preferred stock	—	146
Net income available to common shareholders	\$ 4,006	\$ 3,634

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

Per common share data			
Net income – basic	\$	1.23	\$ 1.14
Net income – assuming dilution	\$	1.19	\$ 1.11
Cash dividends declared	\$	0.29	\$ 0.26
Weighted average number of shares – basic		3,266,712	3,190,518
Weighted average number of shares – assuming dilution		3,371,277	3,264,975

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

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

	Three Months Ended March 31,	
	2013	2012
Net income	\$ 4,006	\$ 3,780
Other comprehensive income (loss), net:		
Changes in defined benefit plan assets and benefit obligations, net	9	7
Unrealized gain on cash flow hedging instruments, net	30	3
Unrealized holding (losses) gains on securities, net of reclassification adjustment	(537)	125
Other comprehensive income (loss), net:	(498)	135
Comprehensive income, net	\$ 3,508	\$ 3,915

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



## CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY

(Unaudited)

(In thousands, except per share amounts)

	Preferred Stock	Common Stock	Additional Paid-In Capital	Retained Earnings	Accumulated Other Comprehensive Income, Net	Total Shareholders' Equity
Balance December 31, 2012	\$ —	\$ 3,162	\$ 5,624	\$ 88,695	\$ 4,716	\$ 102,197
Comprehensive income:						
Net income	—	—	—	4,006	—	4,006
Other comprehensive income (loss), net	—	—	—	—	(498)	(498)
Stock options exercised	—	1	16	—	—	17
Share-based compensation	—	—	140	—	—	140
Cash dividends paid – common stock (\$0.29 per share)	—	—	—	(948)	—	(948)
Balance March 31, 2013	\$ —	\$ 3,163	\$ 5,780	\$ 91,753	\$ 4,218	\$ 104,914

	Preferred Stock	Common Stock	Additional Paid-In Capital	Retained Earnings	Accumulated Other Comprehensive Income, Net	Total Shareholders' Equity
Balance December 31, 2011	\$ 10	\$ 3,091	\$ 13,438	\$ 76,167	\$ 3,384	\$ 96,090
Comprehensive income:						
Net income	—	—	—	3,780	—	3,780
Other comprehensive income, net	—	—	—	—	135	135
Stock options exercised	—	12	247	—	—	259
Share-based compensation	—	—	120	—	—	120
Accretion of preferred stock discount	—	—	21	(21)	—	—
Common stock issued	—	2	40	—	—	42
Cash dividends paid – common stock (\$0.26 per share)	—	—	—	(832)	—	(832)
Cash dividends paid – preferred stock (5% per annum)	—	—	—	(125)	—	(125)
Balance March 31, 2012	\$ 10	\$ 3,105	\$ 13,866	\$ 78,969	\$ 3,519	\$ 99,469

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

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

	Three Months Ended March 31,	
	2013	2012
<b>Operating activities:</b>		
Net income	\$ 4,006	\$ 3,780
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation	562	560
Provision for loan losses	3,180	2,725
Provision for indemnifications	225	125
Provision for other real estate owned losses	150	200
Share-based compensation	140	120
Accretion of discounts and amortization of premiums on securities, net	176	191
Net realized (gain) loss on calls of securities	(2)	—
Realized (gain) losses on sales of other real estate owned	(7)	13
Proceeds from sales of loans held for sale	205,469	179,602
Origination of loans held for sale	(178,174)	(173,296)
Change in other assets and liabilities:		
Accrued interest receivable	107	18
Other assets	(175)	(1,645)
Accrued interest payable	(40)	(4)
Other liabilities	(1,235)	2,470
Net cash provided by operating activities	34,382	14,859
<b>Investing activities:</b>		
Proceeds from maturities, calls and sales of securities available for sale	7,179	7,802
Purchases of securities available for sale	(5,882)	(7,023)
Redemption of Federal Home Loan Bank stock	219	—
Net increase in customer loans	(4,162)	(11,912)
Other real estate owned improvements	—	(205)
Proceeds from sales of other real estate owned	866	944
Purchases of corporate premises and equipment, net	(1,318)	(282)
Net cash used in investing activities	(3,098)	(10,676)
<b>Financing activities:</b>		
Net increase in demand, interest-bearing demand and savings deposits	12,513	11,915
Net (decrease) increase in time deposits	(2,233)	2,223
Net increase (decrease) in borrowings	4,473	(2,746)
Proceeds from exercise of stock options	17	259
Issuance of common stock	—	42
Cash dividends	(948)	(957)
Net cash provided by financing activities	13,822	10,736
Net increase in cash and cash equivalents	45,106	14,919
Cash and cash equivalents at beginning of period	25,620	11,507
Cash and cash equivalents at end of period	\$ 70,726	\$ 26,426

Supplemental disclosure

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

Interest paid	\$	2,188	\$	2,843
Income taxes paid		508		228
Supplemental disclosure of noncash investing and financing activities				
Unrealized (losses) gains on securities available for sale	\$	(827)	\$	192
Loans transferred to other real estate owned		70		102
Pension adjustment		(13)		9
Unrealized gain on cash flow hedging instrument		49		5

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

## 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, 2012.

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

**Nature of Operations:** 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. The Bank and its subsidiaries offer a wide range of banking and related financial services to both individuals and businesses.

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

**Basis of Presentation:** The preparation of financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. Material estimates that are particularly susceptible to significant change in the near term relate to the determination of the allowance for loan losses, the allowance for indemnifications, impairment of loans, impairment of securities, the valuation of other real estate owned, the projected benefit obligation under the defined benefit pension plan, the valuation of deferred taxes, 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. Certain reclassifications have been made to prior period amounts to conform to the current period presentation.

Derivative Financial Instruments: The Corporation recognizes derivative financial instruments at fair value as either an other asset or an other liability in the consolidated balance sheet. The Corporation's derivative financial instruments have been designated as and qualify as cash flow hedges. Accordingly, 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 periods during which the hedged transaction affects earnings. The Corporation's derivative financial instruments are described more fully in Note 10.

Share-Based Compensation: Compensation expense for the first quarter of 2013 included net expense of \$140,000 (\$87,000 after tax) for restricted stock granted since 2008. As of March 31, 2013, there was \$1.87 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 three months of 2013 is presented below:

	Shares	Weighted-Average Grant Date Fair Value
Unvested, January 1, 2013	97,700	\$24.69
Granted	8,600	\$40.37
Cancelled	(700)	\$25.54
Unvested, March 31, 2013	105,600	\$25.96

Stock option activity during the three months ended March 31, 2013 and stock options outstanding at March 31, 2013 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, 2013	276,432	\$ 39.14	2.30	
Exercised	(432)	37.99		
Options outstanding and exercisable at March 31, 2013	276,000	\$ 39.14	2.08	\$ 564

\*

Weighted average

At the 2013 Annual Meeting of Shareholders of the Corporation held on April 16, 2013 (the Annual Meeting), the Corporation's shareholders approved the C&F Financial Corporation 2013 Stock and Incentive Compensation Plan (the 2013 Plan), which was approved by the Corporation's Board of Directors on February 27, 2013, subject to shareholder approval. The 2013 Plan, which became effective upon shareholder approval at the Annual Meeting, replaces the Amended and Restated C&F Financial Corporation 2004 Incentive Stock Plan (the 2004 Plan). Awards previously granted under the 2004 Plan will remain outstanding in accordance with their terms, but no new awards will be granted under the 2004 Plan following the Annual Meeting. A detailed description of the 2013 Plan is contained in, and the full text of the 2013 Plan is included as Appendix A to, the Corporation's definitive proxy statement on Schedule 14A filed with the Securities and Exchange Commission (SEC) on March 15, 2013 in connection with the Annual Meeting, both of which are incorporated herein by reference.

#### Recent Significant Accounting Pronouncements:

In February 2013, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2013-02, Comprehensive Income - Reporting of Amounts Reclassified Out of Accumulated Other Comprehensive Income. The amendments in this ASU require an entity to present (either on the face of the statement where net income is presented or in the notes) the effects on the line items of net income of significant amounts reclassified out of accumulated other comprehensive income. In addition, the amendments require a cross-reference to other disclosures currently required for other reclassification items to be reclassified directly to net income in their entirety in the same reporting period. An entity is required to apply these amendments for fiscal years, and interim periods within those years, beginning on or after December 15, 2012. The Corporation has included the required disclosures

from ASU 2013-02 in the Corporation's financial statements.

In July 2012, the FASB issued ASU 2012-02, Intangibles - Goodwill and Other - Testing Indefinite-Lived Intangible Assets for Impairment. The amendments in this ASU apply to all entities that have indefinite-lived intangible assets, other than goodwill, reported in their financial statements. The amendments in this ASU provide an entity with the option to make a qualitative assessment about the likelihood that an indefinite-lived intangible asset is impaired to determine whether it should perform a quantitative impairment test. The amendments also enhance the consistency of impairment testing guidance among long-lived asset categories by permitting an entity to assess qualitative factors to determine whether it is necessary to calculate the asset's fair value when testing an indefinite-lived intangible asset for impairment. The amendments are effective for annual and interim impairment tests performed for fiscal years beginning after September 15, 2012. The adoption of ASU 2012-02 did not have a material effect on the Corporation's financial statements.

In December 2011, the FASB issued ASU 2011-11, Balance Sheet - Disclosures about Offsetting Assets and Liabilities. This ASU requires entities to disclose both gross information and net information about both instruments and transactions eligible for offset in the balance sheet and instruments and transactions subject to an agreement similar to a master netting arrangement. An entity is required to apply the amendments for annual reporting periods beginning on or after January 1, 2013, and interim periods within those annual periods. An entity should provide the disclosures required by those amendments retrospectively for all comparative periods presented. The adoption of ASU 2011-11 did not have a material effect on the Corporation's financial statements.

In January 2013, the FASB issued ASU 2013-01, Balance Sheet - Clarifying the Scope of Disclosures about Offsetting Assets and Liabilities. The amendments in this ASU clarify the scope for derivatives accounted for in accordance with Topic 815, Derivatives and Hedging, including bifurcated embedded derivatives, repurchase agreements and reverse repurchase agreements and securities borrowing and securities lending transactions that are either offset or subject to netting arrangements. An entity is required to apply the amendments for fiscal years, and interim periods within those years, beginning on or after January 1, 2013. The adoption of ASU 2013-01 did not have a material effect on the Corporation's consolidated financial statements.

#### NOTE 2: Securities

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

(Dollars in thousands)	Amortized Cost	March 31, 2013		Estimated Fair Value
		Gross Unrealized Gains	Gross Unrealized Losses	
U.S. government agencies and corporations	\$26,035	\$5	\$(118)	\$25,922
Mortgage-backed securities	1,899	56	—	1,955
Obligations of states and political subdivisions	114,231	8,336	(111)	122,456
Preferred stock	27	161	—	188
	\$142,192	\$8,558	\$(229)	\$150,521

(Dollars in thousands)	Amortized Cost	December 31, 2012		Estimated Fair Value
		Gross Unrealized Gains	Gross Unrealized Losses	
U.S. government agencies and corporations	\$24,628	\$24	\$(3)	\$24,649
Mortgage-backed securities	2,127	62	—	2,189
Obligations of states and political subdivisions	116,879	9,069	(73)	125,875
Preferred stock	27	77	—	104
	\$143,661	\$9,232	\$(76)	\$152,817



The amortized cost and estimated fair value of securities, all of which were classified as available for sale, at March 31, 2013, by the earlier of contractual maturity or expected maturity, are shown below. Expected maturities will differ from contractual maturities because borrowers may have the right to prepay obligations with or without call or prepayment penalties.

(Dollars in thousands)	March 31, 2013	
	Amortized Cost	Estimated Fair Value
Due in one year or less	\$31,036	\$31,272
Due after one year through five years	39,805	42,011
Due after five years through ten years	45,669	49,147
Due after ten years	25,655	27,903
Preferred stock	27	188
	\$142,192	\$150,521

Proceeds from the maturities, calls and sales of securities available for sale for the three months ended March 31, 2013 were \$7.18 million.

The Corporation pledges securities primarily as collateral for public deposits and repurchase agreements. Securities with an aggregate amortized cost of \$112.18 million and an aggregate fair value of \$118.96 million were pledged at March 31, 2013. Securities with an aggregate amortized cost of \$107.87 million and an aggregate fair value of \$115.14 million were pledged at December 31, 2012.

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

(Dollars in thousands)	Less Than 12 Months		12 Months or More		Total	
	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss
U.S. government agencies and corporations	\$17,033	\$118	\$—	\$—	\$17,033	\$118
Obligations of states and political subdivisions	5,228	106	787	5	6,015	111
Total temporarily impaired securities	\$22,261	\$224	\$787	\$5	\$23,048	\$229

There are 43 debt securities with fair values totaling \$23.05 million considered temporarily impaired at March 31, 2013. The primary cause of the temporary impairments in the Corporation's investments in debt securities was fluctuations in interest rates. During the first quarter of 2013, the municipal bond sector, which is included in the Corporation's obligations of states and political subdivisions category of securities, experienced falling securities prices due to the seasonal trend of tempered demand and light supply, along with an increase in Treasury rates. The vast majority of the Corporation's municipal bond portfolio is made up of securities where the issuing municipalities have unlimited taxing authority to support their debt service obligations. At March 31, 2013, 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 84 percent were rated, as measured by market value, "A" or better at March 31, 2013. 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 March 31, 2013 and no other-than-temporary impairment has been recognized.

Securities in an unrealized loss position at December 31, 2012, by duration of the period of the unrealized loss, are shown below.

(Dollars in thousands)	Less Than 12 Months		12 Months or More		Total	
	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss
U.S. government agencies and corporations	\$ 5,479	\$ 3	\$ —	\$ —	\$ 5,479	\$ 3
Obligations of states and political subdivisions	5,804	71	263	2	6,067	73
Total temporarily impaired securities	\$ 11,283	\$ 74	\$ 263	\$ 2	\$ 11,546	\$ 76

The Corporation's investment in Federal Home Loan Bank (FHLB) stock totaled \$3.53 million at March 31, 2013 and \$3.74 million at December 31, 2012. FHLB stock is generally viewed as a long-term investment and as a restricted investment security, which is carried at cost, because there is no market for the stock, other than the FHLBs or member institutions. Therefore, when evaluating FHLB stock for impairment, its value is based on the ultimate recoverability of the par value rather than by recognizing temporary declines in value. The Corporation does not consider this investment to be other-than-temporarily impaired at March 31, 2013 and no impairment has been recognized. FHLB stock is shown as a separate line item on the balance sheet and is not a part of the available for sale securities portfolio.

#### NOTE 3: Loans

Major classifications of loans are summarized as follows:

(Dollars in thousands)	March 31, 2013	December 31, 2012
Real estate – residential mortgage	\$ 151,908	\$ 149,257
Real estate – construction 1	4,173	5,062
Commercial, financial and agricultural 2	200,280	205,052
Equity lines	32,852	33,324
Consumer	5,129	5,309
Consumer finance	280,774	278,186
	675,116	676,190
Less allowance for loan losses	(33,921 )	(35,907 )
Loans, net	\$641,195	\$640,283

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

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

Consumer loans included \$220,000 and \$293,000 of demand deposit overdrafts at March 31, 2013 and December 31, 2012, respectively.



Loans on nonaccrual status were as follows:

(Dollars in thousands)	March 31, 2013	December 31, 2012
Real estate – residential mortgage	\$1,964	\$1,805
Real estate – construction:		
Construction lending	—	—
Consumer lot lending	—	—
Commercial, financial and agricultural:		
Commercial real estate lending	3,349	3,426
Land acquisition and development lending	—	5,234
Builder line lending	15	15
Commercial business lending	760	759
Equity lines	78	31
Consumer	188	191
Consumer finance	675	655
Total loans on nonaccrual status	\$7,029	\$12,116

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

(Dollars in thousands)	30-59 Days Past Due	60-89 Days Past Due	90+ Days Past Due	Total Past Due	Current	Total Loans	90+ Days Past Due and Accruing
Real estate – residential mortgage	\$1,768	\$530	\$1,217	\$3,515	\$148,393	\$151,908	\$361
Real estate – construction:							
Construction lending	—	—	—	—	3,490	3,490	—
Consumer lot lending	—	—	—	—	683	683	—
Commercial, financial and agricultural:							
Commercial real estate lending	4,681	—	3,171	7,852	116,742	124,594	—
Land acquisition and development lending	—	—	—	—	28,208	28,208	—
Builder line lending	—	—	—	—	13,890	13,890	—
Commercial business lending	20	—	539	559	33,029	33,588	—
Equity lines	90	32	70	192	32,660	32,852	—
Consumer	17	—	189	206	4,923	5,129	1
Consumer finance	5,975	1,175	675	7,825	272,949	280,774	—
Total	\$12,551	\$1,737	\$5,861	\$20,149	\$654,967	\$675,116	\$362

For the purposes of the above table, “Current” includes loans that are 1-29 days past due. In addition, the above table includes nonaccrual loans that are current of \$1.1 million, 30-59 days past due of \$183,000, 60-89 days past due of \$199,000 and 90+ days past due of \$5.5 million.

The past due status of loans as of December 31, 2012 was as follows:

(Dollars in thousands)	30-59 Days Past Due	60-89 Days Past Due	90+ Days Past Due	Total Past Due	Current	Total Loans	90+ Days Past Due and Accruing
Real estate – residential mortgage	\$1,402	\$456	\$641	\$2,499	\$146,758	\$149,257	\$—
Real estate – construction:							
Construction lending	—	—	—	—	3,157	3,157	—
Consumer lot lending	—	—	—	—	1,905	1,905	—
Commercial, financial and agricultural:							
Commercial real estate lending	7,650	496	324	8,470	111,177	119,647	—
Land acquisition and development lending	—	—	5,234	5,234	28,903	34,137	—
Builder line lending	—	—	—	—	15,948	15,948	—
Commercial business lending	794	—	40	834	34,486	35,320	—
Equity lines	270	—	22	292	33,032	33,324	—
Consumer	69	—	191	260	5,049	5,309	—
Consumer finance	10,111	2,052	655	12,818	265,368	278,186	—
Total	\$20,296	\$3,004	\$7,107	\$30,407	\$645,783	\$676,190	\$—

For the purposes of the above table, “Current” includes loans that are 1-29 days past due. In addition, the above table includes nonaccrual loans that are current of \$1.2 million, 30-59 days past due of \$3.4 million, 60-89 days past due of \$421,000 and 90+ days past due of \$7.1 million.

Impaired loans, which consist solely of troubled debt restructurings (TDRs), and the related allowance at March 31, 2013 were as follows:

(Dollars in thousands)	Recorded Investment in Loans	Unpaid Principal Balance	Related Allowance	Average Balance-Impaired Loans	Interest Income Recognized
Real estate – residential mortgage	\$1,844	\$2,066	\$401	\$ 2,022	\$28
Commercial, financial and agricultural:					
Commercial real estate lending	3,967	4,259	582	4,074	68
Commercial business lending	807	811	92	810	2
Consumer	323	323	48	323	3
Total	\$6,941	\$7,459	\$1,123	\$ 7,229	\$101

Impaired loans, which consist solely of TDRs, and the related allowance at December 31, 2012 were as follows:

(Dollars in thousands)	Recorded Investment in Loans	Unpaid Principal Balance	Related Allowance	Average Balance-Impaired Loans	Interest Income Recognized
Real estate – residential mortgage	\$2,230	\$2,283	\$433	\$ 2,266	\$124
Commercial, financial and agricultural:					
Commercial real estate lending	7,892	8,190	1,775	8,260	254
Land acquisition and development lending	5,234	5,234	1,432	5,443	236
Builder line lending	—	—	—	1,407	—
Commercial business lending	812	817	112	827	13
Consumer	324	324	49	324	16
Total	\$16,492	\$16,848	\$3,801	\$ 18,527	\$643

Loan modifications that were classified as TDRs during the three months ended March 31, 2013 and 2012 were as follows:

(Dollars in thousands)	Three Months Ended March 31, 2013		2012	
	Number of Loans	Post-Modification Recorded Investment	Number of Loans	Post-Modification Recorded Investment
Commercial real estate lending – interest rate concession	1	\$ 6	—	\$ —
Consumer – interest reduction	—	—	1	108
Total	1	\$ 6	1	\$ 108

TDR payment defaults during three months ended March 31, 2013 and 2012 were as follows:

(Dollars in thousands)	Three Months Ended March 31, 2013		2012	
	Number of Loans	Recorded Investment	Number of Loans	Recorded Investment
Commercial real estate lending	1	\$ 3	—	\$ —

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

## NOTE 4: Allowance for Loan Losses

The following table presents the changes in the allowance for loan losses by major classification during the three months ended March 31, 2013.

(Dollars in thousands)	Real Estate Residential Mortgage	Real Estate Construction	Commercial, Financial and Agricultural	Equity Lines	Consumer	Consumer Finance	Total
Allowance for loan losses:							
Balance at December 31, 2012	\$2,358	\$ 424	\$ 9,824	\$885	\$283	\$22,133	\$35,907
Provision charged to operations	332	(79 )	67	(12 )	122	2,750	3,180
Loans charged off	(473 )	—	(2,134 )	(37 )	(184 )	(3,393 )	(6,221 )
Recoveries of loans previously charged off	79	—	8	27	47	894	1,055
Balance at March 31, 2013	\$2,296	\$ 345	\$ 7,765	\$863	\$268	\$22,384	\$33,921

The following table presents the changes in the allowance for loan losses by major classification during the three months ended March 31, 2012.

(Dollars in thousands)	Real Estate Residential Mortgage	Real Estate Construction	Commercial, Financial and Agricultural	Equity Lines	Consumer	Consumer Finance	Total
Allowance for loan losses:							
Balance at December 31, 2011	\$2,379	\$ 480	\$ 10,040	\$912	\$319	\$19,547	\$33,677
Provision charged to operations	386	(13 )	335	126	(9 )	1,900	2,725
Loans charged off	(122 )	—	—	(121 )	(90 )	(2,200 )	(2,533 )
Recoveries of loans previously charged off	10	—	35	—	49	794	888
Balance at March 31, 2012	\$2,653	\$ 467	\$ 10,410	\$917	\$269	\$20,041	\$34,757



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

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

(Dollars in thousands)	Real Estate Residential Mortgage	Real Estate Construction	Commercial, Financial and Agricultural	Equity Lines	Consumer	Consumer Finance	Total
<b>Allowance for loan losses:</b>							
Balance at March 31, 2013	\$2,296	\$ 345	\$ 7,765	\$ 863	\$268	\$22,384	\$33,921
<b>Ending balance: individually evaluated for impairment</b>							
	\$401	\$ —	\$ 674	\$ —	\$48	\$—	\$1,123
<b>Ending balance: collectively evaluated for impairment</b>							
	\$1,895	\$ 345	\$ 7,091	\$ 863	\$220	\$22,384	\$32,798
<b>Loans:</b>							
Balance March 31, 2013	\$151,908	\$ 4,173	\$ 200,280	\$ 32,852	\$5,129	\$280,774	\$675,116
<b>Ending balance: individually evaluated for impairment</b>							
	\$1,844	\$ —	\$ 4,774	\$ —	\$323	\$—	\$6,941
<b>Ending balance: collectively evaluated for impairment</b>							
	\$150,064	\$ 4,173	\$ 195,506	\$ 32,852	\$4,806	\$280,774	\$668,175

The following table presents, as of December 31, 2012, the total allowance for loan losses, the allowance by impairment methodology (individually evaluated for impairment or collectively evaluated for impairment), total loans, and loans by impairment methodology (individually evaluated for impairment or collectively evaluated for impairment).

(Dollars in thousands)	Real Estate Residential Mortgage	Real Estate Construction	Commercial, Financial and Agricultural	Equity Lines	Consumer	Consumer Finance	Total
<b>Allowance for loan losses:</b>							
Balance at December 31, 2012	\$2,358	\$ 424	\$ 9,824	\$885	\$283	\$22,133	\$35,907
<b>Ending balance: individually evaluated for impairment</b>							
	\$433	\$ —	\$ 3,319	\$—	\$49	\$—	\$3,801

Ending balance: collectively evaluated for impairment	\$ 1,925	\$ 424	\$ 6,505	\$ 885	\$ 234	\$ 22,133	\$ 32,106
Loans:							
Balance at December 31, 2012	\$ 149,257	\$ 5,062	\$ 205,052	\$ 33,324	\$ 5,309	\$ 278,186	\$ 676,190
Ending balance: individually evaluated for impairment	\$ 2,230	\$ —	\$ 13,938	\$ —	\$ 324	\$ —	\$ 16,492
Ending balance: collectively evaluated for impairment	\$ 147,027	\$ 5,062	\$ 191,114	\$ 33,324	\$ 4,985	\$ 278,186	\$ 659,698

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

(Dollars in thousands)	Pass	Special Mention	Substandard	Substandard Nonaccrual	Total1
Real estate – residential mortgage	\$ 146,665	\$ 871	\$ 2,408	\$ 1,964	\$ 151,908
Real estate – construction:					
Construction lending	561	—	2,929	—	3,490
Consumer lot lending	683	—	—	—	683
Commercial, financial and agricultural:					
Commercial real estate lending	111,453	1,586	8,206	3,349	124,594
Land acquisition and development lending	18,851	1,765	7,592	—	28,208
Builder line lending	11,563	1,774	538	15	13,890
Commercial business lending	30,460	228	2,140	760	33,588
Equity lines	30,759	1,248	767	78	32,852
Consumer	4,570	3	368	188	5,129
	\$ 355,565	\$ 7,475	\$ 24,948	\$ 6,354	\$ 394,342

(Dollars in thousands)	Performing	Non-Performing	Total
Consumer finance	\$ 280,099	\$ 675	\$ 280,774

1 At March 31, 2013, the Corporation did not have any loans classified as Doubtful or Loss.

Loans by credit quality indicators as of December 31, 2012 were as follows:

(Dollars in thousands)	Pass	Special Mention	Substandard	Substandard Nonaccrual	Total1
Real estate – residential mortgage	\$ 143,947	\$ 1,374	\$ 2,131	\$ 1,805	\$ 149,257
Real estate – construction:					
Construction lending	228	—	2,929	—	3,157
Consumer lot lending	1,905	—	—	—	1,905
Commercial, financial and agricultural:					
Commercial real estate lending	102,472	2,776	10,973	3,426	119,647
Land acquisition and development lending	19,422	1,789	7,692	5,234	34,137
Builder line lending	13,469	1,926	538	15	15,948
Commercial business lending	32,330	187	2,044	759	35,320
Equity lines	31,199	1,327	767	31	33,324
Consumer	4,746	3	369	191	5,309
	\$ 349,718	\$ 9,382	\$ 27,443	\$ 11,461	\$ 398,004

(Dollars in thousands)	Performing	Non-Performing	Total
Consumer finance	\$ 277,531	\$ 655	\$ 278,186

1 At December 31, 2012, the Corporation did not have any loans classified as Doubtful or Loss.



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

## Stockholders' Equity - Other Comprehensive Income

The following table presents the cumulative balances of the components of other comprehensive income, net of deferred tax assets of \$2.24 million and \$1.86 million as of March 31, 2013 and 2012, respectively.

(Dollars in thousands)

	March 31,	
	2013	2012
Net unrealized gains on securities	\$5,414	\$4,721
Net unrecognized loss on cash flow hedges	(283 )	(311 )
Net unrecognized losses on defined benefit pension plan	(913 )	(891 )
Total cumulative other comprehensive income	\$4,218	\$3,519

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

	Unrealized Loss on Cash Flow Hedging Instruments	Unrealized Holding Gains on Securities	Defined Benefit Pension Plan Assets and Benefit Obligations	Total
(Dollars in thousands)				
Balance December 31, 2012	\$(313 )	\$5,951	\$(922 )	\$4,716
Net change for the three months ended March 31, 2013	30	(537 )	9	(498 )
Balance at March 31, 2013	\$(283 )	\$5,414	\$(913 )	\$4,218

	Unrealized Loss on Cash Flow Hedging Instruments	Unrealized Holding Gains on Securities	Defined Benefit Pension Plan Assets and Benefit Obligations	Total
(Dollars in thousands)				
Balance December 31, 2011	\$(314 )	\$4,596	\$(898 )	\$3,384
Net change for the three months ended March 31, 2012	3	125	7	135
Balance at March 31, 2012	\$(311 )	\$4,721	\$(891 )	\$3,519

The following tables present the change in each component of other comprehensive income on a pre-tax and after-tax basis for the three months ended March 31, 2013 and 2012.

(Dollars in thousands)

	Three Months Ended March 31, 2013		
	Pre-Tax	Tax Expense (Benefit)	Net-of-Tax
Defined benefit pension plan:			
Net loss <sup>1</sup>	\$30	\$10	\$20
Amortization of prior service costs <sup>1</sup>	(17 )	(6 )	(11 )
Defined benefit pension plan assets and benefit obligations, net <sup>1</sup>	13	4	9
Unrealized gain on cash flow hedging instruments	49	19	30
Unrealized holding losses on securities	(827 )	(290 )	(537 )

Total increase in other comprehensive (loss)	\$ (765	)	\$ (267	)	\$ (498	)
--	---------	---	---------	---	---------	---

---

1 These items are included in the computation of net periodic benefit cost. See Note 6, Employee Benefit Plans, for additional information.

(Dollars in thousands)

	Three Months Ended March 31, 2012		
	Pre-Tax	Tax Expense (Benefit)	Net-of-Tax
<b>Defined benefit pension plan:</b>			
Net loss	\$26	\$8	\$18
Amortization of prior service costs	(17)	(6)	(11)
Defined benefit pension plan assets and benefit obligations, net	9	2	7
Unrealized loss on cash flow hedging instruments	5	2	3
Unrealized holding gains on securities	193	68	125
<b>Total increase in other comprehensive income</b>	<b>\$207</b>	<b>\$72</b>	<b>\$135</b>

The Corporation had \$2,000 and \$0 of net gains from securities reclassified from other comprehensive income to earnings for the three months ended March 31, 2013 and 2012.

### Earnings Per Common Share

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

(Dollars in thousands)

	Three Months Ended March 31,	
	2013	2012
Net income	\$4,006	\$3,780
Accumulated dividends on Series A Preferred Stock	—	(125)
Accretion of Series A Preferred Stock discount	—	(21)
Net income available to common shareholders	\$4,006	\$3,634
Weighted average number of common shares used in earnings per common share – basic	3,266,712	3,190,518
Effect of dilutive securities:		
Stock option awards and Warrant	104,565	74,457
Weighted average number of common shares used in earnings per common share – assuming dilution	3,371,277	3,264,975

Potential common shares that may be issued by the Corporation for its stock option awards and Warrant (defined below) are determined using the treasury stock method. Approximately 69,000 and 277,000 shares issuable upon exercise of options were not included in computing diluted earnings per common share for the three months ended March 31, 2013 and 2012, respectively, because they were anti-dilutive.

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

## NOTE 6: Employee Benefit Plan

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

(Dollars in thousands)	Three Months Ended March 31,	
	2013	2012
Service cost	\$194	\$159
Interest cost	107	99
Expected return on plan assets	(187 )	(158 )
Amortization of net obligation at transition	—	—
Amortization of prior service cost	(17 )	(17 )
Amortization of net loss	30	26
Net periodic benefit cost	\$127	\$109

## NOTE 7: Fair Value of Assets and Liabilities

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

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

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

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. The Corporation has not made any fair value option elections as of March 31, 2013.

## 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 future composition of the portfolio. At March 31, 2013 and December 31, 2012, the Corporation's entire investment securities portfolio was valued using Level 2 fair value measurements. The Corporation has contracted with a third party portfolio accounting service vendor for valuation of its securities portfolio. The vendor's sources for security valuation are Standard & Poor's Securities Evaluations Inc. ("SPSE") and Thomson Reuters Pricing Service ("TRPS"). Both sources provide 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 provides evaluated prices for the Corporation's obligations of states and political subdivisions category of securities. SPSE uses 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 provides evaluated prices for the Corporation's U.S. government agencies and corporations and mortgage-backed categories of securities. Securities in 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. 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") price. TBA prices are obtained from market makers and live trading systems.

Derivative payable. The Corporation's derivative financial instruments have been designated as and qualify as cash flow hedges. The fair value of derivatives is determined using the discounted cash flow method.

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

(Dollars in thousands)	March 31, 2013			Assets at Fair Value
	Fair Value Measurements Using Level 1	Level 2	Level 3	
<b>Assets:</b>				
Securities available for sale				
U.S. government agencies and corporations	\$—	\$25,922	\$—	\$25,922
Mortgage-backed securities	—	1,955	—	1,955
Obligations of states and political subdivisions	—	122,456	—	122,456
Preferred stock	—	188	—	188
Total securities available for sale	\$—	\$150,521	\$—	\$150,521
<b>Liabilities:</b>				
Derivative payable	\$—	\$464	\$—	\$464

(Dollars in thousands)	December 31, 2012			Assets at Fair Value
	Fair Value Measurements Using Level 1	Level 2	Level 3	
<b>Assets:</b>				
Securities available for sale				
U.S. government agencies and corporations	\$—	\$24,649	\$—	\$24,649
Mortgage-backed securities	—	2,189	—	2,189
Obligations of states and political subdivisions	—	125,875	—	125,875
Preferred stock	—	104	—	104
Total securities available for sale	\$—	\$152,817	\$—	\$152,817
<b>Liabilities:</b>				
Derivative payable	\$—	\$513	\$—	\$513

#### 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 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 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. 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.

(Dollars in thousands)	March 31, 2013			Assets at Fair Value
	Fair Value Measurements Using			
	Level 1	Level 2	Level 3	
Impaired loans, net	\$—	\$—	\$2,617	\$2,617
Other real estate owned net	—	—	5,297	5,297

(Dollars in thousands)	December 31, 2012			Assets at Fair Value
	Fair Value Measurements Using			
	Level 1	Level 2	Level 3	
Impaired loans, net	\$ —	\$ —	\$ 9,074	\$ 9,074
Other real estate owned net	—	—	6,236	6,236

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 March 31, 2013:

(Dollars in thousands)	Fair Value	Fair Value Measurements at March 31, 2013		
		Valuation Technique(s)	Unobservable Inputs	Range of Inputs
Impaired loans, net	\$ 2,617	Appraisals	Discount to reflect current market conditions and estimated selling costs	5% - 40%
Other real estate owned, net	5,297	Appraisals	Discount to reflect current market conditions and estimated selling costs	0% - 70%

## Fair Value of Financial Instruments

FASB 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 March 31, 2013 and December 31, 2012.

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 7.

Loans held for sale, net. Loans held for sale are required to be measured at the lower of cost or fair value. These loans currently consist of residential loans originated for sale in the secondary market. Fair value is based on purchase prices agreed to by third party investors, which are obtained simultaneously with the rate lock commitments made to individual borrowers. The Corporation records any fair value adjustments on a nonrecurring basis. No nonrecurring fair value adjustments were recorded on loans held for sale during the three months ended March 31, 2013.

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

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

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.



(Dollars in thousands)	Carrying Value	Fair Value Measurements at March 31, 2013 Using			Total Fair Value
		Level 1	Level 2	Level 3	
<b>Financial assets:</b>					
Cash and short-term investments	\$70,726	\$70,726	\$—	\$—	\$70,726
Securities available for sale	150,521	—	150,521	—	150,521
Loans, net	641,195	—	—	653,499	653,499
Loans held for sale, net	45,432	—	46,508	—	46,508
Accrued interest receivable	5,566	5,566	—	—	5,566
<b>Financial liabilities:</b>					
Demand deposits	\$412,088	\$412,088	\$—	\$—	\$412,088
Time deposits	284,376	—	288,364	—	288,364
Borrowings	167,219	—	162,068	—	162,068
Derivative payable	464	—	464	—	464
Accrued interest payable	797	797	—	—	797

(Dollars in thousands)	Carrying Value	Fair Value Measurements at December 31, 2012 Using			Total Fair Value
		Level 1	Level 2	Level 3	
<b>Financial assets:</b>					
Cash and short-term investments	\$25,620	\$25,620	\$—	\$—	\$25,620
Securities available for sale	152,817	—	152,817	—	152,817
Loans, net	640,283	—	—	651,133	651,133
Loans held for sale, net	72,727	—	74,964	—	74,964
Accrued interest receivable	5,673	5,673	—	—	5,673
<b>Financial liabilities:</b>					
Demand deposits	\$399,575	\$399,575	\$—	\$—	\$399,575
Time deposits	286,609	—	290,483	—	290,483
Borrowings	162,746	—	158,027	—	158,027
Derivative payable	513	—	513	—	513
Accrued interest payable	837	837	—	—	837

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.

#### NOTE 8: Business Segments

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



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

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.

Three Months Ended March 31, 2013

(Dollars in thousands)	Retail Banking	Mortgage Banking	Consumer Finance	Other	Eliminations	Consolidated
<b>Revenues:</b>						
Interest income	\$7,816	\$427	\$12,172	\$—	\$(1,292)	\$ 19,123
Gains on sales of loans	—	4,797	—	—	—	4,797
Other noninterest income	1,711	1,078	298	310	—	3,397
Total operating income	9,527	6,302	12,470	310	(1,292)	27,317
<b>Expenses:</b>						
Interest expense	1,544	92	1,616	188	(1,292)	2,148
Provision for loan losses	400	30	2,750	—	—	3,180
Salaries and employee benefits	4,142	3,841	1,990	192	—	10,165
Other noninterest expenses	3,025	1,429	1,114	392	—	5,960
Total operating expenses	9,111	5,392	7,470	772	(1,292)	21,453
Income (loss) before income taxes	416	910	5,000	(462)	—	5,864
Provision for (benefit from) income taxes	(280)	364	1,950	(176)	—	1,858
Net income (loss)	\$696	\$546	\$3,050	\$(286)	\$—	\$ 4,006
Total assets	\$830,597	\$59,674	\$282,991	\$3,493	\$(183,378)	\$ 993,377
Capital expenditures	\$1,205	\$101	\$19	\$2	\$—	\$ 1,327

Three Months Ended March 31, 2012

(Dollars in thousands)	Retail Banking	Mortgage Banking	Consumer Finance	Other	Eliminations	Consolidated
<b>Revenues:</b>						
Interest income	\$8,066	\$574	\$11,340	\$—	\$(1,224)	\$ 18,756
Gains on sales of loans	—	4,103	—	—	—	4,103
Other noninterest income	1,566	1,115	260	337	2	3,280
Total operating income	9,632	5,792	11,600	337	(1,222)	26,139
<b>Expenses:</b>						
Interest expense	2,158	106	1,550	249	(1,224)	2,839
Provision for loan losses	750	75	1,900	—	—	2,725
Salaries and employee benefits	4,006	3,582	1,876	278	—	9,742
Other noninterest expenses	2,909	1,332	923	151	—	5,315
Total operating expenses	9,823	5,095	6,249	678	(1,224)	20,621
Income (loss) before income taxes	(191)	697	5,351	(341)	2	5,518
Provision for (benefit from) income taxes	(498)	279	2,087	(130)	—	1,738

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

Net income (loss)	\$307	\$418	\$3,264	\$(211	) \$2	\$3,780
Total assets	\$786,829	\$75,864	\$254,913	\$3,077	\$(175,212	) \$945,471
Capital expenditures	\$173	\$51	\$58	\$—	\$—	\$282

25

---

The Retail Banking segment extends a warehouse line of credit to the Mortgage Banking segment, providing a portion of the funds needed to originate mortgage loans. The Retail Banking segment charges the Mortgage Banking segment interest at the daily FHLB advance rate plus 50 basis points. The Retail Banking segment also provides the Consumer Finance segment with a portion of the funds needed to originate loans by means of a variable rate line of credit that carries interest at one-month LIBOR plus 200 basis points and fixed rate loans that carry interest rates ranging from 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 9: Commitments and Financial Instruments with Off-Balance-Sheet Risk

C&F Mortgage sells substantially all of the residential mortgage loans it originates to third-party 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:

(Dollars in thousands)	Three Months Ended March 31,	
	2013	2012
Allowance, beginning of period	\$ 2,092	\$ 1,702
Provision for indemnification losses	225	125
Payments	(235 )	—
Allowance, end of period	\$ 2,082	\$ 1,827

#### NOTE 10: Derivatives

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

The cash flow hedges total notional amount is \$10.00 million. At March 31, 2013, the cash flow hedges had a fair value of (\$464,000), which is recorded in other liabilities. The cash flow hedges were fully effective at March 31, 2013 and therefore the loss on the cash flow hedges was recognized as a component of other comprehensive income (loss), net of deferred income taxes.



## NOTE 11: Other Noninterest Expenses

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

(Dollars in thousands)	Three Months Ended March 31,	
	2013	2012
Loan and OREO expenses	\$ 222	\$ 349
Data processing fees	666	496
Telecommunication expenses	288	284
Professional fees	541	456
All other noninterest expenses	2,475	2,009
Total Other Noninterest Expenses	\$ 4,192	\$ 3,594

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

Cautionary Statement Regarding Forward-Looking Statements

This report contains statements concerning the Corporation's expectations, plans, objectives, future financial performance and other statements that are not historical facts. These statements may constitute "forward-looking statements" as defined by federal securities laws and may include, but are not limited to, statements regarding profitability, liquidity, the Corporation's and each business segment's loan portfolio, allowance for loan losses, trends regarding the provision for loan losses, trends regarding net loan charge-offs 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, levels of noninterest income and expense, interest rates and yields including continuation of the current low interest rate environment, 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, growth strategy and financial and other goals. These statements may address issues that involve estimates and assumptions made by management and risks and uncertainties. Actual results could differ materially from historical results or those anticipated by such statements. Factors that could have a material adverse effect on the operations and future prospects of the Corporation include, but are not limited to, changes in:

- interest rates
- general business conditions, as well as conditions within the financial markets
  - general economic conditions, including unemployment levels
- the legislative/regulatory climate, including the Dodd-Frank Act and regulations promulgated thereunder, 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
  - 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
- 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
    - technology
    - reliance on third parties for key services
  - accounting principles, policies and guidelines

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, 2012, 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.

**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.

**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:** All of the Corporation's goodwill was recognized in connection with the Bank's acquisition of C&F Finance Company in September 2002. With the adoption of Accounting Standards Update 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 C&F Finance Company 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. As part of any impairment test, we will perform 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 impact 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 derivative financial instruments have been designated as and qualify as cash flow hedges. The effective portion of the gain or loss on the cash flow hedges is reported as a component of other comprehensive income, net of deferred taxes, and reclassified into earnings in the same period or periods during which the hedged transactions affect earnings.

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

For further information concerning accounting policies, refer to Item 8, "Financial Statements and Supplementary Data," under the heading "Note 1: Summary of Significant Accounting Policies" in the Corporation's Annual Report on Form 10-K for the year ended December 31, 2012.

## OVERVIEW

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

### Financial Performance Measures

Net income for the Corporation was \$4.0 million for the three months ended March 31, 2013, compared with \$3.8 million for the three months ended March 31, 2012. Net income available to common shareholders was \$4.0 million, or \$1.19 per common share assuming dilution, for the three months ended March 31, 2013, compared with \$3.6 million, or \$1.11 per common share assuming dilution, for the three months ended March 31, 2012. The difference between reported net income and net income available to common shareholders for 2012 is a result of the Preferred Stock dividends and amortization of the Warrant related to the Corporation's participation in the CPP. The Corporation's earnings for the first quarter of 2013 were attributable to profitability at all three of its principal business segments. The Consumer Finance segment continued to benefit from (1) sustained loan growth and (2) the low funding costs on its variable-rate borrowings. The Mortgage Banking segment benefited from higher gains on loans sold and ancillary loan production fees as a result of higher loan production and correspondingly higher sales volume. The Retail Banking segment benefited from the effects of (1) the continued low interest rate environment on the cost of deposits, (2) lower provisions for loan losses and (3) increased overdraft protection fees.

The Corporation's ROE and ROA were 15.46 percent and 1.64 percent, respectively, on an annualized basis for the three months ended March 31, 2013, compared to 16.73 percent and 1.60 percent for the three months ended March 31, 2012. The decline in ROE during the first quarter of 2013, compared to the first quarter of 2012, was attributable to capital growth resulting from record earnings for 2012, which outpaced the increase in net income for the same periods.

**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:** C&F Bank's net income was \$696,000 for the first quarter of 2013, compared to net income of \$307,000 for the first quarter of 2012. The improvement in quarterly financial results for 2013 resulted from the effects of the continued low interest rate environment on the cost of deposits, lower loan loss provision expense, increased overdraft protection fees and lower foreclosed properties expenses due to the disposition of foreclosed properties. Partially offsetting these positive factors were the negative effects of the following: (1) a decrease in average loans to nonaffiliates to \$393.7 million for the first quarter of 2013 from \$400.7 million for the first quarter of 2012 resulting from weak loan demand in the current economic environment and intensified competition for loans in our markets and (2) higher data processing expenses related to expanding the banking services offered to customers and improving operational efficiency.

The Bank's nonperforming assets were \$11.7 million at March 31, 2013, compared to \$17.7 million at December 31, 2012. Nonperforming assets at March 31, 2013 included \$6.4 million in nonaccrual loans and \$5.3 million in foreclosed properties, compared to \$11.5 million in nonaccrual loans and \$6.2 million in foreclosed properties at December 31, 2012. The decrease in nonaccrual loans was primarily the result of the sale of notes totaling \$10.9 million relating to one commercial relationship, \$5.2 million of which was on nonaccrual status at December 31,

2012. This note sale resulted in a \$2.1 million charge-off, which had previously been provided for in the allowance for loan losses. As a result of this charge-off, the Bank's allowance for loan losses as a percentage of average loans declined to 2.84 percent at March 31, 2013 from 3.38 percent at December 31, 2012. Management believes it has provided adequate loan loss reserves for the Retail Banking segment's nonaccrual loans.

Mortgage Banking: C&F Mortgage Corporation's net income was \$546,000 for the first quarter of 2013, compared to \$418,000 for the first quarter of 2012. The improvement in quarterly financial results for 2013 resulted from higher gains on sales of loans and ancillary loan production fees. Loan sales volume increased to \$205.5 million for the first quarter of 2013, compared to \$179.6 million for the first quarter of 2012. Loan origination volume increased to \$178.2 million in the first quarter of 2013, compared to \$173.3 million in the first quarter of 2012. The increase in loan originations is a result of the continued low interest rate environment that has led to increased mortgage borrowing and refinancing activity. During the first quarter of 2013, the amounts of loan originations for refinancings and new and resale home purchases were \$82.0 million and \$96.2 million, respectively, compared to \$79.7 million and \$93.6 million, respectively, during the first quarter of 2012. In connection with the higher originations and net income in the first quarter of 2013, the mortgage banking segment incurred higher production-based and income-based expenses. Higher non-production personnel costs have also been incurred in order to manage the increasingly complex regulatory environment in which the mortgage banking segment operates.

Consumer Finance: C&F Finance Company's net income was \$3.1 million for the first quarter of 2013, compared to net income of \$3.3 million for the first quarter of 2012. Average loans outstanding during the first quarter of 2013 increased \$31.8 million, or 12.79 percent, compared to the first quarter of 2012. Additionally, the consumer finance segment continued to benefit from the low funding costs related to its variable-rate borrowings. Offsetting these items were (1) increases in net charge-offs as a result of economic conditions and lower resale prices of repossessed automobiles, which resulted in an \$850,000 increase in the provision for loan losses during the first quarter of 2013, (2) a decline in average loan yields in response to loan pricing strategies used by competitors to grow market share in automobile financing and (3) an increase in personnel expenses incurred to support loan growth and segment expansion into new markets.

Annualized net charge-offs as a percentage of average loans outstanding increased to 3.57 percent for the first quarter of 2013, compared to 2.76 percent for the year ended December 31, 2012. The allowance for loan losses as a percentage of consumer finance loans was 7.97 percent as of March 31, 2013, compared to 7.96 percent as of December 31, 2012. Management believes that the current allowance for loan losses is adequate to absorb probable losses in the Consumer Finance segment's loan portfolio.

Other and Eliminations: The net loss for the first quarter of 2013 for this combined segment was \$286,000, compared to a net loss of \$209,000 for the first quarter of 2012. Revenue and expense of this combined segment include the results of operations of our investment, insurance and title subsidiaries, interest expense associated with the Corporation's trust preferred capital notes, other general corporate expenses and the effects of intercompany eliminations.

Capital Management. Total shareholders' equity was \$104.9 million at March 31, 2013, compared to \$102.2 million at December 31, 2012. Capital growth resulted from earnings for the first quarter of 2013, offset in part by dividends declared and a decline in unrealized holding gains on securities available for sale, which are a component of accumulated other comprehensive income. The Corporation declared cash dividends of 29 cents per common share during the first quarter of 2013, which was an 11.5 percent increase over the 26 cents per common share declared for the first quarter of 2012. The dividend payout ratio was a 23.6 percent of net income available to common shareholders for the first quarter of 2013.

## 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 months ended March 31, 2013 and 2012. Loans include loans held for sale. Loans placed on nonaccrual status are included in the balances and are included in the computation of yields, but had no material effect. Interest on tax-exempt loans and securities is presented on a taxable-equivalent basis (which converts the income on loans and investments for which no income taxes are paid to the equivalent yield as if income taxes were paid using the federal corporate income tax rate of 34 percent).

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

(Dollars in thousands)	Three Months Ended March 31,					
	Average Balance	2013 Income/ Expense	Yield/ Rate	Average Balance	2012 Income/ Expense	Yield/ Rate
<b>Assets</b>						
<b>Securities:</b>						
Taxable	\$ 32,545	\$ 140	1.72 %	\$ 21,365	\$ 86	1.61 %
Tax-exempt	115,379	1,730	6.00	118,595	1,798	6.06
Total securities	147,924	1,870	5.06	139,960	1,884	5.38
Loans, net	729,444	17,829	9.91	711,451	17,490	9.86
<b>Interest-bearing deposits in other banks and Federal funds sold</b>						
Total earning assets	918,400	19,722	8.71	866,794	19,382	8.94
Allowance for loan losses	(35,796 )			(34,116 )		
Total non-earning assets	95,617			93,045		
Total assets	\$ 978,221			\$ 925,723		
<b>Liabilities and Shareholders' Equity</b>						
<b>Time and savings deposits:</b>						
Interest-bearing deposits	\$ 133,210	\$ 126	0.38 %	\$ 112,868	\$ 142	0.50 %
Money market deposit accounts	112,640	83	0.30	86,512	100	0.46
Savings accounts	48,563	10	0.08	44,057	11	0.09
Certificates of deposit, \$100 or more	126,444	375	1.20	139,219	640	1.85
Other certificates of deposit	159,485	485	1.23	168,516	724	1.72
Total time and savings deposits	580,342	1,079	0.75	551,172	1,617	1.17
Borrowings	163,985	1,069	2.61	159,017	1,222	3.07
Total interest-bearing liabilities	744,327	2,148	1.15	710,189	2,839	1.60
Demand deposits	104,837			94,394		
Other liabilities	25,415			22,627		
Total liabilities	874,579			827,210		
Shareholders' equity	103,642			98,513		
Total liabilities and shareholders' equity	\$ 978,221			\$ 925,723		
Net interest income		\$ 17,574			\$ 16,543	
Interest rate spread			7.56 %			7.34 %
			0.94 %			1.31 %

Interest expense to  
average earning assets  
(annualized)

Net interest margin  
(annualized)

7.75 %

7.63 %

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 2: Rate-Volume Recap

(Dollars in thousands)	Three Months Ended March 31, 2013 from 2012			Total Increase (Decrease)
	Increase (Decrease) Due to			
	Rate		Volume	
<b>Interest income:</b>				
Loans	\$ 25		\$ 314	\$ 339
<b>Securities:</b>				
Taxable	6		48	54
Tax-exempt	(20)	)	(48)	(68)
Interest-bearing deposits in other banks and Federal funds sold	1		14	15
<b>Total interest income</b>	<b>12</b>		<b>328</b>	<b>340</b>
<b>Interest expense:</b>				
<b>Time and savings deposits:</b>				
Interest-bearing deposits	(127)	)	111	(16)
Money market deposit accounts	(141)	)	124	(17)
Savings accounts	(6)	)	5	(1)
Certificates of deposit, \$100 or more	(210)	)	(55)	(265)
Other certificates of deposit	(201)	)	(38)	(239)
<b>Total time and savings deposits</b>	<b>(685)</b>	<b>)</b>	<b>147</b>	<b>(538)</b>
<b>Borrowings (including Trust preferred capital notes)</b>	<b>(379)</b>	<b>)</b>	<b>226</b>	<b>(153)</b>
<b>Total interest expense</b>	<b>(1,064)</b>	<b>)</b>	<b>373</b>	<b>(691)</b>
<b>Change in net interest income</b>	<b>\$ 1,076</b>		<b>\$ (45)</b>	<b>\$ 1,031</b>

Net interest income on a taxable-equivalent basis was \$17.6 million for the first quarter of 2013, compared to \$16.5 million for the first quarter of 2012. The higher net interest income during the first quarter of 2013, as compared to the same period of 2012, resulted from a 12 basis point increase in net interest margin to 7.75 percent, coupled with a 5.9 percent increase in average earning assets. The increase in net interest margin was principally a result of growth in the Consumer Finance segment's loan portfolio (which generates higher yields than the Retail Banking and Mortgage Banking segments' loan portfolios) and decreases in the rates paid by the Retail Banking segment on interest-bearing demand ("NOW") and market market accounts and time deposits. The decreases in rates paid on deposits were primarily a result of the sustained low interest rate environment and the repricing of higher rate certificates of deposit as they matured to lower rates. In addition, the mix in interest-bearing deposits has shifted to non-term deposit accounts, including demand deposits and money market accounts. These factors contributing to improvement in the net interest margin were partially offset by lower yields (1) on average loans held for sale at the Mortgage Banking segment, which typically are lower yielding than loans held for investment, (2) on average loans at the Consumer Finance segment, which have been negatively affected by increasing competition, in part leading to reductions on rates for certain newly-originated consumer finance loans and (3) on securities as a result of calls and maturities of higher-yielding securities and purchases of municipal securities with lower yields in the current low interest rate environment. In addition, deposit growth, in conjunction with a decline in the Retail Banking segment's loans to nonaffiliates, has resulted in an increase in liquidity in the form of low-yielding overnight funds during the first quarter of 2013.

Average loans, which includes both loans held for investment and loans held for sale, increased to \$729.4 million for the first quarter of 2013 from \$711.5 million for the first quarter of 2012. In total, average loans to nonaffiliates held for investment increased \$24.8 million during the first quarter of 2013, compared to the same period of 2012. The Consumer Finance segment's average loan portfolio increased \$31.8 million as a result of robust demand in existing and new markets during 2012. The increase in average loans at the Consumer Finance segment was offset in part by a \$7.0 million decrease in the Retail Banking segment's portfolio of average loans held for investment, where loan production has been negatively affected by weak demand for new loans in the current economic environment and intensified competition for loans in our markets. The Mortgage Banking segment's average portfolio of loans held for sale decreased \$6.8 million during the first quarter of 2013, compared to the same period of 2012. While the demand for mortgage borrowing and refinancing activity during the first quarter of 2013 resulted in an increase in loan originations to \$178.2 million for the first quarter of 2013 from \$173.3 million for the first quarter of 2012, the mortgage banking segment's average balance of loans held for sale fluctuates depending on the period of time between mortgage loan origination and sale to a third-party investor.

The overall yield on average loans increased 5 basis points to 9.91 percent for the first quarter of 2013, compared to the first quarter of 2012, principally as a result of the lower level of the Mortgage Banking segment's loans held for sale and the higher level of the Consumer Finance segment's loans as a percentage of total loans, which were offset in part by the slight decline in yield on the Consumer Finance segment's loan portfolio.

Average securities available for sale increased \$8.0 million for the first quarter of 2013, compared to the same period of 2012. The average balance of shorter-term securities of U.S government agencies and corporations increased \$11.2 million in order to support municipal deposit collateral requirements, while the average balance of municipal securities declined \$3.2 million due to the effect of the lower interest rate environment on call activity, coupled with limited availability of reinvestment opportunities in these longer-term investments. The lower yield on the available-for-sale securities portfolio during the first quarter of 2013 resulted from the calls and maturities of higher-yielding securities and purchases of lower-yielding securities in the current low interest rate environment, as well as purchases of shorter-term securities with lower yields.

Average interest-bearing deposits in other banks and Federal funds sold increased \$25.6 million during the first quarter of 2013, compared to the first quarter of 2012, as a result of deposit growth and lower loan funding needs of the Retail Banking and Mortgage Banking segments. The average yield on these overnight funds increased only 2 basis points during the first quarter of 2013, compared to the same period of 2012, as a result of the continuing low interest rate environment.

Average interest-bearing time and savings deposits increased \$29.2 million during the first quarter of 2013, compared to the first quarter of 2012. The increase in interest-bearing deposits consisted of a \$51.0 million increase in NOW, money market and savings deposit accounts, which was offset in part by a \$21.8 million decline in time deposits. This shift to non-term deposit accounts provides depositors greater flexibility for funds management and investing decisions in this low interest rate environment. The average cost of deposits declined 42 basis points during the first quarter of 2013, compared to the same period of 2012. This decrease resulted from (1) the repricing of time deposits that matured throughout 2012 and into 2013 to lower interest rates, (2) a decline in interest rates paid on NOW, money market deposit and savings accounts in the sustained low interest rate environment and (3) a higher concentration of savings and money market deposits, which pay lower interest rates.

Average borrowings increased \$5.0 million during the first quarter of 2013, compared to the first quarter of 2012. This increase occurred in retail overnight repurchase agreements with commercial depositors. The average cost of borrowings declined 46 basis points during the first quarter of 2013, compared to the same period of 2012, because of the maturity of \$10.0 million of FHLB advances during the third quarter of 2012, which were replaced by advances carrying lower interest rates. In addition, \$5.0 million of trust preferred capital notes issued in 2007 converted to a variable rate from a higher fixed rate.

Based on actions and announcements by the Federal Reserve during the first quarter of 2013, the Corporation anticipates that interest rates will remain low in the short-term, which will most likely preserve the low rate environment that has been favorable throughout 2012 and into 2013 to the Mortgage Banking segment's operations and to C&F Bank's and C&F Finance's cost of funds. The low interest rate environment has caused declines in interest expense, which the Corporation expects to have less of an effect on net interest margin in 2013 than in 2012. 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. With the expectation that short-term interest rates will not change significantly and the current low rate environment will continue, the net interest margin at the Consumer Finance segment will be most affected by increasing competition and loan pricing strategies that these competitors may use to grow market share in automobile financing. This may result result in lower yields as the

Consumer Finance segment responds to competitive pricing pressures and fewer purchases of automobile retail installment sales contracts.

## Noninterest Income

TABLE 3: Noninterest Income

(Dollars in thousands)

	Three Months Ended March 31, 2013				Total
	Retail Banking	Mortgage Banking	Consumer Finance	Other and Eliminations	
Gains on sales of loans	\$—	\$4,797	\$—	\$—	\$4,797
Service charges on deposit accounts	924	—	—	—	924
Other service charges and fees	644	815	2	43	1,504
Gains on calls of available for sale securities	2	—	—	—	2
Other income	141	263	296	267	967
Total noninterest income	\$1,711	\$5,875	\$298	\$ 310	\$8,194

(Dollars in thousands)

	Three Months Ended March 31, 2012				Total
	Retail Banking	Mortgage Banking	Consumer Finance	Other and Eliminations	
Gains on sales of loans	\$—	\$4,103	\$—	\$—	\$4,103
Service charges on deposit accounts	801	—	—	—	801
Other service charges and fees	569	760	4	35	1,368
Gains on calls of available for sale securities	—	—	—	—	—
Other income	196	355	256	304	1,111
Total noninterest income	\$1,566	\$5,218	\$260	\$ 339	\$7,383

Total noninterest income increased \$811,000, or 11.0 percent, in the first quarter of 2013, compared to the first quarter of 2012. This increase resulted from higher gains on sales of loans and ancillary loan production fees at the Mortgage Banking segment due to the increase in loan originations and sales, coupled with higher activity-based debit card interchange fees and overdraft fee income at the Retail Banking segment.

## Noninterest Expense

TABLE 4: Noninterest Expenses

(Dollars in thousands)

	Three Months Ended March 31, 2013				Total
	Retail Banking	Mortgage Banking	Consumer Finance	Other and Eliminations	
Salaries and employee benefits	\$4,142	\$3,841	\$1,990	\$ 192	\$10,165
Occupancy expenses	1,086	479	202	1	1,768
Other expenses:					
OREO expenses	202	—	—	—	202
Provision for indemnification losses	—	225	—	—	225
Other expenses	1,737	725	912	391	3,765
Total other expenses	1,939	950	912	391	4,192
Total noninterest expenses	\$7,167	\$5,270	\$3,104	\$ 584	\$16,125



(Dollars in thousands)

Three Months Ended March 31, 2012

	Retail Banking	Mortgage Banking	Consumer Finance	Other and Eliminations	Total
Salaries and employee benefits	\$4,006	\$3,582	\$1,876	\$ 278	\$9,742
Occupancy expenses	1,032	476	205	8	1,721
Other expenses:					
OREO expenses	242	—	—	—	242
Provision for indemnification losses	—	125	—	—	125
Other expenses	1,635	731	718	143	3,227
Total other expenses	1,877	856	718	143	3,594
Total noninterest expenses	\$6,915	\$4,914	\$2,799	\$ 429	\$15,057

Total noninterest expenses increased \$1.1 million, or 7.1 percent, in the first quarter of 2013, compared to the first quarter of 2012. This increase resulted primarily from higher personnel costs at (1) the Retail Banking segment due to increased staffing in the branch network to support customer service initiatives, (2) the Mortgage Banking segment due to higher production-based and income-based expenses, as well as higher non-production compensation in order to manage the increasingly complex regulatory environment in which the Mortgage Banking segment operates and (3) the Consumer Finance segment due to an increase in the number of personnel to support expansion into new markets and loan growth. In addition, during the first quarter of 2013, the Retail Banking segment recognized higher activity-based expense related to increased debit card activity; the Mortgage Banking segment recognized a higher provision for indemnification losses in connection with loans sold to investors, and; the Finance Company recognized higher volume-related expenses associated with loan underwriting and collection activities. These increases were partially offset by lower OREO expenses at the Retail Banking segment.

#### Income Taxes

Income tax expense for the first quarter of 2013 totaled \$1.9 million, resulting in an effective tax rate of 31.7 percent, compared to \$1.7 million and 31.5 percent for the first quarter of 2012.

## ASSET QUALITY

## Allowance for Loan Losses

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

TABLE 5: Allowance for Loan Losses

(Dollars in thousands)	Three Months Ended March 31,			
	2013		2012	
Allowance, beginning of period	\$35,907		\$33,677	
Provision for loan losses:				
Retail Banking segment	400		750	
Mortgage Banking segment	30		75	
Consumer Finance segment	2,750		1,900	
Total provision for loan losses	3,180		2,725	
Loans charged off:				
Real estate—residential mortgage	473		122	
Real estate—construction 1	—		—	
Commercial, financial and agricultural 2	2,134		—	
Equity lines	37		121	
Consumer	184		90	
Consumer finance	3,393		2,200	
Total loans charged off	6,221		2,533	
Recoveries of loans previously charged off:				
Real estate—residential mortgage	79		10	
Real estate—construction 1	—		—	
Commercial, financial and agricultural 2	8		35	
Equity lines	27		—	
Consumer	47		49	
Consumer finance	894		794	
Total recoveries	1,055		888	
Net loans charged off	5,166		1,645	
Allowance, end of period	\$33,921		\$34,757	
Ratio of annualized net charge-offs to average total loans outstanding during period for Retail Banking and Mortgage Banking	2.69	%	0.24	%
Ratio of annualized net charge-offs to average total loans outstanding during period for Consumer Finance	3.57	%	2.26	%

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.

For the first quarter of 2013, the annualized net charge-off ratio for the combined Retail Banking and Mortgage Banking segments includes a \$2.1 million charge-off for a single commercial lending relationship. As of March 31,



2013, the Corporation does not anticipate incurring similar charge-offs of large lending relationships during the remainder of 2013.

Table 6 discloses the allocation of the allowance for loan losses at March 31, 2013 and December 31, 2012.

TABLE 6: Allocation of Allowance for Loan Losses

(Dollars in thousands)	March 31, 2013	December 31, 2012
Allocation of allowance for loan losses:		
Real estate—residential mortgage	\$2,296	\$2,358
Real estate—construction 1	345	424
Commercial, financial and agricultural 2	7,765	9,824
Equity lines	863	885
Consumer	268	283
Consumer finance	22,384	22,133
Balance	\$33,921	\$35,907

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.

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 7: Credit Quality Indicators

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

(Dollars in thousands)	Pass	Special Mention	Substandard	Substandard Nonaccrual	Total1
Real estate—residential mortgage	\$146,665	\$871	\$2,408	\$1,964	\$151,908
Real estate—construction 2	1,244	—	2,929	—	4,173
Commercial, financial and agricultural 3	172,327	5,353	18,476	4,124	200,280
Equity lines	30,759	1,248	767	78	32,852
Consumer	4,570	3	368	188	5,129
	\$355,565	\$7,475	\$24,948	\$6,354	\$394,342

(Dollars in thousands)	Performing	Non-Performing	Total
Consumer finance	\$280,099	\$675	\$280,774

1 At March 31, 2013, the Corporation did not have any loans classified as Doubtful or Loss.

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

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

Loans by credit quality indicators as of December 31, 2012 were as follows:

(Dollars in thousands)	Pass	Special Mention	Substandard	Substandard Nonaccrual	Total1
Real estate – residential mortgage	\$143,947	\$1,374	\$2,131	\$1,805	\$149,257
Real estate – construction 2	2,133	—	2,929	—	5,062
Commercial, financial and agricultural 3	167,693	6,678	21,247	9,434	205,052
Equity lines	31,199	1,327	767	31	33,324
Consumer	4,746	3	369	191	5,309
	\$349,718	\$9,382	\$27,443	\$11,461	\$398,004

(Dollars in thousands)	Performing	Non-Performing	Total
Consumer finance	\$277,531	\$655	\$278,186

1 At December 31, 2012, the Corporation did not have any loans classified as Doubtful or Loss.

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

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

The combined Retail Banking and Mortgage Banking segments' allowance for loan losses decreased \$2.2 million since December 31, 2012, and the provision for loan losses at these combined segments decreased \$395,000 during the first quarter of 2013, compared to the same period of 2012. The allowance for loan losses to total loans for these combined segments declined to 2.93 percent at March 31, 2013, compared to 3.46 percent at December 31, 2012. Substandard nonaccrual loans decreased to \$6.4 million at March 31, 2013 from \$11.5 million at December 31, 2012. The decline in these balances and the allowance ratio occurred primarily as a result of the sale of notes totaling \$10.9 million relating to one commercial relationship, \$5.2 million of which was a troubled debt restructuring on nonaccrual status

at December 31, 2012. This note sale resulted in a \$2.1 million charge-off. Loss reserves that had previously been recorded for this relationship were adequate to cover the associated charge-off. We believe that the current level of the allowance for loan losses at the combined Retail Banking and Mortgage Banking segments is adequate to absorb any losses on existing loans that may become uncollectible. If current economic conditions continue or worsen, a higher level of nonperforming loans may be experienced in future periods, which may then require a higher provision for loan losses.

The Consumer Finance segment's allowance for loan losses increased to \$22.4 million at March 31, 2013 from \$22.1 million at December 31, 2012, and its provision for loan losses increased \$850,000 during the first quarter of 2013, compared to the same period of 2012. The allowance for loan losses as a percentage of loans at March 31, 2013 was 7.97 percent, compared with 7.96 percent at December 31, 2012. The increase in the provision for loan losses during the first quarter of 2013 was primarily attributable to higher net charge-offs, which resulted from current economic conditions and lower resale prices of repossessed automobiles. We believe that the current level of the allowance for loan losses at the Consumer Finance segment is adequate to absorb any losses on existing loans that may become uncollectible. However, if unemployment levels remain elevated or increase in the future, or if consumer demand for automobiles falls and results in declining values of automobiles securing outstanding loans, a higher provision for loan losses may become necessary.

### Nonperforming Assets

Table 8 summarizes nonperforming assets at March 31, 2013 and December 31, 2012.

TABLE 8: Nonperforming Assets

#### Retail Banking and Mortgage Banking Segments

(Dollars in thousands)	March 31, 2013	December 31, 2012
Nonaccrual loans* - Retail Banking	\$6,354	\$11,461
Nonaccrual loans - Mortgage Banking	—	—
OREO** - Retail Banking	5,297	6,236
OREO** - Mortgage Banking	—	—
Total nonperforming assets	\$11,651	\$17,697
Accruing loans past due for 90 days or more	\$362	\$—
Troubled debt restructurings	\$6,941	\$16,492
Total loans	\$394,242	\$398,004
Allowance for loan losses	\$11,537	\$13,774
Nonperforming assets to total loans and OREO*	2.92	% 4.38
Allowance for loan losses to total loans	2.93	3.46
Allowance for loan losses to nonaccrual loans	181.57	120.18

\*Nonaccrual loans include nonaccrual TDRs of \$4.66 million at March 31, 2013 and \$9.80 million at December 31, 2012.

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

#### Consumer Finance Segment

(Dollars in thousands)	March 31, 2013	December 31, 2012
Nonaccrual loans	\$675	\$655
Accruing loans past due for 90 days or more	\$—	\$—
Total loans	\$280,774	\$278,186
Allowance for loan losses	\$22,384	\$22,133
Nonaccrual consumer finance loans to total consumer finance loans	0.24	% 0.24
Allowance for loan losses to total consumer finance loans	7.97	7.96

Nonperforming assets of the combined Retail Banking and Mortgage Banking segments totaled \$11.7 million at March 31, 2013, compared to \$17.7 million at December 31, 2012. Nonperforming assets at March 31, 2013 included \$6.4 million of nonaccrual loans at the Retail Banking segment, compared to \$11.5 million at December 31, 2012, and \$5.3 million of foreclosed, or OREO, properties, compared to \$6.2 million at December 31, 2012. The decrease in nonaccrual loans since December 31, 2012 was attributable to the sale of notes relating to one commercial relationship, \$5.2 million of which was on nonaccrual status at December 31, 2012. This note sale resulted in a \$2.1 million charge-off which reduced the combined Retail Banking and Mortgage Banking segments' ratio of the allowance for loan losses to total loans to 2.93 percent at March 31, 2013 from 3.46 percent at December 31, 2012. Despite the decline in this ratio, the ratio of the allowance for loan losses to nonaccrual loans increased to 181.57 percent at March 31, 2013 from 120.18 percent at December 31, 2012. We believe we have provided adequate loan loss reserves based on current appraisals or evaluations of the collateral. In some cases, appraisals have been adjusted to reflect current trends including sales prices, expenses, absorption periods and other current relevant factors. OREO properties at March 31, 2013 primarily consisted of residential and non-residential properties associated with commercial relationships. These properties have been written down to their estimated fair values less cost to sell. The decline in OREO properties since December 31, 2012 resulted from sales during the first quarter of 2013 as the Corporation continues to focus efforts on disposing of OREO property, offset in part by transfers from loans to OREO.

Nonaccrual loans at the Consumer Finance segment increased slightly to \$675,000 at March 31, 2013 from \$655,000 at December 31, 2012. As noted above, the allowance for loan losses at the Consumer Finance segment increased from \$22.1 million at December 31, 2012 to \$22.4 million at March 31, 2013, and the ratio of the allowance for loan losses to total consumer finance loans was 7.97 percent as of March 31, 2013, compared with 7.96 percent at December 31, 2012. 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.

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 March 31, 2013, were as follows:

(Dollars in thousands)	Recorded Investment in Loans	Unpaid Principal Balance	Related Allowance	Average Balance-Impaired Loans	Interest Income Recognized
Real estate – residential mortgage	\$1,844	\$2,066	\$401	\$ 2,022	\$28
Commercial, financial and agricultural:					
Commercial real estate lending	3,967	4,259	582	4,074	68
Commercial business lending	807	811	92	810	2
Consumer	323	323	48	323	3
Total	\$6,941	\$7,459	\$1,123	\$ 7,229	\$101

Impaired loans, which consisted solely of TDRs, and the related allowance at December 31, 2012, were as follows:

(Dollars in thousands)	Recorded Investment in Loans	Unpaid Principal Balance	Related Allowance	Average Balance-Impaired Loans	Interest Income Recognized
Real estate – residential mortgage	\$2,230	\$2,283	\$433	\$2,266	\$124
Commercial, financial and agricultural:					
Commercial real estate lending	7,892	8,190	1,775	8,260	254
Land acquisition and development lending	5,234	5,234	1,432	5,443	236
Builder line lending	—	—	—	1,407	—
Commercial business lending	812	817	112	827	13
Consumer	324	324	49	324	16
Total	\$16,492	\$16,848	\$3,801	\$18,527	\$643

Impaired loans at March 31, 2013 and December 31, 2012, which consisted solely of TDRs, were \$6.9 million and \$16.5 million, respectively. As previously described, the decline in impaired loans during the first quarter of 2013



resulted from the sale of notes related to one commercial relationship, \$9.1 million (which is net of a \$1.7 million participation sold) of which was a TDR at December 31, 2012. The Corporation has no obligation to fund additional advances on its impaired loans. As the Retail Banking segment's loan portfolio remains under credit quality pressure, the Corporation may use loan modifications as a responsible approach to managing asset quality when working with borrowers who are experiencing financial difficulty, which may result in additional TDRs.

TDRs at March 31, 2013 and December 31, 2012 were as follows:

TABLE 10: Troubled Debt Restructurings

(Dollars in thousands)	March 31, 2013	December 31, 2012
Accruing TDRs	\$2,279	\$6,692
Nonaccrual TDRs <sup>1</sup>	4,662	9,800
Total TDRs <sup>2</sup>	\$6,941	\$16,492

<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 March 31, 2013 the Corporation had total assets of \$993.4 million compared to \$977.0 million at December 31, 2012. The increase was principally a result of an increase in interest-bearing deposits in other banks due to excess liquidity provided by deposit growth and reduced loan funding needs of the Retail Banking and Mortgage Banking segments. The decision to deploy excess liquidity in interest-bearing deposits in other banks was influenced by the lack of attractively-priced investment securities available for purchase during the first quarter of 2013.

### Loan Portfolio

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

TABLE 11: Summary of Loans Held for Investment

(Dollars in thousands)	March 31, 2013		December 31, 2012	
	Amount	Percent	Amount	Percent
Real estate – residential mortgage	\$151,908	22	\$149,257	22
Real estate – construction <sup>1</sup>	4,173	1	5,062	1
Commercial, financial and agricultural <sup>2</sup>	200,280	30	205,052	30
Equity lines	32,852	5	33,324	5
Consumer	5,129	1	5,309	1
Consumer finance	280,774	41	278,186	41
Total loans	675,116	100	676,190	100
Less allowance for loan losses	(33,921 )		(35,907 )	
Total loans, net	\$641,195		\$640,283	

- 
- 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.

The decline in loans held for investment since December 31, 2012 was primarily attributable to a \$10.9 million sale of notes relating to one commercial lending relationship, which was offset in part by a new \$6.2 million loan to one commercial borrower and growth in the consumer finance category as a result of an increase in demand for automobiles and increased market penetration.

#### Investment Securities

The investment portfolio plays a primary role in the management of the Corporation's interest rate sensitivity. In addition, the portfolio serves as a source of liquidity and is used as needed to meet collateral requirements. The investment portfolio consists of securities available for sale, which may be sold in response to changes in market interest rates, changes in prepayment risk, changes in loan demand, general liquidity needs and other similar factors. These securities are carried at estimated fair value. At March 31, 2013 and December 31, 2012, 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

(Dollars in thousands)	March 31, 2013		December 31, 2012	
	Amount	Percent	Amount	Percent
U.S. government agencies and corporations	\$ 25,922	17	\$ 24,649	16
Mortgage-backed securities	1,955	1	2,189	2
Obligations of states and political subdivisions	122,456	82	125,875	82
Total debt securities	150,333	100	152,713	100
Preferred stock	188	*	104	*
Total available for sale securities at fair value	\$ 150,521	100	\$ 152,817	100

\* Less than one percent.

For more information about the Corporation's securities available for sale, including a description of securities in an unrealized loss position at March 31, 2013 and December 31, 2012, see Note 2 to the consolidated financial statements filed with this Report.

#### Deposits

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

Deposits totaled \$696.5 million at March 31, 2013, compared to \$686.2 million at December 31, 2012. The increase occurred primarily in noninterest-bearing demand deposits, which increased \$9.8 million, or 9.3 percent, from December 31, 2012 to March 31, 2013. Savings and interest-bearing demand deposits increased \$2.7 million since December 31, 2012, while time deposits declined \$2.2 million since December 31, 2012. The Corporation had \$3.3 million in brokered money market deposits outstanding at March 31, 2013, compared to \$2.8 million at December 31, 2012. 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 \$167.2 million at March 31, 2013 from \$162.7 million at December 31, 2012 as a result of a \$4.5 million increase in retail overnight repurchase agreements with commercial depositors.

### Off-Balance Sheet Arrangements

As of March 31, 2013, there have been no material changes to the off-balance sheet arrangements disclosed in “Management’s Discussion and Analysis” in the Corporation’s Annual Report on Form 10-K for the year ended December 31, 2012.

### Contractual Obligations

As of March 31, 2013, there have been no material changes outside the ordinary course of business to the contractual obligations disclosed in “Management’s Discussion and Analysis” in the Corporation’s Annual Report on Form 10-K for the year ended December 31, 2012.

### Liquidity

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

Liquid assets, which include cash and due from banks, interest-bearing deposits at other banks, federal funds sold and nonpledged securities available for sale, at March 31, 2013 totaled \$102.3 million, compared to \$63.3 million at December 31, 2012. The increase in liquid assets since December 31, 2012 resulted primarily from reduced funding needs of the mortgage banking segment, coupled with deposit growth. The Corporation’s funding sources for borrowings, including the capacity, amount outstanding and amount available at March 31, 2013 are presented in Table 13:

TABLE 13: Funding Sources

(Dollars in thousands)	Capacity	March 31, 2013	
		Outstanding	Available
Federal funds purchased	\$59,000	\$—	\$59,000
Repurchase agreements	5,000	5,000	—
Borrowings from FHLB	101,332	52,500	48,832
Borrowings from Federal Reserve Bank	45,702	—	45,702
Revolving line of credit	120,000	75,487	44,513
Total	\$331,034	\$132,987	\$198,047

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.

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 are presented in the following table.

TABLE 14: Capital Ratios

(Dollars in thousands)	Actual		Minimum Capital Requirements		Minimum To Be Well Capitalized Under Prompt Corrective Action Provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
As of March 31, 2013:						
Total Capital (to Risk-Weighted Assets)						
Corporation	\$ 121,850	17.4%	\$ 56,147	8.0%	N/A	N/A
Bank	119,479	17.1	55,919	8.0	\$ 69,899	10.0%
Tier 1 Capital (to Risk-Weighted Assets)						
Corporation	112,767	16.1	28,074	4.0	N/A	N/A
Bank	110,431	15.8	27,960	4.0	41,939	6.0
Tier 1 Capital (to Average Assets)						
Corporation	112,767	11.6	38,812	4.0	N/A	N/A
Bank	110,431	11.4	38,683	4.0	48,353	5.0
As of December 31, 2012:						
Total Capital (to Risk-Weighted Assets)						
Corporation	\$ 118,824	16.6%	\$ 57,216	8.0%	N/A	N/A
Bank	115,892	16.3	56,970	8.0	\$ 71,213	10.0%
Tier 1 Capital (to Risk-Weighted Assets)						
Corporation	109,552	15.3	28,608	4.0	N/A	N/A
Bank	106,657	15.0	28,485	4.0	42,728	6.0
Tier 1 Capital (to Average Assets)						
Corporation	109,552	11.5	38,205	4.0	N/A	N/A
Bank	106,657	11.2	38,091	4.0	47,613	5.0

The Corporation's Tier One Capital and Total Capital presented in Table 14 include \$20.0 million of trust preferred securities. The Federal Reserve Board, acting in concert with the other federal banking regulatory agencies, has published proposed rules that, if adopted, would generally implement the Basel III capital standards and impose upon bank holding companies with under \$15 billion in total consolidated assets a ten-year phase-out period for trust preferred securities from Tier 1 capital. The Federal Reserve Board, acting in concert with the other federal banking regulatory agencies, has delayed adoption and implementation of the proposed rules to consider comments received on the proposed rules. The Federal Reserve Board has not indicated when it expects to propose revised rules or adopt final rules.





## Effects of Inflation and Changing Prices

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

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

There have been no significant changes from the quantitative and qualitative disclosures about market risk made in the Corporation's Annual Report on Form 10-K for the year ended December 31, 2012.

### 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 March 31, 2013 to ensure that information required to be disclosed by the Corporation in reports that it files or submits under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in SEC rules and forms and that such information is accumulated and communicated to the Corporation's management, including the Corporation's Chief Executive Officer and Chief Financial Officer, as appropriate to allow timely decisions regarding required disclosure. Because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that the Corporation's disclosure controls and procedures will detect or uncover every situation involving the failure of persons within the Corporation or its subsidiary to disclose material information required to be set forth in the Corporation's periodic reports.

Management of the Corporation is also responsible for establishing and maintaining adequate internal control over financial reporting (as defined in Rule 13a-15(f) under the Exchange Act). There were no changes in the Corporation's internal control over financial reporting during the Corporation's first quarter ended March 31, 2013 that have materially affected, or are reasonably likely to materially affect, the Corporation's internal control over financial reporting.

## PART II - OTHER INFORMATION

### ITEM 1A. RISK FACTORS

There have been no material changes in the risk factors faced by the Corporation from those disclosed in the Corporation's Annual Report on Form 10-K for the year ended December 31, 2012.

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

There have been no purchases of the Corporation's Common Stock during 2013.

ITEM EXHIBITS

- 6.
- 3.1 Articles of Incorporation of C&F Financial Corporation (incorporated by reference to Exhibit 3.1 to Form 10-KSB filed March 29, 1996)
- 3.1.1 Amendment to Articles of Incorporation of C&F Financial Corporation establishing Series A Preferred Stock, effective January 8, 2009 (incorporated by reference to Exhibit 3.1.1 to Form 8-K filed January 14, 2009)
- 3.2 Amended and Restated Bylaws of C&F Financial Corporation, as adopted October 16, 2007 (incorporated by reference to Exhibit 3.2 to Form 8-K filed October 22, 2007)
- 4.1 Certificate of Designations for 20,000 shares of Fixed Rate Cumulative Perpetual Preferred Stock, Series A (incorporated by reference to Exhibit 3.1.1 to Form 8-K filed January 14, 2009)
- 4.2 Warrant to Purchase up to 167,504 shares of Common Stock, dated January 9, 2009 (incorporated by reference to Exhibit 4.2 to Form 8-K filed January 14, 2009)
- 10.12 Employment Agreement (Amended and Restated) between C&F Mortgage Corporation and Bryan McKernon, dated January 1, 2013 (incorporated by reference to Exhibit 10.12 to Form 10-K filed March 5, 2013)
- 10.29 C&F Financial Corporation 2013 Stock and Incentive Compensation Plan (incorporated by reference to Appendix A to the Corporation's Proxy Statement filed March 15, 2013)
- 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.SCHXBRL Taxonomy Extension Schema Document
- 101.CALXBRL Taxonomy Extension Calculation Linkbase Document
- 101.DEF XBRL Taxonomy Extension Definition Linkbase Document
- 101.LABXBRL Taxonomy Extension Label Linkbase Document
- 101.PRE XBRL Taxonomy Presentation Linkbase Document

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 May 3, 2013

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

Date May 3, 2013

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