

C & F FINANCIAL CORP
Form 10-Q
August 08, 2018
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended June 30, 2018

or

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

For the transition period from _____ to _____

Commission File Number 000-23423

C&F FINANCIAL CORPORATION

(Exact name of registrant as specified in its charter)

Virginia 54-1680165
(State or other jurisdiction of incorporation or organization) (I.R.S. Employer Identification No.)

802 Main Street West Point, VA 23181
(Address of principal executive offices) (Zip Code)

(804) 843-2360

(Registrant's telephone number, including area code)

N/A

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

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required

to submit and post such files). Yes No

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

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

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

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

At August 7, 2018, the latest practicable date for determination, 3,503,279 shares of common stock, \$1.00 par value, of the registrant were outstanding.

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Part I – FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

CONSOLIDATED BALANCE SHEETS

(Dollars in thousands, except for per share amounts)

	June 30, 2018 (unaudited)	December 31, 2017 *
Assets		
Cash and due from banks	\$ 11,458	\$ 14,070
Interest-bearing deposits in other banks	124,285	105,353
Total cash and cash equivalents	135,743	119,423
Securities—available for sale at fair value, amortized cost of \$224,250 and \$218,168, respectively	221,869	218,976
Loans held for sale, at fair value	55,054	55,384
Loans, net of allowance for loan losses of \$35,393 and \$35,726, respectively	996,412	992,062
Restricted stock, at cost	3,353	3,298
Corporate premises and equipment, net	37,151	36,969
Other real estate owned, net of valuation allowance of \$57 and \$57, respectively	168	168
Accrued interest receivable	7,252	7,589
Goodwill	14,425	14,425
Core deposit and other amortizable intangible assets, net	1,339	1,594
Bank-owned life insurance	15,776	15,589
Net deferred tax asset	12,691	12,093
Other assets	34,410	31,486
Total assets	\$ 1,535,643	\$ 1,509,056
Liabilities		
Deposits		
Noninterest-bearing demand deposits	\$ 279,236	\$ 247,669
Savings and interest-bearing demand deposits	563,129	575,807
Time deposits	351,066	347,953
Total deposits	1,193,431	1,171,429
Short-term borrowings	18,829	20,621
Long-term borrowings	122,029	122,029
Trust preferred capital notes	25,228	25,210
Accrued interest payable	882	838

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Other liabilities	28,791	27,227
Total liabilities	1,389,190	1,367,354

Commitments and contingent liabilities (Note 9)

Shareholders' Equity

Common stock (\$1.00 par value, 8,000,000 shares authorized, 3,502,746 and 3,495,845 shares issued and outstanding, respectively, includes 132,805 and 137,880 of unvested shares, respectively)	3,370	3,358
Additional paid-in capital	13,268	12,800
Retained earnings	134,012	127,431
Accumulated other comprehensive loss, net	(4,197)	(1,887)
Total shareholders' equity	146,453	141,702
Total liabilities and shareholders' equity	\$ 1,535,643	\$ 1,509,056

* Derived from audited consolidated financial statements.

See notes to consolidated financial statements.

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CONSOLIDATED STATEMENTS OF INCOME

(Unaudited)

(Dollars in thousands, except for per share amounts)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2018	2017	2018	2017
Interest income				
Interest and fees on loans	\$ 20,626	\$ 20,697	\$ 41,443	\$ 41,065
Interest on interest-bearing deposits and federal funds sold	553	278	1,017	487
Interest and dividends on securities				
U.S. government agencies and corporations	88	86	175	164
Mortgage-backed securities	504	370	988	708
Tax-exempt obligations of states and political subdivisions	696	817	1,411	1,680
Taxable obligations of states and political subdivisions	74	60	145	112
Corporate bonds and other	110	115	216	228
Total interest income	22,651	22,423	45,395	44,444
Interest expense				
Savings and interest-bearing deposits	348	281	712	568
Time deposits	981	879	1,937	1,727
Borrowings	1,048	906	2,021	1,758
Trust preferred capital notes	287	279	570	562
Total interest expense	2,664	2,345	5,240	4,615
Net interest income	19,987	20,078	40,155	39,829
Provision for loan losses	2,000	3,100	5,300	7,500
Net interest income after provision for loan losses	17,987	16,978	34,855	32,329
Noninterest income				
Gains on sales of loans	2,408	2,619	4,647	4,562
Service charges on deposit accounts	1,041	1,109	2,090	2,178
Other service charges and fees	1,544	1,429	2,604	2,624
Net (losses) gains on calls of available for sale securities	(1)	7	4	8
Wealth management services income, net	459	428	884	750
Interchange income	981	858	1,887	1,709
Other	809	962	1,571	1,850
Total noninterest income	7,241	7,412	13,687	13,681
Noninterest expenses				
Salaries and employee benefits	11,073	11,184	21,806	21,976
Occupancy	2,024	1,877	4,055	3,848

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Other	5,664	5,342	11,439	10,547
Total noninterest expenses	18,761	18,403	37,300	36,371
Income before income taxes	6,467	5,987	11,242	9,639
Income tax expense	1,397	1,848	2,280	2,769
Net income	\$ 5,070	\$ 4,139	\$ 8,962	\$ 6,870
Net income per share - basic	\$ 1.45	\$ 1.19	\$ 2.56	\$ 1.97
Net income per share - assuming dilution	\$ 1.45	\$ 1.19	\$ 2.56	\$ 1.97
Weighted average number of shares outstanding				
- basic	3,503,114	3,486,997	3,502,139	3,485,002
Weighted average number of shares outstanding				
- assuming dilution	3,503,114	3,486,997	3,502,139	3,485,160

See notes to consolidated financial statements.

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CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(Unaudited)

(Dollars in thousands)

	Three Months Ended		Six Months Ended	
	June 30,		June 30,	
	2018	2017	2018	2017
Net income	\$ 5,070	\$ 4,139	\$ 8,962	\$ 6,870
Other comprehensive (loss) income:				
Defined benefit plan:				
Reclassification of recognized net actuarial losses into net income ¹	32	36	61	74
Related income tax effects	(7)	(12)	(13)	(25)
Amortization of prior service credit into net income ¹	(15)	(15)	(30)	(30)
Related income tax effects	3	6	6	11
Defined benefit plan, net of tax	13	15	24	30
Cash flow hedges:				
Unrealized holding gains (losses) arising during the period	38	(68)	250	(3)
Related income tax effects	(9)	26	(64)	1
Cash flow hedges, net of tax	29	(42)	186	(2)
Securities available for sale:				
Unrealized holding (losses) gains arising during the period	(648)	265	(3,186)	571
Related income tax effects	136	(93)	669	(200)
Reclassification of net realized losses (gains) into net income ²	1	(7)	(4)	(8)
Related income tax effects	—	3	1	3
Securities available for sale, net of tax	(511)	168	(2,520)	366
Other comprehensive (loss) income, net of tax	(469)	141	(2,310)	394
Comprehensive income	\$ 4,601	\$ 4,280	\$ 6,652	\$ 7,264

¹ These items are included in the computation of net periodic benefit cost and are included in “Noninterest income-Other” on the Consolidated Statements of Income. See “Note 6: Employee Benefit Plans,” for additional information.

² These items are included in “Net (losses) gains on calls of available for sale securities” on the Consolidated Statements of Income.

See notes to consolidated financial statements.

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CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY

(Unaudited)

(Dollars in thousands, except for per share amounts)

	Common Stock	Additional Paid - In Capital	Retained Earnings	Accumulated Other Comprehensive Loss	Total Shareholders' Equity
Balance December 31, 2017	\$ 3,358	\$ 12,800	\$ 127,431	\$ (1,887)	\$ 141,702
Comprehensive income:					
Net income	—	—	8,962	—	8,962
Other comprehensive loss	—	—	—	(2,310)	(2,310)
Share-based compensation	—	640	—	—	640
Restricted stock vested	15	(15)	—	—	—
Common stock issued	1	71	—	—	72
Common stock purchased	(4)	(228)	—	—	(232)
Cash dividends declared – common stock (\$0.68 per share)	—	—	(2,381)	—	(2,381)
Balance June 30, 2018	\$ 3,370	\$ 13,268	\$ 134,012	\$ (4,197)	\$ 146,453

	Common Stock	Additional Paid - In Capital	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total Shareholders' Equity
Balance December 31, 2016	\$ 3,331	\$ 11,705	\$ 125,162	\$ (984)	\$ 139,214
Comprehensive income:					
Net income	—	—	6,870	—	6,870
Other comprehensive income	—	—	—	394	394
Stock options exercised	2	81	—	—	83
Share-based compensation	—	754	—	—	754
Restricted stock vested	17	(17)	—	—	—
Common stock issued	1	74	—	—	75
Common stock purchased	(4)	(181)	—	—	(185)
	—	—	(2,300)	—	(2,300)

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Cash dividends declared – common stock
(\$0.66 per share)

Balance June 30, 2017	\$ 3,347	\$ 12,416	\$ 129,732	\$ (590)	\$ 144,905
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See notes to consolidated financial statements.

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CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited)

(Dollars in thousands)

	Six Months Ended June 30,	
	2018	2017
Operating activities:		
Net income	\$ 8,962	\$ 6,870
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation	1,533	1,352
Provision for loan losses	5,300	7,500
Provision for indemnifications	52	88
Share-based compensation	640	754
Net accretion of certain acquisition-related discounts	(1,366)	(986)
Net amortization of premiums and discounts on securities	895	815
Amortization of intangible assets	253	286
Net realized gains on calls of securities available for sale	(4)	(8)
Net realized losses on sales of other real estate owned	—	4
Net realized gains on sale of corporate premises and equipment	(37)	(2)
Income from bank-owned life insurance	(164)	(168)
Origination of loans held for sale	(347,642)	(349,908)
Proceeds from sales of loans held for sale	352,619	359,171
Gains on sales of loans held for sale	(4,647)	(4,562)
Net periodic pension expense	224	312
Pension contribution	(3,000)	(1,500)
Change in other assets and liabilities:		
Accrued interest receivable	337	376
Other assets	304	(463)
Accrued interest payable	44	22
Other liabilities	1,232	(3,389)
Net cash provided by operating activities	15,535	16,564
Investing activities:		
Proceeds from maturities and calls of securities available for sale and payments on mortgage-backed securities	22,402	21,488
Purchases of securities available for sale	(29,375)	(24,742)
Net purchases of restricted stock	(55)	(40)
Purchases of loans held for investment by non-bank affiliates	(64,792)	(54,113)
Repayments on loans held for investment by non-bank affiliates	55,365	57,113
Net decrease (increase) in retail banking loans held for investment	1,161	(6,614)
Proceeds from sales of other real estate owned	—	115
Purchases of corporate premises and equipment, net	(1,678)	(1,090)
Net cash used in investing activities	(16,972)	(7,883)

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Financing activities:

Net increase in demand, interest-bearing demand and savings deposits	18,889	4,071
Net increase in time deposits	3,113	4,207
Net (decrease) increase in borrowings	(1,792)	879
Issuance of common stock	72	75
Proceeds from exercise of stock options	—	83
Cash dividends paid	(2,381)	(2,300)
Other financing activities	(144)	—
Net cash provided by financing activities	17,757	7,015
Net increase in cash and cash equivalents	16,320	15,696
Cash and cash equivalents at beginning of period	119,423	103,201
Cash and cash equivalents at end of period	\$ 135,743	\$ 118,897
Supplemental disclosure		
Interest paid	\$ 5,178	\$ 4,575
Income taxes paid	762	2,890
Supplemental disclosure of noncash investing and financing activities		
Unrealized (losses) gains on securities available for sale	\$ (3,190)	\$ 563
Transfers from loans to other real estate owned	—	208
Shares withheld at vesting for employee taxes	232	185
Unrealized gains (losses) on cash flow hedging instruments	250	(3)

See notes to consolidated financial statements.

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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, 2017.

The unaudited consolidated financial statements include the accounts of C&F Financial Corporation (the Corporation) and its wholly-owned subsidiary, Citizens and Farmers Bank (the Bank or C&F Bank). All significant intercompany accounts and transactions have been eliminated in consolidation. In addition, the Corporation owns C&F Financial Statutory Trust I, C&F Financial Statutory Trust II and Central Virginia Bankshares Statutory Trust I, all of which are unconsolidated subsidiaries. The subordinated debt owed to these trusts is reported as liabilities of the Corporation. The accounting and reporting policies of C&F Financial Corporation and Subsidiary conform to U.S. GAAP and to predominant practices within the banking industry.

Nature of Operations: The Corporation is a bank holding company incorporated under the laws of the Commonwealth of Virginia. The Corporation owns all of the stock of its subsidiary, C&F Bank, which is an independent commercial bank chartered under the laws of the Commonwealth of Virginia.

C&F Bank has five wholly-owned subsidiaries: C&F Mortgage Corporation and Subsidiary (C&F Mortgage), C&F Finance Company (C&F Finance), C&F Wealth Management Corporation (C&F Wealth Management), C&F Insurance Services, Inc. and CVB Title Services, Inc., all incorporated under the laws of the Commonwealth of Virginia. C&F Mortgage, organized in September 1995, was formed to originate and sell residential mortgages and through its subsidiary, Certified Appraisals LLC, provides ancillary mortgage loan production services for residential appraisals. C&F Finance, acquired on September 1, 2002, is a finance company purchasing automobile, boat and recreational vehicle (RV) loans through indirect lending programs. C&F Wealth Management, organized in April 1995, is a full-service brokerage firm offering a comprehensive range of wealth management services and insurance products through an alliance with an independent broker/dealer. C&F Insurance Services, Inc. was organized in July 1999 for the primary purpose of owning an equity interest in an independent insurance agency that operates in Virginia and North Carolina. CVB Title Services, Inc. was organized for the primary purpose of owning an equity

interest in an independent title insurance company. 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 (OREO), the projected benefit obligation under the defined benefit pension plan, the valuation of deferred taxes and goodwill impairment. In the opinion of management, all adjustments, consisting only of normal recurring adjustments, which are necessary for a fair presentation of the results of operations in these financial statements, have been made.

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

Derivative Financial Instruments: The Corporation recognizes derivative financial instruments at fair value as either an other asset or other liability in the Consolidated Balance Sheets. The Corporation's derivative financial instruments include (1) interest rate lock commitments (IRLCs) on mortgage loans that will be sold in the secondary market on a best efforts

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basis and the related forward commitments to sell mortgage loans, (2) interest rate swaps with certain qualifying commercial loan customers and dealer counterparties and (3) interest rate swaps that qualify as cash flow hedges on the Corporation's trust preferred capital notes. Because the IRLCs, forward sales commitments and interest rate swaps with loan customers and dealer counterparties are not designated as hedging instruments, adjustments to reflect unrealized gains and losses resulting from changes in the fair value of these instruments are reported as noninterest income or noninterest expense, as applicable. The effective portion of the gain or loss on the Corporation's cash flow hedges is reported as a component of other comprehensive income, net of deferred income taxes, and reclassified into earnings in the same period(s) during which the hedged transactions affect earnings. The Corporation's derivative financial instruments are described more fully in Note 10.

Share-Based Compensation: Shared-based compensation expense, net of forfeitures, for the second quarter of 2018 and the first six months of 2018 was \$321,000 (\$238,000 after tax) and \$640,000 (\$475,000 after tax), respectively, for restricted stock granted during 2013 through 2018. As of June 30, 2018, there was \$2.96 million of total unrecognized compensation expense related to unvested restricted stock that will be recognized over the remaining requisite service periods.

A summary of activity for restricted stock awards during the first six months of 2018 and 2017 is presented below:

	2018	
	Shares	Weighted-Average Grant Date Fair Value
Unvested, December 31, 2017	137,880	\$ 43.52
Granted	11,510	58.26
Vested	(14,625)	40.47
Forfeited	(1,960)	43.26
Unvested, June 30, 2018	132,805	45.13

	2017	
	Shares	Weighted-Average Grant Date Fair Value
Unvested, December 31, 2016	141,755	\$ 39.77
Granted	15,725	45.46

Vested	(16,760)	35.30
Forfeited	(1,590)	42.81
Unvested, June 30, 2017	139,130	40.91

Recently Adopted Accounting Pronouncements:

On January 1, 2018, the Corporation adopted Accounting Standards Update (ASU) 2014-09, “Revenue from Contracts with Customers (Topic 606),” and all amendments thereto (collectively, ASU 2014-09), which (i) creates a single framework for recognizing revenue from contracts with customers that fall within its scope and (ii) revises when it is appropriate to recognize a gain/loss from the transfer of nonfinancial assets, such as OREO. The Corporation adopted ASU 2014-09 using the modified retrospective method applied to all contracts not completed as of January 1, 2018. Results for reporting periods beginning after January 1, 2018 are presented under ASU 2014-09, while prior period amounts continue to be reported in accordance with pronouncements in effect prior to January 1, 2018. The adoption of ASU 2014-09 did not result in a change to the accounting for any of the in-scope revenue streams; therefore, no cumulative effect adjustment was recorded.

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Most revenue associated with the Corporation's financial instruments, including interest income and gains/losses on investment securities, derivatives and sales of financial instruments are outside the scope of ASU 2014-09. The Corporation's services that fall within the scope of ASU 2014-09 are presented within noninterest income and are recognized as revenue as the Corporation satisfies its obligation to the customer. A description of the Corporation's primary revenue streams accounted for under ASU 2014-09 follows:

Service Charges on Deposit Accounts. The Corporation earns fees from its deposit customers for overdraft and account maintenance services. Overdraft fees are recognized when the overdraft occurs. Account maintenance fees, which relate primarily to monthly maintenance, are earned over the course of a month, representing the period over which the Corporation satisfies the performance obligation.

Other Service Charges and Fees. The Corporation earns fees from its customers for transaction-based services. Such services include safe deposit box, ATM, stop payment and wire transfer fees at the retail banking segment and on-line payment processing and statement request fees at the consumer finance segment. In each case, these service charges and fees are recognized in income at the time or within the same period that the Corporation's performance obligation is satisfied.

Interchange Income. The Corporation earns interchange fees from debit and affinity credit cardholder transactions conducted through various payment networks. Interchange fees from cardholder transactions represent a percentage of the underlying transaction value and are recognized daily, concurrently with the transaction processing services.

Wealth Management Services Income. The Corporation earns wealth management services income by providing investment brokerage services and health and life insurance products to its customers through third-party service providers. Fees that are transaction-based (e.g., execution of trades) are recognized on a monthly basis. Other fees, or commissions, are earned over time as the contracted monthly or quarterly services are provided and are generally assessed based on either account activity or the market value of assets under management at month or quarter end.

Gains/Losses on Sales of OREO. The Corporation records a gain/loss from the sale of OREO when control of the property transfers to the buyer, which generally occurs at the time of an executed deed. When the Corporation finances the sale of OREO to the buyer, the Corporation assesses whether the buyer is committed to perform the obligations under the contract and whether collectability of the transaction price is probable. In determining the gain/loss on the sale, the Corporation adjusts the transaction price and the related gain/loss on sale if a significant financing component is present.

On January 1, 2018, the Corporation adopted ASU 2016-01, “Financial Instruments – Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities.” ASU 2016-01 makes targeted improvements to several areas of U.S. GAAP including the disclosure of the fair value of financial instruments that are not measured at fair value on a recurring basis. The new guidance, among other things, (i) eliminates the requirements to disclose the methods and significant assumptions used to estimate the fair value and the description of the changes therein, if any, during the period, (ii) requires the use of the exit price notion in calculating the fair values of financial instruments not measured at fair value on a recurring basis and (iii) eliminates the guidance that allowed the use of the entry price notion to calculate the fair value of certain financial instruments, such as loans and long-term debt. Accordingly, the Corporation disclosed the fair value of these financial instruments as of June 30, 2018 using an exit price notion rather than an entry price notion (see “Note 7: Fair Value of Assets and Liabilities”).

On January 1, 2018, the Bank adopted ASU 2017-07, “Compensation-Retirement Benefits (Topic 715): Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost.” ASU 2017-07 requires that the service cost component of the net periodic benefit cost be presented with other employee compensation costs and that the remaining components be presented in the aggregate with noninterest income or noninterest expense, as appropriate. This guidance is required to be applied on a retrospective basis. Accordingly, income of \$123,000 and \$246,000 was reclassified from “Salaries and employee benefits” to “Noninterest income – Other” on the Consolidated Statements of Income for the three and six months ended June 30, 2017, respectively, to reflect the adoption of ASU 2017-07.

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Recent Significant Accounting Pronouncements:

In February 2016, the Financial Accounting Standards Board (FASB) issued ASU 2016-02, “Leases (Topic 842).” Among other things, in the amendments in ASU 2016-02, lessees will be required to recognize the following for all leases (with the exception of short-term leases) at the commencement date: (1) a lease liability, which is a lessee’s obligation to make lease payments arising from a lease, measured on a discounted basis; and (2) a right-of-use asset, which is an asset that represents the lessee’s right to use, or control the use of, a specified asset for the lease term. Under the new guidance, lessor accounting is largely unchanged. Certain targeted improvements were made to align, where necessary, lessor accounting with the lessee accounting model and Topic 606, Revenue from Contracts with Customers. The amendments in this ASU are effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. Early application is permitted. Lessees (for capital and operating leases) and lessors (for sales-type, direct financing, and operating leases) must apply a modified retrospective transition approach for leases existing at, or entered into after, the beginning of the earliest comparative period presented in the financial statements. The modified retrospective approach would not require any transition accounting for leases that expired before the earliest comparative period presented. Lessees and lessors may not apply a full retrospective transition approach. The Corporation has completed an inventory of all buildings and equipment it leases from third parties. The Corporation has not yet determined an estimate of the effect that ASU 2016-02 will have on its financial statements.

In June 2016, the FASB issued ASU 2016-13, “Financial Instruments – Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments”, as part of its project on financial instruments. ASU 2016-13 introduces an approach based on expected losses to estimate credit losses on certain types of financial instruments. It also modifies the impairment model for available-for-sale debt securities and provides for a simplified accounting model for purchased financial assets with credit deterioration since their origination. For public business entities that are SEC filers, the new standard is effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2019. Early adoption will be permitted for all organizations for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2018. The Corporation has established a working group that is in the process of gathering historical data and evaluating appropriate portfolio segmentation and modeling methods. The Corporation has not yet determined an estimate of the effect that ASU 2016-13 will have on its financial statements.

In January 2017, the FASB issued ASU 2017-04, “Intangibles – Goodwill and Other (Topic 350): Simplifying the Test for Goodwill Impairment”, which removes the requirement to compare the implied fair value of goodwill with its carrying amount as part of step 2 of the goodwill impairment test. As a result, under ASU 2017-04, an entity should perform its annual, or interim, goodwill impairment test by comparing the fair value of a reporting unit with its carrying amount and should recognize an impairment charge for the amount by which the carrying amount exceeds the reporting unit’s fair value; however, the loss recognized should not exceed the total amount of goodwill allocated to that reporting unit. ASU 2017-04 is effective for public business entities that are SEC filers for annual and interim periods beginning after December 15, 2019. Early adoption is permitted. The Corporation does not expect the adoption of ASU 2017-04 to have a material effect on its financial statements.

In March 2017, the FASB issued ASU 2017-08, “Receivables – Nonrefundable Fees and Other Costs (Subtopic 310-20)”, which requires all entities that hold investments in callable debt securities at a premium to amortize the premium to the earliest call date. ASU 2017-08 does not require an accounting change for securities held at a discount. ASU 2017-08 is effective for public business entities for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2018. Early adoption is permitted. The Corporation does not expect the adoption of ASU 2017-08 to have a material effect on its financial statements.

In August 2017, the FASB issued ASU 2017-12, “Derivatives and Hedging (Topic 815): Targeted Improvements to Accounting for Hedging Activities.” The amendments in this ASU modify the designation and measurement guidance for hedge accounting as well as provide for increased transparency regarding the presentation of economic results on both the financial statements and related footnotes. Certain aspects of hedge effectiveness assessments will also be simplified upon implementation of this update. The amendments are effective for annual periods, including interim periods within those annual periods, beginning after December 15, 2018. Early adoption is permitted, including adoption in any interim period. The Corporation does not expect the adoption of ASU 2017-12 to have a material effect on its financial statements.

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

NOTE 2: Securities

The Corporation's debt securities, all of which are classified as available for sale, are summarized as follows:

	June 30, 2018			
(Dollars in thousands)	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
U.S. government agencies and corporations	\$ 16,261	\$ —	\$ (708)	\$ 15,553
Mortgage-backed securities	106,981	44	(2,603)	104,422
Obligations of states and political subdivisions	101,008	1,236	(350)	101,894
	\$ 224,250	\$ 1,280	\$ (3,661)	\$ 221,869

	December 31, 2017			
(Dollars in thousands)	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
U.S. government agencies and corporations	\$ 16,514	\$ —	\$ (341)	\$ 16,173
Mortgage-backed securities	97,677	142	(761)	97,058
Obligations of states and political subdivisions	103,977	2,022	(254)	105,745
	\$ 218,168	\$ 2,164	\$ (1,356)	\$ 218,976

The amortized cost and estimated fair value of securities at June 30, 2018, by the earlier of contractual maturity or expected maturity, are shown below. Expected maturities will differ from contractual maturities because borrowers may have the right to prepay obligations with or without call or prepayment penalties.

(Dollars in thousands)	June 30, 2018	
	Amortized	
	Cost	Fair Value
Due in one year or less	\$ 48,728	\$ 48,782
Due after one year through five years	155,492	153,022
Due after five years through ten years	16,700	16,654
Due after ten years	3,330	3,411
	\$ 224,250	\$ 221,869

The following table presents the gross realized gains and losses on and the proceeds from maturities, calls and paydowns of securities. There were no sales of securities during the periods presented.

(Dollars in thousands)	Three Months Ended June 30,		Six Months Ended June 30,	
	2018	2017	2018	2017
Realized gains and losses from calls of securities:				
Gross realized gains	\$ —	\$ 11	\$ 5	\$ 12
Gross realized losses	(1)	(4)	(1)	(4)
Net realized (losses) gains	\$ (1)	\$ 7	\$ 4	\$ 8
Proceeds from maturities, calls and paydowns of securities	\$ 9,668	\$ 10,122	\$ 22,402	\$ 21,488

The Corporation pledges securities primarily to secure public deposits and repurchase agreements. Securities with an aggregate amortized cost of \$105.49 million and aggregate fair value of \$104.48 million were pledged at June 30, 2018.

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Securities with an aggregate amortized cost of \$118.70 million and an aggregate fair value of \$119.26 million were pledged at December 31, 2017.

Securities in an unrealized loss position at June 30, 2018, by duration of the period of the unrealized loss, are shown below.

(Dollars in thousands)	Less Than 12 Months		12 Months or More		Total	Unrealized Loss
	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value	
U.S. government agencies and corporations	\$ 2,915	\$ 84	\$ 12,638	\$ 624	\$ 15,553	\$ 708
Mortgage-backed securities	74,171	1,773	20,722	830	94,893	2,603
Obligations of states and political subdivisions	25,744	152	10,629	198	36,373	350
Total temporarily impaired securities	\$ 102,830	\$ 2,009	\$ 43,989	\$ 1,652	\$ 146,819	\$ 3,661

There were 251 debt securities totaling \$146.82 million considered temporarily impaired at June 30, 2018. The primary cause of the temporary impairments in the Corporation's investments in debt securities was fluctuations in interest rates. Interest rates increased during the second quarter of 2018, more significantly in the short-term portion of the United States Treasury security yield curve, thereby increasing unrealized losses on the Corporation's debt securities. The Corporation's mortgage-backed securities are entirely issued by either U.S. government agencies or U.S. government-sponsored enterprises. Collectively, these entities provide a guarantee, which is either explicitly or implicitly supported by the full faith and credit of the U.S. government, that investors in such mortgage-backed securities will receive timely principal and interest payments. At June 30, 2018, 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 (S&P) or Moody's Investors Service (Moody's). Of those in a net unrealized loss position, approximately 98 percent were rated "A" or better by S&P or Moody's, as measured by market value, at June 30, 2018. For the approximately two percent not rated "A" or better, as measured by market value at June 30, 2018, the Corporation considers these to meet regulatory credit quality standards, meaning that the securities have low risk of default by the obligor, and the full and timely repayment of principal and interest is expected over the expected life of the investment. Because the Corporation intends to hold these investments in debt securities to maturity and it is more likely than not that the Corporation will not be required to sell these investments before a recovery of unrealized losses, the Corporation does not consider these investments to be other-than-temporarily impaired at June 30, 2018 and no other-than-temporary impairment loss has been recognized in net income.

Securities in an unrealized loss position at December 31, 2017, by duration of the period of the unrealized loss, are shown below.

(Dollars in thousands)	Less Than 12 Months		12 Months or More		Total	
	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss
U.S. government agencies and corporations	\$ 2,972	\$ 31	\$ 13,201	\$ 310	\$ 16,173	\$ 341
Mortgage-backed securities	57,116	341	22,545	420	79,661	761
Obligations of states and political subdivisions	18,644	117	9,363	137	28,007	254
Total temporarily impaired securities	\$ 78,732	\$ 489	\$ 45,109	\$ 867	\$ 123,841	\$ 1,356

The Corporation's investment in restricted stock totaled \$3.35 million at June 30, 2018 and consisted of Federal Home Loan Bank (FHLB) stock. Restricted stock is generally viewed as a long-term investment, which is carried at cost because there is no market for the stock other than the FHLBs. Therefore, when evaluating restricted stock for impairment, its value is based on the ultimate recoverability of the par value rather than by recognizing any temporary decline in value. The Corporation does not consider its investment in restricted stock to be other-than-temporarily impaired at June 30, 2018 and no impairment has been recognized. Total restricted stock is shown as a separate line item on the Consolidated Balance Sheets and is not a part of the available-for-sale securities portfolio.

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NOTE 3: Loans

Major classifications of loans are summarized as follows:

(Dollars in thousands)	June 30, 2018	December 31, 2017
Real estate – residential mortgage	\$ 184,101	\$ 184,863
Real estate – construction 1	67,550	44,782
Commercial, financial and agricultural 2	414,643	437,884
Equity lines	56,118	55,237
Consumer	13,572	13,018
Consumer finance	295,821	292,004
	1,031,805	1,027,788
Less allowance for loan losses	(35,393)	(35,726)
Loans, net	\$ 996,412	\$ 992,062

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 \$255,000 and \$290,000 of demand deposit overdrafts at June 30, 2018 and December 31, 2017, respectively.

The outstanding principal balance and the carrying amount of loans acquired pursuant to the Corporation's acquisition of Central Virginia Bank (CVB) on October 1, 2013 (or acquired loans) that were recorded at fair value at the acquisition date and are included in the Consolidated Balance Sheets are as follows:

(Dollars in thousands)	June 30, 2018			December 31, 2017		
	Acquired Loans - Purchased	Acquired Loans - Performing	Acquired Loans - Total	Acquired Loans - Purchased	Acquired Loans - Performing	Acquired Loans - Total
	\$ 11,541	\$ 42,534	\$ 54,075	\$ 12,856	\$ 45,083	\$ 57,939

Outstanding principal balance						
Carrying amount						
Real estate – residential mortgage	\$ 487	\$ 10,235	\$ 10,722	\$ 492	\$ 10,855	\$ 11,347
Commercial, financial and agricultural ¹	2,074	20,778	22,852	2,472	22,305	24,777
Equity lines	134	9,436	9,570	139	9,621	9,760
Consumer	—	9	9	—	12	12
Total acquired loans	\$ 2,695	\$ 40,458	\$ 43,153	\$ 3,103	\$ 42,793	\$ 45,896

¹ Includes acquired loans classified by the Corporation as commercial real estate lending, land acquisition and development lending, builder line lending and commercial business lending.

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Loans on nonaccrual status were as follows:

(Dollars in thousands)	June 30, 2018	December 31, 2017
Real estate – residential mortgage	\$ 773	\$ 830
Commercial, financial and agricultural:		
Commercial real estate lending	1,211	3,796
Commercial business lending	25	34
Equity lines	824	651
Consumer	—	—
Consumer finance	560	764
Total loans on nonaccrual status	\$ 3,393	\$ 6,075

The past due status of loans as of June 30, 2018 was as follows:

(Dollars in thousands)	30 - 59 Days Past Due	60 - 89 Days Past Due	90+ Days Past Due	Total Past Due	PCI	Current ¹	Total Loans	90+ Days Past Due and Accruing 2
Real estate – residential mortgage	\$ 643	\$ 116	\$ 103	\$ 862	\$ 487	\$ 182,752	\$ 184,101	\$ 216
Real estate – construction:								
Construction lending	—	—	—	—	—	58,900	58,900	—
Consumer lot lending	—	—	—	—	—	8,650	8,650	—
Commercial, financial and agricultural:								
Commercial real estate lending	—	130	315	445	2,074	292,482	295,001	315
Land acquisition and development lending	—	—	—	—	—	31,055	31,055	—
Builder line lending	—	—	—	—	—	31,632	31,632	—
Commercial business lending	—	25	—	25	—	56,930	56,955	—
Equity lines	311	641	—	952	134	55,032	56,118	—
Consumer	77	1	—	78	—	13,494	13,572	—
Consumer finance	9,927	1,890	560	12,377	—	283,444	295,821	—
Total	\$ 10,958	\$ 2,803	\$ 978	\$ 14,739	\$ 2,695	\$ 1,014,371	\$ 1,031,805	\$ 531

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

² Includes purchased credit impaired (PCI) loans of \$167,000.

The table above includes the following:

- nonaccrual loans that are current of \$2.02 million, 30-59 days past due of \$98,000, 60-89 days past due of \$666,000 and 90+ days past due of \$613,000.
- performing loans purchased in the acquisition of CVB that are current of \$40.17 million, 30-59 days past due of \$271,000 and 90+ days past due of \$20,000.

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The past due status of loans as of December 31, 2017 was as follows:

(Dollars in thousands)	30 - 59 Days Past Due	60 - 89 Days Past Due	90+ Days Past Due	Total Past Due	PCI	Current ¹	Total Loans	90+ Days Past Due and Accruing ²
Real estate – residential mortgage	\$ 1,905	\$ 14	\$ 245	\$ 2,164	\$ 492	\$ 182,207	\$ 184,863	\$ 90
Real estate – construction:								
Construction lending	—	—	—	—	—	41,449	41,449	—
Consumer lot lending	—	—	—	—	—	3,333	3,333	—
Commercial, financial and agricultural:								
Commercial real estate lending	241	—	3,874	4,115	2,472	297,903	304,490	78
Land acquisition and development lending	—	—	—	—	—	39,844	39,844	—
Builder line lending	685	—	—	685	—	28,911	29,596	—
Commercial business lending	—	—	2	2	—	63,952	63,954	2
Equity lines	550	—	136	686	139	54,412	55,237	136
Consumer	9	—	—	9	—	13,009	13,018	—
Consumer finance	12,273	2,061	764	15,098	—	276,906	292,004	—
Total	\$ 15,663	\$ 2,075	\$ 5,021	\$ 22,759	\$ 3,103	\$ 1,001,926	\$ 1,027,788	\$ 306

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

² Includes PCI loans of \$90,000.

The table above includes the following:

- nonaccrual loans that are current of \$890,000, 30-59 days past due of \$458,000, 60 - 89 days past due of \$14,000 and 90+ days past due of \$4.71 million.
- performing loans purchased in the acquisition of CVB that are current of \$42.53 million, 30-59 days past due of \$137,000, 60-89 days past due of \$14,000 and 90+ days past due of \$115,000.

Loan modifications that were classified as troubled debt restructurings (TDRs) were as follows:

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	Three Months Ended June 30, 2018			2017		
	Number of Loans	Pre- Modification Recorded Investment	Post- Modification Recorded Investment	Number of Loans	Pre- Modification Recorded Investment	Post- Modification Recorded Investment
(Dollars in thousands)						
Commercial real estate lending – interest rate concession	—	\$ —	\$ —	3	\$ 2,142	\$ 2,142
Total	—	\$ —	\$ —	3	\$ 2,142	\$ 2,142

	Six Months Ended June 30, 2018			2017		
	Number of Loans	Pre- Modification Recorded Investment	Post- Modification Recorded Investment	Number of Loans	Pre- Modification Recorded Investment	Post- Modification Recorded Investment
(Dollars in thousands)						
Commercial real estate lending – interest rate and term concession	—	\$ —	\$ —	3	\$ 4,646	\$ 4,646
Commercial real estate lending – interest rate concession	—	—	—	4	2,154	2,154
Total	—	\$ —	\$ —	7	\$ 6,800	\$ 6,800

A TDR payment default occurs when, within 12 months of the original TDR modification, either a full or partial charge-off occurs or a TDR becomes 90 days or more past due. There were no TDR payment defaults during the three and six months ended June 30, 2018 and 2017.

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Impaired loans, which included TDRs of \$7.93 million, and the related allowance at June 30, 2018 were as follows:

	Unpaid Principal	Recorded Investment in Loans without Specific Reserve	Recorded Investment in Loans with Specific Reserve	Related Allowance	Average Balance- Impaired Loans	Interest Income Recognized
(Dollars in thousands)	Balance					
Real estate – residential mortgage	\$ 3,669	\$ 1,259	\$ 2,308	\$ 111	\$ 3,642	\$ 85
Commercial, financial and agricultural:						
Commercial real estate lending	4,390	1,956	2,155	680	5,386	76
Commercial business lending	33	26	—	—	28	—
Equity lines	228	31	194	194	226	1
Consumer	321	322	—	—	322	7
Total	\$ 8,641	\$ 3,594	\$ 4,657	\$ 985	\$ 9,604	\$ 169

Impaired loans, which consisted solely of TDRs, and the related allowance at December 31, 2017 were as follows:

	Unpaid Principal	Recorded Investment in Loans without Specific Reserve	Recorded Investment in Loans with Specific Reserve	Related Allowance	Average Balance- Impaired Loans	Interest Income Recognized
(Dollars in thousands)	Balance					
Real estate – residential mortgage	\$ 3,745	\$ 1,603	\$ 2,033	\$ 214	\$ 3,743	\$ 184
Commercial, financial and agricultural:						
Commercial real estate lending	6,981	2,841	4,031	615	7,818	168
Commercial business lending	41	35	—	—	45	—
Equity lines	32	31	—	—	32	2
Consumer	321	322	—	—	321	13
Total	\$ 11,120	\$ 4,832	\$ 6,064	\$ 829	\$ 11,959	\$ 367

PCI loans had an unpaid principal balance of \$11.54 million and a carrying value of \$2.70 million at June 30, 2018. Determining the fair value of PCI loans required the Corporation to estimate cash flows expected to result from those loans and to discount those cash flows at appropriate rates of interest. For such loans, the excess of the cash flows expected at acquisition over the estimated fair value is recognized as interest income over the remaining lives of the loans and is called the accretable yield. The difference between contractually required payments at acquisition and the

cash flows expected to be collected at acquisition reflects the effect of estimated credit losses and is called the nonaccretable difference, and is not recorded. In accordance with U.S. GAAP, there was no carry-over of the previously established allowance for loan losses for acquired loans.

The following table presents a summary of the change in the accretable yield of the PCI loan portfolio:

(Dollars in thousands)	Six Months Ended	
	June 30,	
	2018	2017
Accretable yield, balance at beginning of period	\$ 7,304	\$ 8,637
Accretion	(1,278)	(1,318)
Reclassification of nonaccretable difference due to improvement in expected cash flows	1,072	561
Other changes, net	(422)	(239)
Accretable yield, balance at end of period	\$ 6,676	\$ 7,641

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NOTE 4: Allowance for Loan Losses

The following table presents the changes in the allowance for loan losses by major classification during the six months ended June 30, 2018:

(Dollars in thousands)	Real Estate Residential Mortgage	Real Estate Construction	Commercial, Financial & Agricultural	Equity Lines	Consumer	Consumer Finance	Total
Allowance for loan losses:							
Balance at							
December 31, 2017	\$ 2,371	\$ 605	\$ 7,478	\$ 688	\$ 231	\$ 24,353	\$ 35,726
Provision charged (credited) to operations	(108)	340	(520)	229	59	5,300	5,300
Loans charged off	—	—	(2)	—	(133)	(7,948)	(8,083)
Recoveries of loans previously charged off	35	—	22	—	95	2,298	2,450
Balance at June 30, 2018	\$ 2,298	\$ 945	\$ 6,978	\$ 917	\$ 252	\$ 24,003	\$ 35,393

The following table presents the changes in the allowance for loan losses by major classification during the six months ended June 30, 2017:

(Dollars in thousands)	Real Estate Residential Mortgage	Real Estate Construction	Commercial, Financial & Agricultural	Equity Lines	Consumer	Consumer Finance	Total
Allowance for loan losses:							
Balance at							
December 31, 2016	\$ 2,559	\$ 816	\$ 7,393	\$ 685	\$ 261	\$ 25,352	\$ 37,066
Provision charged (credited) to operations	(44)	(365)	596	22	(9)	7,300	7,500
Loans charged off	(6)	—	(154)	—	(130)	(10,105)	(10,395)
Recoveries of loans previously charged off	38	—	11	—	87	2,189	2,325
Balance at June 30, 2017	\$ 2,547	\$ 451	\$ 7,846	\$ 707	\$ 209	\$ 24,736	\$ 36,496

The following table presents, as of June 30, 2018, the total allowance for loan losses, the allowance by impairment methodology, total loans and loans by impairment methodology.

(Dollars in thousands)	Real Estate Residential Mortgage	Real Estate Construction	Commercial, Financial & Agricultural	Equity Lines	Consumer	Consumer Finance	Total
Allowance for loan losses:							
Ending balance at June 30, 2018	\$ 2,298	\$ 945	\$ 6,978	\$ 917	\$ 252	\$ 24,003	\$ 35,393
Ending balance: individually evaluated for impairment	\$ 111	\$ —	\$ 680	\$ 194	\$ —	\$ —	\$ 985
Ending balance: collectively evaluated for impairment	\$ 2,187	\$ 945	\$ 6,298	\$ 723	\$ 252	\$ 24,003	\$ 34,408
Ending balance: acquired loans - PCI	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —
Loans:							
Ending balance at June 30, 2018	\$ 184,101	\$ 67,550	\$ 414,643	\$ 56,118	\$ 13,572	\$ 295,821	\$ 1,031,805
Ending balance: individually evaluated for impairment	\$ 3,567	\$ —	\$ 4,137	\$ 225	\$ 322	\$ —	\$ 8,251
Ending balance: collectively evaluated for impairment	\$ 180,047	\$ 67,550	\$ 408,432	\$ 55,759	\$ 13,250	\$ 295,821	\$ 1,020,859
Ending balance: acquired loans - PCI	\$ 487	\$ —	\$ 2,074	\$ 134	\$ —	\$ —	\$ 2,695

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The following table presents, as of December 31, 2017, the total allowance for loan losses, the allowance by impairment methodology, total loans and loans by impairment methodology.

(Dollars in thousands)	Real Estate Residential Mortgage	Real Estate Construction	Commercial, Financial & Agricultural	Equity Lines	Consumer	Consumer Finance	Total
Allowance for loan losses:							
Ending balance at December 31, 2017	\$ 2,371	\$ 605	\$ 7,478	\$ 688	\$ 231	\$ 24,353	\$ 35,726
Ending balance: individually evaluated for impairment	\$ 214	\$ —	\$ 615	\$ —	\$ —	\$ —	\$ 829
Ending balance: collectively evaluated for impairment	\$ 2,157	\$ 605	\$ 6,863	\$ 688	\$ 231	\$ 24,353	\$ 34,897
Ending balance: acquired loans - PCI	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —
Loans:							
Ending balance at December 31, 2017	\$ 184,863	\$ 44,782	\$ 437,884	\$ 55,237	\$ 13,018	\$ 292,004	\$ 1,027,788
Ending balance: individually evaluated for impairment	\$ 3,636	\$ —	\$ 6,907	\$ 31	\$ 322	\$ —	\$ 10,896
Ending balance: collectively evaluated for impairment	\$ 180,735	\$ 44,782	\$ 428,505	\$ 55,067	\$ 12,696	\$ 292,004	\$ 1,013,789
Ending balance: acquired loans - PCI	\$ 492	\$ —	\$ 2,472	\$ 139	\$ —	\$ —	\$ 3,103

Loans by credit quality indicators as of June 30, 2018 were as follows:

(Dollars in thousands)	Pass	Special Mention	Substandard	Substandard Nonaccrual	Total
Real estate – residential mortgage	\$ 180,214	\$ 1,223	\$ 1,891	\$ 773	\$ 184,101
Real estate – construction:					
Construction lending	58,900	—	—	—	58,900
Consumer lot lending	7,896	754	—	—	8,650
Commercial, financial and agricultural:					
Commercial real estate lending	287,547	2,338	3,905	1,211	295,001

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Land acquisition and development lending	19,893	—	11,162	—	31,055
Builder line lending	31,632	—	—	—	31,632
Commercial business lending	56,542	16	372	25	56,955
Equity lines	54,759	314	221	824	56,118
Consumer	13,248	3	321	—	13,572
	\$ 710,631	\$ 4,648	\$ 17,872	\$ 2,833	\$ 735,984

¹ At June 30, 2018, the Corporation did not have any loans classified as Doubtful or Loss.

Included in the table above are loans purchased in connection with the acquisition of CVB of \$40.35 million pass rated, \$1.14 million special mention, \$1.52 million substandard and \$140,000 substandard nonaccrual.

(Dollars in thousands)	Performing	Non-Performing	Total
Consumer finance	\$ 295,261	\$ 560	\$ 295,821

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Loans by credit quality indicators as of December 31, 2017 were as follows:

(Dollars in thousands)	Pass	Special Mention	Substandard	Substandard Nonaccrual	Total ¹
Real estate – residential mortgage	\$ 179,963	\$ 1,235	\$ 2,835	\$ 830	\$ 184,863
Real estate – construction:					
Construction lending	41,449	—	—	—	41,449
Consumer lot lending	3,333	—	—	—	3,333
Commercial, financial and agricultural:					
Commercial real estate lending	293,292	2,874	4,528	3,796	304,490
Land acquisition and development lending	24,253	—	15,591	—	39,844
Builder line lending	29,596	—	—	—	29,596
Commercial business lending	63,749	34	137	34	63,954
Equity lines	53,870	465	251	651	55,237
Consumer	12,693	3	322	—	13,018
	\$ 702,198	\$ 4,611	\$ 23,664	\$ 5,311	\$ 735,784

¹ At December 31, 2017, the Corporation did not have any loans classified as Doubtful or Loss.

Included in the table above are loans purchased in connection with the acquisition of CVB of \$42.67 million pass rated, \$1.09 million special mention, \$1.98 million substandard and \$161,000 substandard nonaccrual.

(Dollars in thousands)	Performing	Non- Performing	Total
Consumer finance	\$ 291,240	\$ 764	\$ 292,004

NOTE 5: Shareholders' Equity, Other Comprehensive Income and Earnings Per Share

Shareholders' Equity

During the first six months of 2018 and 2017, no shares of the Corporation's common stock were purchased under the share repurchase program authorized by the Corporation's Board of Directors. The Corporation withheld 3,947 and

4,049 shares of its common stock from employees to satisfy tax withholding obligations arising upon the vesting of restricted shares during the first six months of 2018 and 2017, respectively.

Accumulated Other Comprehensive Loss

The following table presents the cumulative balances of the components of accumulated other comprehensive loss, net of deferred taxes of \$1.09 million and \$491,000 as of June 30, 2018 and December 31, 2017, respectively.

(Dollars in thousands)	June 30, 2018	December 31, 2017
Net unrealized (losses) gains on securities	\$ (1,881)	\$ 638
Net unrecognized gains on cash flow hedges	309	124
Net unrecognized losses on defined benefit plan	(2,625)	(2,649)
Total accumulated other comprehensive loss	\$ (4,197)	\$ (1,887)

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Earnings Per Share (EPS)

The components of the Corporation's EPS calculations are as follows:

(Dollars in thousands)	Three Months Ended June 30,	
	2018	2017
Net income	\$ 5,070	\$ 4,139
Weighted average number of shares used in earnings per share—basic	3,503,114	3,486,997
Effect of dilutive securities	—	—
Weighted average number of shares used in earnings per share—assuming dilution	3,503,114	3,486,997

(Dollars in thousands)	Six Months Ended June 30,	
	2018	2017
Net income	\$ 8,962	\$ 6,870
Weighted average number of shares used in earnings per share—basic	3,502,139	3,485,002
Effect of dilutive securities—stock option awards	—	158
Weighted average number of shares used in earnings per share—assuming dilution	3,502,139	3,485,160

The Corporation has applied the two-class method of computing basic and diluted EPS for each period presented because the Corporation's unvested restricted shares outstanding contain rights to nonforfeitable dividends. Accordingly, the weighted average number of shares used in the calculation of basic and diluted EPS includes both vested and unvested shares outstanding.

Potential shares that may be issued by the Corporation for its stock option awards are determined using the treasury stock method. Accordingly, anti-dilutive shares are not included in computing diluted earnings per share. There were no anti-dilutive stock options outstanding for the three and six months ended June 30, 2017. There were no stock options outstanding during the first half of 2018.

NOTE 6: Employee Benefit Plans

The components of net periodic benefit cost for the Bank's non-contributory cash balance pension plan are as follows:

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(Dollars in thousands)	Three Months Ended June 30,		Six Months Ended June 30,	
	2018	2017	2018	2017
Components of net periodic benefit cost:				
Service cost, included in salaries and employee benefits	\$ 308	\$ 283	\$ 614	\$ 566
Other components of net periodic benefit cost:				
Interest cost	113	138	246	276
Expected return on plan assets	(348)	(287)	(666)	(574)
Amortization of prior service credit	(14)	(15)	(29)	(30)
Recognized net actuarial losses	30	37	59	74
Other components of net periodic benefit cost, included in other noninterest income	(219)	(127)	(390)	(254)
Net periodic benefit cost	\$ 89	\$ 156	\$ 224	\$ 312

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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 elected to use fair value accounting for its entire portfolio of loans held for sale (LHFS).

Assets and Liabilities Measured at Fair Value on a Recurring Basis

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

Securities available for sale. The Corporation primarily values its investment portfolio using Level 2 fair value measurements, but may also use Level 1 or Level 3 measurements if required by the composition of the portfolio. At June 30, 2018 and December 31, 2017, the Corporation's entire investment securities portfolio was comprised of

securities available for sale, which were valued using Level 2 fair value measurements. The Corporation has contracted with third party portfolio accounting service vendors for valuation of its securities portfolio. The vendors' sources for security valuation are ICE Data Services (ICE) and Thomson Reuters Pricing Service (TRPS). Each source provides opinions, known as evaluated prices, as to the value of individual securities based on model-based pricing techniques that are partially based on available market data, including prices for similar instruments in active markets and prices for identical assets in markets that are not active. ICE provides evaluated prices for the Corporation's obligations of states and political subdivisions category of securities. ICE 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. Fixed-rate callable securities of the U.S. government agencies and corporations category are individually evaluated on an option adjusted spread basis for callable issues or on a nominal spread basis incorporating the term structure of agency market spreads and the appropriate risk free benchmark curve for non-callable issues. Fixed-rate securities issued by the Small Business Association in the U.S. government agencies and corporations category are individually evaluated based upon a hierarchy of security specific information and market data regarding that security or securities with similar characteristics. Pass-through mortgage-backed securities (MBS) in the mortgage-backed category are grouped into aggregate categories defined by issuer program, weighted average coupon, and weighted average maturity. Each aggregate is benchmarked to a relative mortgage-backed to-be-announced (TBA) or other benchmark price. TBA prices are obtained from market makers and live trading systems. Collateralized mortgage obligations in the mortgage-backed category are individually evaluated based upon a hierarchy of

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security specific information and market data regarding that security or securities with similar characteristics. Each evaluation is determined using an option adjusted spread and prepayment model based on volatility-driven, multi-dimensional spread tables.

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

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

Derivative asset/liability – interest rate swaps on loans. The Corporation recognizes interest rate swaps at fair value. The Corporation has contracted with a third party vendor to provide valuations for these interest rate swaps using standard valuation techniques. All of the Corporation's interest rate swaps on loans are classified as Level 2.

Derivative asset - cash flow hedges. The Corporation recognizes cash flow hedges at fair value. The fair value of the Corporation's cash flow hedges is determined using the discounted cash flow method. All of the Corporation's cash flow hedges are classified as Level 2.

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

(Dollars in thousands)	June 30, 2018			Assets/Liabilities at Fair Value
	Fair Value	Measurements Using	Level 3	
	Level 1	Level 2	Level 3	Fair Value
Assets:				
Securities available for sale				
U.S. government agencies and corporations	\$ —	\$ 15,553	\$ —	\$ 15,553
Mortgage-backed securities	—	104,422	—	104,422
Obligations of states and political subdivisions	—	101,894	—	101,894
Total securities available for sale	—	221,869	—	221,869

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Loans held for sale	—	55,054	—	55,054
Derivative asset - IRLC	—	1,312	—	1,312
Derivative asset - interest rate swaps on loans	—	2,301	—	2,301
Derivative asset - cash flow hedges	—	417	—	417
Total assets	\$ —	\$ 280,953	\$ —	\$ 280,953
Liabilities:				
Derivative liability - interest rate swaps on loans	\$ —	\$ 2,301	\$ —	\$ 2,301
Total liabilities	\$ —	\$ 2,301	\$ —	\$ 2,301

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(Dollars in thousands)	December 31, 2017			Assets/Liabilities at Fair Value
	Fair Value Measurements Using Level 1	Level 2	Level 3	
Assets:				
Securities available for sale				
U.S. government agencies and corporations	\$ —	\$ 16,173	\$ —	\$ 16,173
Mortgage-backed securities	—	97,058	—	97,058
Obligations of states and political subdivisions	—	105,745	—	105,745
Total securities available for sale	—	218,976	—	218,976
Loans held for sale	—	55,384	—	55,384
Derivative asset - IRLC	—	528	—	528
Derivative asset - interest rate swaps on loans	—	1,261	—	1,261
Derivative asset - cash flow hedges	—	166	—	166
Total assets	\$ —	\$ 276,315	\$ —	\$ 276,315
Liabilities:				
Derivative liability - interest rate swaps on loans	\$ —	\$ 1,261	\$ —	\$ 1,261
Total liabilities	\$ —	\$ 1,261	\$ —	\$ 1,261

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 assets at fair value on a nonrecurring basis in accordance with U. S. GAAP. The following describes the valuation techniques and inputs used by the Corporation in determining the fair value of certain assets recorded at fair value on a nonrecurring basis in the financial statements.

Impaired loans. The Corporation does not record loans held for investment at fair value on a recurring basis. However, there are instances when a loan is considered impaired and an allowance for loan losses is established. The Corporation measures impairment either based on the fair value of the loan using the loan's obtainable market price or the fair value of the collateral if the loan is collateral dependent, or using the present value of expected future cash flows discounted at the loan's effective interest rate, which is not a fair value measurement. The Corporation maintains a valuation allowance to the extent that this measure of the impaired loan is less than the recorded investment in the loan. When an impaired loan is measured at fair value based solely on observable market prices or a current appraisal without further adjustment for unobservable inputs, the Corporation records the impaired loan as a nonrecurring fair value measurement classified as Level 2. However, if based on management's review, additional discounts to observed market prices or appraisals are required or if observable inputs are not available, the Corporation records the impaired loan as a nonrecurring fair value measurement classified as Level 3.

Impaired loans that are measured based on expected future cash flows discounted at the loan's effective interest rate rather than the market rate of interest, are not recorded at fair value and are therefore excluded from fair value disclosure requirements.

OREO. Assets acquired through, or in lieu of, loan foreclosure are held for sale and are initially recorded at fair value less estimated 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 similar properties, length of time the properties have been held, and our ability and intent with regard to continued ownership of the properties. The Corporation may incur additional write-downs of foreclosed assets to fair value less estimated costs to sell if valuations

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indicate a further deterioration in market conditions. As such, the Corporation records OREO as a nonrecurring fair value measurement classified as Level 3.

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

(Dollars in thousands)	June 30, 2018			
	Fair Value Measurements Using Assets at Fair			
	Level 1	Level 2	Level 3	Value
Impaired loans, net	\$ —	\$ —	\$ 648	\$ 648
Other real estate owned, net	—	—	168	168
Total	\$ —	\$ —	\$ 816	\$ 816

(Dollars in thousands)	December 31, 2017			
	Fair Value Measurements Using Assets at Fair			
	Level 1	Level 2	Level 3	Value
Impaired loans, net	\$ —	\$ —	\$ 3,438	\$ 3,438
Other real estate owned, net	—	—	168	168
Total	\$ —	\$ —	\$ 3,606	\$ 3,606

The following table presents quantitative information about Level 3 fair value measurements for financial assets measured at fair value on a nonrecurring basis:

(Dollars in thousands)	Fair Value Measurements at June 30, 2018			Range of Inputs
	Fair Value	Valuation Technique(s)	Unobservable Inputs	
Impaired loans, net	\$ 648	Appraisals	Discount to reflect current market conditions and estimated selling costs	30% - 38%
Other real estate owned, net	168	Appraisals	Discount to reflect current market conditions and estimated selling costs	28%
Total	\$ 816			

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. Additionally, in accordance with ASU 2016-01, which the Corporation adopted on January 1, 2018 on a prospective basis, the Corporation uses the exit price notion, rather than the entry price notion, in calculating the fair values of financial instruments not measured at fair value on a recurring basis.

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

(Dollars in thousands)	Carrying Value	Fair Value Measurements at June 30, 2018 Using			Total Fair Value
		Level 1	Level 2	Level 3	
Financial assets:					
Cash and short-term investments	\$ 135,743	\$ 135,743	\$ —	\$ —	\$ 135,743
Securities available for sale	221,869	—	221,869	—	221,869
Loans, net	996,412	—	—	979,114	979,114
Loans held for sale	55,054	—	55,054	—	55,054
Derivative asset - IRLC	1,312	—	1,312	—	1,312
Derivative asset - interest rate swaps on loans	2,301	—	2,301	—	2,301
Derivative asset - cash flow hedges	417	—	417	—	417
Bank-owned life insurance	15,776	—	15,776	—	15,776
Accrued interest receivable	7,252	7,252	—	—	7,252
Financial liabilities:					
Demand deposits	\$ 842,365	\$ 842,365	\$ —	\$ —	\$ 842,365
Time deposits	351,066	—	350,333	—	350,333
Borrowings	166,086	—	157,729	—	157,729
Derivative liability - interest rate swaps on loans	2,301	—	2,301	—	2,301
Accrued interest payable	882	882	—	—	882

(Dollars in thousands)	Carrying Value	Fair Value Measurements at December 31, 2017 Using			Total Fair Value
		Level 1	Level 2	Level 3	
Financial assets:					
Cash and short-term investments	\$ 119,423	\$ 119,423	\$ —	\$ —	\$ 119,423
Securities available for sale	218,976	—	218,976	—	218,976
Loans, net	992,062	—	—	983,620	983,620
Loans held for sale	55,384	—	55,384	—	55,384
Derivative asset - IRLC	528	—	528	—	528
Derivative asset - interest rate swaps on loans	1,261	—	1,261	—	1,261
Derivative asset - cash flow hedges	166	—	166	—	166
Bank-owned life insurance	15,589	—	15,589	—	15,589
Accrued interest receivable	7,589	7,589	—	—	7,589
Financial liabilities:					

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Demand deposits	\$ 823,476	\$ 823,476	\$ —	\$ —	\$ 823,476
Time deposits	347,953	—	350,681	—	350,681
Borrowings	167,860	—	159,670	—	159,670
Derivative liability - interest rate swaps on loans	1,261	—	1,261	—	1,261
Accrued interest payable	838	838	—	—	838

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 purchased retail installment sales contracts.

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The Corporation's other segment includes a full-service brokerage firm that derives revenues from offering wealth management services and insurance products through an alliance with an independent broker/dealer and an insurance company that derives revenues from owning an equity interest in an insurance agency that offers insurance products and services. The results of the other segment are not significant to the Corporation as a whole and have been included in "Other." Revenue and expenses of the Corporation are also included in "Other," and consist primarily of interest expense associated with the Corporation's trust preferred capital notes and other general corporate expenses.

(Dollars in thousands)	Three Months Ended June 30, 2018					
	Retail Banking	Mortgage Banking	Consumer Finance	Other	Eliminations	Consolidated
Revenues:						
Interest income	\$ 13,209	\$ 499	\$ 10,731	\$ —	\$ (1,788)	\$ 22,651
Gains on sales of loans	—	2,408	—	—	—	2,408
Other noninterest income	2,896	1,246	162	529	—	4,833
Total operating income	16,105	4,153	10,893	529	(1,788)	29,892
Expenses:						
Provision for loan losses	—	—	2,000	—	—	2,000
Interest expense	1,631	217	2,317	287	(1,788)	2,664
Salaries and employee benefits	6,754	1,560	2,228	531	—	11,073
Other noninterest expenses	4,837	1,318	1,388	145	—	7,688
Total operating expenses	13,222	3,095	7,933	963	(1,788)	23,425
Income (loss) before income taxes	2,883	1,058	2,960	(434)	—	6,467
Income tax expense (benefit)	439	279	804	(125)	—	1,397
Net income (loss)	\$ 2,444	\$ 779	\$ 2,156	\$ (309)	\$ —	\$ 5,070
Total assets	\$ 1,366,671	\$ 69,916	\$ 295,678	\$ 5,038	\$ (201,660)	\$ 1,535,643
Goodwill	\$ 3,702	\$ —	\$ 10,723	\$ —	\$ —	\$ 14,425
Capital expenditures	\$ 1,050	\$ 38	\$ 7	\$ —	\$ —	\$ 1,095

(Dollars in thousands)	Three Months Ended June 30, 2017					
	Retail Banking	Mortgage Banking	Consumer Finance	Other	Eliminations	Consolidated
Revenues:						
Interest income	\$ 12,365	\$ 431	\$ 11,197	\$ —	\$ (1,570)	\$ 22,423

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Gains on sales of loans	—	2,619	—	—	—	2,619
Other noninterest income	2,885	1,219	199	490	—	4,793
Total operating income	15,250	4,269	11,396	490	(1,570)	29,835
Expenses:						
Provision for loan losses	100	—	3,000	—	—	3,100
Interest expense	1,495	143	1,998	279	(1,570)	2,345
Salaries and employee benefits	6,543	1,804	2,395	442	—	11,184
Other noninterest expenses	4,435	1,319	1,305	160	—	7,219
Total operating expenses	12,573	3,266	8,698	881	(1,570)	23,848
Income (loss) before income taxes	2,677	1,003	2,698	(391)	—	5,987
Income tax expense (benefit)	578	396	1,062	(188)	—	1,848
Net income (loss)	\$ 2,099	\$ 607	\$ 1,636	\$ (203)	\$ —	\$ 4,139
Total assets	\$ 1,302,634	\$ 62,728	\$ 295,242	\$ 5,925	\$ (202,450)	\$ 1,464,079
Goodwill	\$ 3,702	\$ —	\$ 10,723	\$ —	\$ —	\$ 14,425
Capital expenditures	\$ 560	\$ 88	\$ 52	\$ —	\$ —	\$ 700

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(Dollars in thousands)	Six Months Ended June 30, 2018					
	Retail Banking	Mortgage Banking	Consumer Finance	Other	Eliminations	Consolidated
Revenues:						
Interest income	\$ 26,369	\$ 866	\$ 21,580	\$ —	\$ (3,420)	\$ 45,395
Gains on sales of loans	—	4,647	—	—	—	4,647
Other noninterest income	5,515	2,103	410	1,012	—	9,040
Total operating income	31,884	7,616	21,990	1,012	(3,420)	59,082
Expenses:						
Provision for loan losses	—	—	5,300	—	—	5,300
Interest expense	3,248	360	4,482	570	(3,420)	5,240
Salaries and employee benefits	13,240	3,003	4,493	1,070	—	21,806
Other noninterest expenses	9,818	2,593	2,695	388	—	15,494
Total operating expenses	26,306	5,956	16,970	2,028	(3,420)	47,840
Income (loss) before income taxes	5,578	1,660	5,020	(1,016)	—	11,242
Income tax expense (benefit)	822	446	1,366	(354)	—	2,280
Net income (loss)	\$ 4,756	\$ 1,214	\$ 3,654	\$ (662)	\$ —	\$ 8,962
Total assets	\$ 1,366,671	\$ 69,916	\$ 295,678	\$ 5,038	\$ (201,660)	\$ 1,535,643
Goodwill	\$ 3,702	\$ —	\$ 10,723	\$ —	\$ —	\$ 14,425
Capital expenditures	\$ 1,674	\$ 59	\$ 35	\$ —	\$ —	\$ 1,768

(Dollars in thousands)	Six Months Ended June 30, 2017					
	Retail Banking	Mortgage Banking	Consumer Finance	Other	Eliminations	Consolidated
Revenues:						
Interest income	\$ 24,337	\$ 747	\$ 22,403	\$ —	\$ (3,043)	\$ 44,444
Gains on sales of loans	—	4,562	—	—	—	4,562
Other noninterest income	5,508	2,307	431	873	—	9,119
Total operating income	29,845	7,616	22,834	873	(3,043)	58,125
Expenses:						
Provision for loan losses	200	—	7,300	—	—	7,500
Interest expense	2,960	231	3,905	562	(3,043)	4,615

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Salaries and employee benefits	12,902	3,287	4,807	980	—	21,976
Other noninterest expenses	8,878	2,598	2,558	361	—	14,395
Total operating expenses	24,940	6,116	18,570	1,903	(3,043)	48,486
Income (loss) before income taxes	4,905	1,500	4,264	(1,030)	—	9,639
Income tax expense (benefit)	984	596	1,686	(497)	—	2,769
Net income (loss)	\$ 3,921	\$ 904	\$ 2,578	\$ (533)	\$ —	\$ 6,870
Total assets	\$ 1,302,634	\$ 62,728	\$ 295,242	\$ 5,925	\$ (202,450)	\$ 1,464,079
Goodwill	\$ 3,702	\$ —	\$ 10,723	\$ —	\$ —	\$ 14,425
Capital expenditures	\$ 939	\$ 282	\$ 65	\$ 11	\$ —	\$ 1,297

The retail banking segment extends a warehouse line of credit to the mortgage banking segment, providing a portion of the funds needed to originate mortgage loans. The retail banking segment charges the mortgage banking segment interest at the daily FHLB advance rate plus 50 basis points. The retail banking segment also provides the consumer finance segment with a portion of the funds needed to purchase loan contracts by means of variable rate notes that carry interest at one-month LIBOR plus 200 basis points and fixed rate notes that carry interest at rates ranging from 2.0 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.

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NOTE 9: Commitments and Contingent Liabilities

The Corporation enters into commitments to extend credit in the normal course of business to meet the financing needs of its customers, including loan commitments and standby letters of credit. These instruments involve elements of credit and interest rate risk in excess of the amounts recorded on the Consolidated Balance Sheets. The Corporation's exposure to credit loss in the event of nonperformance by the other party to the financial instrument for commitments to extend credit and standby letters of credit written is represented by the contractual amount of these instruments.

Loan commitments are agreements to extend credit to a customer provided that there are no violations of the terms of the contract prior to funding. Commitments have fixed expiration dates or other termination clauses and may require payment of a fee by the customer. Since many of the commitments may expire without being completely drawn upon, the total commitment amounts do not necessarily represent future cash requirements. The amount of loan commitments was \$234.37 million at June 30, 2018 and \$224.50 million at December 31, 2017.

Standby letters of credit are written conditional commitments issued by the Bank to guarantee the performance of a customer to a third party. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loans to customers. The total contract amount of standby letters of credit, whose contract amounts represent credit risk, was \$16.27 million at June 30, 2018 and \$15.46 million at December 31, 2017.

C&F Mortgage sells substantially all of the residential mortgage loans it originates to third-party counterparties (i.e., investors). 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 June 30,		Six Months Ended	
	2018	2017	June 30, 2018	2017

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Allowance, beginning of period	\$ 2,525	\$ 2,339	\$ 2,489	\$ 2,303
Provision for indemnification losses	16	52	52	88
Payments	—	—	—	—
Allowance, end of period	\$ 2,541	\$ 2,391	\$ 2,541	\$ 2,391

NOTE 10: Derivative Financial Instruments

The Corporation uses derivative financial instruments (or derivatives) primarily to manage risks to the Corporation associated with changing interest rates, and to assist customers with their risk management objectives. The Corporation designates certain derivatives as hedging instruments in a qualifying hedge accounting relationship (cash flow or fair value hedge). The remaining derivatives are classified as free standing derivatives consisting of customer accommodation loan swaps (or loan swaps) and IRLCs.

Cash flow hedges. The Corporation designates derivatives as cash flow hedges when they are used to manage exposure to variability in cash flows on variable rate borrowings such as the Corporation's trust preferred capital notes. The Corporation uses interest rate swap agreements as part of its hedging strategy by exchanging variable-rate interest payments on a notional amount equal to the principal amount of the borrowings for fixed-rate interest payments, with such interest rates set based on benchmarked interest rates.

All interest rate swaps were entered into with counterparties that met the Corporation's credit standards and the agreements contain collateral provisions protecting the at-risk party. The Corporation believes that the credit risk inherent in these derivative contracts is not significant.

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The terms and conditions of the interest rate swaps vary and amounts receivable or payable are recognized as accrued under the terms of the agreements. The Corporation assesses the effectiveness of each hedging relationship on a periodic basis. In accordance with ASC 815, Derivatives and Hedging, the effective portions of the derivatives' unrealized gains or losses are recorded as a component of other comprehensive income. Based on the Corporation's assessment its cash flow hedges are highly effective, but to the extent that any ineffectiveness exists in the hedge relationships, the amounts would be recorded in interest income and interest expense in the Corporation's Consolidated Statements of Income.

Loan swaps. The Bank also enters into interest rate swaps with certain qualifying commercial loan customers to meet their interest rate risk management needs. The Bank simultaneously enters into interest rate swaps with dealer counterparties, with identical notional amounts and terms. The net result of these interest rate swaps is that the customer pays a fixed rate of interest and the Corporation receives a floating rate. These back-to-back loan swaps qualify as financial derivatives with fair values reported in "Other assets" and "Other liabilities" in the Consolidated Balance Sheets. Changes in fair value are recorded in other noninterest expense and net to zero because of the identical amounts and terms of the swaps.

IRLCs. C&F Mortgage enters into IRLCs with customers to originate loans for which the interest rates are determined prior to funding. C&F Mortgage then mitigates interest rate risk on these IRLCs and loans held for sale by (a) entering into forward loan sales contracts with investors for loans to be delivered on a best efforts basis or (b) entering into forward sales contracts of mortgage backed securities for loans to be delivered on a mandatory basis. At June 30, 2018, each loan held for sale by C&F Mortgage was subject to a forward sales agreement on a best efforts basis. The fair value of these derivative instruments is reported in "Other assets" in the Consolidated Balance Sheets.

The following tables summarize key elements of the Corporation's derivative instruments:

(Dollars in thousands)	June 30, 2018				Collateral Pledged ³
	Notional Amount ¹	Positions	Assets ²	Liabilities ²	
Cash flow hedges:					
Interest rate swaps:					
Variable-rate to fixed-rate swaps with counterparty	\$ 25,000	3	\$ 417	\$ —	\$ —
Not designated as hedges:					
Customer-related interest rate contracts:					
Matched interest rate swaps with borrower	46,279	8	403	1,898	—
Matched interest rate swaps with counterparty	46,279	8	1,898	403	—
Other contracts:					
IRLCs	149,044	642	1,312	—	—

(Dollars in thousands)	December 31, 2017				Collateral Pledged ³
	Notional Amount ¹	Positions	Assets ²	Liabilities ²	
Cash flow hedges:					
Interest rate swaps:					
Variable-rate to fixed-rate swaps with counterparty	\$ 25,000	3	\$ 166	\$ —	\$ —
Not designated as hedges:					
Customer-related interest rate contracts:					
Matched interest rate swaps with borrower	41,295	6	284	977	—
Matched interest rate swaps with counterparty	41,295	6	977	284	—
Other contracts:					
IRLCs	99,140	440	528	—	—

¹ Notional amounts are not recorded in the Consolidated Balance Sheets and are generally used only as a basis on which interest and other payments are determined.

² Balances represent the fair value of derivative financial instruments.

³ Collateral pledged may be comprised of cash or securities.

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NOTE 11: Other Noninterest Expenses

The following table presents the significant components in the Consolidated Statements of Income line “Noninterest Expenses-Other.”

(Dollars in thousands)	Three Months Ended June 30,		Six Months Ended June 30,	
	2018	2017	2018	2017
Data processing service and maintenance contracts	\$ 1,457	\$ 1,331	\$ 2,950	\$ 2,588
Professional fees	779	575	1,517	1,281
Marketing and advertising expenses	383	438	843	803
Travel and educational expenses	300	291	671	577
Telecommunication expenses	333	316	679	646
Interchange expense	361	261	695	510
All other noninterest expenses	2,051	2,130	4,084	4,142
Total other noninterest expenses	\$ 5,664	\$ 5,342	\$ 11,439	\$ 10,547

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

Cautionary Statement Regarding Forward-Looking Statements

This report contains statements concerning the Corporation’s expectations, plans, objectives, future financial performance and other statements that are not historical facts. These statements may constitute “forward-looking statements” as defined by federal securities laws and may include, but are not limited to: statements regarding future financial performance; strategic business initiatives including the expansion of the indirect lending program to include boats and recreational vehicles (RVs); development of our digital platform; liquidity and capital levels; net interest margin compression; the effect of future market and industry trends including competitive trends in the non-prime consumer finance markets, the Corporation’s and each business segment’s loan portfolio; and business prospects related to each segment’s loan portfolio; asset quality and adequacy of the allowance for loan losses and the level of future charge-offs; trends regarding asset quality and related expenses; the effects of future interest rate levels and fluctuations; the amount and timing of accretion associated with the fair value accounting adjustments recorded in connection with the 2013 acquisition of Central Virginia Bankshares, Inc. (CVBK); adequacy of the allowance for indemnification losses; levels of noninterest income and expense; interest rates and yields including possible future interest rate increases; the deposit portfolio including trends in deposit maturities and rates; interest rate sensitivity; market risk; regulatory developments; monetary policy implemented by the Federal Reserve Board of Governors of the Federal Reserve Bank (the Federal Reserve Board) including changes to the federal funds rate; capital requirements; growth strategy; hedging strategy; and, financial and other goals. These statements may address issues that involve estimates and assumptions made by management, management’s current beliefs, and risks and uncertainties. These statements are inherently uncertain and there can be no assurance that the underlying estimates, assumptions or beliefs will be proven to be accurate. Actual results could differ materially from historical results or those anticipated or implied by such statements. Factors that could have a material adverse effect on the operations and future prospects of the Corporation include, but are not limited to, changes in:

- interest rates, such as increases in the Federal Funds rate

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

- general economic conditions, including unemployment levels

- the legislative/regulatory climate with respect to financial institutions, 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 the application of the Basel III capital standards to the Corporation and the Bank

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- the effect of the Tax Cuts and Jobs Act (the Act) and changes in the effect of the Act due to issuance of interpretive regulatory guidance or enactment of corrective or supplemental legislation

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

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

- demand for loan products
 - 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 new and used automobiles, including sales prices of repossessed vehicles

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- the level of net charge-offs on loans and the adequacy of our allowance for loan losses
- deposit flows
- demand in the secondary residential mortgage loan markets
- the level of indemnification losses related to mortgage loans sold
- the strength of the Corporation's counterparties and the economy in general
- competition from both banks and non-banks, including competition in the non-prime automobile finance markets
- demand for financial services in the Corporation's market area
- the Corporation's branch and market expansions and technology initiatives
- cyber threats, attacks or events
- reliance on third parties for key services
- the Bank's product offerings
- accounting principles, policies and guidelines, and elections made by the Corporation thereunder

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, 2017, 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. We undertake no obligation to update or revise any forward-looking statement to reflect events or circumstances arising after the date on which the statement was made, except as otherwise required by law.

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 management's 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 probable losses inherent in the loan portfolio. 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 for relevant periods of time, 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. For more information see the section titled "Asset Quality" within Part I, Item 2.

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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 when a purchaser of a loan (investor) sold by C&F Mortgage incurs a validated indemnified 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 valid indemnification requests for loans that have been sold by C&F Mortgage. 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 based on 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 in the loan. All TDRs are also considered impaired loans and are evaluated individually. A TDR occurs 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.

Loans Acquired in a Business Combination: Loans acquired in the acquisition of CVBK and its subsidiary CVB were segregated between (i) PCI loans and (ii) purchased performing loans and were recorded at estimated fair value on the date of acquisition without the carryover of the related allowance for loan losses.

PCI loans are those for which there is evidence of credit deterioration since origination and for which it is probable at the date of acquisition that the Corporation will not collect all contractually required principal and interest payments. When determining fair value, PCI loans were aggregated into pools of loans based on common risk characteristics as of the date of acquisition such as loan type, date of origination, and evidence of credit quality deterioration such as internal risk grades and past due and nonaccrual status. The difference between contractually required payments at acquisition and the cash flows expected to be collected at acquisition is referred to as the "nonaccretable difference." Any excess of cash flows expected at acquisition over the estimated fair value is referred to as the "accretable yield" and is recognized as interest income over the remaining life of the loan when there is a reasonable expectation about the amount and timing of such cash flows.

On a quarterly basis, we evaluate our estimate of cash flows expected to be collected on PCI loans. Estimates of cash flows for PCI loans require significant judgment. Subsequent decreases to the expected cash flows will generally result in a provision for loan losses resulting in an increase to the allowance for loan losses. Subsequent significant increases in cash flows may result in a reversal of post-acquisition provision for loan losses or a transfer from

nonaccretable difference to accretable yield that increases interest income over the remaining life of the loan or pool(s) of loans. Disposals of loans, which may include sale of loans to third parties, receipt of payments in full or in part from the borrower or foreclosure of the collateral, result in removal of the loan from the PCI loan portfolio at its carrying amount.

The Corporation's PCI loans currently consist of loans acquired in connection with the acquisition of CVB. PCI loans that were classified as nonperforming loans by CVB are no longer classified as nonperforming so long as, at quarterly re-estimation periods, we believe we will fully collect the new carrying value of the pools of loans.

The Corporation accounts for purchased performing loans using the contractual cash flows method of recognizing discount accretion based on the acquired loans' contractual cash flows. Purchased performing loans are recorded at fair value, including a credit discount. The fair value discount is accreted as an adjustment to yield over the estimated lives of the loans. There is no allowance for loan losses established at the acquisition date for purchased performing loans. A provision for loan losses may be required for any deterioration in these loans in future periods.

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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.

We regularly review each investment security for other-than-temporary impairment based on criteria that includes the extent to which cost exceeds market price, the duration of that market decline, the financial health of and specific prospects for the issuer, our best estimate of the present value of cash flows expected to be collected from debt securities, our intention with regard to holding the security to maturity and the likelihood that we would be required to sell the security before recovery.

Other Real Estate Owned (OREO): Assets acquired through, or in lieu of, loan foreclosure are held for sale and are initially recorded at the fair value less estimated 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 similar 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 estimated costs to sell if valuations indicate a further deterioration in market conditions.

Goodwill: The Corporation's goodwill was recognized in connection with the Corporation's acquisition of CVBK in October 2013 and C&F Bank's acquisition of C&F Finance Company in September 2002. The Corporation reviews the carrying value of goodwill at least annually or more frequently if certain impairment indicators exist. In assessing the recoverability of the Corporation's goodwill, major assumptions used in determining impairment are increases in future income, sales multiples in determining terminal value and the discount rate applied to future cash flows. If an impairment test is performed, we will prepare a sensitivity analysis by increasing the discount rate, lowering sales multiples and reducing increases in future income.

Retirement Plan: C&F 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. C&F Bank's actuary determines plan obligations and annual pension expense using a number of key assumptions. Key assumptions may include the discount rate, the interest crediting rate, the estimated future return on plan assets and the anticipated rate of future salary increases. Changes in these assumptions in the future, if any, or in the method under which

benefits are calculated may affect pension assets, liabilities or expense.

Derivative Financial Instruments: The Corporation uses derivatives primarily to manage risk associated with changing interest rates and to assist customers with their risk management objectives. The Corporation's derivative financial instruments may include (1) interest rate lock commitments (IRLCs) on mortgage loans that will be held for sale and the related forward sales commitments, (2) interest rate swaps with certain qualifying commercial loan customers and dealer counterparties and (3) interest rate swaps that qualify as cash flow hedges of the Corporation's trust preferred capital notes. The Corporation recognizes derivative financial instruments at fair value as either an other asset or other liability in the Consolidated Balance Sheets. Because the IRLCs, forward sales commitments and interest rate swaps with loan customers and dealer counterparties are classified as free standing derivatives, adjustments to reflect unrealized gains and losses resulting from changes in fair value of these instruments are reported in the Consolidated Statements of Income. The effective portion of the gain or loss on the Corporation's cash flow hedges is reported as a component of other comprehensive income, net of deferred income taxes, and is reclassified into earnings in the same period or periods during which the hedged transactions affect earnings.

Income Taxes: Determining the Corporation's effective tax rate requires judgment. The Corporation's net deferred tax asset is determined annually for differences between the financial statement and tax bases of assets and liabilities that

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will result in taxable or deductible amounts in the future based on enacted tax laws and rates applicable to the periods in which the differences are expected to affect taxable income. In addition, there may be transactions and calculations for which the ultimate tax outcomes are uncertain and 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, 2017.

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 equity (ROE), and (iii) growth in earnings. In addition to these financial performance measures, we track the performance of the Corporation's three principal business segments: Retail Banking, Mortgage Banking, and Consumer Finance. We also actively manage our capital through growth, dividends and share repurchases, while considering the need to maintain a strong regulatory capital position.

Financial Performance Measures

Net income for the Corporation was \$5.1 million for the second quarter of 2018, or \$1.45 per common share assuming dilution, compared with net income of \$4.1 million for the second quarter of 2017, or \$1.19 per common share assuming dilution. Net income for the Corporation was \$9.0 million for the first half of 2018, or \$2.56 per common share assuming dilution, compared with net income of \$6.9 million for the first half of 2017, or \$1.97 per common share assuming dilution.

The Corporation's annualized ROE and ROA were 14.16 percent and 1.34 percent, respectively, for the second quarter of 2018, compared to 11.63 percent and 1.14 percent, respectively, for the second quarter of 2017. The Corporation's annualized ROE and ROA were 12.62 percent and 1.19 percent, respectively, for the first half of 2018, compared to 9.76 percent and 0.95 percent, respectively, for the first half of 2017. The increases in ROE and ROA for the second quarter and first half of 2018, compared to the same periods in 2017, resulted from higher earnings.

Principal Business Segments

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

Retail Banking: The retail banking segment reported net income of \$2.4 million for the second quarter of 2018, compared to net income of \$2.1 million for the second quarter of 2017. For the first six months of 2018, the retail banking segment reported net income of \$4.8 million, compared to \$3.9 million for the first six months of 2017.

In addition to the favorable effect of the lower federal corporate income tax rate, positive factors influencing net income of the retail banking segment for the second quarter and first half of 2018 included: (1) the effect of loan growth on interest income, as average loans increased \$36.3 million or 5.2 percent during the second quarter of 2018 and \$37.2 million or 5.4 percent during the first half of 2018 compared to the same periods in 2017 and (2) a decline in the provision for loan losses primarily attributable to the stabilization of certain commercial credits in 2018 that were concerns in 2017. Partially offsetting these factors were (1) higher operating expenses associated with C&F Bank continuing to (a) strengthen its technology infrastructure, (b) expand its product offerings, (c) promote brand awareness, (d) expand its market presence in Charlottesville, Virginia and (e) enhance compliance processes and (2) margin compression resulting from an increase in excess cash balances, a decline in yield on securities resulting from a higher mix of lower-yielding taxable securities in 2018, compared to 2017, and an increase in interest-bearing deposits as interest rates continue to rise.

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C&F Bank's total nonperforming assets were \$3.0 million at June 30, 2018, compared to \$5.4 million at December 31, 2017. Nonperforming assets at June 30, 2018 consisted primarily of \$2.8 million in nonaccrual loans, compared to \$5.3 million at December 31, 2017. The decline in nonaccrual loans since December 31, 2017 resulted primarily from a partial repayment of one commercial relationship.

Mortgage Banking: The mortgage banking segment reported net income of \$779,000 for the second quarter of 2018, compared to net income of \$607,000 for the second quarter of 2017. For the first six months of 2018, the mortgage banking segment reported net income of \$1.2 million, compared to net income of \$904,000 for the first six months of 2017.

In addition to the favorable effect of the lower federal corporate income tax rate, the increase in net income of the mortgage banking segment for the second quarter and first half of 2018 was due primarily to a decrease in operating expenses compared to the same periods in 2017 resulting from operational efficiencies and management of personnel costs. In addition, the Lender Solutions division, which provides certain mortgage origination services to third parties, produced fee income of \$92,000 and \$172,000 in the second quarter and first half of 2018, respectively, compared to \$55,000 and \$101,000 in the second quarter and first half of 2017. Partially offsetting these factors were a 2.4 percent decrease in loan production in the second quarter of 2018 compared to the second quarter of 2017, which resulted in a decrease in gains on sales of loans, and a decrease in ancillary loan origination fees in the first half of 2018 compared to the first half of 2017. Mortgage loan originations during the second quarter of 2018 for refinancings and home purchases were \$22.6 million and \$183.9 million, respectively, compared to \$22.9 million and \$185.9 million, respectively, during the second quarter of 2017. Mortgage loan originations during the first half of 2018 for refinancings and home purchases were \$45.2 million and \$302.4 million, respectively, compared to \$45.5 million and \$304.4 million, respectively, during the first half of 2017.

Consumer Finance: The consumer finance segment reported net income of \$2.2 million for the second quarter of 2018, compared to net income of \$1.6 million for the second quarter of 2017. For the first six months of 2018, the consumer finance segment reported net income of \$3.7 million, compared to net income of \$2.6 million for the first six months of 2017.

In addition to the favorable effect of the lower federal corporate income tax rate, positive factors influencing net income of the consumer finance segment for the second quarter and first half of 2018 included (1) a decline of \$1.0 million and \$2.0 million in the provision for loan losses for the second quarter and first half of 2018, respectively, compared to the same periods in 2017, as a result of lower charge-offs and improving credit quality of the portfolio, as discussed below, and (2) lower personnel and operating expenses resulting from underwriting efficiencies and the purchase of loans with higher credit metrics. Partially offsetting these factors were (1) lower loan yields resulting from competition in the non-prime automobile loan business and the acquisition of loan contracts with higher credit metrics, as well as relatively lower yields on boat and RV loans, and (2) higher-cost variable-rate borrowings resulting from increases in short-term interest rates since the first quarter of 2017.

The annualized net charge-off ratio for the first six months of 2018 decreased to 3.85 percent from 5.34 percent for the first six months of 2017 as a result of a lower number of charge-offs during the first half of 2018. At June 30, 2018, total delinquent loans as a percentage of total loans was 4.18 percent, compared to 5.17 percent at December 31, 2017 and 4.40 percent at June 30, 2017. At June 30, 2018, repossessed vehicles available for sale totaled \$247,000, compared to \$250,000 at December 31, 2017 and \$351,000 at June 30, 2017. The allowance for loan losses was \$24.0 million, or 8.11 percent of total loans at June 30, 2018, compared to \$24.4 million, or 8.34 percent of total loans at December 31, 2017. If factors influencing the consumer finance segment result in a higher net charge-off ratio in the future, or if the consumer finance segment's loan portfolio should grow, the segment may need to increase the level of its allowance for loan losses, which would negatively affect future earnings.

During the first quarter of 2018, C&F Finance Company began the expansion of its indirect lending programs to include boats and RVs. These contracts are for prime loans made to individuals with very high credit quality and are therefore priced at rates lower than the consumer finance segment's non-prime automobile portfolio. While these loans may contribute to net interest margin compression, management expects they will require both a lower provision for loan losses and allowance for loan losses than the consumer finance segment's non-prime automobile loans, contributing to a decrease in the overall level of the consumer finance segment's allowance for loan losses as a percentage of total loans. At June 30,

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2018, compared to December 31, 2017, the higher composition within the consumer finance segment's loan portfolio of boat and RV loans accounted for 16 basis points of the 23 basis points decrease in this ratio.

Other Segments: Other segments, which principally includes the Corporation's holding company operations and wealth management subsidiary, reported an aggregate net loss of \$309,000 and \$662,000 for the second quarter and first half of 2018, compared to a net loss of \$203,000 and \$533,000 for the second quarter and first half of 2017. The higher net loss during 2018, compared to 2017, included higher operating expenses at the holding company and a lower federal income tax benefit, which were offset in part by higher earnings at the Corporation's wealth management subsidiary.

Capital Management. Total shareholders' equity was \$146.5 million at June 30, 2018, compared to \$141.7 million at December 31, 2017. Capital growth resulted primarily from earnings for the first half of 2018, which was offset in part by dividends declared of 34 cents and 68 cents per share during the second quarter and first half of 2018, respectively, and an increase in unrealized holding losses on securities available for sale, which is a component of accumulated other comprehensive loss. The second quarter dividend was paid on July 1, 2018 and equated to a payout ratio of 23.4 percent of second quarter earnings per share. For the four quarters ended June 30, 2018, dividends declared of \$1.35 per share equated to 54.5 percent of net income during the same period, which included a \$6.6 million reduction in net income due to the remeasurement of deferred income taxes as a result of the enactment of a reduction in the federal corporate income tax rate in December 2017. The Board of Directors of the Corporation continually reviews the amount of cash dividends per share and the resulting dividend payout ratio in light of changes in economic conditions, current and future capital requirements and expected future earnings.

On April 18, 2018, the Board of Directors reauthorized the Corporation's share repurchase program for the Corporation's outstanding common stock (the Repurchase Program) to purchase up to \$5.0 million of the Corporation's common stock through May 31, 2019. As of June 30, 2018, the Corporation had not used any of this authority and remained authorized to purchase up to \$5.0 million of the Corporation's common stock under the Repurchase Program.

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RESULTS OF OPERATIONS

The following table presents the average balance sheets, the amounts of interest earned on earning assets, with related yields, and interest expense on interest-bearing liabilities, with related rates, for the three and six months ended June 30, 2018 and 2017. Loans include loans held for sale. Loans placed on a nonaccrual status are included in the balances and are included in the computation of yields, but had no material effect. Accretion and amortization of fair value purchase adjustments are included in the computation of yields on loans and investments and on the cost of borrowings acquired in connection with the purchase of CVBK. The CVBK accretion contributed approximately 17 basis points to the yield on loans and 12 basis points to both the yield on interest earning assets and the net interest margin for the second quarter of 2018, compared to approximately 13 basis points to the yield on loans and 10 basis points to both the yield on interest earning assets and the net interest margin for the second quarter of 2017. The CVBK accretion contributed approximately 25 basis points to the yield on loans and 19 basis points to both the yield on interest earning assets and the net interest margin for the first six months of 2018, compared to approximately 16 basis points to the yield on loans and 13 basis points to both the yield on interest earning assets and the net interest margin for the first six months of 2017. 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 21 percent that was applicable for the second quarter and first half of 2018 and 34 percent that was applicable for the second quarter and first half of 2017.

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

(Dollars in thousands)	Three Months Ended June 30, 2018				2017			
	Average Balance	Income/ Expense	Yield/ Rate		Average Balance	Income/ Expense	Yield/ Rate	
Assets								
Securities:								
Taxable	\$ 136,185	\$ 776	2.28	%	\$ 115,040	\$ 631	2.19	%
Tax-exempt	88,452	880	3.98		99,729	1,238	4.97	
Total securities	224,637	1,656	2.95		214,769	1,869	3.48	
Total loans	1,068,305	20,632	7.75		1,030,699	20,711	8.06	
Interest-bearing deposits in other banks	129,698	553	1.71		112,177	278	0.99	
Total earning assets	1,422,640	22,841	6.44		1,357,645	22,858	6.75	
Allowance for loan losses	(35,649)				(36,163)			
Total non-earning assets	125,912				132,890			
Total assets	\$ 1,512,903				\$ 1,454,372			

Liabilities and Shareholders'

Equity

Time and savings deposits:

Interest-bearing demand

deposits

\$ 225,460

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