C & F FINANCIAL CORP
Form 10-Q
August 08, 2011

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

(Mark One)
x QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended June 30, 2011

¨ TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from to
Commission File Number: 000-23423

C&F Financial Corporation
(Exact name of registrant as specified in its charter)

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

(804) 843-2360
(Registrant's telephone number, including area code)

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

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

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

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

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

At August 4, 2011, the latest practicable date for determination, 3,132,166 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

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

	June 30, 2011 (Unaudited)	December 31, 2010
ASSETS		
Cash and due from banks	$11,248	$7,150
Interest-bearing deposits in other banks	3,072	2,530
Federal funds sold	800	--
Total cash and cash equivalents	15,120	9,680
Securities-available for sale at fair value, amortized cost of $136,083 and $129,505, respectively	140,154	130,275
Loans held for sale, net	42,490	67,153
Loans, net of allowance for loan losses of $30,211 and $28,840, respectively	620,947	606,744
Federal Home Loan Bank stock, at cost	3,828	3,887
Corporate premises and equipment, net	28,899	28,743
Other real estate owned, net of valuation allowance of $3,700 and $3,979, respectively	8,173	10,674
Accrued interest receivable	5,120	5,073
Goodwill	10,724	10,724
Other assets	31,116	31,184
Total assets	$906,571	$904,137
LIABILITIES AND SHAREHOLDERS' EQUITY		
Deposits		
Noninterest-bearing demand deposits	$95,685	$87,263
Savings and interest-bearing demand deposits	226,959	228,185
Time deposits	303,201	309,686
Total deposits	625,845	625,134
Short-term borrowings	7,750	10,618
Long-term borrowings	133,121	132,902
Trust preferred capital notes	20,620	20,620
Accrued interest payable	1,145	1,160
Other liabilities	18,982	20,926
Total liabilities	807,463	811,360
Commitments and contingent liabilities		
Shareholders' equity		
	20	20

Preferred stock ($1.00 par value, 3,000,000 shares authorized, 20,000 shares issued and outstanding)		
Common stock ($1.00 par value, 8,000,000 shares authorized, 3,132,366 and 3,118,066 shares issued and outstanding, respectively)	3,045	3,032
Additional paid-in capital	22,452	22,112
Retained earnings	71,451	67,542
Accumulated other comprehensive income, net	2,140	71
Total shareholders' equity	99,108	92,777
Total liabilities and shareholders' equity	$906,571	$904,137

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

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CONSOLIDATED STATEMENTS OF INCOME
(Unaudited)
(In thousands, except for share and per share amounts)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2011	2010	2011	2010
Interest income				
Interest and fees on loans	$17,043	$16,146	$33,389	$31,485
Interest on money market investments	16	9	31	27
Interest and dividends on securities				
U.S. government agencies and corporations	55	80	106	167
Tax-exempt obligations of states and political subdivisions	1,225	1,099	2,419	2,202
Corporate bonds and other	30	28	56	73
Total interest income	18,369	17,362	36,001	33,954
Interest expense				
Savings and interest-bearing deposits	274	226	606	545
Certificates of deposit, $100 or more	663	841	1,336	1,662
Other time deposits	819	1,006	1,669	2,044
Borrowings	966	996	1,932	1,949
Trust preferred capital notes	246	249	489	494
Total interest expense	2,968	3,318	6,032	6,694
Net interest income	15,401	14,044	29,969	27,260
Provision for loan losses	3,390	3,300	6,210	6,500
Net interest income after provision for loan losses	12,011	10,744	23,759	20,760
Noninterest income				
Gains on sales of loans	3,696	4,679	7,496	8,427
Service charges on deposit accounts	846	865	1,694	1,606
Other service charges and fees	1,314	1,085	2,406	1,994
Net gains on calls and sales of available for sale securities	--	16	--	76
Other income	502	549	1,219	973
Total noninterest income	6,358	7,194	12,815	13,076
Noninterest expenses				
Salaries and employee benefits	8,430	8,763	16,922	16,663
Occupancy expenses	1,611	1,389	3,137	2,786
Other expenses	3,928	6,054	7,859	10,349
Total noninterest expenses	13,969	16,206	27,918	29,798
Income before income taxes	4,400	1,732	8,656	4,038
Income tax expense	1,317	315	2,604	891

Net income	3,083	1,417	6,052	3,147
Effective dividends on preferred stock	290	287	579	574
Net income available to common shareholders	$2,793	$1,130	$5,473	$2,573
Per common share data				
Net income – basic	$0.89	$0.37	$1.75	$0.84
Net income – assuming dilution	$0.88	$0.36	$1.73	$0.83
Cash dividends declared	$0.25	$0.25	$0.50	$0.50
Weighted average number of shares – basic	3,131,203	3,084,255	3,127,536	3,078,970
Weighted average number of shares – assuming dilution	3,159,260	3,102,643	3,163,210	3,100,669

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

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CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY
(Unaudited)
(In thousands, except per share amounts)

	Preferred Stock	Common Stock	Additional Paid-In Capital	Retained Earnings	Accumulated Other Comprehensive Income	Total Shareholders' Equity
Balance December 31, 2010	$20	$3,032	$22,112	$67,542	$ 71	$ 92,777
Comprehensive income:						
Net income	—	—	—	6,052	—	6,052
Other comprehensive income, net						
Changes in defined benefit plan assets and benefit obligations, net	—	—	—	—	7	
Unrealized loss on cash flow hedging instruments, net	—	—	—	—	(84)	
Unrealized holding gains on securities, net of reclassification adjustment	—	—	—	—	2,146	
Other comprehensive income, net	—	—	—	—	2,069	2,069
Comprehensive income	—	—	—	—	—	8,121
Share-based compensation	—	—	132	—	—	132
Stock options exercised	—	8	134	—	—	142
Restricted stock vested	—	5	(5)	—	—	—
Accretion of preferred stock discount	—	—	79	(79)	—	—
Cash dividends paid – common stock ($0.50 per share)	—	—	—	(1,564)	—	(1,564)
Cash dividends paid – preferred stock (5% per annum)	—	—	—	(500)	—	(500)
Balance June 30, 2011	$20	$3,045	$22,452	$71,451	$ 2,140	$ 99,108

	Preferred Stock	Common Stock	Additional Paid-In Capital	Retained Earnings	Accumulated Other Comprehensive Income	Total Shareholders' Equity
Balance December 31, 2009	$20	$3,009	$21,210	$63,669	$ 968	$ 88,876
Comprehensive income:						
Net income	—	—	—	3,147	—	3,147
Other comprehensive income, net						
Changes in defined benefit plan assets and benefit obligations, net	—	—	—	—	(8)	

Unrealized loss on cash flow hedging instruments, net	—	—	—	—	(93)	
Unrealized holding gains on securities, net of reclassification adjustment	—	—	—	—	340	
Other comprehensive income, net	—	—	—	—	239	239
Comprehensive income	—	—	—	—	—	3,386
Share-based compensation	—	—	194	—	—	194
Stock options exercised	—	9	136	—	—	145
Accretion of preferred stock discount	—	—	74	(74)	—	—
Cash dividends paid – common stock ($0.50 per share)	—	—	—	(1,541)	—	(1,541)
Cash dividends paid – preferred stock (5% per annum)	—	—	—	(500)	—	(500)
Balance June 30, 2010	$20	$3,018	$21,614	$64,701	$ 1,207	$ 90,560

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

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

	Six Months Ended June 30, 2011	Six Months Ended June 30, 2010
Operating activities:		
Net income	$6,052	$3,147
Adjustments to reconcile net income to net cash provided by (used in) operating activities:		
Depreciation	1,025	942
Provision for loan losses	6,210	6,500
Provision for indemnifications	406	3,177
Provision for other real estate owned losses	411	1,220
Share-based compensation	132	194
Accretion of discounts and amortization of premiums on securities, net	388	244
Net realized gain on securities	--	(76)
Realized losses (gains) on sales of other real estate owned	21	(6)
Proceeds from sales of loans	297,725	308,493
Origination of loans held for sale	(273,062)	(343,355)
Change in other assets and liabilities:		
Accrued interest receivable	(47)	249
Other assets	(1,240)	(1,169)
Accrued interest payable	(15)	35
Other liabilities	(2,477)	(3,599)
Net cash provided by (used in) operating activities	35,529	(24,004)
Investing activities:		
Proceeds from maturities, calls and sales of securities available for sale	15,311	15,140
Purchases of securities available for sale	(22,219)	(17,434)
Net increase in customer loans	(24,034)	(9,859)
Other real estate owned improvements	--	(131)
Proceeds from sales of other real estate owned	5,894	993
Purchases of corporate premises and equipment, net	(1,181)	(1,078)
Net cash used in investing activities	(26,229)	(12,369)
Financing activities:		
Net increase (decrease) in demand, interest-bearing demand and savings deposits	7,196	(5,932)
Net (decrease) increase in time deposits	(6,485)	13,947
Net (decrease) increase in borrowings	(2,649)	6,281
Proceeds from exercise of stock options	142	145
Cash dividends	(2,064)	(2,041)
Net cash (used in) provided by financing activities	(3,860)	12,400
Net increase (decrease) in cash and cash equivalents	5,440	(23,973)
Cash and cash equivalents at beginning of period	9,680	38,061
Cash and cash equivalents at end of period	$15,120	$14,088

Supplemental disclosure		
Interest paid	$6,047	$6,659
Income taxes paid	4,261	3,268
Supplemental disclosure of noncash investing and financing activities		
Unrealized gains on securities available for sale	$3,300	$521
Loans transferred to other real estate owned	(3,621)	(2,278)
Pension adjustment	11	(12)
Unrealized loss on cash flow hedging instrument	(138)	(149)

The accompanying notes are an integral part of the 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, 2010.

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

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

The Bank has five wholly-owned subsidiaries: C&F Mortgage Corporation and Subsidiaries (C&F Mortgage), C&F Finance Company (C&F Finance), C&F Title Agency, Inc., C&F Investment Services, Inc. and C&F Insurance Services, Inc., all incorporated under the laws of the Commonwealth of Virginia. C&F Mortgage, organized in September 1995, was formed to originate and sell residential mortgages and through its subsidiaries, Hometown Settlement Services LLC and Certified Appraisals LLC, provides ancillary mortgage loan production services, such as loan settlements, title searches and residential appraisals. C&F Finance, acquired on September 1, 2002, is a regional finance company providing automobile loans. C&F Title Agency, Inc., organized in October 1992, primarily sells title insurance to the mortgage loan customers of the Bank and C&F Mortgage. C&F Investment Services, Inc., organized in April 1995, is a full-service brokerage firm offering a comprehensive range of investment services. C&F Insurance Services, Inc., organized in July 1999, owns an equity interest in an insurance agency that sells insurance products to customers of the Bank, C&F Mortgage and other financial institutions that have an equity interest in the agency. Business segment data is presented in Note 9.

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

Derivative Financial Instruments: The Corporation recognizes derivative financial instruments at fair value as either an other asset or other liability in the consolidated balance sheets. The derivative financial instruments have been designated as and qualify as cash flow hedges. The effective portion of the gain or loss on cash flow hedges is reported as a component of other comprehensive income, net of deferred income taxes, and reclassified into earnings in the same period or periods during which the hedged transaction affects earnings.

Share-Based Compensation: Compensation expense for the second quarter and first six months of 2011 included net forfeitures of $25,000 ($15,000 after tax benefit) and net expense of $132,000 ($82,000 after tax), respectively, for restricted stock granted since 2006. As of June 30, 2011, there was $1.06 million of total unrecognized compensation expense related to unvested restricted stock that will be recognized over the remaining requisite service periods.

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Stock option activity during the six months ended June 30, 2011 and stock options outstanding as of June 30, 2011 are summarized below:

	Shares	Exercise Price*	Remaining Contractual Life (in years)*	Intrinsic Value of Unexercised In-The Money Options (in 000's)
Options outstanding at January 1, 2011	390,617	$34.95	3.7	
Exercised	(8,500)	16.75		
Cancelled	(2,000)	16.75		
Options outstanding and exercisable at June 30, 2011	380,117	$35.45	3.3	$58

* Weighted average

A summary of activity for restricted stock awards during the first six months of 2011 is presented below:

	Shares	Weighted-Average Grant Date Fair Value
Unvested, January 1, 2011	86,025	$ 25.89
Granted	12,950	$ 22.42
Vested	(4,850)	$ 25.76
Cancelled	(7,150)	$ 27.04
Unvested, June 30, 2011	86,975	$ 25.29

Recent Significant Accounting Pronouncements:

In July 2010, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) No. 2010-20, Disclosures about the Credit Quality of Financing Receivables and the Allowance for Credit Losses (ASU 2010-20). The new disclosure guidance significantly expands the existing disclosure requirements and is intended to lead to greater transparency into a company's exposure to credit losses from lending arrangements. The extensive new disclosures of information as of the end of a reporting period became effective for both interim and annual reporting periods ending after December 15, 2010. Specific items regarding activity that occurred before the issuance of the ASU, such as the allowance rollforward and modification disclosures, are required for periods beginning after December 15, 2010. The adoption of ASU 2010-20 did not have a material effect on the Corporation's consolidated financial statements. The required disclosures have been included in the Corporation's consolidated financial statements.

In December 2010, the FASB issued ASU 2010-28, When to Perform Step 2 of the Goodwill Impairment Test for Reporting Units with Zero or Negative Carrying Amounts. The amendments in this ASU modify Step 1 of the goodwill impairment test for reporting units with zero or negative carrying amounts. For those reporting units, an entity is required to perform Step 2 of the goodwill impairment test if it is more likely than not that a goodwill impairment exists. For public entities, the amendments in this ASU were effective for fiscal years, and interim periods within those years, beginning after December 15, 2010. Early adoption was not permitted. The adoption of the new guidance did not have a material effect on the Corporation's consolidated financial statements.

In April 2011, the FASB issued ASU 2011-02, A Creditor's Determination of Whether a Restructuring Is a Troubled Debt Restructuring. The amendments in this ASU are intended to provide guidance to allow a creditor to determine whether a restructuring is a troubled debt restructuring (TDR) by clarifying the guidance on a creditor's evaluation of whether it has granted a concession or not and whether a debtor is experiencing financial difficulties or not. The amendments in this ASU are effective for periods beginning after June 15, 2011 and should be applied retrospectively to the beginning of the annual period of adoption. Upon adoption, the disclosure requirements promulgated in ASU 2010-20 related to TDRs will become effective. The adoption of ASU 2011-02 is not expected to have a material effect on the Corporation's consolidated financial statements.

In April 2011, the FASB issued ASU 2011-03, Transfers and Servicing – Reconsideration of Effective Control for Repurchase Agreements. The amendments in this ASU remove from the assessment of effective control (1) the criterion requiring the transferor to have the ability to repurchase or redeem the financial assets on substantially the agreed terms, even in the event of default by the transferee and (2) the collateral maintenance implementation guidance related to that criterion. The amendments in this ASU are effective for the first interim or annual period beginning on or after December 15, 2011. The guidance should be applied prospectively to transactions or modification of existing transactions that occur on or after the effective date. The adoption of the new guidance is not expected to have a material effect on the Corporation's consolidated financial statements.

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In May 2011, the FASB issued ASU 2011-04, Fair Value Measurement – Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs. This ASU is the result of joint efforts by the FASB and the International Accounting Standards Board to develop a single, converged fair value framework on how (not when) to measure fair value and what disclosures to provide about fair value measurements. The ASU is largely consistent with existing fair value measurement principles in U.S. GAAP, with many of the amendments made to eliminate unnecessary wording differences between U.S. GAAP and International Financial Reporting Standards. The amendments are effective for interim and annual periods beginning after December 15, 2011, with prospective application. The adoption of the amendments is not expected to have a material effect on the Corporation's consolidated financial statements.

In June 2011, the FASB issued ASU 2011-05, Comprehensive Income – Presentation of Comprehensive Income. The objective of this ASU is to improve the comparability, consistency and transparency of financial reporting and to increase the prominence of items reported in other comprehensive income by eliminating the option to present components of other comprehensive income as part of the statement of changes in stockholders' equity. The amendments require that all non-owner changes in stockholders' equity be presented either in a single continuous statement of comprehensive income or in two separate but consecutive statements. The amendments do not change the items that must be reported in other comprehensive income, the option for an entity to present components of other comprehensive income either net of related tax effects or before related tax effects, or the calculation or reporting of earnings per share. The amendments in this ASU should be applied retrospectively. The amendments are effective for fiscal years and interim periods within those years beginning after December 15, 2011. Early adoption is permitted because compliance with the amendments is already permitted. The amendments do not require transition disclosures. The adoption of the amendments is not expected to have a material effect on the Corporation's consolidated financial statements.

The SEC issued Final Rule No. 33-9002, Interactive Data to Improve Financial Reporting. The rule requires companies to submit financial statements in extensible business reporting language (i.e., XBRL) format with their SEC filings on a phased-in schedule. Based on this schedule, the Corporation is required to provide interactive data reports starting with the quarterly report for the period ending June 30, 2011. The rule had no effect on the Corporation's consolidated financial statements. The interactive data reports have been included in this quarterly report as Exhibit 101.

NOTE 2: Securities

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

	June 30, 2011			
(Dollars in thousands)	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
U.S. government agencies and corporations	$12,506	$72	$(4)	$12,574
Mortgage-backed securities	2,608	91	—	2,699
Obligations of states and political subdivisions	120,942	3,980	(194)	124,728
Preferred stock	27	126	—	153
	$136,083	$4,269	$(198)	$140,154

	December 31, 2010			
(Dollars in thousands)	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value

U.S. government agencies and corporations	$13,629	$57	$(30)	$13,656
Mortgage-backed securities	2,229	78	(7)	2,300
Obligations of states and political subdivisions	113,620	1,694	(1,026)	114,288
Preferred stock	27	7	(3)	31
	$129,505	$1,836	$(1,066)	$130,275

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The amortized cost and estimated fair value of securities, all of which were classified as available for sale, at June 30, 2011, by the earlier of contractual maturity or expected maturity, are shown below. Expected maturities will differ from contractual maturities because borrowers may have the right to prepay obligations with or without call or prepayment penalties.

	June 30, 2011	
(Dollars in thousands)	Amortized Cost	Estimated Fair Value
Due in one year or less	$ 27,613	$ 27,811
Due after one year through five years	30,332	30,923
Due after five years through ten years	49,854	51,712
Due after ten years	28,257	29,555
Preferred stock	27	153
	$ 136,083	$ 140,154

Proceeds from the maturities, calls and sales of securities available for sale for the six months ended June 30, 2011 were $15.31 million.

The Corporation pledges securities primarily as collateral for public deposits and repurchase agreements. Securities with an aggregate amortized cost of $89.80 million and an aggregate fair value of $92.79 million were pledged at June 30, 2011. Securities with an aggregate amortized cost of $93.56 million and an aggregate fair value of $94.28 million were pledged at December 31, 2010.

Securities in an unrealized loss position at June 30, 2011, by duration of the period of the unrealized loss, are shown below.

	Less Than 12 Months		12 Months or More		Total	
(Dollars in thousands)	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss
U.S. government agencies and corporations	$1,529	$4	$—	$—	$1,529	$4
Obligations of states and political subdivisions	9,040	107	1,408	87	10,448	194
Total temporarily impaired securities	$10,569	$111	$1,408	$87	$11,977	$198