C & F FINANCIAL CORP
Form 10-Q
August 11, 2014

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, 2014

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

For the transition period from to

Commission File Number: 000-23423

C&F Financial Corporation

(Exact name of registrant as specified in its charter)

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, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

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

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

At August 6, 2014, the latest practicable date for determination, 3,405,986 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, 2014 (Unaudited)	December 31, 2013
ASSETS		
Cash and due from banks	**$ 10,782**	$ 14,666
Interest-bearing deposits in other banks	**171,572**	41,750
Federal funds sold	**—**	91,723
Total cash and cash equivalents	**182,354**	148,139
Securities-available for sale at fair value, amortized cost of $211,794 and $217,708, respectively	**217,308**	218,110
Loans held for sale, at fair value	**33,603**	35,879
Loans, net of allowance for loan losses of $35,258 and $34,852, respectively	**791,170**	785,532
Restricted stocks, at cost	**3,690**	4,336
Corporate premises and equipment, net	**38,937**	39,142
Other real estate owned, net of valuation allowance of $188 and $4,135, respectively	**817**	2,769
Accrued interest receivable	**6,255**	6,360
Goodwill	**16,630**	16,630
Core deposit intangible, net	**3,151**	3,774
Bank-owned life insurance	**14,176**	13,988
Other assets	**39,400**	37,638
Total assets	**$ 1,347,491**	$ 1,312,297
LIABILITIES AND SHAREHOLDERS' EQUITY		
Deposits		
Noninterest-bearing demand deposits	**$ 176,868**	$ 147,520
Savings and interest-bearing demand deposits	**483,096**	460,889
Time deposits	**379,788**	399,883
Total deposits	**1,039,752**	1,008,292
Short-term borrowings	**11,535**	11,780
Long-term borrowings	**132,987**	132,987
Trust preferred capital notes	**25,086**	25,068
Accrued interest payable	**807**	843
Other liabilities	**18,121**	20,386

Total liabilities	**1,228,288**	1,199,356
Commitments and contingent liabilities	**—**	—
Shareholders' equity		
Common stock ($1.00 par value, 8,000,000 shares authorized, 3,405,321 and 3,388,793 shares issued and outstanding, respectively)	**3,278**	3,269
Additional paid-in capital	**8,919**	10,686
Retained earnings	**103,878**	99,252
Accumulated other comprehensive income (loss), net	**3,128**	(266)
Total shareholders' equity	**119,203**	112,941
Total liabilities and shareholders' equity	**$ 1,347,491**	$ 1,312,297

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

CONSOLIDATED STATEMENTS OF INCOME

(Unaudited)

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2014	**2013**	**2014**	**2013**
Interest income				
Interest and fees on loans	**$19,849**	$17,918	**$39,316**	$35,737
Interest on money market investments and federal funds sold	**115**	38	**196**	61
Interest and dividends on securities				
U.S. government agencies and corporations	**190**	100	**384**	206
Tax-exempt obligations of states and political subdivisions	**1,105**	1,136	**2,232**	2,278
Corporate bonds and other	**453**	38	**878**	71
Total interest income	**21,712**	19,230	**43,006**	38,353
Interest expense				
Savings and interest-bearing deposits	**248**	186	**520**	405
Certificates of deposit, $100 or more	**317**	354	**670**	729
Other time deposits	**463**	468	**951**	953
Borrowings	**878**	885	**1,748**	1,766
Trust preferred capital notes	**235**	189	**472**	377
Total interest expense	**2,141**	2,082	**4,361**	4,230
Net interest income	**19,571**	17,148	**38,645**	34,123
Provision for loan losses	**3,265**	3,120	**6,775**	6,300
Net interest income after provision for loan losses	**16,306**	14,028	**31,870**	27,823
Noninterest income				
Gains on sales of loans	**1,647**	3,577	**2,837**	5,278
Service charges on deposit accounts	**1,116**	996	**2,178**	1,920
Other service charges and fees	**1,615**	1,472	**2,996**	2,976
Net gains on sales/calls of available for sale securities	**3**	4	**3**	6
Other income	**885**	914	**2,064**	1,881
Total noninterest income	**5,266**	6,963	**10,078**	12,061
Noninterest expenses				
Salaries and employee benefits	**9,065**	8,229	**18,224**	15,298
Occupancy expenses	**2,183**	1,770	**4,315**	3,538
Other expenses	**5,008**	4,549	**10,071**	8,741
Total noninterest expenses	**16,256**	14,548	**32,610**	27,577

Income before income taxes	**5,316**	6,443	**9,338**	12,307
Income tax expense	**1,574**	2,265	**2,703**	4,123
Net income	**$3,742**	$4,178	**$6,635**	$8,184
Per common share data				
Net income – basic	**$1.10**	$1.28	**$1.95**	$2.50
Net income – assuming dilution	**$1.09**	$1.22	**$1.91**	$2.41
Weighted average number of shares – basic	**3,405,245**	3,276,039	**3,403,042**	3,271,376
Weighted average number of shares – assuming dilution	**3,442,468**	3,413,052	**3,467,054**	3,392,165

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

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CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(Unaudited)

(In thousands)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2014	**2013**	**2014**	**2013**
Net income	**$3,742**	$4,178	**$6,635**	$8,184
Other comprehensive income (loss), net:				
Changes in defined benefit plan assets and benefit obligations				
Changes in net loss arising during the period[1]	**(8)**	31	**(16)**	61
Tax effect	**3**	(11)	**6**	(21)
Amortization of prior service cost[1]	**17**	(17)	**34**	(34)
Tax effect	**(6)**	6	**(12)**	12
Net of tax amount	**6**	9	**12**	18
Unrealized gain on cash flow hedging instruments				
Unrealized holding gain arising during the period	**46**	67	**86**	116
Tax effect	**(19)**	(26)	**(34)**	(45)
Net of tax amount	**27**	41	**52**	71
Unrealized holding gains (losses) on securities				
Unrealized holding gains (losses) arising during the period	**1,943**	(4,960)	**5,113**	(5,785)
Tax effect	**(680)**	1,736	**(1,781)**	2,025
Reclassification adjustment for gains included in net income[2]	**(3)**	(4)	**(3)**	(6)
Tax effect	**1**	1	**1**	2
Net of tax amount	**1,261**	(3,227)	**3,330**	(3,764)
Other comprehensive income (loss), net:	**1,294**	(3,177)	**3,394**	(3,675)
Comprehensive income, net	**$5,036**	$1,001	**$10,029**	$4,509

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

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

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

CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY

(Unaudited)

(In thousands, except per share amounts)

	Common Stock	Additional Paid-In Capital	Retained Earnings	Accumulated Other Comprehensive Income (Loss), Net	Total Shareholders' Equity
Balance December 31, 2013	**$ 3,269**	**$ 10,686**	**$ 99,252**	**$ (266)**	**$ 112,941**
Comprehensive income:					
Net income	**—**	**—**	**6,635**	**—**	**6,635**
Other comprehensive income, net	**—**	**—**	**—**	**3,394**	**3,394**
Common stock warrant repurchased	**—**	**(2,303)**	**—**	**—**	**(2,303)**
Share-based compensation	**—**	**487**	**—**	**—**	**487**
Restricted stock vested	**7**	**(15)**	**—**	**—**	**(8)**
Common stock issued	**2**	**64**	**—**	**—**	**66**
Cash dividends paid – common stock ($0.59 per share)	**—**	**—**	**(2,009)**	**—**	**(2,009)**
Balance June 30, 2014	**$ 3,278**	**$ 8,919**	**$ 103,878**	**$ 3,128**	**$ 119,203**

	Common Stock	Additional Paid-In Capital	Retained Earnings	Accumulated Other Comprehensive Income (Loss), Net	Total Shareholders' Equity
Balance December 31, 2012	$ 3,162	$ 5,624	$ 88,695	$ 4,716	$ 102,197
Comprehensive income:					
Net income	—	—	8,184	—	8,184
Other comprehensive (loss), net	—	—	—	(3,675)	(3,675)
Stock options exercised	17	646	—	—	663
Share-based compensation	—	289	—	—	289
Restricted stock vested	5	(5)	—	—	—

Common stock issued	1	41	—	—	42
Cash dividends paid – common stock ($0.58 per share)	—	—	(1,900)	—	(1,900)
Balance June 30, 2013	$3,185	$6,595	$94,979	$1,041	$105,800

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

CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited)

(In thousands)

	Six Months Ended June 30, 2014	2013
Operating activities:		
Net income	**$6,635**	$8,184
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation	**1,403**	1,128
Provision for loan losses	**6,775**	6,300
Provision for indemnifications	**109**	375
Provision for other real estate owned losses	**—**	308
Share-based compensation	**479**	289
Net accretion of acquisition-related fair value adjustments	**(1,664)**	—
Accretion of discounts and amortization of premiums on securities, net	**629**	335
Net realized gains on sales/calls of securities	**(3)**	(6)
Net realized gains on sales of other real estate owned	**(227)**	(115)
Net realized gain on sale of equipment	**(38)**	—
Income from bank-owned life insurance	**(188)**	—
Proceeds from sales of loans held for sale	**219,742**	403,617
Origination of loans held for sale	**(217,466)**	(390,202)
Change in other assets and liabilities:		
Accrued interest receivable	**105**	128
Other assets	**(3,590)**	(1,736)
Accrued interest payable	**(36)**	(51)
Other liabilities	**(2,378)**	(126)
Net cash provided by operating activities	**10,287**	28,428
Investing activities:		
Proceeds from maturities, calls and sales of securities available for sale	**21,545**	15,357
Purchases of securities available for sale	**(15,981)**	(16,248)
Redemption of restricted stocks	**646**	219
Net increase in customer loans	**(12,870)**	(4,644)
Proceeds from sales of other real estate owned	**4,274**	2,188
Purchases of corporate premises and equipment, net	**(1,218)**	(1,897)
Net cash used in investing activities	**(3,604)**	(5,025)
Financing activities:		
Net increase in demand, interest-bearing demand and savings deposits	**51,555**	13,292
Net decrease in time deposits	**(19,532)**	(5,679)
Net (decrease) increase in borrowings	**(245)**	4,392
Proceeds from exercise of stock options	**—**	663

Repurchase of common stock warrant	**(2,303)**	—
Issuance of common stock	**66**	42
Cash dividends	**(2,009)**	(1,900)
Net cash provided by financing activities	**27,532**	10,810
Net increase in cash and cash equivalents	**34,215**	34,213
Cash and cash equivalents at beginning of period	**148,139**	25,620
Cash and cash equivalents at end of period	**$182,354**	$59,833
Supplemental disclosure		
Interest paid	**$4,942**	$4,281
Income taxes paid	**2,041**	3,034
Supplemental disclosure of noncash investing and financing activities		
Unrealized gains (losses) on securities available for sale	**$5,110**	$(5,791)
Loans transferred to other real estate owned	**1,980**	(70)
Pension adjustment	**18**	27
Unrealized gain on cash flow hedging instrument	**86**	116

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

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

NOTE 1: Summary of Significant Accounting Policies

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

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

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

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

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

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

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

Share-Based Compensation: Compensation expense for the second quarter of 2014 and first six months of 2014 included expense, net of forfeitures, of $246,000 ($153,000 after tax) and $487,000 ($302,000 after tax), respectively, for restricted stock granted during 2009 through 2014. As of June 30, 2014, there was $2.69 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 2014 is presented below:

	Shares	**Weighted-Average Grant Date Fair Value**
Unvested, January 1, 2014	120,183	$ 31.18
Granted	15,750	$ 41.38
Vested	(8,100)	$ 18.77
Forfeitures	(700)	$ 33.96
Unvested, June 30, 2014	127,133	$ 33.22

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

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

Options outstanding and exercisable at June 30, 2014	152,150	$ 38.27	1.3	$ 9

*Weighted average

Recent Significant Accounting Pronouncements:

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

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

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

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

NOTE 2: Business Combinations

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

The Corporation accounted for the acquisition using the acquisition method of accounting in accordance with Accounting Standards Codification (ASC) 805, *Business Combinations*. Under the acquisition method of accounting, the assets and liabilities of CVBK were recorded at their respective acquisition date fair values. Determining the fair value of assets and liabilities, particularly related to the loan portfolio, is a complicated process involving significant judgment regarding methods and assumptions used to calculate the estimated fair values. The fair values are preliminary and subject to refinement for up to one year after the acquisition date as additional information relative to the acquisition date fair values becomes available. The Corporation has not made any such adjustments since the acquisition date. The following table details the total consideration paid by the Corporation on October 1, 2013 in connection with the acquisition of CVBK, the fair values of the assets acquired and liabilities assumed, and the resulting goodwill.

(Dollars in thousands)	**As Recorded by CVBK**	**Fair Value Adjustments**	**As Recorded by the Corporation**
Consideration paid:			
CVBK common stock			$ 846
CVBK preferred stock and warrants			3,350
Total consideration paid			4,196
Identifiable assets acquired:			
Cash and cash equivalents	$ 59,775	$ —	$ 59,775
Securities available for sale, at fair value	119,916	181	120,097
Loans, net of allowance and unearned income	164,814	(17,748)	147,066
Corporate premises and equipment, net	7,448	3,500	10,948
Other real estate owned, net	895	(500)	395
Core deposit intangibles	41	4,066	4,107
Other assets	16,623	6,030	22,653
Total identifiable assets acquired	369,512	(4,471)	365,041
Identifiable liabilities assumed:			
Deposits	313,711	1,710	315,421
Borrowings	40,000	2,124	42,124
Trust preferred capital notes	5,155	(716)	4,439
Other liabilities	4,684	84	4,768
Total identifiable liabilities assumed	363,550	3,202	366,752
Net identifiable assets (liabilities) assumed	$ 5,962	$ (7,673)	(1,711)
Goodwill resulting from acquisition			$ 5,907

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

(Dollars in thousands)	**Unaudited Pro Forma Three Months**	**Unaudited Pro Forma Six Months Ended**

	Ended June 30, 2013	**June 30, 2013**
Total revenues, net of interest expense	$ 28,044	$ 54,159
Net income	4,205	9,037

NOTE 3: Securities

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

(Dollars in thousands)	**June 30, 2014** Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
U.S. government agencies and corporations	**$29,723**	**$ 27**	**$ (848)**	**$ 28,902**
Mortgage-backed securities	**57,411**	**585**	**(244)**	**57,752**
Obligations of states and political subdivisions	**124,660**	**6,296**	**(302)**	**130,654**
	$211,794	**$ 6,908**	**$ (1,394)**	**$ 217,308**

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

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

(Dollars in thousands)	**June 30, 2014** Amortized	Estimated

	Cost	Fair Value
Due in one year or less	**$28,062**	**$27,899**
Due after one year through five years	**90,906**	**93,851**
Due after five years through ten years	**63,093**	**64,459**
Due after ten years	**29,733**	**31,099**
	$211,794	**$217,308**

Proceeds from the maturities, calls and sales of securities available for sale for the six months ended June 30, 2014 were $21.55 million.

The Corporation pledges securities primarily as collateral for public deposits and repurchase agreements. Securities with an aggregate amortized cost of $105.19 million and an aggregate fair value of $108.01 million were pledged at June 30, 2014. Securities with an aggregate amortized cost of $149.22 million and an aggregate fair value of $149.83 million were pledged at December 31, 2013.

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

	Less Than 12 Months		**12 Months or More**		**Total**	
	Fair	**Unrealized**	**Fair**	**Unrealized**	**Fair**	**Unrealized**
(Dollars in thousands)	**Value**	**Loss**	**Value**	**Loss**	**Value**	**Loss**
U.S. government agencies and corporations	**$7,370**	**$ 87**	**$21,147**	**$ 761**	**$28,517**	**$ 848**
Mortgage backed securities	**8,330**	**177**	**1,442**	**67**	**9,772**	**244**
Obligations of states and political subdivisions	**5,765**	**83**	**10,448**	**219**	**16,213**	**302**
Total temporarily impaired securities	**$21,465**	**$ 347**	**$33,037**	**$ 1,047**	**$54,502**	**$ 1,394**

There are 96 debt securities totaling $54.50 million considered temporarily impaired at June 30, 2014. The Corporation's unrealized loss position has improved since December 31, 2013 because interest rates fell during the first half of 2014, primarily in the intermediate and long-end of the United States Treasury yield curve, thereby increasing market values of the Corporation's portfolio of securities of U.S. government agencies and corporations and obligations of states and political subdivisions. The United States fixed income markets continued to rally throughout the second quarter due to uneven economic performance, low levels of inflation and the accommodative monetary policy maintained by the Federal Reserve. At June 30, 2014, approximately 97 percent of the Corporation's obligations of states and political subdivisions, as measured by market value, were rated “A” or better by Standard & Poor's or Moody's Investors Service. Of those in a net unrealized loss position, approximately 96 percent were rated “A” or better, as measured by market value, at June 30, 2014. For the approximate four percent not rated “A” or better, as measured by market value at June 30, 2014, the Corporation considers these to meet regulatory credit quality standards, such that the securities have low risk of default by the obligor, and the full and timely repayment of principal and interest is expected over the expected life of the investment. Because the Corporation intends to hold these investments in debt securities to maturity and it is more likely than not that the Corporation will not be required to sell these investments before a recovery of unrealized losses, the Corporation does not consider these investments to be other-than-temporarily impaired at June 30, 2014 and no other-than-temporary impairment has been recognized.

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

	Less Than 12 Months		**12 Months or More**		**Total**	
	Fair	**Unrealized**	**Fair**	**Unrealized**	**Fair**	**Unrealized**
(Dollars in thousands)	**Value**	**Loss**	**Value**	**Loss**	**Value**	**Loss**
U.S. government agencies and corporations	$29,430	$ 1,385	$8,948	$ 1,172	$38,378	$ 2,557

Mortgage-backed securities	40,090	555	—	—	40,090	555
Obligations of states and political subdivisions	21,260	656	3,078	157	24,338	813
Total temporarily impaired securities	$90,780	$ 2,596	$12,026	$ 1,329	$102,806	$ 3,925

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

NOTE 4: Loans

Major classifications of loans are summarized as follows:

(Dollars in thousands)	**June 30, 2014**	**December 31, 2013**
Real estate – residential mortgage	**$180,514**	$188,455
Real estate – construction [1]	**7,580**	5,810
Commercial, financial and agricultural [2]	**295,545**	288,593
Equity lines	**50,577**	50,795
Consumer	**8,239**	9,007
Consumer finance	**283,973**	277,724
	826,428	820,384
Less allowance for loan losses	**(35,258)**	(34,852)
Loans, net	**$791,170**	$785,532

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 $338,000 and $354,000 of demand deposit overdrafts at June 30, 2014 and December 31, 2013, respectively.

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

	June 30, 2014			**December 31, 2013**		
(Dollars in thousands)	**Acquired Loans -Purchased Credit Impaired (PCI)**	**Acquired Loans -Purchased Performing**	**Acquired Loans - Total**	**Acquired Loans -Purchased Credit Impaired**	**Acquired Loans -Purchased Performing**	**Acquired Loans - Total**
Outstanding principal balance	**$42,616**	**$ 98,071**	**$140,687**	$49,041	$ 110,977	$160,018
Carrying amount						
Real estate – residential mortgage	**$2,078**	**$ 20,135**	**$22,213**	$2,694	$ 29,285	$31,979

Real estate – construction[1]	**401**	**191**	**592**	771	917	1,688
Commercial, financial and agricultural[2]	**24,619**	**54,421**	**79,040**	28,602	55,204	83,806
Equity lines	**334**	**16,403**	**16,737**	332	16,909	17,241
Consumer	**24**	**1,438**	**1,462**	121	2,156	2,277
Total acquired loans	**$27,456**	**$ 92,588**	**$120,044**	$32,520	$ 104,471	$136,991

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.

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Loans on nonaccrual status were as follows:

(Dollars in thousands)	**June 30, 2014**	**December 31, 2013**
Real estate – residential mortgage	**$2,153**	$ 1,996
Commercial, financial and agricultural:		
Commercial real estate lending	**1,702**	1,486
Land acquisition and development lending	**—**	—
Builder line lending	**—**	13
Commercial business lending	**374**	374
Equity lines	**209**	291
Consumer	**232**	231
Consumer finance	**646**	1,187
Total loans on nonaccrual status	**$5,316**	$ 5,578

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

(Dollars in thousands)	**30-59 Days Past Due**	**60-89 Days Past Due**	**90+ Days Past Due**	**Total Past Due**	**Current [1]**	**Total Loans**	**90+ Days Past Due and Accruing**
Real estate – residential mortgage	**$1,038**	**$919**	**$1,482**	**$3,439**	**$177,075**	**$180,514**	**$ 72**
Real estate – construction:							
Construction lending	**—**	**—**	**—**	**—**	**4,408**	**4,408**	**—**
Consumer lot lending	**—**	**—**	**—**	**—**	**3,172**	**3,172**	**—**
Commercial, financial and agricultural:							
Commercial real estate lending	**904**	**103**	**942**	**1,949**	**184,268**	**186,217**	**178**
Land acquisition and development lending	**—**	**—**	**2,936**	**2,936**	**30,710**	**33,646**	**—**
Builder line lending	**—**	**—**	**—**	**—**	**18,132**	**18,132**	**—**
Commercial business lending	**364**	**11**	**342**	**717**	**56,833**	**57,550**	**—**
Equity lines	**349**	**17**	**35**	**401**	**50,176**	**50,577**	**—**
Consumer	**35**	**32**	**194**	**261**	**7,978**	**8,239**	**—**
Consumer finance	**9,670**	**2,491**	**646**	**12,807**	**271,166**	**283,973**	**—**
Total	**$12,360**	**$3,573**	**$6,577**	**$22,510**	**$803,918**	**$826,428**	**$ 250**

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

The table above includes the following:

- nonaccrual loans that are current of $2.56 million, 30-59 days past due of $90,000, 60-89 days past due of $92,000 and 90+ days past due of $2.57 million and
- loans purchased (both performing and PCI) in the acquisition of CVBK that are current of $114.69 million, 30-59 days past due of $1.39 million, 60-89 days past due of $161,000 and 90+ days past due of $3.80 million.

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

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

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

The table above includes the following:

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

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

	Three Months Ended June 30,			
	2014		2013	
(Dollars in thousands)	Number of Loans	Post-Modification Recorded Investment	Number of Loans	Post-Modification Recorded Investment

Real estate - residential mortgage - interest rate concession	**1**	**$**	**328**	1	$	89
Commercial, financial and agricultural:						
Commercial real estate lending - interest rate concession	**—**		**—**	1		473
Builder line lending - interest rate concession	**—**		**—**	1		17
Total	**1**	**$**	**328**	3	$	579

(Dollars in thousands)	**Six Months Ended June 30, 2014** Number of Loans	Post-Modification Recorded Investment	**2013** Number of Loans	Post-Modification Recorded Investment
Real estate - residential mortgage - interest rate concession	**1**	**$ 328**	1	$ 89
Commercial, financial and agricultural:				
Commercial real estate lending - interest rate concession	**—**	**—**	2	479
Builder line lending - interest rate concession	**—**	**—**	1	17
Total	**1**	**$ 328**	4	$ 585

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

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

(Dollars in thousands)	**Recorded Investment in Loans**	**Unpaid Principal Balance**	**Related Allowance**	**Average Balance-Impaired Loans**	**Interest Income Recognized**
Real estate – residential mortgage	**$ 2,348**	**$ 2,460**	**$ 430**	**$ 2,374**	**$ 57**
Commercial, financial and agricultural:					
Commercial real estate lending	**2,711**	**2,851**	**416**	**2,776**	**65**
Builder line lending	**—**	**—**	**—**	**—**	**—**
Commercial business lending	**489**	**489**	**129**	**492**	**5**
Equity lines	**30**	**32**	**1**	**32**	**—**
Consumer	**93**	**93**	**14**	**93**	**2**
Total	**$ 5,671**	**$ 5,925**	**$ 990**	**$ 5,767**	**$ 129**

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

(Dollars in thousands)	**Recorded Investment in**	**Unpaid Principal**	**Related Allowance**	**Average Balance-Impaired**	**Interest Income**

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

PCI loans had an unpaid principal balance of $42.62 million and a carrying value of $27.46 million at June 30, 2014. Determining the fair value of purchased credit impaired loans required the Corporation to estimate cash flows expected to result from those loans and to discount those cash flows at appropriate rates of interest. For such loans, the excess of the cash flows expected at acquisition over the estimated fair value is recognized as interest income over the remaining lives of the loans and is called the accretable yield. The difference between contractually required payments at acquisition and the cash flows expected to be collected at acquisition reflects the effect of estimated credit losses and is called the nonaccretable difference. In accordance with GAAP, there was no carry-over of previously established allowance for loan losses from acquired loans.

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

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

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

(Dollars in thousands)	**Accretable Yield**
Accretable yield, December 31, 2013	$ 7,776
Accretion	(1,529)
Reclassification of nonaccretable difference due to improvement in expected cash flows	1,820
Changes in expected cash flows [1]	7,056
Accretable yield, June 30, 2014	$ 15,123

[1] Represents changes in cash flows expected to be collected due to the effects of changes in recovery approach and prepayment assumptions.

NOTE 5: 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, 2014.

(Dollars in thousands)	Real Estate Residential Mortgage	Real Estate Construction	Commercial, Financial and Agricultural	Equity Lines	Consumer	Consumer Finance	Total
Allowance for loan losses:							
Balance at December 31, 2013	$ 2,355	$ 434	$ 7,805	$ 892	$ 273	$ 23,093	$ 34,852
Provision charged to operations	30	—	—	—	—	6,745	6,775
Loans charged off	(79)	—	(174)	(47)	(147)	(8,098)	(8,545)
Recoveries of loans previously charged off	24	—	47	—	170	1,935	2,176
Balance at June 30, 2014	$ 2,330	$ 434	$ 7,678	$ 845	$ 296	$ 23,675	$ 35,258

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

(Dollars in thousands)	**Real Estate Residential Mortgage**	**Real Estate Construction**	**Commercial, Financial and Agricultural**	**Equity Lines**	**Consumer**	**Consumer Finance**	**Total**
Allowance for loan losses:							
Balance at December 31, 2012	$ 2,358	$ 424	$ 9,824	$ 885	$ 283	$ 22,133	$ 35,907
Provision charged to operations	522	50	328	11	149	5,240	6,300
Loans charged off	(475)	—	(2,270)	(37)	(228)	(6,361)	(9,371)
Recoveries of loans previously charged off	86	—	60	27	79	1,681	1,933
Balance at June 30, 2013	$ 2,491	$ 474	$ 7,942	$ 886	$ 283	$ 22,693	$ 34,769

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

(Dollars in thousands)	**Real Estate Residential Mortgage**	**Real Estate Construction**	**Commercial, Financial and Agricultural**	**Equity Lines**	**Consumer**	**Consumer Finance**	**Total**
Allowance for loan losses:							
Balance at June 30, 2014	**$ 2,330**	**$ 434**	**$ 7,678**	**$ 845**	**$ 296**	**$ 23,675**	**$ 35,258**
Ending balance: individually evaluated for impairment	**$ 430**	**$ —**	**$ 545**	**$ 1**	**$ 14**	**$ —**	**$ 990**
Ending balance: collectively evaluated for impairment	**$ 1,900**	**$ 434**	**$ 7,133**	**$ 844**	**$ 282**	**$ 23,675**	**$ 34,268**
Ending balance: PCI loans	**$ —**	**$ —**	**$ —**	**$ —**	**$ —**	**$ —**	**$ —**
Loans:							
Balance at June 30, 2014	**$ 180,514**	**$ 7,580**	**$ 295,545**	**$ 50,577**	**$ 8,239**	**$ 283,973**	**$ 826,428**
Ending balance: individually evaluated for impairment	**$ 2,348**	**$ —**	**$ 3,200**	**$ 30**	**$ 93**	**$ —**	**$ 5,671**
Ending balance: collectively evaluated for impairment	**$ 176,088**	**$ 7,179**	**$ 267,726**	**$ 50,213**	**$ 8,122**	**$ 283,973**	**$ 793,301**

Ending balance: PCI loans	**$ 2,078**	**$ 401**	**$ 24,619**	**$ 334**	**$ 24**	**$ —**	**$ 27,456**

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

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

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

(Dollars in thousands)	**Pass**	**Special Mention**	**Substandard**	**Substandard Nonaccrual**	**Total[1]**
Real estate – residential mortgage	**$172,699**	**$1,975**	**$3,687**	**$2,153**	**$180,514**
Real estate – construction:					
Construction lending	**1,759**	**—**	**2,649**	**—**	**4,408**
Consumer lot lending	**3,085**	**87**	**—**	**—**	**3,172**
Commercial, financial and agricultural:					
Commercial real estate lending	**166,679**	**4,403**	**13,434**	**1,702**	**186,218**
Land acquisition and development lending	**28,608**	**1,341**	**3,697**	**—**	**33,646**
Builder line lending	**16,390**	**1,174**	**568**	**—**	**18,132**
Commercial business lending	**43,174**	**1,231**	**12,771**	**374**	**57,550**
Equity lines	**48,644**	**775**	**949**	**209**	**50,577**

Consumer	**7,889**	**2**	**116**	**232**	**8,239**
	$488,927	**$10,988**	**$37,871**	**$4,670**	**$542,456**

[1] At June 30, 2014, the Corporation did not have any loans classified as Doubtful or Loss.

Included in the table above are loans purchased in connection with the acquisition of CVBK of $102.44 million pass rated, $2.82 million special mention, $14.14 million substandard and $641,000 substandard nonaccrual.

(Dollars in thousands)	**Performing**	**Non-Performing**	**Total**
Consumer finance	**$283,327**	**$646**	**$283,973**

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

(Dollars in thousands)	**Pass**	**Special Mention**	**Substandard**	**Substandard Nonaccrual**	**Total[1]**
Real estate – residential mortgage	$180,670	$2,209	$ 3,580	$ 1,996	$188,455
Real estate – construction:					
Construction lending	1,068	11	2,649	—	3,728
Consumer lot lending	1,831	105	146	—	2,082
Commercial, financial and agricultural:					
Commercial real estate lending	152,017	2,934	11,685	1,486	168,122
Land acquisition and development lending	18,236	1,601	5,803	—	25,640
Builder line lending	11,608	1,278	527	13	13,426
Commercial business lending	61,715	2,758	16,558	374	81,405
Equity lines	48,603	1,003	898	291	50,795
Consumer	8,616	2	158	231	9,007
	$484,364	$11,901	$ 42,004	$ 4,391	$542,660

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

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

(Dollars in thousands)	**Performing**	**Non-Performing**	**Total**
Consumer finance	$ 276,537	$ 1,187	$277,724

NOTE 6: Shareholders' Equity and Earnings Per Common Share

Accumulated Other Comprehensive Income (Loss)

The following table presents the cumulative balances of the components of accumulated other comprehensive income (loss), net of deferred tax of $1.66 million and $163,000 as of June 30, 2014 and December 31, 2013, respectively.

(Dollars in thousands)	**June 30, 2014**	**December 31, 2013**
Net unrealized gains on securities	**$3,591**	$ 261
Net unrecognized loss on cash flow hedges	**(150)**	(202)
Net unrecognized losses on defined benefit plan	**(313)**	(325)
Total accumulated other comprehensive income (loss)	**$3,128**	$ (266)

Common Shares

During the first six months of 2014, the Corporation repurchased 225 shares of its common stock from employees to satisfy tax withholding obligations arising upon the vesting of restricted shares. There were no stock repurchases during the first six months of 2013.

Earnings Per Common Share

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

(Dollars in thousands)	**Three Months Ended June 30,**	
	2014	**2013**
Net income	**$3,742**	$4,178
Weighted average number of common shares used in earnings per common share – basic	**3,405,245**	3,276,039
Effect of dilutive securities:		
Stock option awards and Warrant	**37,223**	137,013
Weighted average number of common shares used in earnings per common share – assuming dilution	**3,442,468**	3,413,052

(Dollars in thousands)	**Six Months Ended June 30,**	
	2014	**2013**
Net income available to common shareholders	**$6,635**	$8,184
Weighted average number of common shares used in earnings per common share – basic	**3,403,042**	3,271,376
Effect of dilutive securities:		
Stock option awards and Warrant	**64,012**	120,789
Weighted average number of common shares used in earnings per common share – assuming dilution	**3,467,054**	3,392,165

Potential common shares that may be issued by the Corporation for its stock option awards and Warrant are determined using the treasury stock method. Approximately 156,110 and 500 shares issuable upon exercise of options were not included in computing diluted earnings per common share for the three months ended June 30, 2014 and 2013, respectively, and approximately 136,130 and 35,100 shares issuable upon exercise of options were not included in computing earnings per common share for the six months ended June 30, 2014 and 2013, respectively, because they were anti-dilutive.

NOTE 7: Employee Benefit Plan

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

(Dollars in thousands)	**Three Months Ended June 30,**		**Six Months Ended June 30,**	
	2014	2013	**2014**	2013
Service cost	**$191**	$194	**$382**	$388
Interest cost	**113**	107	**226**	213
Expected return on plan assets	**(208)**	(187)	**(416)**	(374)
Amortization of prior service cost	**(17)**	(17)	**(34)**	(34)
Amortization of net loss	**8**	31	**16**	61
Net periodic benefit cost	**$87**	$128	**$174**	$254

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NOTE 8: Fair Value of Assets and Liabilities

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

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

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

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

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

Assets and Liabilities Measured at Fair Value on a Recurring Basis

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

Securities available for sale. The Corporation primarily values its investment portfolio using Level 2 fair value measurements, but may also use Level 1 or Level 3 measurements if required by the composition of the portfolio. At June 30, 2014 and December 31, 2013, the Corporation's entire investment securities portfolio was valued using Level 2 fair value measurements. The Corporation has contracted with third party portfolio accounting service vendors for valuation of its securities portfolio. The vendors' sources for security valuation are Standard & Poor's Securities Evaluations Inc. (SPSE), Thomson Reuters Pricing Service (TRPS) and Interactive Data Pricing and Reference Data LLC (IDC). Each source provides opinions, known as evaluated prices, as to the value of individual securities based on model-based pricing techniques that are partially based on available market data, including prices for similar instruments in active markets and prices for identical assets in markets that are not active. SPSE and IDC provide evaluated prices for the Corporation's obligations of states and political subdivisions category of securities. Both sources use proprietary pricing models and pricing systems, mathematical tools and judgment to determine an evaluated price for a security based upon a hierarchy of market information regarding that security or securities with similar characteristics. TRPS and IDC provide evaluated prices for the Corporation's U.S. government agencies and corporations and mortgage-backed categories of securities. Fixed-rate callable securities of the U.S. government agencies and corporations category are individually evaluated on an option adjusted spread basis for callable issues or on a nominal spread basis incorporating the term structure of agency market spreads and the appropriate risk free benchmark curve for non-callable issues. Fixed-rate securities issued by the Small Business Association in the U.S. government agencies and corporations category are individually evaluated based upon a hierarchy of security specific information and market data regarding that security or securities with similar characteristics. Pass-through mortgage-backed securities in the mortgage-backed category are grouped into aggregate categories defined by issuer program, weighted average coupon, and weighted average maturity. Each aggregate is benchmarked to a relative mortgage-backed to-be-announced (TBA) or other benchmark price. TBA prices are obtained from market makers and live trading systems. Collateralized mortgage obligations in the mortgage-backed category are individually evaluated based upon a hierarchy of security specific information and market data regarding that security or securities with similar characteristics. Each evaluation is determined using an option adjusted spread and prepayment model based on volatility-driven, multi-dimensional spread tables.

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

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

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

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

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

(Dollars in thousands)	**June 30, 2014 Fair Value Measurements Using**			
	Level 1	**Level 2**	**Level 3**	**Assets at Fair Value**
Assets:				
Securities available for sale				
U.S. government agencies and corporations	**$—**	**$28,902**	**$ —**	**$28,902**
Mortgage-backed securities	**—**	**57,752**	**—**	**57,752**
Obligations of states and political subdivisions	**—**	**130,654**	**—**	**130,654**
Total securities available for sale	**—**	**217,308**	**—**	**217,308**
Loans held for sale	**—**	**33,603**	**—**	**33,603**
Interest rate lock commitments included in other assets	**—**	**950**	**—**	**950**
Total assets measured at fair value on a recurring basis	**$—**	**$251,861**	**$ —**	**$251,861**
Liabilities:				
Derivative liability - cash flow hedges	**$—**	**$245**	**$ —**	**$245**

(Dollars in thousands)	**December 31, 2013 Fair Value Measurements Using**			
	Level 1	**Level 2**	**Level 3**	**Assets at Fair Value**
Assets:				
Securities available for sale				
U.S. Treasury securities	$—	$10,000	$ —	$10,000
U.S. government agencies and corporations		29,950		29,950
Mortgage-backed securities	—	50,863	—	50,863
Obligations of states and political subdivisions	—	127,139	—	127,139
Preferred stock	—	158	—	158
Total securities available for sale	—	218,110	—	218,110
Loans held for sale	—	35,879	—	35,879
Interest rate lock commitments included in other assets	—	511	—	511
Forward sales commitments included in other assets	—	22	—	22
Total assets	$—	$254,522	$ —	$254,522
Liabilities:				
Derivative liability - cash flow hedges	$—	$331	$ —	$331

Assets and Liabilities Measured at Fair Value on a Nonrecurring Basis

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

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

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

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

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

(Dollars in thousands)	**June 30, 2014 Fair Value Measurements Using**			**Assets at Fair Value**
	Level 1	**Level 2**	**Level 3**	
Impaired loans, net	**$ —**	**$ —**	**$ 2,583**	**$ 2,583**
Other real estate owned, net	**—**	**—**	**817**	**817**
Total	**$ —**	**$ —**	**$ 3,400**	**$ 3,400**

(Dollars in thousands)	**December 31, 2013 Fair Value Measurements Using**			**Assets at Fair Value**
	Level 1	**Level 2**	**Level 3**	
Impaired loans, net	**$ —**	**$ —**	**$ 3,646**	**$ 3,646**
Other real estate owned, net	**—**	**—**	**2,769**	**2,769**
Total	**$ —**	**$ —**	**$ 6,415**	**$ 6,415**

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

	Fair Value Measurements at June 30, 2014			
(Dollars in thousands)	**Fair Value**	**Valuation Technique(s)**	**Unobservable Inputs**	**Range of Inputs**
Impaired loans, net	$ 2,583	Appraisals	Discount for current market conditions and estimated selling costs	0%-50%
Other real estate owned, net	$ 817	Appraisals	Discount for current market conditions and estimated selling costs	0%-25%
Total	$ 3,400			

Fair Value of Financial Instruments

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

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

Cash and short-term investments. The nature of these instruments and their relatively short maturities provide for the reporting of fair value equal to the historical cost.

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

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

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

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

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

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

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

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

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

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

		Fair Value Measurements at June 30, 2014 Using			
(Dollars in thousands)	**Carrying Value**	**Level 1**	**Level 2**	**Level 3**	**Total Fair Value**
Financial assets:					
Cash and cash equivalents	**$182,354**	**$182,354**	**$—**	**$—**	**$182,354**
Securities available for sale	**217,308**	**—**	**217,308**	**—**	**217,308**
Restricted stocks	**3,690**	**3,690**	**—**	**—**	**3,690**
Loans, net	**791,170**	**—**	**—**	**806,770**	**806,770**
Loans held for sale	**33,603**	**—**	**33,603**	**—**	**33,603**
Accrued interest receivable	**6,255**	**6,255**	**—**	**—**	**6,255**
BOLI	**14,176**	**—**	**14,176**	**—**	**14,176**
Derivative asset	**950**	**—**	**950**	**—**	**950**
Financial liabilities:					
Demand deposits	**$659,964**	**$659,964**	**$—**	**$—**	**$659,964**
Time deposits	**379,788**	**—**	**382,934**	**—**	**382,934**

Borrowings	**169,608**	**—**	**162,368**	**—**	**162,368**
Derivative liability	**245**	**—**	**245**	**—**	**245**
Accrued interest payable	**807**	**807**	**—**	**—**	**807**

(Dollars in thousands)	Carrying Value	Fair Value Measurements at December 31, 2013 Using Level 1	Level 2	Level 3	Total Fair Value
Financial assets:					
Cash and cash equivalents	$148,139	$148,139	$—	$ —	$148,139
Securities available for sale	218,110	—	218,110	—	218,110
Restricted stocks	4,336	4,336	—	—	4,336
Loans, net					