

C & F FINANCIAL CORP  
Form 10-Q  
May 09, 2007  
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**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

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**FORM 10-Q**

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(Mark One)

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

For the quarterly period ended March 31, 2007

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

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**C&F Financial Corporation**

(Exact name of registrant as specified in its charter)

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**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)

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23181

(Zip Code)

(804) 843-2360

(Registrant's telephone number, including area code)

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

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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 is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act.

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

At May 4, 2007, the latest practicable date for determination, 3,092,811 shares of common stock, \$1.00 par value, of the registrant were outstanding.

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**Table of Contents****PART I - FINANCIAL INFORMATION****ITEM 1. FINANCIAL STATEMENTS****CONSOLIDATED BALANCE SHEETS**

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

|   | March 31, 2007<br>(Unaudited) | December 31, 2006 |
|---|-------------------------------|-------------------|
| <b>ASSETS</b>   |                               |                   |
| Cash and due from banks   | \$ 11,390                     | \$ 11,496         |
| Interest-bearing deposits in other banks  | 20,882                        | 17,010            |
| Total cash and cash equivalents   | 32,272                        | 28,506            |
| Securities-available for sale at fair value, amortized cost of \$66,311 and \$66,407, respectively                                | 67,388                        | 67,584            |
| Loans held for sale, net  | 45,448                        | 53,504            |
| Loans, net  | 523,263                       | 517,843           |
| Federal Home Loan Bank stock  | 2,070                         | 2,093             |
| Corporate premises and equipment, net   | 33,777                        | 33,189            |
| Accrued interest receivable   | 4,360                         | 4,432             |
| Goodwill  | 10,724                        | 10,724            |
| Other assets  | 16,477                        | 16,593            |
| Total assets  | \$ 735,779                    | \$ 734,468        |
| <b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>   |                               |                   |
| Deposits  |                               |                   |
| Noninterest-bearing demand deposits   | \$ 85,318                     | \$ 90,260         |
| Savings and interest-bearing demand deposits  | 178,403                       | 188,450           |
| Time deposits   | 269,046                       | 254,125           |
| Total deposits  | 532,767                       | 532,835           |
| Short-term borrowings   | 11,107                        | 12,462            |
| Long-term borrowings  | 95,686                        | 92,284            |
| Trust preferred capital notes   | 10,310                        | 10,310            |
| Accrued interest payable  | 2,181                         | 1,915             |
| Other liabilities   | 18,713                        | 16,656            |
| Total liabilities   | 670,764                       | 666,462           |
| Commitments and contingent liabilities  |                               |                   |
| Shareholders' equity  |                               |                   |
| Preferred stock (\$1.00 par value, 3,000,000 shares authorized)   |                               |                   |
| Common stock (\$1.00 par value, 8,000,000 shares authorized, 3,090,211 and 3,182,411 shares issued and outstanding, respectively) | 3,067                         | 3,159             |
| Additional paid-in capital  |                               | 324               |
| Retained earnings   | 61,888                        | 64,402            |
| Accumulated other comprehensive income, net   | 60                            | 121               |
| Total shareholders' equity  | 65,015                        | 68,006            |

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|  |    |         |    |         |
|--|----|---------|----|---------|
| Total liabilities and shareholders' equity | \$ | 735,779 | \$ | 734,468 |
|--|----|---------|----|---------|

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

**Table of Contents****CONSOLIDATED STATEMENTS OF INCOME**

(Unaudited)

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

|   | <b>Three Months Ended March 31,</b> |                 |
|---|-------------------------------------|-----------------|
|   | <b>2007</b>                         | <b>2006</b>     |
| <b>Interest income</b>                                      |                                     |                 |
| Interest and fees on loans                                  | \$ 14,168                           | \$ 12,595       |
| Interest on money market investments                        | 351                                 | 131             |
| Interest and dividends on securities                        |                                     |                 |
| U.S. government agencies and corporations                   | 63                                  | 59              |
| Tax-exempt obligations of states and political subdivisions | 602                                 | 584             |
| Corporate bonds and other                                   | 115                                 | 124             |
| <b>Total interest income</b>                                | <b>15,299</b>                       | <b>13,493</b>   |
| <b>Interest expense</b>                                     |                                     |                 |
| Savings and interest-bearing deposits                       | 680                                 | 563             |
| Certificates of deposit, \$100 or more                      | 1,125                               | 614             |
| Other time deposits   | 1,740                               | 1,211           |
| Borrowings  | 1,676                               | 1,388           |
| Trust preferred capital notes                               | 168                                 | 157             |
| <b>Total interest expense</b>                               | <b>5,389</b>                        | <b>3,933</b>    |
| <b>Net interest income</b>                                  | <b>9,910</b>                        | <b>9,560</b>    |
| Provision for loan losses                                   | 1,400                               | 1,275           |
| <b>Net interest income after provision for loan losses</b>  | <b>8,510</b>                        | <b>8,285</b>    |
| <b>Noninterest income</b>                                   |                                     |                 |
| Gains on sales of loans                                     | 3,628                               | 3,863           |
| Service charges on deposit accounts                         | 853                                 | 674             |
| Other service charges and fees                              | 939                                 | 1,092           |
| Gain on calls of available for sale securities              | 3                                   | 31              |
| Other income  | 375                                 | 326             |
| <b>Total noninterest income</b>                             | <b>5,798</b>                        | <b>5,986</b>    |
| <b>Noninterest expenses</b>                                 |                                     |                 |
| Salaries and employee benefits                              | 7,302                               | 6,949           |
| Occupancy expenses  | 1,444                               | 1,208           |
| Other expenses  | 2,736                               | 2,473           |
| <b>Total noninterest expenses</b>                           | <b>11,482</b>                       | <b>10,630</b>   |
| <b>Income before income taxes</b>                           | <b>2,826</b>                        | <b>3,641</b>    |
| Income tax expense  | 815                                 | 1,115           |
| <b>Net income</b>   | <b>\$ 2,011</b>                     | <b>\$ 2,526</b> |

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### Per share data

|   |    |           |    |           |
|---|----|-----------|----|-----------|
| Net income basic                                    | \$ | .65       | \$ | .80       |
| Net income assuming dilution                        | \$ | .62       | \$ | .77       |
| Cash dividends paid and declared                    | \$ | .31       | \$ | .27       |
| Weighted average number of shares basic             |    | 3,105,461 |    | 3,148,640 |
| Weighted average number of shares assuming dilution |    | 3,242,081 |    | 3,274,462 |

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

**Table of Contents****CONSOLIDATED STATEMENTS OF SHAREHOLDERS EQUITY**

(Unaudited)

(In thousands)

|   |                 |                                  | Accumulated             |                      |                              |           |
|---|-----------------|----------------------------------|-------------------------|----------------------|------------------------------|-----------|
|   |                 |                                  | Other                   |                      |                              |           |
|   | Common<br>Stock | Additional<br>Paid-In<br>Capital | Comprehensive<br>Income | Retained<br>Earnings | Comprehensive<br>Income, Net | Total     |
| December 31, 2006   | \$ 3,159        | \$ 324                           |                         | \$ 64,402            | \$ 121                       | \$ 68,006 |
| Comprehensive income  |                 |                                  |                         |                      |                              |           |
| Net income  |                 |                                  | \$ 2,011                | 2,011                |                              | 2,011     |
| Other comprehensive loss, net of tax                              |                 |                                  |                         |                      |                              |           |
| Amortization of prepaid pension transition costs                  |                 |                                  | 4                       |                      | 4                            | 4         |
| Unrealized loss on securities, net of reclassification adjustment |                 |                                  | (65)                    |                      | (65)                         | (65)      |
| Comprehensive income  |                 |                                  | \$ 1,950                |                      |                              |           |
| Purchase of common stock  | (106)           | (716)                            |                         | (3,566)              |                              | (4,388)   |
| Stock options exercised   | 14              | 313                              |                         |                      |                              | 327       |
| Stock-based compensation  |                 | 79                               |                         |                      |                              | 79        |
| Cash dividends  |                 |                                  |                         | (959)                |                              | (959)     |
| March 31, 2007  | \$ 3,067        | \$                               |                         | \$ 61,888            | \$ 60                        | \$ 65,015 |

**Disclosure of Reclassification Amount:**

|   |         |
|---|---------|
| Unrealized net holding losses arising during period                 | \$ (63) |
| Less: reclassification adjustment for gains included in net income  | 2       |
| Unrealized losses on securities, net of reclassification adjustment | \$ (65) |

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



**Table of Contents****CONSOLIDATED STATEMENTS OF SHAREHOLDERS EQUITY**

(Unaudited)

(In thousands)

|  | Common<br>Stock | Additional<br>Paid-In<br>Capital | Comprehensive<br>Income | Retained<br>Earnings | Accumulated<br>Other<br>Comprehensive<br>Income, Net | Total     |
|--|-----------------|----------------------------------|-------------------------|----------------------|--|-----------|
| December 31, 2005  | \$ 3,141        | \$ 183                           |                         | \$ 55,930            | \$ 832   | \$ 60,086 |
| Comprehensive income   |                 |                                  |                         |                      |  |           |
| Net income   |                 |                                  | \$ 2,526                | 2,526                |  | 2,526     |
| Other comprehensive loss, net of tax                                 |                 |                                  |                         |                      |  |           |
| Unrealized loss on securities, net of reclassification<br>adjustment |                 |                                  | (295)                   |                      | (295)  | (295)     |
| Comprehensive income   |                 |                                  | \$ 2,231                |                      |  |           |
| Purchase of common stock   | (1)             | (59)                             |                         |                      |  | (60)      |
| Stock options exercised  | 13              | 227                              |                         |                      |  | 240       |
| Cash dividends   |                 |                                  |                         | (851)                |  | (851)     |
| March 31, 2006   | \$ 3,153        | \$ 351                           |                         | \$ 57,605            | \$ 537   | \$ 61,646 |

**Disclosure of Reclassification Amount:**

|   |          |
|---|----------|
| Unrealized net holding losses arising during period                 | \$ (275) |
| Less: reclassification adjustment for gains included in net income  | 20       |
| Unrealized losses on securities, net of reclassification adjustment | \$ (295) |

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

**Table of Contents****CONSOLIDATED STATEMENTS OF CASH FLOWS**

(Unaudited)

(In thousands)

|   | <b>Three Months Ended March 31,</b> |                  |
|---|-------------------------------------|------------------|
|   | <b>2007</b>                         | <b>2006</b>      |
| <b>Operating activities:</b>  |                                     |                  |
| Net income  | \$ 2,011                            | \$ 2,526         |
| Adjustments to reconcile net income to net cash provided by (used in) operating activities: |                                     |                  |
| Depreciation  | 614                                 | 466              |
| Provision for loan losses   | 1,400                               | 1,275            |
| Stock-based compensation  | 79                                  |                  |
| Amortization of prepaid pension transition costs  | 4                                   |                  |
| Accretion of discounts and amortization of premiums on investment securities, net           | 10                                  | 8                |
| Net realized gain on securities   | (3)                                 | (31)             |
| Proceeds from sale of loans   | 206,714                             | 208,499          |
| Origination of loans held for sale  | (198,658)                           | (214,292)        |
| Change in other assets and liabilities:   |                                     |                  |
| Accrued interest receivable   | 72                                  | (151)            |
| Other assets  | 151                                 | (1,125)          |
| Accrued interest payable  | 266                                 | 74               |
| Other liabilities   | 2,057                               | (1,362)          |
| <b>Net cash provided by (used in) operating activities</b>                                  | <b>14,717</b>                       | <b>(4,113)</b>   |
| <b>Investing activities:</b>  |                                     |                  |
| Proceeds from maturities and calls of securities available for sale                         | 1,544                               | 1,656            |
| Purchases of securities available for sale  | (1,455)                             | (2,766)          |
| Purchases of Federal Home Loan Bank stock   |                                     | (802)            |
| Redemptions of Federal Home Loan Bank stock   | 23                                  |                  |
| Net increase in customer loans  | (6,820)                             | (24,426)         |
| Purchases of corporate premises and equipment   | (1,224)                             | (2,771)          |
| Disposals of corporate premises and equipment   | 22                                  |                  |
| <b>Net cash used in investing activities</b>  | <b>(7,910)</b>                      | <b>(29,109)</b>  |
| <b>Financing activities:</b>  |                                     |                  |
| Net decrease in demand, interest bearing demand and savings deposits                        | (14,989)                            | (8,842)          |
| Net increase in time deposits   | 14,921                              | 1,518            |
| Net increase in borrowings  | 2,047                               | 16,670           |
| Purchase of common stock  | (4,388)                             | (60)             |
| Proceeds from exercise of stock options   | 327                                 | 240              |
| Cash dividends  | (959)                               | (851)            |
| <b>Net cash (used in) provided by financing activities</b>                                  | <b>(3,041)</b>                      | <b>8,675</b>     |
| <b>Net increase (decrease) in cash and cash equivalents</b>                                 | <b>3,766</b>                        | <b>(24,547)</b>  |
| Cash and cash equivalents at beginning of period  | 28,506                              | 42,878           |
| <b>Cash and cash equivalents at end of period</b>   | <b>\$ 32,272</b>                    | <b>\$ 18,331</b> |

Supplemental disclosure

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|                   |    |       |    |       |
|-------------------|----|-------|----|-------|
| Interest paid     | \$ | 5,123 | \$ | 3,859 |
| Income taxes paid | \$ | 8     | \$ | 19    |

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

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**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**(Unaudited)**

**Note 1**

The accompanying unaudited consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America for interim financial reporting and with applicable quarterly reporting regulations of the Securities and Exchange Commission. They do not include all of the information and notes required by accounting principles generally accepted in the United States of America 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, 2006.

In the opinion of C&F Financial Corporation's management, all adjustments, consisting only of normal recurring accruals, necessary to present fairly the financial position as of March 31, 2007 and the results of operations and cash flows for the three months ended March 31, 2007 and 2006 have been made. The results of operations for the interim periods are not necessarily indicative of the results to be expected for the full year.

The consolidated financial statements include the accounts of C&F Financial Corporation (the Corporation) and its subsidiary, Citizens and Farmers Bank (the Bank), with all significant intercompany transactions and accounts being eliminated in consolidation. In addition, the Corporation owns C&F Financial Statutory Trust I, an unconsolidated subsidiary. The subordinated debt owed to the trust is reported as a liability of the Corporation.

**Share-Based Compensation:** Effective January 1, 2006, the Corporation adopted the provisions of Statement of Financial Accounting Standards (SFAS) No. 123(R), *Share-Based Payment*, which requires that the Corporation recognize expense related to the fair value of share-based compensation awards in net income.

The Corporation has elected to follow the modified prospective transition method allowed by SFAS 123(R). Under the modified prospective transition method, compensation expense is recognized prospectively for all unvested options outstanding at January 1, 2006 and for all awards modified or granted after that date. There were no unvested options outstanding at January 1, 2006 and no awards were granted during the first quarter of 2006. Therefore, no share-based compensation expense was recognized in the first quarter of 2006. Compensation expense for the quarter ended March 31, 2007 included \$79,000 (\$49,000 after tax) for options and restricted stock granted during 2006. As of March 31, 2007, there was \$851,000 of total unrecognized compensation expense related to nonvested stock options and restricted stock that will be recognized over the remaining requisite service period.

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Stock option plan activity for the three months ended March 31, 2007 is summarized below:

|                                       | Shares   | Exercise Price* | Remaining Contractual Life (in years)* | Intrinsic Value of Unexercised In-The Money Options (in 000 s) |
|---------------------------------------|----------|-----------------|--|--|
| Options outstanding, January 1, 2007  | 530,167  | \$ 31.54        | 6.7                                    | \$ 4,511   |
| Exercised                             | (13,700) | 23.87           |  |  |
| Options outstanding at March 31, 2007 | 516,467  | \$ 31.75        | 6.5                                    | \$ 6,303   |
| Options exercisable at March 31, 2007 | 502,967  | \$ 31.54        | 6.4                                    | \$ 6,244   |

*\*Weighted average*

The total intrinsic value of in-the-money options exercised during the first three months of 2007 was \$266,000. Cash received from option exercises during the first three months of 2007 was \$327,000. The Corporation issues new shares to satisfy the exercise of stock options.

**Note 2**

Diluted net income per share has been calculated on the basis of the weighted average number of shares of common stock and common stock equivalents outstanding for the applicable periods. Potentially-dilutive common stock had no effect on income available to common shareholders.

**Note 3**

During the first three months of 2007, the Corporation purchased 105,900 shares of its common stock in negotiated and open-market transactions at prices from \$41.25 to \$45.06. During the first three months of 2006, the Corporation purchased 1,520 shares of its common stock in open-market transactions at prices from \$39.43 to \$40.00.

**Table of Contents****Note 4**

Securities in an unrealized loss position at March 31, 2007, by duration of the period of unrealized loss, are shown below. No impairment has been recognized on any securities in a loss position based on management's intent and demonstrated ability to hold such securities to scheduled maturity or call dates and management's evaluation that there is no permanent impairment in the value of these securities.

|  | Less Than 12 Months |            | 12 Months or More |            | Total     |            |
|--|---------------------|------------|-------------------|------------|-----------|------------|
|  | Fair                | Unrealized | Fair              | Unrealized | Fair      | Unrealized |
| (in 000's)                                       | Value               | Loss       | Value             | Loss       | Value     | Loss       |
| U.S. government agencies and corporations        | \$ 477              | \$ 1       | \$ 4,668          | \$ 78      | \$ 5,145  | \$ 79      |
| Mortgage-backed securities                       |                     |            | 1,191             | 27         | 1,191     | 27         |
| Obligations of states and political subdivisions | 2,173               | 3          | 6,484             | 65         | 8,657     | 68         |
| Subtotal-debt securities                         | 2,650               | 4          | 12,343            | 170        | 14,993    | 174        |
| Preferred stock                                  |                     |            | 645               | 25         | 645       | 25         |
| Total temporarily impaired securities            | \$ 2,650            | \$ 4       | \$ 12,988         | \$ 195     | \$ 15,638 | \$ 199     |

The primary cause of the temporary impairments in the Corporation's investment in debt securities was the decline in prices as interest rates have risen. There are 37 debt securities and two equity securities totaling \$15.0 million and \$645,000, respectively, considered temporarily impaired at March 31, 2007. Because the Corporation has the intent and demonstrated ability to hold these investments until a recovery of unrealized losses, which may be maturity, the Corporation does not consider these investments to be other-than-temporarily impaired at March 31, 2007.

Securities in an unrealized loss position at December 31, 2006 are shown below by duration of the period of unrealized loss.

|  | Less Than 12 Months |            | 12 Months or More |            | Total     |            |
|--|---------------------|------------|-------------------|------------|-----------|------------|
|  | Fair                | Unrealized | Fair              | Unrealized | Fair      | Unrealized |
| (in 000's)                                       | Value               | Loss       | Value             | Loss       | Value     | Loss       |
| U.S government agencies and corporations         | \$ 476              | \$ 2       | \$ 4,654          | \$ 92      | \$ 5,130  | \$ 94      |
| Mortgage-backed securities                       | 1,246               | 33         | 427               | 1          | 1,673     | 34         |
| Obligations of states and political subdivisions | 2,284               | 10         | 4,530             | 49         | 6,814     | 59         |
| Subtotal-debt securities                         | 4,006               | 45         | 9,611             | 142        | 13,617    | 187        |
| Preferred stock                                  | 585                 | 10         | 1,178             | 19         | 1,763     | 29         |
| Total temporarily impaired securities            | \$ 4,591            | \$ 55      | \$ 10,789         | \$ 161     | \$ 15,380 | \$ 216     |

**Table of Contents****Note 5**

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

| (in 000 s)                                   | Three Months Ended |        |
|--|--------------------|--------|
|  | 2007               | 2006   |
| Service cost                                 | \$ 194             | \$ 188 |
| Interest cost                                | 96                 | 86     |
| Expected return on plan assets               | (112)              | (107)  |
| Amortization of net obligation at transition | (1)                | (1)    |
| Amortization of prior service cost           | 2                  | 2      |
| Amortization of net loss                     | 4                  | 11     |
| Net periodic benefit cost                    | \$ 183             | \$ 179 |

In December 2006, the Bank made a \$1.18 million contribution to the plan. The estimated minimum contribution for 2007 is approximately \$58,000.

**Note 6**

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

The Corporation's other subsidiaries include:

an investment company that derives revenues from brokerage services,

an insurance company that derives revenues from insurance services, and

a title company that derives revenues from title insurance services.

The results of these other subsidiaries are not significant to the Corporation as a whole and have been included in Other.

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| (in 000 s)                 | Three Months Ended March 31, 2007 |                  |                  |       |              |    | Consolidated |
|----------------------------|-----------------------------------|------------------|------------------|-------|--------------|----|--------------|
|                            | Retail Banking                    | Mortgage Banking | Consumer Finance | Other | Eliminations |    |              |
| <b>Revenues:</b>           |                                   |                  |                  |       |              |    |              |
| Interest income            | \$ 9,532                          | \$ 521           | \$ 5,937         | \$    | \$ (691)     | \$ | \$ 15,299    |
| Gains on sales of loans    |                                   | 3,632            |                  |       | (4)          |    | 3,628        |
| Other                      | 1,181                             | 591              | 130              | 268   |              |    | 2,170        |
| Total operating income     | 10,713                            | 4,744            | 6,067            | 268   | (695)        |    | 21,097       |
| <b>Expenses:</b>           |                                   |                  |                  |       |              |    |              |
| Interest expense           | 3,928                             | 170              | 1,944            | 43    | (696)        |    | 5,389        |
| Personnel expenses         | 3,565                             | 2,566            | 989              | 173   | 9            |    | 7,302        |
| Provision for loan losses  |                                   |                  | 1,400            |       |              |    | 1,400        |
| Other                      | 2,137                             | 1,448            | 559              | 36    |              |    | 4,180        |
| Total operating expenses   | 9,630                             | 4,184            | 4,892            | 252   | (687)        |    | 18,271       |
| Income before income taxes | 1,083                             | 560              | 1,175            | 16    | (8)          |    | 2,826        |
| Provision for income taxes | 150                               | 213              | 446              | 6     |              |    | 815          |
| Net income                 | \$ 933                            | \$ 347           | \$ 729           | \$ 10 | \$ (8)       | \$ | \$ 2,011     |
| Total assets               | \$ 607,240                        | \$ 52,994        | \$ 145,498       | \$ 15 | \$ (69,968)  | \$ | \$ 735,779   |
| Capital expenditures       | \$ 1,085                          | \$ 54            | \$ 85            | \$    | \$           | \$ | \$ 1,224     |

| (in 000 s)                 | Three Months Ended March 31, 2006 |                  |                  |       |              |    | Consolidated |
|----------------------------|-----------------------------------|------------------|------------------|-------|--------------|----|--------------|
|                            | Retail Banking                    | Mortgage Banking | Consumer Finance | Other | Eliminations |    |              |
| <b>Revenues:</b>           |                                   |                  |                  |       |              |    |              |
| Interest income            | \$ 8,630                          | \$ 576           | \$ 4,970         | \$    | \$ (683)     | \$ | \$ 13,493    |
| Gains on sales of loans    |                                   | 3,878            |                  |       | (15)         |    | 3,863        |
| Other                      | 1,038                             | 760              | 108              | 217   |              |    | 2,123        |
| Total operating income     | 9,668                             | 5,214            | 5,078            | 217   | (698)        |    | 19,479       |
| <b>Expenses:</b>           |                                   |                  |                  |       |              |    |              |
| Interest expense           | 2,909                             | 283              | 1,459            |       | (718)        |    | 3,933        |
| Personnel expenses         | 3,160                             | 2,899            | 724              | 147   | 19           |    | 6,949        |
| Provision for loan losses  |                                   |                  | 1,275            |       |              |    | 1,275        |
| Other                      | 1,847                             | 1,304            | 490              | 40    |              |    | 3,681        |
| Total operating expenses   | 7,916                             | 4,486            | 3,948            | 187   | (699)        |    | 15,838       |
| Income before income taxes | 1,752                             | 728              | 1,130            | 30    | 1            |    | 3,641        |
| Provision for income taxes | 398                               | 277              | 429              | 11    |              |    | 1,115        |
| Net income                 | \$ 1,354                          | \$ 451           | \$ 701           | \$ 19 | \$ 1         | \$ | \$ 2,526     |
| Total assets               | \$ 579,244                        | \$ 54,402        | \$ 123,242       | \$ 15 | \$ (75,328)  | \$ | \$ 681,575   |
| Capital expenditures       | \$ 2,565                          | \$ 113           | \$ 93            | \$    | \$           | \$ | \$ 2,771     |

The Retail Banking segment extends a warehouse line of credit to the Mortgage Banking segment, providing the funds needed to originate mortgage loans. The Retail Banking segment charges the Mortgage Banking segment interest at the daily FHLB advance rate plus 50 basis points. The Retail Banking segment also provides the Consumer Finance segment with a portion of the funds needed to originate loans and charges the Consumer Finance segment interest at LIBOR plus 175



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basis points. The Retail Banking segment acquires certain lot and permanent loans, second mortgage loans and home equity lines of credit from the Mortgage Banking segment at prices similar to those paid by third-party investors. These transactions are eliminated to reach consolidated totals. Certain corporate overhead costs incurred by the Retail Banking segment are not allocated to the Mortgage Banking, Consumer Finance and Other segments.

**Note 7**

In February 2006, the Financial Accounting Standards Board (the FASB) issued SFAS No. 155, *Accounting for Certain Hybrid Financial Instruments – an amendment of FASB Statements No. 133 and 140*. SFAS 155 permits fair value measurement of any hybrid financial instrument that contains an embedded derivative that otherwise would require bifurcation. SFAS 155 also clarifies which interest-only strips and principal-only strips are not subject to the requirements of SFAS 133. It establishes a requirement to evaluate interests in securitized financial assets to identify interests that are freestanding derivatives or that are hybrid financial instruments that contain an embedded derivative requiring bifurcation. SFAS 155 also clarifies that concentrations of credit risk in the form of subordination are not embedded derivatives. SFAS 155 is effective for all financial instruments acquired or issued after the beginning of an entity's first fiscal year that begins after September 15, 2006. The implementation of SFAS 155 did not have a material effect on the Corporation's financial statements.

In March 2006, the FASB issued SFAS No. 156, *Accounting for Servicing of Financial Assets – an amendment of FASB Statement No. 140*. SFAS 156 requires an entity to recognize a servicing asset or servicing liability each time it undertakes an obligation to service a financial asset by entering into certain servicing contracts. SFAS 156 also requires all separately recognized servicing assets and servicing liabilities to be initially measured at fair value, if practicable. SFAS 156 permits an entity to choose between the amortization and fair value methods for subsequent measurements. At initial adoption, SFAS 156 permits a one-time reclassification of available for sale securities to trading securities by entities with recognized servicing rights. SFAS 156 also requires separate presentation of servicing assets and servicing liabilities subsequently measured at fair value in the statement of financial position and additional disclosures for all separately recognized servicing assets and servicing liabilities. This Statement is effective as of the beginning of an entity's first fiscal year that begins after September 15, 2006. The implementation of SFAS 156 did not have a material effect on the Corporation's financial statements.

In September 2006, the FASB issued SFAS No. 157, *Fair Value Measurements*. SFAS 157 defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles, and expands disclosures about fair value measurements. SFAS 157 does not require any new fair value measurements but may change current practice for some entities. SFAS 157 is effective for financial statements issued for fiscal years beginning after November 15, 2007 and interim periods within those years. The Corporation does not expect the implementation of SFAS 157 to have a material effect on its financial statements.

In September 2006, the FASB issued SFAS No. 158, *Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans – an amendment of FASB Statements No. 87, 88, 106, and 132(R)*. SFAS 158 requires an employer to recognize the overfunded or underfunded status of a defined benefit postretirement plan as an asset or liability in its statement of financial position and to recognize changes in that funded status in the year in which the changes occur through comprehensive income. The funded status of a benefit plan will be measured as the difference between plan assets at fair value and the benefit obligation. For a pension plan, the benefit obligation is the projected benefit

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obligation. For any other postretirement plan, the benefit obligation is the accumulated postretirement benefit obligation. SFAS 158 also requires an employer to measure the funded status of a plan as of the date of its year-end statement of financial position. SFAS 158 also requires additional disclosure in the notes to financial statements about certain effects on net periodic benefit cost for the next fiscal year that arise from delayed recognition of the gains or losses, prior service costs or credits, and transition asset or obligation. The Corporation initially recognized the funded status of its defined benefit retirement plan and provided the required disclosures as of December 31, 2006. In connection with the implementation of SFAS 158, the Corporation made a \$1.18 million contribution to the Bank's non-contributory, defined benefit pension, which fully funded the plan's projected benefit obligation as of the valuation date, and recognized \$644,000 as a reduction in accumulated other comprehensive income. The requirement to measure plan assets and benefit obligations as of the date of the employer's fiscal year-end statement of financial position is effective for fiscal years ending after December 15, 2008.

In February 2007, the FASB issued SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities*. SFAS 159 permits entities to choose to measure many financial instruments and certain other items at fair value. The objective is to improve financial reporting by providing entities with the opportunity to mitigate volatility in reported earnings caused by measuring related assets and liabilities differently without having to apply complex hedge accounting provisions. The fair value option established by SFAS 159 permits all entities to choose to measure eligible items at fair value at specified election dates. A business entity shall report unrealized gains and losses on items for which the fair value option has been elected in earnings at each subsequent reporting date. The fair value option may be applied instrument by instrument and is irrevocable. SFAS 159 is effective as of the beginning of an entity's first fiscal year that begins after November 15, 2007. Early adoption is permitted as of the beginning of a fiscal year that begins on or before November 15, 2007, provided the entity also elects to apply the provisions of SFAS 157. The Corporation is currently evaluating the effect of SFAS 159 and has not opted for early adoption.

In June 2006, the FASB issued Interpretation No. 48, *Accounting for Uncertainty in Income Taxes: An Interpretation of FASB Statement No. 109*, (FIN 48). FIN 48 clarifies the accounting for uncertainty in income taxes recognized in an entity's financial statements in accordance with SFAS 109. FIN 48 prescribes a recognition threshold and measurement principles for the financial statement recognition and measurement of tax positions taken or expected to be taken on a tax return that are not certain to be realized. FIN 48 is effective for fiscal years beginning after December 15, 2006. The implementation of FIN 48 did not have a material effect on the Corporation's financial statements.

In September 2006, the Emerging Issues Task Force issued EITF 06-4, *Accounting for Deferred Compensation and Postretirement Benefit Aspects of Endorsement Split-Dollar Life Insurance Arrangements*. EITF 06-4 concludes that for a split-dollar life insurance arrangement within the scope of this consensus, an employer should recognize a liability for future benefits in accordance with SFAS 106 (if, in substance, a postretirement benefit plan exists) or APB Opinion No. 12 (if the arrangement is, in substance, an individual deferred compensation contract) based on the substantive agreement with the employee. The consensus is effective for fiscal years beginning after December 15, 2007. The Corporation is currently evaluating the effect that EITF No. 06-4 will have on its financial statements when implemented.

In September 2006, the Emerging Issues Task Force issued EITF 06-5, *Accounting for Purchases of Life Insurance - Determining the Amount That Could Be Realized in Accordance with FASB Technical Bulletin No. 85-4*. EITF 06-5 concludes that a policyholder should consider any

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additional amounts included in the contractual terms of the insurance policy other than the cash surrender value in determining the amount that could be realized under the insurance contract. A consensus also was reached that a policyholder should determine the amount that could be realized under the life insurance contract assuming the surrender of an individual-life by individual-life policy (or certificate by certificate in a group policy). The consensuses are effective for fiscal years beginning after December 15, 2006. The implementation of EITF No. 06-5 did not have a material effect on the Corporation's financial statements.

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

**CAUTIONARY STATEMENT REGARDING FORWARD-LOOKING STATEMENTS**

This report contains statements concerning the Corporation's expectations, plans, objectives, future financial performance and other statements that are not historical facts. These statements may constitute forward-looking statements as defined by federal securities laws. These statements may address issues that involve estimates and assumptions made by management and risks and uncertainties. Actual results could differ materially from historical results or those anticipated by such statements. Factors that could have a material adverse effect on the operations and future prospects of the Corporation include, but are not limited to, changes in:

- 1) interest rates
- 2) general economic conditions
- 3) the legislative/regulatory climate
- 4) monetary and fiscal policies of the U.S. Government, including policies of the U.S. Treasury and the Federal Reserve Board
- 5) the quality or composition of the loan and/or investment portfolios
- 6) demand for loan products
- 7) deposit flows
- 8) competition
- 9) demand for financial services in the Corporation's market area
- 10) technology
- 11) reliance on third parties for key services
- 12) the real estate market
- 13) the Corporation's expansion and technology initiatives and

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14) accounting principles, policies and guidelines

These risks and uncertainties should be considered in evaluating the forward-looking statements contained herein. We caution readers not to place undue reliance on those statements, which speak only as of the date of this report.

The following discussion supplements and provides information about the major components of the results of operations, financial condition, liquidity and capital resources of the Corporation. This discussion and analysis should be read in conjunction with the accompanying consolidated financial statements.

### CRITICAL ACCOUNTING POLICIES

The preparation of financial statements requires us to make estimates and assumptions. Those accounting policies with the greatest uncertainty and that require our most difficult, subjective or complex judgments affecting the application of these policies, and the likelihood that materially different amounts would be reported under different conditions, or using different assumptions, are described below.

**Allowance for Loan Losses:** We establish the allowance for loan losses through charges to earnings in the form of a provision for loan losses. Loan losses are charged against the allowance when we believe that the collection of the principal is unlikely. Subsequent recoveries of losses previously

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charged against the allowance are credited to the allowance. The allowance represents an amount that, in our judgment, will be adequate to absorb any losses on existing loans that may become uncollectible. Our judgment in determining the adequacy of the allowance is based on evaluations of the collectibility of loans while taking into consideration such factors as trends in delinquencies and charge-offs, changes in the nature and volume of the loan portfolio, current economic conditions that may affect a borrower's ability to repay, overall portfolio quality and specific potential losses. This evaluation is inherently subjective because it requires estimates that are susceptible to significant revision as more information becomes available.

**Impairment of Loans:** We measure impaired loans based on the present value of expected future cash flows discounted at the effective interest rate of the loan (or, as a practical expedient, at the loan's observable market price) or the fair value of the collateral if the loan is collateral dependent. We consider a loan impaired when it is probable that the Corporation will be unable to collect all interest and principal payments as scheduled in the loan agreement. We do not consider a loan impaired during a period of delay in payment if we expect the ultimate collection of all amounts due. We maintain a valuation allowance to the extent that the measure of the impaired loan is less than the recorded investment.

**Impairment of Securities:** Impairment of investment securities results in a write-down that must be included in net income when a market decline below cost is other-than-temporary. We regularly review each investment security for impairment based on criteria that include the extent to which cost exceeds market price, the duration of that market decline, the financial health of and specific prospects for the issuer and our ability and intention with regard to holding the security to maturity.

**Goodwill:** Goodwill is no longer subject to amortization over its estimated useful life, but is subject to at least an annual assessment for impairment using a two-step process that begins with an estimation of the fair value of the reporting unit. In assessing the recoverability of the Corporation's goodwill, all of which was recognized in connection with the Bank's acquisition of C&F Finance in September 2002, we must make assumptions in order to determine the fair value of the respective assets. Major assumptions used in determining impairment were increases in future income, sales multiples in determining terminal value and the discount rate applied to future cash flows. As part of the impairment test, we performed sensitivity analysis by increasing the discount rate, lowering sales multiples and reducing increases in future income. We completed the annual test for impairment during the fourth quarter of 2006 and determined there was no impairment to be recognized in 2006. If the underlying estimates and related assumptions change in the future, we may be required to record impairment charges.

**Defined Benefit Pension Plan:** The Bank maintains a non-contributory, defined benefit pension plan for eligible full-time employees as specified by the plan. Plan assets, which consist primarily of marketable equity securities and corporate and government fixed income securities, are valued using market quotations. The Bank's actuary determines plan obligations and annual pension expense using a number of key assumptions. Key assumptions include the discount rate, the estimated future return on plan assets and the anticipated rate of future salary increases. Changes in these assumptions in the future, if any, may impact pension assets, liabilities or expense.

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

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For further information concerning accounting policies, refer to Note 1 of the Corporation's Consolidated Financial Statements in the Corporation's Annual Report on Form 10-K for the year ended December 31, 2006.

### OVERVIEW

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

**Financial Performance Measures.** For the Corporation, net income decreased 20.4 percent to \$2.0 million for the first quarter ended March 31, 2007 compared to the first quarter of 2006. Earnings per share assuming dilution decreased 19.5 percent to 62 cents for the quarter ended March 31, 2007. First quarter 2007 results included the effects of net interest margin compression and higher operating expenses associated with expansion initiatives at the Retail Banking segment and a decline in earnings at the Mortgage Banking segment resulting from competition for loans in the tighter real estate market.

For the first quarter of 2007, on an annualized basis, the Corporation's ROE was 12.05 percent and its ROA was 1.11 percent, compared with a 16.65 percent ROE and a 1.51 percent ROA for the first quarter of 2006. The decline in these measures resulted from lower earnings in the first quarter of 2007, coupled with asset and capital growth.

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

*Retail Banking:* Pretax earnings for the Retail Banking segment were \$1.1 million for the quarter ended March 31, 2007, compared with \$1.8 million for the first quarter of 2006. The decline in quarterly earnings for 2007 included (1) the effect of margin compression on net interest income, (2) the effects on operating expenses of the Peninsula and Richmond branch expansions and the operations center relocation, (3) higher operational and administrative personnel costs to support growth and (4) the recognition of compensation expense in connection with the Corporation's issuance of stock options to directors in May 2006 and the issuance of restricted stock to employees in December 2006 under existing plans. The current static interest rate environment contributed to net interest margin compression at the Retail Banking segment during the first quarter of 2007 as deposits continued to reprice at higher rates relative to their maturing rates, while rates on interest-earning assets remained level throughout the first quarter of 2007. C&F Bank opened four new branches within a 15-month period beginning in the first quarter of 2006. As a result, the Retail Banking segment is incurring operating expenses for these branches before they have generated sufficient new loan and deposit growth to become profitable. Even though these costs will impact the Corporation's short-term profits, we expect these branches will contribute to the Corporation's long-term profitability.

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*Mortgage Banking:* Pretax earnings for C&F Mortgage Corporation were \$560,000 for the quarter ended March 31, 2007, compared with \$728,000 for the first quarter of 2006. The decline in quarterly earnings for 2007 included (1) the effects of the slowdown in the housing market on loan origination volume, which declined 7.3 percent, and (2) higher operating expenses in 2007 to generate more loan production by opening new offices, such as the new office opened in the first quarter of 2007 in Fairfax, Virginia, and incurring more business development costs. For the first quarter of 2007, the amount of loan originations at C&F Mortgage resulting from refinancings was \$61.6 million compared to \$72.9 million for the first quarter of 2006. Loans originated for new and resale home purchases for these two time periods were \$137.1 million and \$141.4 million, respectively. Future earnings of the Mortgage Banking segment may continue to be negatively affected if interest rate trends result in fewer new and resale home sales and loan refinancings. However, we plan to continue to expand into new and within existing markets that provide the potential for increased loan production.

*Consumer Finance:* Pretax earnings for C&F Finance Company were \$1.2 million for the quarter ended March 31, 2007, compared with \$1.1 million for the first quarter of 2006. The improvement in quarterly earnings for 2007 resulted from a 19 percent increase in average consumer finance loans outstanding, which more than offset the increases in the cost of borrowings attributable to rising interest rates during 2006, the provision for loan losses resulting from higher charge-offs and operating expenses to support growth. The increase in charge-offs during 2007 was attributable to loan growth, as opposed to any significant increase in the ratio of net charge-offs to average loans. We believe that with the investments that have been made in personnel and technology we have established a platform with the capacity to support current operations and future growth, which we expect will enhance long-term earnings. Future earnings at the Consumer Finance segment will be further impacted by economic conditions including, but not limited to, the employment market, interest rate levels and the resale market for used automobiles.

**Capital Management.** Total shareholders' equity decreased \$3.0 million to \$65.0 million at March 31, 2007, compared to \$68.0 million at December 31, 2006. This decline was attributable to the effects of (1) dividends to shareholders of \$959,000, resulting in a 47.7 percent dividend payout, and (2) the purchase of 105,900 shares of the Corporation's common stock totaling \$4.4 million.



**Table of Contents****RESULTS OF OPERATIONS****Net Interest Income****Selected Average Balance Sheet Data and Net Interest Margin**

| (in 000 s)                                | Three Months Ended |              |                   |              |
|---|--------------------|--------------|-------------------|--------------|
|   | March 31, 2007     |              | March 31, 2006    |              |
|   | Average Balance    | Yield/ Cost  | Average Balance   | Yield/ Cost  |
| Securities                                | \$ 68,267          | 6.50%        | \$ 66,631         | 6.54%        |
| Loans held for sale                       | 36,837             | 5.66         | 40,735            | 5.66         |
| Loans                                     | 530,286            | 10.30        | 490,725           | 9.81         |
| Interest-bearing deposits in other banks  | 26,971             | 5.21         | 11,440            | 4.58         |
| <b>Total earning assets</b>               | <b>\$ 662,361</b>  | <b>9.44%</b> | <b>\$ 609,531</b> | <b>9.07%</b> |
| Time and savings deposits                 | \$ 446,518         | 3.18%        | \$ 409,355        | 2.33%        |
| Borrowings                                | 115,567            | 6.38         | 112,004           | 5.52         |
| <b>Total interest-bearing liabilities</b> | <b>\$ 562,085</b>  | <b>3.84%</b> | <b>\$ 521,359</b> | <b>3.02%</b> |
| <b>Net interest margin</b>                |                    | <b>6.19%</b> |                   | <b>6.49%</b> |

Interest income and expense are affected by fluctuations in interest rates, by changes in the volume of earning assets and interest-bearing liabilities, and by the interaction of rate and volume factors. The following table shows the direct causes of the changes from the first quarter of 2006 to the first quarter of 2007 in the components of net interest income on a taxable-equivalent basis. Rate/volume variances, the third element in the calculation, are not shown separately in the table, but are allocated to the rate and volume variances in proportion to the relationship of the absolute dollar amounts of the change in each. Loans include both nonaccrual loans and loans held for sale.

| (in 000 s)                               | 2007 from 2006                       |              | Total Increase (Decrease) |
|--|--------------------------------------|--------------|---------------------------|
|  | Increase(Decrease) Due to Changes in |              |                           |
|  | Rate                                 | Volume       |                           |
| <b>Interest income:</b>                  |                                      |              |                           |
| Securities                               | \$ (14)                              | \$ 34        | \$ 20                     |
| Loans                                    | 698                                  | 871          | 1,569                     |
| Interest-bearing deposits in other banks | 20                                   | 200          | 220                       |
| <b>Total interest income</b>             | <b>704</b>                           | <b>1,105</b> | <b>1,809</b>              |
| <b>Interest expense:</b>                 |                                      |              |                           |
| Time and savings deposits                | 777                                  | 380          | 1,157                     |
| Borrowings                               | 249                                  | 50           | 299                       |
| <b>Total interest expense</b>            | <b>1,026</b>                         | <b>430</b>   | <b>1,456</b>              |

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|                               |          |        |        |
|-------------------------------|----------|--------|--------|
| Change in net interest income | \$ (322) | \$ 675 | \$ 353 |
|-------------------------------|----------|--------|--------|

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Net interest income, on a taxable equivalent basis, for the three months ended March 31, 2007 was \$10.2 million, compared to \$9.9 million for the first quarter of 2006. The higher net interest income resulted primarily from an 8.7 percent increase in the average balance of interest-earning assets, which was partially offset by a decrease in net interest margin to 6.19 percent in the first quarter of 2007 from 6.49 percent in the first quarter of 2006. The decrease in the net interest margin was a result of an 82 basis point increase in the rate on interest-bearing liabilities that was offset in part by a 37 basis point increase in the yield on interest-earning assets.

Average loans held for investment increased \$39.6 million during the first quarter of 2007, compared to the first quarter of 2006. The Retail Banking segment's average loan portfolio increased \$17.8 million during the first quarter of 2007. This increase was mainly attributable to higher loan production in the Virginia Peninsula market and residential construction loan growth. The Consumer Finance segment's average loan portfolio increased \$21.8 million during the first quarter of 2007. This increase was attributable to overall growth at existing locations and, more recently, the expansion into new markets. Average loans held for sale at the Mortgage Banking segment decreased \$3.9 million during the first quarter of 2007. Mortgage interest rate trends over the last 15 months have contributed to a 7.3 percent decline in loan origination volume at the Mortgage Banking segment during the first quarter of 2007. The yield on loans held for investment and loans held for sale increased as a result of a general increase in interest rates since mid-2004.

Average securities available for sale increased \$1.6 million during the first quarter of 2007, compared to the first quarter of 2006. Their average yield declined 4 basis points. The increase in the average balance resulted from excess liquidity created by the increase in deposits, which outpaced loan demand at the Retail Banking segment. The yield decreases reflected the impact of the flat yield curve on long-term interest rates and thus the yield on securities purchased throughout 2006.

Average interest-bearing deposits at other banks, primarily the FHLB, increased \$15.5 million during the first quarter of 2007, compared to the first quarter of 2006. This increase was a result of excess liquidity created by the increase in deposits, which outpaced loan demand at the Retail Banking segment. The average yield on interest-earning deposits at other banks was 63 basis points higher during the first quarter of 2007 than the same period of 2006. The higher yield was due to increases beginning in mid-2004 in short-term interest rates.

Although average time and savings deposits increased \$37.2 million during the first quarter of 2007, compared to the first quarter of 2006, the increase in interest expense on deposits was influenced to a greater extent by the increase in deposit rates. The average cost of deposits was 85 basis points higher during the first quarter of 2007 than the same period of 2006 due to the increase in short-term interest rates over the past several years, coupled with the repricing of deposits at higher interest rates relative to their maturing rates.

Average borrowings increased \$3.6 million during the first quarter of 2007, compared to the first quarter of 2006. This increase was mainly attributable to loan growth at the Consumer Finance segment. The increase in interest expense on borrowings was influenced to a greater extent by a higher cost of funds, which increased 86 basis points during the first quarter of 2007, than by increased volume. The majority of the Corporation's borrowings is indexed to short-term interest rates and reprices as short-term interest rates change.

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Interest rates will be a significant factor influencing the performance of all of the Corporation's business segments during 2007. The current static interest rate environment is contributing to net interest margin compression at the Retail Banking and Consumer Finance segments, and the flat interest rate yield curve, coupled with the slowdown in the housing market, is resulting in lower demand for home mortgage loans at the Mortgage Banking segment.

**Noninterest Income**

| (in 000 s)                                     | Three Months Ended March 31, 2007 |                     |                     |                           | Total    |
|--|-----------------------------------|---------------------|---------------------|---------------------------|----------|
|  | Retail<br>Banking                 | Mortgage<br>Banking | Consumer<br>Finance | Other and<br>Eliminations |          |
| Gains on sales of loans                        | \$                                | \$ 3,632            | \$                  | \$ (4)                    | \$ 3,628 |
| Service charges on deposit accounts            | 853                               |                     |                     |                           | 853      |
| Other service charges and fees                 | 303                               | 572                 | 64                  |                           | 939      |
| Gain on calls of available for sale securities | 3                                 |                     |                     |                           | 3        |
| Other income                                   | 22                                | 19                  | 66                  | 268                       | 375      |
| Total noninterest income                       | \$ 1,181                          | \$ 4,223            | \$ 130              | \$ 264                    | \$ 5,798 |

| (in 000 s)                                     | Three Months Ended March 31, 2006 |                     |                     |                           | Total    |
|--|-----------------------------------|---------------------|---------------------|---------------------------|----------|
|  | Retail<br>Banking                 | Mortgage<br>Banking | Consumer<br>Finance | Other and<br>Eliminations |          |
| Gains on sales of loans                        | \$                                | \$ 3,878            | \$                  | \$ (15)                   | \$ 3,863 |
| Service charges on deposit accounts            | 674                               |                     |                     |                           | 674      |
| Other service charges and fees                 | 273                               | 752                 | 67                  |                           | 1,092    |
| Gain on calls of available for sale securities | 31                                |                     |                     |                           | 31       |
| Other income                                   | 60                                | 8                   | 41                  | 217                       | 326      |
| Total noninterest income                       | \$ 1,038                          | \$ 4,638            | \$ 108              | \$ 202                    | \$ 5,986 |

Total noninterest income declined \$188,000 or 3.1 percent, to \$5.8 million during the first quarter of 2007, compared to the first quarter of 2006. A \$415,000 decrease at the Mortgage Banking segment was attributable to lower gains on loan sales due to the decline in sales volume and lower ancillary fees, both of which resulted from reduced loan demand. The decrease in noninterest income at the Mortgage Banking segment was offset in part by increases of \$143,000 at the Retail Banking and \$22,000 at the Consumer Finance segments during the first quarter of 2007 because of (1) higher service charges and fees on deposit accounts at the Retail Banking segment resulting from deposit account growth, coupled with the expansion of our overdraft protection services and (2) higher service charges and fees at the Consumer Finance segment resulting from fees generated from loan processing and collection.

**Table of Contents****Noninterest Expense**

| (in 000 s)                     | Three Months Ended March 31, 2007 |                  |                  |                        | Total     |
|--------------------------------|-----------------------------------|------------------|------------------|------------------------|-----------|
|                                | Retail Banking                    | Mortgage Banking | Consumer Finance | Other and Eliminations |           |
| Salaries and employee benefits | \$ 3,565                          | \$ 2,566         | \$ 989           | \$ 182                 | \$ 7,302  |
| Occupancy expense              | 919                               | 444              | 75               | 6                      | 1,444     |
| Other expenses                 | 1,218                             | 1,004            | 484              | 30                     | 2,736     |
| Total noninterest expense      | \$ 5,702                          | \$ 4,014         | \$ 1,548         | \$ 218                 | \$ 11,482 |

| (in 000 s)                     | Three Months Ended March 31, 2006 |                  |                  |                        | Total     |
|--------------------------------|-----------------------------------|------------------|------------------|------------------------|-----------|
|                                | Retail Banking                    | Mortgage Banking | Consumer Finance | Other and Eliminations |           |
| Salaries and employee benefits | \$ 3,160                          | \$ 2,899         | \$ 724           | \$ 166                 | \$ 6,949  |
| Occupancy expense              | 727                               | 414              | 61               | 6                      | 1,208     |
| Other expenses                 | 1,120                             | 890              | 429              | 34                     | 2,473     |
| Total noninterest expense      | \$ 5,007                          | \$ 4,203         | \$ 1,214         | \$ 206                 | \$ 10,630 |

Total noninterest expense increased \$852,000, or 8.0 percent, to \$11.5 million during the first quarter of 2007. The Retail Banking and the Consumer Finance segments reported increases in total noninterest expense that were primarily attributable to higher personnel and operating expenses to support growth and technology enhancements at both segments. Noninterest expense of the Retail Banking segment included operating expenses associated with our new Patterson Avenue and Chester retail banking branches in the Richmond, Virginia area, which opened in the first quarter of 2007, our Hampton and Yorktown retail banking branches on the Virginia Peninsula, which opened in 2006, and our new operations center, which opened in late 2005. Noninterest expenses of the Consumer Finance segment included costs associated with building depth in our sales force, entering new markets and increasing the administrative staff to support the increase in the loan portfolio. Total noninterest expense declined during the first quarter of 2007 for the Mortgage Banking segment because of lower production-based personnel costs due to lower origination volume in the first quarter of 2007. The decrease in personnel expenses was offset in part by higher overhead, including occupancy and other expenses, associated with opening new loan production offices in 2007 and 2006.

**Income Taxes**

Income tax expense for the three months ended March 31, 2007 amounted to \$815,000, resulting in an effective tax rate of 28.8 percent, compared to \$1.12 million, or 30.6 percent, for the three months ended March 31, 2006. The decline in the effective tax rate during the first quarter of 2007 resulted from higher tax-exempt income on securities and loans as a percentage of pre-tax income.

**Table of Contents****ASSET QUALITY****Allowance for Loan Losses**

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

| (in 000 s)                                 | Three Months Ended March 31, 2007 |                     |           |
|--|-----------------------------------|---------------------|-----------|
|  | Retail and<br>Mortgage<br>Banking | Consumer<br>Finance | Total     |
| Allowance, beginning of period             | \$ 4,326                          | \$ 9,890            | \$ 14,216 |
| Provision for loan losses                  |                                   | 1,400               | 1,400     |
|  | 4,326                             | 11,290              | 15,616    |
| Loans charged off                          | (57)                              | (1,508)             | (1,565)   |
| Recoveries of loans previously charged off | 38                                | 438                 | 476       |
| Net loans charged off                      | (19)                              | (1,070)             | (1,089)   |
| Allowance, end of period                   | \$ 4,307                          | \$ 10,220           | \$ 14,527 |

| (in 000 s)                                 | Three Months Ended March 31, 2006 |                     |           |
|--|-----------------------------------|---------------------|-----------|
|  | Retail and<br>Mortgage<br>Banking | Consumer<br>Finance | Total     |
| Allowance, beginning of period             | \$ 4,718                          | \$ 8,346            | \$ 13,064 |
| Provision for loan losses                  |                                   | 1,275               | 1,275     |
|  | 4,718                             | 9,621               | 14,339    |
| Loans charged off                          | (147)                             | (1,116)             | (1,263)   |
| Recoveries of loans previously charged off | 114                               | 268                 | 382       |
| Net loans charged off                      | (33)                              | (848)               | (881)     |
| Allowance, end of period                   | \$ 4,685                          | \$ 8,773            | \$ 13,458 |

During the first quarter of 2007, there was a slight decline in the allowance for loan losses at the combined Retail Banking and Mortgage Banking segments since December 31, 2006. No provision was made to increase the allowance because we believe that the current level of the allowance for loan losses is adequate to absorb any losses on existing loans that may become uncollectible.

The Consumer Finance segment accounted for the majority of the activity in the allowance for loan losses during the first quarter of 2007. The increase in the provision for loan losses occurred as a result of loan growth and higher charge-offs. The increase in charge-offs during 2007 was attributable to loan growth, as opposed to any significant increase in the ratio of net charge-offs to average loans.

**Table of Contents****Nonperforming Assets****Retail and Mortgage Banking**

|  | March 31, | December 31, |
|--|-----------|--------------|
| (in 000 \$)  | 2007      | 2006         |
| Nonperforming assets*                              | \$ 815    | \$ 955       |
| Accruing loans** past due for 90 days or more      | 1,682     | 1,629        |
| Total loans**                                      | 399,179   | 399,195      |
| Allowance for loan losses                          | 4,307     | 4,326        |
| Nonperforming assets* to total loans**             | .20%      | 0.24%        |
| Allowance for loan losses to total loans**         | 1.08      | 1.08         |
| Allowance for loan losses to nonperforming assets* | 528.47    | 452.98       |

\* Nonperforming assets consist solely of nonaccrual loans for each period presented.

\*\* Loans exclude Consumer Finance segment loans presented below.

**Consumer Finance**

|   | March 31,  | December 31, |
|---|------------|--------------|
| (in 000 \$)   | 2007       | 2006         |
| Nonaccrual loans  | \$ 662     | \$ 880       |
| Accruing loans past due for 90 days or more                       | \$ 10      | \$ 8         |
| Total loans   | \$ 138,611 | \$ 132,864   |
| Allowance for loan losses   | \$ 10,220  | \$ 9,890     |
| Nonaccrual consumer finance loans to total consumer finance loans | .48%       | 0.66%        |
| Allowance for loan losses to total consumer finance loans         | 7.37       | 7.44         |

As of March 31, 2007, there have been no material changes since December 31, 2006 in nonperforming assets and accruing loans past due 90 days or more at any of the Corporation's business segments. At the Consumer Finance segment, the ratio of the allowance for loan losses to total consumer finance loans declined slightly as a result of loan growth during the first quarter of 2007.

**FINANCIAL CONDITION**

At March 31, 2007, the Corporation had total assets of \$735.8 million compared to \$734.5 million at December 31, 2006. The increase was principally a result of an increase in loans held for investment at the Consumer Finance segment, which was offset by the decline in loans held for sale due to reduced demand for home mortgage loans.





**Table of Contents****Loan Portfolio**

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

| (in 000 \$)                            | March 31, 2007    |             | December 31, 2006 |             |
|--|-------------------|-------------|-------------------|-------------|
|  | Amount            | Percent     | Amount            | Percent     |
| Real estate - mortgage                 | \$ 122,511        | 23%         | \$ 115,885        | 22%         |
| Real estate - construction             | 11,961            | 2           | 13,650            | 2           |
| Commercial, financial and agricultural | 231,978           | 43          | 236,157           | 44          |
| Equity lines                           | 25,048            | 5           | 24,880            | 5           |
| Consumer                               | 8,016             | 1           | 8,951             | 2           |
| Consumer - C&F Finance                 | 138,611           | 26          | 132,864           | 25          |
| <b>Total loans</b>                     | <b>538,125</b>    | <b>100%</b> | <b>532,387</b>    | <b>100%</b> |
| Less unearned loan fees                | (335)             |             | (328)             |             |
| Less allowance for loan losses         |                   |             |                   |             |
| Retail and Mortgage Banking            | (4,307)           |             | (4,326)           |             |
| Consumer Finance                       | (10,220)          |             | (9,890)           |             |
| <b>Total loans, net</b>                | <b>\$ 523,263</b> |             | <b>\$ 517,843</b> |             |

**Investment Securities**

The following table sets forth the composition of the Corporation's securities available for sale in dollar amounts at fair value and as a percentage of the Corporation's total securities available for sale at the dates indicated:

| (in 000 \$)                                      | March 31, 2007   |             | December 31, 2006 |             |
|--|------------------|-------------|-------------------|-------------|
|  | Amount           | Percent     | Amount            | Percent     |
| U.S. government agencies and corporations        | \$ 5,738         | 9%          | \$ 6,222          | 9%          |
| Mortgage-backed securities                       | 2,072            | 3           | 2,208             | 3           |
| Obligations of states and political subdivisions | 55,425           | 82          | 55,027            | 82          |
| <b>Total debt securities</b>                     | <b>63,235</b>    | <b>94</b>   | <b>63,457</b>     | <b>94</b>   |
| Preferred stock                                  | 4,153            | 6           | 4,127             | 6           |
| <b>Total available for sale securities</b>       | <b>\$ 67,388</b> | <b>100%</b> | <b>\$ 67,584</b>  | <b>100%</b> |



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### **Deposits**

While total deposits totaled \$532.8 million at both March 31, 2007 and December 31, 2006, an increase of \$14.9 million in time deposits was offset by a \$14.9 million decrease in transaction accounts. This shift is a result of the competitive environment for lower-costing transaction deposits.

### **Borrowings**

Borrowings totaled \$106.8 million at March 31, 2007 compared to \$104.7 million at December 31, 2006. This increase was attributable to loan growth at the Consumer Finance segment, which was offset in part by lower funding needs at the Mortgage Banking segment.

### **Off-Balance Sheet Arrangements**

As of March 31, 2007, there have been no material changes to the off-balance sheet arrangements disclosed in Management's Discussion and Analysis in the Corporation's Annual Report on Form 10-K for the year ended December 31, 2006.

### **Contractual Obligations**

As of March 31, 2007, there have been no material changes outside the ordinary course of business to the contractual obligations disclosed in Management's Discussion and Analysis in the Corporation's Annual Report on Form 10-K for the year ended December 31, 2006.

### **Liquidity**

Liquid assets, which include unrestricted cash and due from banks, interest-bearing deposits at other banks and nonpledged securities available-for-sale, at March 31, 2007 totaled \$49.6 million. The Corporation's funding sources consist of an established federal funds line with a regional correspondent bank of \$14.0 million that had no outstanding balance as of March 31, 2007, an established line with the FHLB that had \$15.0 million outstanding under a total line of \$129.7 million as of March 31, 2007, an unsecured revolving line of credit with a third-party lender that had \$7.0 million outstanding under a total line of \$7.0 million as of March 31, 2007 and a revolving line of credit with a third party bank that had \$80.7 million outstanding under a total line of \$100.0 million as of March 31, 2007. We have no reason to believe these arrangements will not be renewed at maturity.

As a result of the Corporation's management of liquid assets and the ability to generate liquidity through liability funding, management believes that the Corporation maintains overall liquidity sufficient to satisfy its operational requirements and contractual obligations.

**Table of Contents****Capital Resources**

The Corporation's and the Bank's actual capital amounts and ratios are presented in the following table.

| (in 000's)                               | Actual    |       | Minimum Capital Requirements |       | Minimum To Be Well Capitalized Under Prompt Corrective Action Provisions |       |
|--|-----------|-------|------------------------------|-------|--|-------|
|  | Amount    | Ratio | Amount                       | Ratio | Amount   | Ratio |
| <i>As of March 31, 2007:</i>             |           |       |                              |       |  |       |
| Total Capital (to Risk-Weighted Assets)  |           |       |                              |       |  |       |
| Corporation                              | \$ 71,707 | 12.1% | \$47,278                     | 8.0%  | N/A  | N/A   |
| Bank                                     | 73,500    | 12.3  | 46,843                       | 8.0   | \$ 58,554  | 10.0% |
| Tier I Capital (to Risk-Weighted Assets) |           |       |                              |       |  |       |
| Corporation                              | 64,232    | 10.9  | 23,639                       | 4.0   | N/A  | N/A   |
| Bank                                     | 66,092    | 11.3  | 23,421                       | 4.0   | 35,132   | 6.0   |
| Tier I Capital (to Average Assets)       |           |       |                              |       |  |       |
| Corporation                              | 64,232    | 8.9   | 28,667                       | 4.0   | N/A  | N/A   |
| Bank                                     | 66,092    | 9.3   | 28,459                       | 4.0   | 35,574   | 5.0   |
| <i>As of December 31, 2006:</i>          |           |       |                              |       |  |       |
| Total Capital (to Risk-Weighted Assets)  |           |       |                              |       |  |       |
| Corporation                              | \$ 74,646 | 12.6% | \$47,413                     | 8.0%  | N/A  | N/A   |
| Bank                                     | 76,571    | 13.0  | 46,992                       | 8.0   | \$ 58,740  | 10.0% |
| Tier I Capital (to Risk-Weighted Assets) |           |       |                              |       |  |       |
| Corporation                              | 67,161    | 11.3  | 23,707                       | 4.0   | N/A  | N/A   |
| Bank                                     | 69,144    | 11.8  | 23,496                       | 4.0   | 35,244   | 6.0   |
| Tier I Capital (to Average Assets)       |           |       |                              |       |  |       |
| Corporation                              | 67,161    | 9.6   | 28,123                       | 4.0   | N/A  | N/A   |
| Bank                                     | 69,144    | 9.9   | 27,918                       | 4.0   | 34,897   | 5.0   |

**Effects of Inflation**

The effect of changing prices on financial institutions is typically different from other industries as the Corporation's assets and liabilities are monetary in nature. Interest rates are significantly impacted by inflation, but neither the timing nor the magnitude of the changes is directly related to price level indices. Impacts of inflation on interest rates, loan demand and deposits are reflected in the consolidated financial statements.

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

There have been no significant changes from the quantitative and qualitative disclosures made in the Corporation's Annual Report on Form 10-K for the year ended December 31, 2006.

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**ITEM 4. CONTROLS AND PROCEDURES**

The Corporation, under the supervision and with the participation of the Corporation's management, including the Corporation's Chief Executive Officer and the Chief Financial Officer, has evaluated the effectiveness of the Corporation's disclosure controls and procedures as of the end of the period covered by this report. Based on that evaluation, the Chief Executive Officer and the Chief Financial Officer have concluded that the Corporation's disclosure controls and procedures were effective as of March 31, 2007 to ensure that information required to be disclosed by the Corporation in reports that it files or submits under the Securities Exchange Act of 1934 is recorded, processed, summarized and reported within the time periods specified in Securities and Exchange Commission rules and regulations and that such information is accumulated and communicated to the Corporation's management, including the Corporation's Chief Executive Officer and Chief Financial Officer, as appropriate to allow timely decisions regarding required disclosure. Because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that the Corporation's disclosure controls and procedures will detect or uncover every situation involving the failure of persons within the Corporation or its subsidiary to disclose material information otherwise required to be set forth in the Corporation's periodic reports.

Management of the Corporation is also responsible for establishing and maintaining adequate internal control over financial reporting and control of the Corporation's assets to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with accounting principles generally accepted in the United States of America. There were no changes in the Corporation's internal control over financial reporting during the Corporation's first quarter ended March 31, 2007 that have materially affected, or are reasonably likely to materially affect, the Corporation's internal control over financial reporting.

**Table of Contents****PART II - OTHER INFORMATION****ITEM 1A. RISK FACTORS**

There have been no material changes in the risk factors faced by the Corporation from those disclosed in the Corporation's Annual Report on Form 10-K for the year ended December 31, 2006.

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

|                     | Issuer Purchases of Equity Securities |                              |   | Maximum Number of Shares that May Yet Be Purchased Under the Program <sup>1</sup> |
|---------------------|---------------------------------------|------------------------------|---|---|
|                     | Total Number Of Shares Purchased      | Average Price Paid Per Share | Total Number of Shares Purchased as Part of Publicly Announced Program <sup>1</sup> |   |
| January 1-31, 2007  |                                       | \$                           |   | 149,865   |
| February 1-28, 2007 | 103,100                               | 41.29                        | 103,100   | 46,765  |
| March 1-31, 2007    | 2,800                                 | 44.53                        | 2,800   | 43,965  |
| Total               | 105,900                               | \$ 41.38                     | 105,900   |   |

<sup>1</sup> On November 3, 2006, the Corporation's board of directors authorized the purchase of up to 150,000 shares of the Corporation's common stock over the twelve months ending November 3, 2007. The stock will be purchased in the open market and/or by privately negotiated transactions, as management and the board of directors deem prudent.

**ITEM 6. EXHIBITS****(a) Exhibits**

- 3.1 Articles of Incorporation of C&F Financial Corporation (incorporated by reference to Exhibit 3.1 to Form 10-KSB filed March 29, 1996)
- 3.2 Bylaws of C&F Financial Corporation (incorporated by reference to Exhibit 3.2 to Form 10-KSB filed March 29, 1996)
- 10.21 Second Amendment to the Loan and Security Agreement by and between Wells Fargo Financial Preferred Capital, Inc. and C&F Finance Company dated as of March 16, 2007
- 31.1 Certification of CEO pursuant to Rule 13a-14(a)
- 31.2 Certification of CFO pursuant to Rule 13a-14(a)
- 32 Certification of CEO/CFO pursuant to 18 U.S.C. Section 1350



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SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

C&F FINANCIAL CORPORATION

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(Registrant)

|      |             |  |
|------|-------------|--|
| Date | May 7, 2007 | /s/ Larry G. Dillon<br>Larry G. Dillon<br>Chairman, President and Chief Executive Officer<br>(Principal Executive Officer) |
|------|-------------|--|

|      |             |  |
|------|-------------|--|
| Date | May 7, 2007 | /s/ Thomas F. Cherry<br>Thomas F. Cherry<br>Executive Vice President,<br>Chief Financial Officer and Secretary<br>(Principal Financial and Accounting Officer) |
|------|-------------|--|