

C & F FINANCIAL CORP  
Form 10-Q  
August 08, 2017  
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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 June 30, 2017

or

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission File Number 000-23423

C&F FINANCIAL CORPORATION

(Exact name of registrant as specified in its charter)

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

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

(804) 843-2360

(Registrant's telephone number, including area code)

N/A

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

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

to submit and post such files). Yes No

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

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

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

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

At August 4, 2017, the latest practicable date for determination, 3,487,223 shares of common stock, \$1.00 par value, of the registrant were outstanding.

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## Part I – FINANCIAL INFORMATION

## ITEM 1. FINANCIAL STATEMENTS

## CONSOLIDATED BALANCE SHEETS

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

|  | June 30,<br>2017<br>(unaudited) | December 31,<br>2016<br>* |
|--|---------------------------------|---------------------------|
| <b>Assets</b>  |                                 |                           |
| Cash and due from banks  | \$ 12,560                       | \$ 12,892                 |
| Interest-bearing deposits in other banks   | 106,337                         | 90,309                    |
| Total cash and cash equivalents  | 118,897                         | 103,201                   |
| Securities—available for sale at fair value, amortized cost of \$210,340 and \$207,893, respectively | 213,036                         | 210,026                   |
| Loans held for sale, at fair value   | 47,326                          | 52,027                    |
| Loans, net of allowance for loan losses of \$36,496 and \$37,066, respectively                       | 957,072                         | 960,162                   |
| Restricted stocks, at cost   | 3,443                           | 3,403                     |
| Corporate premises and equipment, net  | 35,544                          | 35,804                    |
| Other real estate owned, net of valuation allowance of \$57 and \$86, respectively                   | 284                             | 195                       |
| Accrued interest receivable  | 6,885                           | 7,261                     |
| Goodwill   | 14,425                          | 14,425                    |
| Core deposit and other amortizable intangibles, net  | 1,903                           | 2,269                     |
| Bank-owned life insurance  | 15,294                          | 15,103                    |
| Other assets   | 49,970                          | 48,116                    |
| <b>Total assets</b>  | <b>\$ 1,464,079</b>             | <b>\$ 1,451,992</b>       |
| <b>Liabilities</b>   |                                 |                           |
| <b>Deposits</b>  |                                 |                           |
| Noninterest-bearing demand deposits  | \$ 239,612                      | \$ 218,655                |
| Savings and interest-bearing demand deposits   | 539,965                         | 556,851                   |
| Time deposits  | 348,622                         | 344,415                   |
| <b>Total deposits</b>  | <b>1,128,199</b>                | <b>1,119,921</b>          |
| Short-term borrowings  | 13,243                          | 12,363                    |
| Long-term borrowings   | 127,029                         | 127,029                   |
| Trust preferred capital notes  | 25,192                          | 25,175                    |
| Accrued interest payable   | 725                             | 703                       |
| Other liabilities  | 24,786                          | 27,587                    |

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|  |              |              |
|--|--------------|--------------|
| Total liabilities  | 1,319,174    | 1,312,778    |
| Commitments and contingent liabilities   |              |              |
| Shareholders' Equity   |              |              |
| Common stock (\$1.00 par value, 8,000,000 shares authorized, 3,486,476 and 3,472,561 shares issued and outstanding, respectively, includes 139,130 and 141,755 of unvested shares, respectively) | 3,347        | 3,331        |
| Additional paid-in capital   | 12,416       | 11,705       |
| Retained earnings  | 129,732      | 125,162      |
| Accumulated other comprehensive loss, net  | (590)        | (984)        |
| Total shareholders' equity   | 144,905      | 139,214      |
| Total liabilities and shareholders' equity   | \$ 1,464,079 | \$ 1,451,992 |

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\* Derived from audited consolidated financial statements.

See notes to consolidated financial statements.

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## CONSOLIDATED STATEMENTS OF INCOME

(Unaudited)

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

|   | Three Months Ended June 30, |           | Six Months Ended June 30, |           |
|---|-----------------------------|-----------|---------------------------|-----------|
|   | 2017                        | 2016      | 2017                      | 2016      |
| Interest income   |                             |           |                           |           |
| Interest and fees on loans                                    | \$ 20,697                   | \$ 20,636 | \$ 41,065                 | \$ 40,842 |
| Interest on interest-bearing deposits and federal funds sold  | 278                         | 143       | 487                       | 320       |
| Interest and dividends on securities                          |                             |           |                           |           |
| U.S. government agencies and corporations                     | 86                          | 85        | 164                       | 186       |
| Mortgage-backed securities                                    | 370                         | 312       | 708                       | 646       |
| Tax-exempt obligations of states and political subdivisions   | 817                         | 954       | 1,680                     | 1,935     |
| Taxable obligations of states and political subdivisions      | 60                          | 45        | 112                       | 91        |
| Corporate bonds and other                                     | 115                         | 128       | 228                       | 248       |
| Total interest income   | 22,423                      | 22,303    | 44,444                    | 44,268    |
| Interest expense  |                             |           |                           |           |
| Savings and interest-bearing deposits                         | 281                         | 267       | 568                       | 559       |
| Time deposits   | 879                         | 802       | 1,727                     | 1,611     |
| Borrowings  | 906                         | 861       | 1,758                     | 1,739     |
| Trust preferred capital notes                                 | 279                         | 288       | 562                       | 571       |
| Total interest expense  | 2,345                       | 2,218     | 4,615                     | 4,480     |
| Net interest income   | 20,078                      | 20,085    | 39,829                    | 39,788    |
| Provision for loan losses                                     | 3,100                       | 3,600     | 7,500                     | 8,200     |
| Net interest income after provision for loan losses           | 16,978                      | 16,485    | 32,329                    | 31,588    |
| Noninterest income  |                             |           |                           |           |
| Gains on sales of loans                                       | 2,619                       | 2,552     | 4,562                     | 4,282     |
| Service charges on deposit accounts                           | 1,109                       | 1,041     | 2,178                     | 2,004     |
| Other service charges and fees                                | 2,287                       | 2,363     | 4,333                     | 4,047     |
| Net gains on calls and sales of available for sale securities | 7                           | 44        | 8                         | 45        |
| Wealth management services income                             | 428                         | 315       | 750                       | 591       |
| Other   | 839                         | 1,408     | 1,604                     | 1,917     |
| Total noninterest income                                      | 7,289                       | 7,723     | 13,435                    | 12,886    |
| Noninterest expenses  |                             |           |                           |           |
| Salaries and employee benefits                                | 11,061                      | 10,522    | 21,730                    | 20,693    |
| Occupancy   | 2,632                       | 2,365     | 5,253                     | 4,699     |
| Other   | 4,587                       | 4,760     | 9,142                     | 9,345     |

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|  |           |           |           |           |
|--|-----------|-----------|-----------|-----------|
| Total noninterest expenses   | 18,280    | 17,647    | 36,125    | 34,737    |
| Income before income taxes   | 5,987     | 6,561     | 9,639     | 9,737     |
| Income tax expense   | 1,848     | 1,855     | 2,769     | 2,547     |
| Net income   | \$ 4,139  | \$ 4,706  | \$ 6,870  | \$ 7,190  |
| Net income per share - basic   | \$ 1.19   | \$ 1.36   | \$ 1.97   | \$ 2.08   |
| Net income per share - assuming dilution                             | \$ 1.19   | \$ 1.36   | \$ 1.97   | \$ 2.08   |
| Weighted average number of shares outstanding<br>- basic             | 3,486,997 | 3,451,746 | 3,485,002 | 3,450,188 |
| Weighted average number of shares outstanding<br>- assuming dilution | 3,486,997 | 3,453,136 | 3,485,160 | 3,451,438 |

See notes to consolidated financial statements.



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## CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(Unaudited)

(In thousands)

|   | Three Months Ended<br>June 30, |          | Six Months Ended<br>June 30, |          |
|---|--------------------------------|----------|------------------------------|----------|
|   | 2017                           | 2016     | 2017                         | 2016     |
| Net income  | \$ 4,139                       | \$ 4,706 | \$ 6,870                     | \$ 7,190 |
| Other comprehensive income:   |                                |          |                              |          |
| Changes in defined benefit plan assets and benefit obligations            |                                |          |                              |          |
| Changes in net loss arising during the period <sup>1</sup>                | 36                             | 38       | 74                           | 76       |
| Tax effect  | (12)                           | (13)     | (25)                         | (26)     |
| Amortization of prior service cost arising during the period <sup>1</sup> | (15)                           | (15)     | (30)                         | (30)     |
| Tax effect  | 6                              | 5        | 11                           | 10       |
| Net of tax amount   | 15                             | 15       | 30                           | 30       |
| Unrealized losses on cash flow hedging instruments                        |                                |          |                              |          |
| Unrealized holding losses arising during the period                       | (68)                           | (134)    | (3)                          | (672)    |
| Tax effect  | 26                             | 53       | 1                            | 241      |
| Net of tax amount   | (42)                           | (81)     | (2)                          | (431)    |
| Unrealized holding gains on securities                                    |                                |          |                              |          |
| Unrealized holding gains arising during the period                        | 265                            | 755      | 571                          | 2,439    |
| Tax effect  | (93)                           | (264)    | (200)                        | (853)    |
| Reclassification adjustment for gains included in net income <sup>2</sup> | (7)                            | (44)     | (8)                          | (45)     |
| Tax effect  | 3                              | 15       | 3                            | 15       |
| Net of tax amount   | 168                            | 462      | 366                          | 1,556    |
| Other comprehensive income  | 141                            | 396      | 394                          | 1,155    |
| Comprehensive income  | \$ 4,280                       | \$ 5,102 | \$ 7,264                     | \$ 8,345 |

<sup>1</sup> These items are included in the computation of net periodic benefit cost, which is a component of "Salaries and employee benefits" on the consolidated statements of income. See "Note 6: Employee Benefit Plans," for additional information.

<sup>2</sup> Gains are included in "Net gains on calls and sales of available for sale securities" on the consolidated statements of income.

See notes to consolidated financial statements.



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## CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY

(Unaudited)

(In thousands, except per share amounts)

|  | Common<br>Stock | Additional<br>Paid - In<br>Capital | Retained<br>Earnings | Accumulated<br>Other<br>Comprehensive<br>Income (Loss) | Total<br>Shareholders'<br>Equity |
|--|-----------------|------------------------------------|----------------------|--|----------------------------------|
| Balance December 31, 2016                                    | \$ 3,331        | \$ 11,705                          | \$ 125,162           | \$ (984)   | \$ 139,214                       |
| Comprehensive income:  |                 |                                    |                      |  |                                  |
| Net income   | —               | —                                  | 6,870                | —  | 6,870                            |
| Other comprehensive income                                   | —               | —                                  | —                    | 394  | 394                              |
| Stock options exercised                                      | 2               | 81                                 | —                    | —  | 83                               |
| Share-based compensation                                     | —               | 754                                | —                    | —  | 754                              |
| Restricted stock vested                                      | 17              | (17)                               | —                    | —  | —                                |
| Common stock issued  | 1               | 74                                 | —                    | —  | 75                               |
| Common stock purchased                                       | (4)             | (181)                              | —                    | —  | (185)                            |
| Cash dividends declared – common stock<br>(\$0.66 per share) | —               | —                                  | (2,300)              | —  | (2,300)                          |
| Balance June 30, 2017  | \$ 3,347        | \$ 12,416                          | \$ 129,732           | \$ (590)   | \$ 144,905                       |

|                            | Common<br>Stock | Additional<br>Paid - In<br>Capital | Retained<br>Earnings | Accumulated<br>Other<br>Comprehensive<br>Income | Total<br>Shareholders'<br>Equity |
|----------------------------|-----------------|------------------------------------|----------------------|---|----------------------------------|
| Balance December 31, 2015  | \$ 3,301        | \$ 10,420                          | \$ 116,167           | \$ 1,171  | \$ 131,059                       |
| Comprehensive income:      |                 |                                    |                      |   |                                  |
| Net income                 | —               | —                                  | 7,190                | —   | 7,190                            |
| Other comprehensive income | —               | —                                  | —                    | 1,155   | 1,155                            |
| Share-based compensation   | —               | 615                                | —                    | —   | 615                              |
| Restricted stock vested    | 10              | (10)                               | —                    | —   | —                                |
| Common stock issued        | 2               | 72                                 | —                    | —   | 74                               |
| Common stock purchased     | (4)             | (138)                              | —                    | —   | (142)                            |
|                            | —               | —                                  | (2,209)              | —   | (2,209)                          |

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Cash dividends declared – common stock  
(\$0.64 per share)

|                       |          |           |            |          |            |
|-----------------------|----------|-----------|------------|----------|------------|
| Balance June 30, 2016 | \$ 3,309 | \$ 10,959 | \$ 121,148 | \$ 2,326 | \$ 137,742 |
|-----------------------|----------|-----------|------------|----------|------------|

See notes to consolidated financial statements.

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## CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited)

(In thousands)

|   | Six Months Ended June 30, |           |
|---|---------------------------|-----------|
|   | 2017                      | 2016      |
| Operating activities:   |                           |           |
| Net income  | \$ 6,870                  | \$ 7,190  |
| Adjustments to reconcile net income to net cash provided by operating activities:                                     |                           |           |
| Depreciation  | 1,305                     | 1,275     |
| Provision for loan losses   | 7,500                     | 8,200     |
| Provision for indemnifications  | 88                        | 140       |
| Provision for other real estate owned losses  | —                         | 70        |
| Share-based compensation  | 754                       | 615       |
| Net accretion of certain acquisition-related fair value adjustments   | (629)                     | (748)     |
| Net amortization of discounts and amortization of premiums on securities  | 955                       | 856       |
| Realized gains on sales and calls of securities   | (8)                       | (45)      |
| Net realized losses (gains) on sales of other real estate owned   | 4                         | (98)      |
| Net realized gains on sale of corporate premises and equipment  | (2)                       | (183)     |
| Income from bank-owned life insurance   | (168)                     | (664)     |
| Origination of loans held for sale  | (349,908)                 | (280,047) |
| Proceeds from sales of loans held for sale  | 359,171                   | 266,756   |
| Gains on sales of loans held for sale   | (4,562)                   | (4,282)   |
| Change in other assets and liabilities:   |                           |           |
| Accrued interest receivable   | 376                       | (171)     |
| Other assets  | (1,963)                   | (1,699)   |
| Accrued interest payable  | 22                        | 13        |
| Other liabilities   | (2,892)                   | 3,048     |
| Net cash provided by operating activities   | 16,913                    | 226       |
| Investing activities:   |                           |           |
| Proceeds from maturities, calls and sales of securities available for sale and payments on mortgage-backed securities | 21,488                    | 31,530    |
| Purchases of securities available for sale  | (24,742)                  | (22,381)  |
| Net purchases of restricted stocks  | (40)                      | (58)      |
| Net increase in loans   | (3,778)                   | (65,975)  |
| Other real estate owned improvements  | —                         | (20)      |
| Proceeds from sales of other real estate owned  | 115                       | 805       |
| Purchases of corporate premises and equipment, net  | (1,090)                   | (885)     |
| Net cash used in investing activities   | (8,047)                   | (56,984)  |
| Financing activities:   |                           |           |
| Net increase in demand, interest-bearing demand and savings deposits  | 4,071                     | 9,984     |
| Net increase (decrease) in time deposits  | 4,207                     | (5,158)   |

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|   |            |           |
|---|------------|-----------|
| Net increase (decrease) in borrowings                                 | 879        | (6,225)   |
| Issuance of common stock  | 75         | 74        |
| Purchase of common stock, including shares withheld to pay taxes      | (185)      | (142)     |
| Proceeds from exercise of stock options                               | 83         | —         |
| Cash dividends  | (2,300)    | (2,209)   |
| Net cash provided by (used in) financing activities                   | 6,830      | (3,676)   |
| Net increase (decrease) in cash and cash equivalents                  | 15,696     | (60,434)  |
| Cash and cash equivalents at beginning of period                      | 103,201    | 152,943   |
| Cash and cash equivalents at end of period                            | \$ 118,897 | \$ 92,509 |
| Supplemental disclosure   |            |           |
| Interest paid   | \$ 4,575   | \$ 4,449  |
| Income taxes paid   | 2,890      | 1,230     |
| Supplemental disclosure of noncash investing and financing activities |            |           |
| Unrealized gains on securities available for sale                     | \$ 563     | \$ 2,394  |
| Transfers from loans to other real estate owned                       | 208        | 394       |
| Pension adjustment  | 44         | 46        |
| Unrealized losses on cash flow hedging instruments                    | (3)        | (672)     |

See notes to consolidated financial statements.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

NOTE 1: Summary of Significant Accounting Policies

**Principles of Consolidation:** The accompanying unaudited consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America (U.S. GAAP) for interim financial reporting and with applicable quarterly reporting regulations of the Securities and Exchange Commission (the SEC). They do not include all of the information and notes required by U.S. GAAP for complete financial statements. Therefore, these consolidated financial statements should be read in conjunction with the consolidated financial statements and notes thereto included in the C&F Financial Corporation Annual Report on Form 10-K for the year ended December 31, 2016.

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

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

C&F Bank has five wholly-owned subsidiaries: C&F Mortgage Corporation and Subsidiary (C&F Mortgage), C&F Finance Company (C&F Finance), C&F Wealth Management Corporation (C&F Wealth Management), C&F Insurance Services, Inc. and CVB Title Services, Inc., all incorporated under the laws of the Commonwealth of Virginia. C&F Mortgage, organized in September 1995, was formed to originate and sell residential mortgages and through its subsidiary, Certified Appraisals LLC, provides ancillary mortgage loan production services for residential appraisals. C&F Finance, acquired on September 1, 2002, is a finance company purchasing automobile loans through indirect lending programs. C&F Wealth Management, organized in April 1995, is a full-service brokerage firm

offering a comprehensive range of wealth management services and insurance products through an alliance with an independent broker/dealer. C&F Insurance Services, Inc., organized in July 1999, owns an equity interest in an insurance agency that sells insurance products to customers of C&F Bank, C&F Mortgage and other financial institutions that have an equity interest in the agency. CVB Title Services, Inc. was organized for the primary purpose of owning membership interests in two insurance-related limited liability companies. Business segment data is presented in Note 8.

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

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



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**Adoption of New Accounting Standard:** During the fourth quarter of 2016, the Corporation adopted Accounting Standards Update (ASU) 2016-09 “Compensation-Stock Compensation (Topic 718): Improvements to Employer Share-Based Payment Accounting”. This ASU simplifies several aspects of the accounting for share-based payment award transactions, one of which is the recognition of excess tax benefits and deficiencies related to share-based payments, including tax benefits of dividends on share-based payment awards. Prior to the adoption of ASU 2016-09, such tax consequences were recognized as components of additional paid-in capital. With the adoption of this ASU, tax benefits and deficiencies are recognized within income tax expense. In accordance with the adoption provisions of ASU 2016-09, the results for the second quarter and first six months of 2016 include only the excess tax (expense) benefits attributable to the second quarter and first six months of 2016 of \$(37,000) and \$23,000, respectively.

**Derivative Financial Instruments:** The Corporation recognizes derivative financial instruments at fair value as either an other asset or other liability in the consolidated balance sheet. The Corporation’s derivative financial instruments may include (1) interest rate lock commitments (IRLCs) on mortgage loans that will be sold in the secondary market on a best efforts basis and the related forward commitments to sell mortgage loans, (2) interest rate swaps with certain qualifying commercial loan customers and dealer counterparties and (3) interest rate swaps that qualify as cash flow hedges on the Corporation’s trust preferred capital notes. Because the IRLCs, forward sales commitments and interest rate swaps with loan customers and dealer counterparties are not designated as hedging instruments, adjustments to reflect unrealized gains and losses resulting from changes in fair value of these instruments are reported as noninterest income or noninterest expense, as applicable. The effective portion of the gain or loss on the Corporation’s cash flow hedges is reported as a component of other comprehensive income, net of deferred income taxes, and reclassified into earnings in the same period(s) during which the hedged transactions affect earnings. The Corporation’s derivative financial instruments are described more fully in Note 10.

**Share-Based Compensation:** Share-based compensation expense, net of forfeitures, for the second quarter of 2017 and the first six months of 2017 was \$351,000 (\$217,000 after tax) and \$754,000 (\$467,000 after tax), respectively, for restricted stock granted during 2012 through 2017. As of June 30, 2017, there was \$2.84 million of total unrecognized compensation expense related to unvested restricted stock that will be recognized over the remaining requisite service periods.

A summary of activity for restricted stock awards during the first six months of 2017 and 2016 is presented below:

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

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

|                             | 2016              | Weighted-<br>Average<br>Grant Date<br>Fair Value |
|-----------------------------|-------------------|--|
| Unvested, December 31, 2015 | Shares<br>137,200 | \$ 36.50   |
| Granted                     | 17,265            | 38.39  |
| Vested                      | (10,500)          | 31.04  |
| Forfeited                   | (950)             | 38.88  |
| Unvested, June 30, 2016     | 143,015           | \$ 37.11   |

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Stock option activity during the six months ended June 30, 2017 and 2016 and stock options outstanding at June 30, 2017 and 2016 are summarized below.

|  | Shares  | Exercise Price* | Remaining Contractual Life (in years)* | Intrinsic Value of Unexercised In-The Money Options (in 000's) |
|--|---------|-----------------|--|--|
| Options outstanding and exercisable at December 31, 2016 | 2,250   | \$ 37.17        | 0.3                                    | \$ 29  |
| Exercised  | (2,250) | 37.17           |  |  |
| Options outstanding and exercisable at June 30, 2017     | —       | \$ —            | —                                      | \$ —   |

  

|  | Shares   | Exercise Price* | Remaining Contractual Life (in years)* | Intrinsic Value of Unexercised In-The Money Options (in 000's) |
|--|----------|-----------------|--|--|
| Options outstanding and exercisable at December 31, 2015 | 24,000   | \$ 38.39        | 0.8                                    | \$ 22  |
| Expired  | (12,000) | \$ 39.60        |  |  |
| Options outstanding and exercisable at June 30, 2016     | 12,000   | \$ 37.17        | 0.8                                    | \$ 91  |

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\* Weighted average

#### Recent Significant Accounting Pronouncements:

In May 2014, the Financial Accounting Standards Board (FASB) issued ASU 2014-09, "Revenue from Contracts with Customers (Topic 606)." There have been several clarifying amendments issued by the FASB since the original issuance of this guidance. The core principle of ASU 2014-09 is that an entity should recognize revenue to reflect the transfer of goods and services to customers in an amount equal to the consideration the entity receives or expects to receive. This guidance also includes expanded disclosure requirements that result in an entity providing users of financial statements with comprehensive information about the nature, amount, timing and uncertainty of revenue and

cash flows arising from the entity's contracts with customers. The guidance will be effective for public companies for reporting periods beginning after December 15, 2017, including interim reporting periods within that reporting period. The number of years that revenue and the direct effects of change in accounting principle associated with ASU 2014-09 will be restated is dependent upon whether an entity uses a full retrospective approach or a modified retrospective approach. The Corporation is currently assessing the effect that ASU 2014-09 will have on its financial statements.

In January 2016, the FASB issued ASU 2016-01, "Financial Instruments – Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities." The amendments in ASU 2016-01 require, among other things, equity investments (except those accounted for under the equity method of accounting, or those that result in consolidation of the investee) to be measured at fair value with changes in fair value recognized in net income; public business entities to use the exit price notion when measuring the fair value of financial instruments for disclosure purposes; and separate presentation of financial assets and financial liabilities by measurement category and form of financial asset (i.e., securities or loans and receivables). It also eliminates the requirement for public business entities to disclose the method(s) and significant assumptions used to estimate the fair value that is required to be disclosed for financial instruments measured at amortized cost. The amendments in this ASU are effective for public companies for fiscal years beginning after December 15, 2017, including interim periods within those fiscal years. The Corporation is currently assessing the effect that ASU 2016-01 will have on its financial statements.

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

In June 2016, the FASB issued ASU 2016-13, “Financial Instruments – Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments”, as part of its project on financial instruments. ASU 2016-13 introduces an approach based on expected losses to estimate credit losses on certain types of financial instruments. It also modifies the impairment model for available-for-sale debt securities and provides for a simplified accounting model for purchased financial assets with credit deterioration since their origination. For public business entities that are SEC filers, the new standard is effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2019. Early adoption will be permitted for all organizations for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2018. The Corporation is currently assessing the effect that ASU 2016-13 will have on its financial statements.

In August 2016, the FASB issued ASU 2016-15, “Statement of Cash Flows (Topic 230): Classification of Certain Cash Receipts and Cash Payments”, to address diversity in how certain cash receipts and cash payments are presented and classified in the statement of cash flows. The amendments are effective for public business entities for fiscal years beginning after December 15, 2017, and interim periods within those fiscal years. The amendments should be applied using a retrospective transition method to each period presented. If retrospective application is impractical for some of the issues addressed by the update, the amendments for those issues would be applied prospectively as of the earliest date practicable. Early adoption is permitted, including adoption in an interim period. The Corporation does not expect the adoption of ASU 2016-15 to have a material effect on its financial statements.

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

periods beginning after December 15, 2019. Early adoption is permitted. The Corporation does not expect the adoption of ASU 2017-04 to have a material effect on its financial statements.

In March 2017, the FASB issued ASU 2017-07, “Compensation – Retirement Benefits (Topic 715)”, which requires an employer to disaggregate the service cost component from the other components of net benefit cost. ASU 2017-07 provides explicit guidance on how to present the service cost component and the other components of net benefit cost in the income statement and allow only the service cost component of net benefit cost to be eligible for capitalization. ASU 2017-07 is effective for public business entities for annual periods beginning after December 15, 2017, including interim periods within those annual periods. Early adoption is permitted. The Corporation does not expect the adoption of ASU 2017-07 to have a material effect on its financial statements.

In March 2017, the FASB issued ASU 2017-08, “Receivables – Nonrefundable Fees and Other Costs (Subtopic 310-20)”, which requires all entities that hold investments in callable debt securities at a premium to amortize the premium to the

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earliest call date. ASU 2017-08 does not require an accounting change for securities held at a discount. ASU 2017-08 is effective for public business entities for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2018. Early adoption is permitted. The Corporation does not expect the adoption of ASU 2017-08 to have a material effect on its financial statements.

In May 2017, the FASB issued ASU 2017-09, “Compensation – Stock Compensation (Topic 718): Scope of Modification Accounting.” The amendments provide guidance on determining which changes to the terms and conditions of share-based payment awards require an entity to apply modification accounting under Topic 718. The amendments are effective for all entities for annual periods, including interim periods within those annual periods, beginning after December 15, 2017. Early adoption is permitted, including adoption in any interim period, for reporting periods for which financial statements have not yet been issued. The Corporation does not expect the adoption of ASU 2017-09 to have a material effect on its financial statements.

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

## NOTE 2: Securities

The Corporation’s debt and equity securities, all of which are classified as available for sale, at June 30, 2017 and December 31, 2016 are summarized as follows:

|  | June 30, 2017     |                              |                               |            |
|--|-------------------|------------------------------|-------------------------------|------------|
| (Dollars in thousands)                           | Amortized<br>Cost | Gross<br>Unrealized<br>Gains | Gross<br>Unrealized<br>Losses | Fair Value |
| U.S. government agencies and corporations        | \$ 17,012         | \$ —                         | \$ (270)                      | \$ 16,742  |
| Mortgage-backed securities                       | 84,355            | 297                          | (354)                         | 84,298     |
| Obligations of states and political subdivisions | 108,973           | 3,181                        | (158)                         | 111,996    |
|  | \$ 210,340        | \$ 3,478                     | \$ (782)                      | \$ 213,036 |

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| (Dollars in thousands)                           | December 31, 2016 |                        |                         | Fair Value |
|--|-------------------|------------------------|-------------------------|------------|
|  | Amortized Cost    | Gross Unrealized Gains | Gross Unrealized Losses |            |
| U.S. government agencies and corporations        | \$ 16,526         | \$ —                   | \$ (414)                | \$ 16,112  |
| Mortgage-backed securities                       | 77,210            | 228                    | (622)                   | 76,816     |
| Obligations of states and political subdivisions | 114,157           | 3,265                  | (324)                   | 117,098    |
|  | \$ 207,893        | \$ 3,493               | \$ (1,360)              | \$ 210,026 |

The amortized cost and estimated fair value of securities at June 30, 2017, by the earlier of contractual maturity or expected maturity, are shown below. Expected maturities will differ from contractual maturities because borrowers may have the right to prepay obligations with or without call or prepayment penalties.

| (Dollars in thousands)                 | June 30, 2017  |            |
|--|----------------|------------|
|  | Amortized Cost | Fair Value |
| Due in one year or less                | \$ 28,819      | \$ 28,952  |
| Due after one year through five years  | 155,537        | 157,423    |
| Due after five years through ten years | 18,265         | 18,521     |
| Due after ten years                    | 7,719          | 8,140      |
|  | \$ 210,340     | \$ 213,036 |



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Proceeds from the maturities, calls and payments on available for sale securities for the three months ended June 30, 2017 and 2016 were \$10.12 million and \$18.34 million, respectively, resulting in gross realized gains of \$11,000 and gross realized losses of \$4,000 for the three months ended June 30, 2017 and gross realized gains of \$8,000 for the three months ended June 30, 2016. There were no securities sales during the second quarter of 2017. Proceeds from the sales of available for sale securities for the second quarter of 2016 were \$970,000, resulting in gross realized gains of \$62,000 and gross realized losses of \$26,000.

Proceeds from the maturities, calls and payments on available for sale securities for the first six months of 2017 and 2016 were \$21.49 million and \$20.52 million, respectively, resulting in gross realized gains of \$12,000 and gross realized losses of \$4,000 for the first six months of 2017 and gross realized gains of \$9,000 for the first six months of 2016. There were no securities sales during the first half of 2017. Proceeds from the sales of available for sale securities for the first half of 2016 were \$970,000, resulting in gross realized gains of \$62,000 and gross realized losses of \$26,000.

The Corporation pledges securities to primarily secure public deposits and repurchase agreements. Securities with an aggregate amortized cost of \$103.49 million and an aggregate fair value of \$104.65 million were pledged at June 30, 2017. Securities with an aggregate amortized cost of \$113.07 million and an aggregate fair value of \$114.16 million were pledged at December 31, 2016.

Securities in an unrealized loss position at June 30, 2017, by duration of the period of the unrealized loss, are shown below.

| (Dollars in thousands)                           | Less Than 12 Months |                 | 12 Months or More |                 | Total      |                 |
|--|---------------------|-----------------|-------------------|-----------------|------------|-----------------|
|  | Fair Value          | Unrealized Loss | Fair Value        | Unrealized Loss | Fair Value | Unrealized Loss |
| U.S. government agencies and corporations        | \$ 15,241           | \$ 270          | \$ —              | \$ —            | \$ 15,241  | \$ 270          |
| Mortgage-backed securities                       | 44,247              | 354             | —                 | —               | 44,247     | 354             |
| Obligations of states and political subdivisions | 13,517              | 120             | 2,995             | 38              | 16,512     | 158             |
| Total temporarily impaired securities            | \$ 73,005           | \$ 744          | \$ 2,995          | \$ 38           | \$ 76,000  | \$ 782          |

There were 117 debt securities totaling \$76.00 million considered temporarily impaired at June 30, 2017. The primary cause of the temporary impairments in the Corporation's investments in debt securities was fluctuations in interest rates. At June 30, 2017, approximately 97 percent of the Corporation's obligations of states and political subdivisions, as measured by market value, were rated "A" or better by Standard & Poor's or Moody's Investors Service. Of those in a net unrealized loss position, approximately 97 percent were rated "A" or better, as measured by market value, at June

30, 2017. The Corporation considers all of its debt securities to meet regulatory credit quality standards, meaning that the securities have low risk of default by the obligor, and the full and timely repayment of principal and interest is expected over the expected life of the investment. Because the Corporation intends to hold these investments in debt securities to maturity and it is more likely than not that the Corporation will not be required to sell these investments before a recovery of unrealized losses, the Corporation does not consider these investments to be other-than-temporarily impaired at June 30, 2017 and no other-than-temporary impairment has been recognized.

Securities in an unrealized loss position at December 31, 2016, by duration of the period of the unrealized loss, are shown below.

| (Dollars in thousands)                           | Less Than 12 Months |                 | 12 Months or More |                 | Total      |                 |
|--|---------------------|-----------------|-------------------|-----------------|------------|-----------------|
|  | Fair Value          | Unrealized Loss | Fair Value        | Unrealized Loss | Fair Value | Unrealized Loss |
| U.S. government agencies and corporations        | \$ 16,111           | \$ 414          | \$ —              | \$ —            | \$ 16,111  | \$ 414          |
| Mortgage-backed securities                       | 54,227              | 621             | 671               | 1               | 54,898     | 622             |
| Obligations of states and political subdivisions | 21,835              | 283             | 1,891             | 41              | 23,726     | 324             |
| Total temporarily impaired securities            | \$ 92,173           | \$ 1,318        | \$ 2,562          | \$ 42           | \$ 94,735  | \$ 1,360        |

The Corporation's investment in restricted stocks totaled \$3.44 million at June 30, 2017 and consisted of both Federal Home Loan Bank (FHLB) stock and Community Bankers Bank (CBB) stock. Restricted stocks are generally viewed as

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long-term investments, which are carried at cost because there is no market for the stock other than the FHLBs with respect to FHLB stock, or member institutions with respect to CBB stock. Therefore, when evaluating restricted stock for impairment, their respective values are based on the ultimate recoverability of the par value rather than by recognizing temporary declines in value. The Corporation does not consider its investment in restricted stocks to be other-than-temporarily impaired at June 30, 2017 and no impairment has been recognized. Total restricted stocks is shown as a separate line item on the balance sheet and is not a part of the available for sale securities portfolio.

## NOTE 3: Loans

Major classifications of loans are summarized as follows:

| (Dollars in thousands)                   | June 30,<br>2017 | December 31,<br>2016 |
|--|------------------|----------------------|
| Real estate – residential mortgage       | \$ 186,952       | \$ 188,264           |
| Real estate – construction 1             | 34,683           | 55,732               |
| Commercial, financial and agricultural 2 | 415,449          | 390,388              |
| Equity lines                             | 52,893           | 52,600               |
| Consumer                                 | 12,334           | 8,399                |
| Consumer finance                         | 291,257          | 301,845              |
|  | 993,568          | 997,228              |
| Less allowance for loan losses           | (36,496)         | (37,066)             |
| Loans, net                               | \$ 957,072       | \$ 960,162           |

<sup>1</sup> Includes the Corporation's real estate construction lending and consumer real estate lot lending.

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

Consumer loans included \$235,000 and \$284,000 of demand deposit overdrafts at June 30, 2017 and December 31, 2016, respectively.

The outstanding principal balance and the carrying amount of loans acquired pursuant to the Corporation's acquisition of Central Virginia Bank (CVB) on October 1, 2013 (or acquired loans) that were recorded at fair value at the acquisition date and are included in the consolidated balance sheet at June 30, 2017 and December 31, 2016 were as follows:

| (Dollars in thousands)                    | June 30, 2017                                    |   |                           | December 31, 2016                                |   |                           |
|---|--|---|---------------------------|--|---|---------------------------|
|   | Acquired Loans -<br>Purchased<br>Credit Impaired | Acquired Loans -<br>Purchased<br>Performing | Acquired Loans -<br>Total | Acquired Loans -<br>Purchased<br>Credit Impaired | Acquired Loans -<br>Purchased<br>Performing | Acquired Loans -<br>Total |
| Outstanding principal<br>balance          | \$ 16,628  | \$ 52,113                                   | \$ 68,741                 | \$ 19,770  | \$ 56,213                                   | \$ 75,983                 |
| Carrying amount                           |  |   |                           |  |   |                           |
| Real estate – residential<br>mortgage     | \$ 1,150   | \$ 12,948                                   | \$ 14,098                 | \$ 1,219   | \$ 13,422                                   | \$ 14,641                 |
| Commercial, financial and<br>agricultural | 5,322  | 26,321                                      | 31,643                    | 7,759  | 28,615                                      | 36,374                    |
| Equity lines                              | 270  | 10,198                                      | 10,468                    | 278  | 11,178                                      | 11,456                    |
| Consumer                                  | —  | 18  | 18                        | —  | 114   | 114                       |
| Total acquired loans                      | \$ 6,742   | \$ 49,485                                   | \$ 56,227                 | \$ 9,256   | \$ 53,329                                   | \$ 62,585                 |

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

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Loans on nonaccrual status were as follows:

| (Dollars in thousands)                  | June 30,<br>2017 | December 31,<br>2016 |
|---|------------------|----------------------|
| Real estate – residential mortgage      | \$ 1,329         | \$ 1,652             |
| Real estate – construction              | —                | —                    |
| Commercial, financial and agricultural: |                  |                      |
| Commercial real estate lending          | 6,507            | 1,619                |
| Commercial business lending             | 52               | 131                  |
| Equity lines                            | 721              | 757                  |
| Consumer                                | 1                | 118                  |
| Consumer finance                        | 497              | 565                  |
| Total loans on nonaccrual status        | \$ 9,107         | \$ 4,842             |

The past due status of loans as of June 30, 2017 was as follows:

| (Dollars in thousands)                   | 30 - 59 Days<br>Past Due | 60 - 89 Days<br>Past Due | 90+ Days<br>Past Due | Total<br>Past Due | PCI      | Current <sup>1</sup> | Total Loans | 90+ Days<br>Past Due and<br>Accruing<br><sup>2</sup> |
|--|--------------------------|--------------------------|----------------------|-------------------|----------|----------------------|-------------|--|
| Real estate – residential mortgage       | \$ 916                   | \$ 126                   | \$ 703               | \$ 1,745          | \$ 1,150 | \$ 184,057           | \$ 186,952  | \$ 201   |
| Real estate – construction:              |                          |                          |                      |                   |          |                      |             |  |
| Construction lending                     | —                        | —                        | —                    | —                 | —        | 29,095               | 29,095      | —  |
| Consumer lot lending                     | —                        | —                        | —                    | —                 | —        | 5,588                | 5,588       | —  |
| Commercial, financial and agricultural:  |                          |                          |                      |                   |          |                      |             |  |
| Commercial real estate lending           | 274                      | 5,600                    | —                    | 5,874             | 5,322    | 278,037              | 289,233     | —  |
| Land acquisition and development lending | —                        | —                        | —                    | —                 | —        | 40,546               | 40,546      | —  |
| Builder line lending                     | —                        | —                        | —                    | —                 | —        | 26,368               | 26,368      | —  |
| Commercial business lending              | 70                       | 52                       | —                    | 122               | —        | 59,180               | 59,302      | —  |
| Equity lines                             | 140                      | 25                       | —                    | 165               | 270      | 52,458               | 52,893      | —  |

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|                  |           |          |          |           |          |            |            |        |
|------------------|-----------|----------|----------|-----------|----------|------------|------------|--------|
| Consumer         | 75        | 2        | 2        | 79        | —        | 12,255     | 12,334     | 10     |
| Consumer finance | 10,501    | 1,811    | 497      | 12,809    | —        | 278,448    | 291,257    | —      |
| Total            | \$ 11,976 | \$ 7,616 | \$ 1,202 | \$ 20,794 | \$ 6,742 | \$ 966,032 | \$ 993,568 | \$ 211 |

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

<sup>2</sup> Includes purchased credit impaired (PCI) loans of \$188,000.

The table above includes the following:

- nonaccrual loans that are current of \$3.18 million, 30-59 days past due of \$103,000, 60-89 days past due of \$4.82 million and 90+ days past due of \$1.00 million.
- performing loans purchased in the acquisition of CVB that are current of \$49.30 million, 30-59 days past due of \$56,000 and 60-89 days past due of \$125,000.

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The past due status of loans as of December 31, 2016 was as follows:

| (Dollars in thousands)                   | 30 - 59 Days<br>Past Due | 60 - 89 Day<br>Past Due | 90+ Days<br>Past Due | Total<br>Past Due | PCI      | Current <sup>1</sup> | Total Loans | 90+ Days<br>Past Due and<br>Accruing |
|--|--------------------------|-------------------------|----------------------|-------------------|----------|----------------------|-------------|--------------------------------------|
| Real estate – residential mortgage       | \$ 848                   | \$ 233                  | \$ 184               | \$ 1,265          | \$ 1,219 | \$ 185,780           | \$ 188,264  | \$ —                                 |
| Real estate – construction:              |                          |                         |                      |                   |          |                      |             |                                      |
| Construction lending                     | —                        | —                       | —                    | —                 | —        | 47,062               | 47,062      | —                                    |
| Consumer lot lending                     | —                        | —                       | —                    | —                 | —        | 8,670                | 8,670       | —                                    |
| Commercial, financial and agricultural:  |                          |                         |                      |                   |          |                      |             |                                      |
| Commercial real estate lending           | 5,121                    | 12                      | —                    | 5,133             | 7,245    | 249,408              | 261,786     | —                                    |
| Land acquisition and development lending | —                        | —                       | —                    | —                 | —        | 43,472               | 43,472      | —                                    |
| Builder line lending                     | —                        | —                       | —                    | —                 | —        | 22,391               | 22,391      | —                                    |
| Commercial business lending              | 75                       | —                       | —                    | 75                | 514      | 62,150               | 62,739      | —                                    |
| Equity lines                             | 853                      | 138                     | —                    | 991               | 278      | 51,331               | 52,600      | —                                    |
| Consumer                                 | 22                       | —                       | 118                  | 140               | —        | 8,259                | 8,399       | 6                                    |
| Consumer finance                         | 13,011                   | 1,975                   | 565                  | 15,551            | —        | 286,294              | 301,845     | —                                    |
| Total                                    | \$ 19,930                | \$ 2,358                | \$ 867               | \$ 23,155         | \$ 9,256 | \$ 964,817           | \$ 997,228  | \$ 6                                 |

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

The table above includes the following:

- nonaccrual loans that are current of \$3.04 million, 30-59 days past due of \$570,000, 60-89 days past due of \$370,000 and 90+ days past due of \$867,000.
- performing loans purchased in the acquisition of CVB that are current of \$52.64 million, 30-59 days past due of \$532,000, 60-89 days past due of \$143,000 and 90+ days past due of \$17,000.

Loan modifications that were classified as troubled debt restructurings (TDRs) during the three and six months ended June 30, 2017 and 2016 were as follows:

|   | Three Months Ended June 30,<br>2017 |  |   | 2016               |  |   |
|---|-------------------------------------|--|---|--------------------|--|---|
|   | Number of<br>Loans                  | Pre-<br>Modification<br>Recorded<br>Investment | Post-<br>Modification<br>Recorded<br>Investment | Number of<br>Loans | Pre-<br>Modification<br>Recorded<br>Investment | Post-<br>Modification<br>Recorded<br>Investment |
| (Dollars in thousands)  |                                     |  |   |                    |  |   |
| Real estate – residential<br>mortgage – interest rate<br>concession | —                                   | \$ —   | \$ —  | 2                  | \$ 736   | \$ 760  |
| Commercial, financial and<br>agricultural:                          |                                     |  |   |                    |  |   |
| Commercial real estate<br>lending – interest rate<br>concession     | 3                                   | 2,142  | 2,142   | 2                  | 131  | 131   |
| Commercial business lending<br>– term concession                    | —                                   | —  | —   | 1                  | 25   | 25  |
| Total   | 3                                   | \$ 2,142                                       | \$ 2,142  | 5                  | \$ 892   | \$ 916  |



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| (Dollars in thousands)   | Six Months Ended June 30,<br>2017 |  | 2016  |                    | Pre-<br>Modification<br>Recorded<br>Investment | Post-<br>Modification<br>Recorded<br>Investment |
|--|-----------------------------------|--|---|--------------------|--|---|
|  | Number of<br>Loans                | Pre-<br>Modification<br>Recorded<br>Investment | Post-<br>Modification<br>Recorded<br>Investment | Number of<br>Loans |  |   |
| Real estate – residential mortgage – interest rate concession      | —                                 | \$ —   | \$ —  | 3                  | \$ 793   | \$ 817  |
| Commercial, financial and agricultural:                            |                                   |  |   |                    |  |   |
| Commercial real estate lending – interest rate and term concession | 3                                 | 4,646  | 4,646   | —                  | —  | —   |
| Commercial real estate lending – interest rate concession          | 4                                 | 2,154  | 2,154   | 2                  | 131  | 131   |
| Commercial business lending – interest rate concession             | —                                 | —  | —   | 1                  | 100  | 100   |
| Commercial business lending – term concession                      | —                                 | —  | —   | 1                  | 25   | 25  |
| Consumer – interest rate concession                                | —                                 | —  | —   | 1                  | 291  | 291   |
| Total  | 7                                 | \$ 6,800                                       | \$ 6,800  | 8                  | \$ 1,340                                       | \$ 1,364  |

A TDR payment default occurs when, within 12 months of the original TDR modification, either a full or partial charge-off occurs or a TDR becomes 90 days or more past due. There were no TDR payment defaults during the three and six months ended June 30, 2017 and 2016.

Impaired loans, which consisted solely of TDRs, and the related allowance at June 30, 2017 were as follows:

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|  | Unpaid<br>Principal | Recorded<br>Investment<br>in Loans<br>without<br>Specific<br>Reserve | Recorded<br>Investment<br>in Loans<br>with<br>Specific<br>Reserve | Related<br>Allowance | Average<br>Balance-<br>Impaired<br>Loans | Interest<br>Income<br>Recognized |
|--|---------------------|--|---|----------------------|--|----------------------------------|
| (Dollars in thousands)                     | Balance             |  |   |                      |  |                                  |
| Real estate – residential mortgage         | \$ 3,504            | \$ 1,257   | \$ 2,137  | \$ 304               | \$ 3,479                                 | \$ 87                            |
| Commercial, financial and<br>agricultural: |                     |  |   |                      |  |                                  |
| Commercial real estate lending             | 8,190               | 1,065  | 6,932   | 963                  | 8,207                                    | 42                               |
| Commercial business lending                | 123                 | 60   | 61  | 33                   | 128                                      | 2                                |
| Equity lines                               | 32                  | —  | 31  | 31                   | 32                                       | 1                                |
| Consumer                                   | 321                 | —  | 322   | 3                    | 321                                      | 6                                |
| Total                                      | \$ 12,170           | \$ 2,382   | \$ 9,483  | \$ 1,334             | \$ 12,167                                | \$ 138                           |

Impaired loans, which consisted solely of TDRs, and the related allowance at December 31, 2016 were as follows:

|  | Unpaid<br>Principal | Recorded<br>Investment<br>in Loans<br>without<br>Specific<br>Reserve | Recorded<br>Investment<br>in Loans<br>with<br>Specific<br>Reserve | Related<br>Allowance | Average<br>Balance-<br>Impaired<br>Loans | Interest<br>Income<br>Recognized |
|--|---------------------|--|---|----------------------|--|----------------------------------|
| (Dollars in thousands)                     | Balance             |  |   |                      |  |                                  |
| Real estate – residential mortgage         | \$ 3,539            | \$ 1,676   | \$ 1,732  | \$ 251               | \$ 3,446                                 | \$ 122                           |
| Commercial, financial and<br>agricultural: |                     |  |   |                      |  |                                  |
| Commercial real estate lending             | 1,967               | 430  | 1,272   | 261                  | 1,746                                    | 29                               |
| Commercial business lending                | 167                 | 89   | 74  | 46                   | 181                                      | 8                                |
| Equity lines                               | 32                  | 32   | —   | —                    | 32                                       | 1                                |
| Consumer                                   | 520                 | —  | 520   | 94                   | 521                                      | 8                                |
| Total                                      | \$ 6,225            | \$ 2,227   | \$ 3,598  | \$ 652               | \$ 5,926                                 | \$ 168                           |

PCI loans had an unpaid principal balance of \$16.63 million and a carrying value of \$6.74 million at June 30, 2017. Determining the fair value of purchased credit impaired loans required the Corporation to estimate cash flows expected to result from those loans and to discount those cash flows at appropriate rates of interest. For such loans, the excess of the cash flows expected at acquisition over the estimated fair value is recognized as interest income over the remaining lives of the loans and is called the accretable yield. The difference between contractually required payments at acquisition and

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

The following table presents a summary of the change in the accretable yield of the PCI loan portfolio for the six months ended June 30, 2017:

| (Dollars in thousands)   | June 30,<br>2017 | 2016      |
|--|------------------|-----------|
| Accretable yield, balance at beginning of period                                       | \$ 8,637         | \$ 10,419 |
| Accretion  | (1,318)          | (1,029)   |
| Reclassification of nonaccretable difference due to improvement in expected cash flows | 561              | 656       |
| Other changes, net   | (239)            | (302)     |
| Accretable yield, balance at end of period   | \$ 7,641         | \$ 9,744  |

## NOTE 4: Allowance for Loan Losses

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

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

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The following table presents the changes in the allowance for loan losses by major classification during the six months ended June 30, 2016:

| (Dollars in thousands)     | Real Estate<br>Residential<br>Mortgage | Real Estate<br>Construction | Commercial,<br>Financial &<br>Agricultural | Equity<br>Lines | Consumer | Consumer<br>Finance | Total     |
|----------------------------|--|-----------------------------|--|-----------------|----------|---------------------|-----------|
| Allowance for loan losses: |  |                             |  |                 |          |                     |           |
| Balance at                 |  |                             |  |                 |          |                     |           |
| December 31, 2015          | \$ 2,471                               | \$ 94                       | \$ 7,755                                   | \$ 1,052        | \$ 243   | \$ 23,954           | \$ 35,569 |
| Provision charged          |  |                             |  |                 |          |                     |           |
| (credited) to operations   | (102)                                  | 292                         | (308)                                      | 46              | 72       | 8,200               | 8,200     |
| Loans charged off          | (80)                                   | —                           | (35)                                       | (55)            | (131)    | (9,204)             | (9,505)   |
| Recoveries of loans        |  |                             |  |                 |          |                     |           |
| previously charged off     | 44                                     | —                           | 183  | —               | 164      | 2,079               | 2,470     |
| Balance at June 30, 2016   | \$ 2,333                               | \$ 386                      | \$ 7,595                                   | \$ 1,043        | \$ 348   | \$ 25,029           | \$ 36,734 |

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The following table presents, as of June 30, 2017, the total allowance for loan losses, the allowance by impairment methodology, total loans and loans by impairment methodology.

| (Dollars in thousands)                                | Real Estate Residential Mortgage | Real Estate Construction | Commercial, Financial & Agricultural | Equity Lines | Consumer  | Consumer Finance | Total      |
|---|----------------------------------|--------------------------|--------------------------------------|--------------|-----------|------------------|------------|
| Allowance for loan losses:                            |                                  |                          |                                      |              |           |                  |            |
| Balance at June 30, 2017                              | \$ 2,547                         | \$ 451                   | \$ 7,846                             | \$ 707       | \$ 209    | \$ 24,736        | \$ 36,496  |
| Ending balance: individually evaluated for impairment | \$ 304                           | \$ —                     | \$ 996                               | \$ 31        | \$ 3      | \$ —             | \$ 1,334   |
| Ending balance: collectively evaluated for impairment | \$ 2,243                         | \$ 451                   | \$ 6,850                             | \$ 676       | \$ 206    | \$ 24,736        | \$ 35,162  |
| Ending balance: acquired loans - PCI                  | \$ —                             | \$ —                     | \$ —                                 | \$ —         | \$ —      | \$ —             | \$ —       |
| Loans:  |                                  |                          |                                      |              |           |                  |            |
| Balance at June 30, 2017                              | \$ 186,952                       | \$ 34,683                | \$ 415,449                           | \$ 52,893    | \$ 12,334 | \$ 291,257       | \$ 993,568 |
| Ending balance: individually evaluated for impairment | \$ 3,394                         | \$ —                     | \$ 8,118                             | \$ 31        | \$ 322    | \$ —             | \$ 11,865  |
| Ending balance: collectively evaluated for impairment | \$ 182,408                       | \$ 34,683                | \$ 402,009                           | \$ 52,592    | \$ 12,012 | \$ 291,257       | \$ 974,961 |
| Ending balance: acquired loans - PCI                  | \$ 1,150                         | \$ —                     | \$ 5,322                             | \$ 270       | \$ —      | \$ —             | \$ 6,742   |

The following table presents, as of December 31, 2016, the total allowance for loan losses, the allowance by impairment methodology, total loans and loans by impairment methodology.

| (Dollars in thousands)       | Real Estate Residential Mortgage | Real Estate Construction | Commercial, Financial & Agricultural | Equity Lines | Consumer | Consumer Finance | Total     |
|------------------------------|----------------------------------|--------------------------|--------------------------------------|--------------|----------|------------------|-----------|
| Allowance for loan losses:   |                                  |                          |                                      |              |          |                  |           |
| Balance at December 31, 2016 | \$ 2,559                         | \$ 816                   | \$ 7,393                             | \$ 685       | \$ 261   | \$ 25,352        | \$ 37,066 |

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|   |            |           |            |           |          |            |            |
|---|------------|-----------|------------|-----------|----------|------------|------------|
| Ending balance:<br>individually evaluated<br>for impairment | \$ 251     | \$ —      | \$ 307     | \$ —      | \$ 94    | \$ —       | \$ 652     |
| Ending balance:<br>collectively evaluated<br>for impairment | \$ 2,308   | \$ 816    | \$ 7,086   | \$ 685    | \$ 167   | \$ 25,352  | \$ 36,414  |
| Ending balance:<br>acquired loans - PCI<br>Loans:           | \$ —       | \$ —      | \$ —       | \$ —      | \$ —     | \$ —       | \$ —       |
| Balance at December<br>31, 2016                             | \$ 188,264 | \$ 55,732 | \$ 390,388 | \$ 52,600 | \$ 8,399 | \$ 301,845 | \$ 997,228 |
| Ending balance:<br>individually evaluated<br>for impairment | \$ 3,408   | \$ —      | \$ 1,865   | \$ 32     | \$ 520   | \$ —       | \$ 5,825   |
| Ending balance:<br>collectively evaluated<br>for impairment | \$ 183,637 | \$ 55,732 | \$ 380,764 | \$ 52,290 | \$ 7,879 | \$ 301,845 | \$ 982,147 |
| Ending balance:<br>acquired loans - PCI                     | \$ 1,219   | \$ —      | \$ 7,759   | \$ 278    | \$ —     | \$ —       | \$ 9,256   |

Loans by credit quality indicators as of June 30, 2017 were as follows:

| (Dollars in thousands)                   | Pass       | Special<br>Mention | Substandard | Substandard<br>Nonaccrual | Total <sup>1</sup> |
|--|------------|--------------------|-------------|---------------------------|--------------------|
| Real estate – residential mortgage       | \$ 180,499 | \$ 1,990           | \$ 3,134    | \$ 1,329                  | \$ 186,952         |
| Real estate – construction:              |            |                    |             |                           |                    |
| Construction lending                     | 29,095     | —                  | —           | —                         | 29,095             |
| Consumer lot lending                     | 5,588      | —                  | —           | —                         | 5,588              |
| Commercial, financial and agricultural:  |            |                    |             |                           |                    |
| Commercial real estate lending           | 275,327    | 3,873              | 3,526       | 6,507                     | 289,233            |
| Land acquisition and development lending | 26,376     | —                  | 14,170      | —                         | 40,546             |
| Builder line lending                     | 26,368     | —                  | —           | —                         | 26,368             |
| Commercial business lending              | 58,466     | 215                | 569         | 52                        | 59,302             |
| Equity lines                             | 51,406     | 501                | 265         | 721                       | 52,893             |
| Consumer                                 | 12,003     | —                  | 330         | 1                         | 12,334             |
|  | \$ 665,128 | \$ 6,579           | \$ 21,994   | \$ 8,610                  | \$ 702,311         |

<sup>1</sup> At June 30, 2017, the Corporation did not have any loans classified as Doubtful or Loss.

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Included in the table above are loans purchased in connection with the acquisition of CVB of \$49.11 million pass rated, \$2.52 million special mention, \$2.57 million substandard and \$2.04 million substandard nonaccrual.

| (Dollars in thousands) | Performing | Non-Performing | Total      |
|------------------------|------------|----------------|------------|
| Consumer finance       | \$ 290,760 | \$ 497         | \$ 291,257 |

Loans by credit quality indicators as of December 31, 2016 were as follows:

| (Dollars in thousands)                   | Pass       | Special Mention | Substandard | Substandard Nonaccrual | Total <sup>1</sup> |
|--|------------|-----------------|-------------|------------------------|--------------------|
| Real estate – residential mortgage       | \$ 181,814 | \$ 2,037        | \$ 2,761    | \$ 1,652               | \$ 188,264         |
| Real estate – construction:              |            |                 |             |                        |                    |
| Construction lending                     | 47,062     | —               | —           | —                      | 47,062             |
| Consumer lot lending                     | 8,670      | —               | —           | —                      | 8,670              |
| Commercial, financial and agricultural:  |            |                 |             |                        |                    |
| Commercial real estate lending           | 243,427    | 5,860           | 10,880      | 1,619                  | 261,786            |
| Land acquisition and development lending | 29,595     | 565             | 13,312      | —                      | 43,472             |
| Builder line lending                     | 21,235     | 789             | 367         | —                      | 22,391             |
| Commercial business lending              | 62,044     | 255             | 309         | 131                    | 62,739             |
| Equity lines                             | 51,186     | 480             | 177         | 757                    | 52,600             |
| Consumer                                 | 7,870      | 2               | 409         | 118                    | 8,399              |
|  | \$ 652,903 | \$ 9,988        | \$ 28,215   | \$ 4,277               | \$ 695,383         |

<sup>1</sup> At December 31, 2016, the Corporation did not have any loans classified as Doubtful or Loss.

Included in the table above are loans purchased in connection with the acquisition of CVB of \$54.06 million pass rated, \$2.59 million special mention, \$5.74 million substandard and \$196,000 substandard nonaccrual.

| (Dollars in thousands) | Performing | Non-Performing | Total      |
|------------------------|------------|----------------|------------|
| Consumer finance       | \$ 301,280 | \$ 565         | \$ 301,845 |

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

## Accumulated Other Comprehensive Loss

The following table presents the cumulative balances of the components of accumulated other comprehensive income, net of deferred taxes of \$321,000 and \$534,000 as of June 30, 2017 and December 31, 2016, respectively.

| (Dollars in thousands)                          | June 30,<br>2017 | December 31,<br>2016 |
|---|------------------|----------------------|
| Net unrealized gains on securities              | \$ 1,752         | \$ 1,386             |
| Net unrecognized losses on cash flow hedges     | (36)             | (34)                 |
| Net unrecognized losses on defined benefit plan | (2,306)          | (2,336)              |
| Total accumulated other comprehensive loss      | \$ (590)         | \$ (984)             |

## Common Shares

The Corporation purchased 4,049 and 3,660 shares of its common stock from employees to satisfy tax withholding obligations arising upon the vesting of restricted shares during the first six months of 2017 and 2016, respectively. During the first six months of 2017 and 2016, no shares were purchased under the share repurchase program authorized by the Corporation's Board of Directors.



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## Earnings Per Common Share (EPS)

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

| (Dollars in thousands)   | Three Months Ended June 30, |           |
|--|-----------------------------|-----------|
|  | 2017                        | 2016      |
| Net income   | \$ 4,139                    | \$ 4,706  |
| Weighted average number of common shares used in earnings per common share—basic             | 3,486,997                   | 3,451,746 |
| Effect of dilutive securities:   |                             |           |
| Stock option awards  | —                           | 1,390     |
| Weighted average number of common shares used in earnings per common share—assuming dilution | 3,486,997                   | 3,453,136 |

| (Dollars in thousands)   | Six Months Ended June 30, |           |
|--|---------------------------|-----------|
|  | 2017                      | 2016      |
| Net income   | \$ 6,870                  | \$ 7,190  |
| Weighted average number of common shares used in earnings per common share—basic             | 3,485,002                 | 3,450,188 |
| Effect of dilutive securities:   |                           |           |
| Stock option awards  | 158                       | 1,250     |
| Weighted average number of common shares used in earnings per common share—assuming dilution | 3,485,160                 | 3,451,438 |

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

Potential common shares that may be issued by the Corporation for its stock option awards are determined using the treasury stock method. Accordingly, anti-dilutive shares are not included in computing diluted earnings per share. No shares issuable upon exercise of options were anti-dilutive for the three months ended June 30, 2017 and 2016. No shares issuable upon exercise of options were anti-dilutive for the six months ended June 30, 2017; whereas, 6,000 shares issuable upon exercise of stock options were anti-dilutive for the six months ended June 30, 2016.

## NOTE 6: Employee Benefit Plans

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

| (Dollars in thousands)                   | Three Months Ended June 30, |        | Six Months Ended June 30, |        |
|--|-----------------------------|--------|---------------------------|--------|
|  | 2017                        | 2016   | 2017                      | 2016   |
| Components of net periodic benefit cost: |                             |        |                           |        |
| Service cost                             | \$ 283                      | \$ 262 | \$ 566                    | \$ 524 |
| Interest cost                            | 138                         | 130    | 276                       | 260    |
| Expected return on plan assets           | (287)                       | (261)  | (574)                     | (522)  |
| Amortization of prior service cost       | (15)                        | (15)   | (30)                      | (30)   |
| Recognized net actuarial loss            | 37                          | 38     | 74                        | 76     |
| Net periodic benefit cost                | \$ 156                      | \$ 154 | \$ 312                    | \$ 308 |

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NOTE 7: Fair Value of Assets and Liabilities

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

- Level 1—Valuation is based upon quoted prices for identical instruments traded in active markets. Level 1 assets and liabilities include debt and equity securities traded in an active exchange market, as well as U.S. Treasury securities.
- Level 2—Valuation is based upon quoted prices for similar instruments in active markets, quoted prices for identical or similar instruments in markets that are not active, and model based valuation techniques for which all significant assumptions are observable in the market or can be corroborated by observable market data for substantially the full term of the assets or liabilities.
- Level 3—Valuation is determined using model-based techniques that use at least one significant assumption not observable in the market. These unobservable assumptions reflect the Corporation's estimates of assumptions that market participants would use in pricing the respective asset or liability. Valuation techniques may include the use of pricing models, discounted cash flow models and similar techniques.

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

Assets and Liabilities Measured at Fair Value on a Recurring Basis

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

Securities available for sale. The Corporation primarily values its investment portfolio using Level 2 fair value measurements, but may also use Level 1 or Level 3 measurements if required by the composition of the portfolio. At June 30, 2017 and December 31, 2016, the Corporation's entire investment securities portfolio was comprised of

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

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obligations in the mortgage-backed category are individually evaluated based upon a hierarchy of security specific information and market data regarding that security or securities with similar characteristics. Each evaluation is determined using an option adjusted spread and prepayment model based on volatility-driven, multi-dimensional spread tables.

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

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

Derivative asset (liability) – interest rate swaps on loans. As discussed in “Note 10: Derivative Financial Instruments”, the Corporation recognizes interest rate swaps at fair value on a recurring basis. The Corporation has contracted with a third party vendor to provide valuations for these interest rate swaps using standard valuation techniques and therefore classifies such interest rate swaps as Level 2.

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

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

| (Dollars in thousands)                           | June 30, 2017 |           |         | Assets/Liabilities at<br>Fair Value |
|--|---------------|-----------|---------|-------------------------------------|
|  | Level 1       | Level 2   | Level 3 |                                     |
| Assets:  |               |           |         |                                     |
| Securities available for sale                    |               |           |         |                                     |
| U.S. government agencies and corporations        | \$ —          | \$ 16,742 | \$ —    | \$ 16,742                           |
| Mortgage-backed securities                       | —             | 84,298    | —       | 84,298                              |
| Obligations of states and political subdivisions | —             | 111,996   | —       | 111,996                             |

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|   |      |            |      |            |
|---|------|------------|------|------------|
| Total securities available for sale                 | —    | 213,036    | —    | 213,036    |
| Loans held for sale                                 | —    | 47,326     | —    | 47,326     |
| Derivative asset - IRLC                             | —    | 1,377      | —    | 1,377      |
| Derivative asset - interest rate swaps on loans     | —    | 941        | —    | 941        |
| Total assets  | \$ — | \$ 262,680 | \$ — | \$ 262,680 |
| Liabilities:  |      |            |      |            |
| Derivative liability - cash flow hedges             | \$ — | \$ 59      | \$ — | \$ 59      |
| Derivative liability - interest rate swaps on loans | —    | 941        | —    | 941        |
| Total liabilities                                   | \$ — | \$ 1,000   | \$ — | \$ 1,000   |

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| (Dollars in thousands)                              | December 31, 2016 |                    |         | Assets/Liabilities at<br>Fair Value |
|---|-------------------|--------------------|---------|-------------------------------------|
|   | Fair Value        | Measurements Using | Level 3 |                                     |
|   | Level 1           | Level 2            |         |                                     |
| <b>Assets:</b>                                      |                   |                    |         |                                     |
| Securities available for sale                       |                   |                    |         |                                     |
| U.S. government agencies and corporations           | \$ —              | \$ 16,112          | \$ —    | \$ 16,112                           |
| Mortgage-backed securities                          | —                 | 76,816             | —       | 76,816                              |
| Obligations of states and political subdivisions    | —                 | 117,098            | —       | 117,098                             |
| Total securities available for sale                 | —                 | 210,026            | —       | 210,026                             |
| Loans held for sale                                 | —                 | 52,027             | —       | 52,027                              |
| Derivative asset - IRLC                             | —                 | 663                | —       | 663                                 |
| Derivative asset - interest rate swaps on loans     | —                 | 1,032              | —       | 1,032                               |
| Total assets  | \$ —              | \$ 263,748         | \$ —    | \$ 263,748                          |
| <b>Liabilities:</b>                                 |                   |                    |         |                                     |
| Derivative liability - cash flow hedges             | \$ —              | \$ 56              | \$ —    | \$ 56                               |
| Derivative liability - interest rate swaps on loans | —                 | 1,032              | —       | 1,032                               |
| Total liabilities                                   | \$ —              | \$ 1,088           | \$ —    | \$ 1,088                            |

**Assets and Liabilities Measured at Fair Value on a Nonrecurring Basis**

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

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

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

Other real estate owned (OREO). Assets acquired through, or in lieu of, loan foreclosure are held for sale and are initially recorded at fair value less costs to sell at the date of foreclosure. Initial fair value is based upon appraisals the Corporation obtains from independent licensed appraisers. Subsequent to foreclosure, management periodically performs valuations of the foreclosed assets based on updated appraisals, general market conditions, recent sales of similar properties, length of time the properties have been held, and our ability and intent with regard to continued ownership of the properties. The

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Corporation may incur additional write-downs of foreclosed assets to fair value less costs to sell if valuations indicate a further deterioration in market conditions. As such, the Corporation records OREO as nonrecurring Level 3.

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

| (Dollars in thousands)       | June 30, 2017 |         |          | Assets at Fair Value |
|------------------------------|---------------|---------|----------|----------------------|
|                              | Level 1       | Level 2 | Level 3  |                      |
| Impaired loans, net          | \$ —          | \$ —    | \$ 4,464 | \$ 4,464             |
| Other real estate owned, net | —             | —       | 284      | 284                  |
| Total                        | \$ —          | \$ —    | \$ 4,748 | \$ 4,748             |

| (Dollars in thousands)       | December 31, 2016 |         |          | Assets at Fair Value |
|------------------------------|-------------------|---------|----------|----------------------|
|                              | Level 1           | Level 2 | Level 3  |                      |
| Impaired loans, net          | \$ —              | \$ —    | \$ 2,303 | \$ 2,303             |
| Other real estate owned, net | —                 | —       | 195      | 195                  |
| Total                        | \$ —              | \$ —    | \$ 2,498 | \$ 2,498             |

The following table presents quantitative information about Level 3 fair value measurements for financial assets measured at fair value on a non-recurring basis as of June 30, 2017:

| (Dollars in thousands)       | Fair Value Measurements at June 30, 2017 |                        |   | Range of Inputs |
|------------------------------|--|------------------------|---|-----------------|
|                              | Fair Value                               | Valuation Technique(s) | Unobservable Inputs   |                 |
| Impaired loans, net          | \$ 4,464                                 | Appraisals             | Discount to reflect current market conditions and estimated selling costs | 16% - 57%       |
| Other real estate owned, net | 284                                      | Appraisals             | Discount to reflect current market conditions and estimated selling costs | 23% - 28%       |
| Total                        | \$ 4,748                                 |                        |   |                 |

## Fair Value of Financial Instruments

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

The following describes the valuation techniques used by the Corporation to measure certain of its financial instruments at fair value as of June 30, 2017 and December 31, 2016.

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

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

Loan totals, as listed in the table below, include impaired loans. For valuation techniques used in relation to impaired loans, see the “Assets and Liabilities Measured at Fair Value on a Nonrecurring Basis” section in this Note 7.

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Loans held for sale, net. As described in the “Assets and Liabilities Measured at Fair Value on a Recurring Basis” section in this Note 7, the Corporation has elected to carry its portfolio of loans held for sale at fair value, measured on a recurring basis.

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

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

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

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

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

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

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

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

| (Dollars in thousands)                                 | Carrying<br>Value | Fair Value Measurements at June 30, 2017 Using |         |         | Total Fair<br>Value |
|--|-------------------|--|---------|---------|---------------------|
|  |                   | Level 1  | Level 2 | Level 3 |                     |
| <b>Financial assets:</b>                               |                   |  |         |         |                     |
| Cash and short-term investments                        | \$ 118,897        | \$ 118,897                                     | \$ —    | \$ —    | \$ 118,897          |
| Securities available for sale                          | 213,036           | —  | 213,036 | —       | 213,036             |
| Loans, net   | 957,072           | —  | —       | 954,787 | 954,787             |
| Loans held for sale                                    | 47,326            | —  | 47,326  | —       | 47,326              |
| Derivative asset - IRLC                                | 1,377             | —  | 1,377   | —       | 1,377               |
| Derivative asset - interest rate swaps<br>on loans     | 941               | —  | 941     | —       | 941                 |
| Bank-owned life insurance                              | 15,294            | —  | 15,294  | —       | 15,294              |
| Accrued interest receivable                            | 6,885             | 6,885  | —       | —       | 6,885               |
| <b>Financial liabilities:</b>                          |                   |  |         |         |                     |
| Demand deposits  | \$ 779,577        | \$ 779,577                                     | \$ —    | \$ —    | \$ 779,577          |
| Time deposits  | 348,622           | —  | 350,490 | —       | 350,490             |
| Borrowings   | 165,464           | —  | 158,043 | —       | 158,043             |
| Derivative liability - cash flow<br>hedges             | 59                | —  | 59      | —       | 59                  |
| Derivative liability - interest rate<br>swaps on loans | 941               | —  | 941     | —       | 941                 |
| Accrued interest payable                               | 725               | 725  | —       | —       | 725                 |

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| (Dollars in thousands)                              | Carrying Value | Fair Value Measurements at December 31, 2016 |         |         | Total Fair Value |
|---|----------------|--|---------|---------|------------------|
|   |                | Level 1                                      | Level 2 | Level 3 |                  |
| Financial assets:                                   |                |  |         |         |                  |
| Cash and short-term investments                     | \$ 103,201     | \$ 103,201                                   | \$ —    | \$ —    | \$ 103,201       |
| Securities available for sale                       | 210,026        | —  | 210,026 | —       | 210,026          |
| Loans, net  | 960,162        | —  | —       | 961,546 | 961,546          |
| Loans held for sale                                 | 52,027         | —  | 52,027  | —       | 52,027           |
| Derivative asset - IRLC                             | 663            | —  | 663     | —       | 663              |
| Derivative asset - interest rate swaps on loans     | 1,032          | —  | 1,032   | —       | 1,032            |
| Bank-owned life insurance                           | 15,103         | —  | 15,103  | —       | 15,103           |
| Accrued interest receivable                         | 7,261          | 7,261  | —       | —       | 7,261            |
| Financial liabilities:                              |                |  |         |         |                  |
| Demand deposits                                     | \$ 775,506     | \$ 775,506                                   | \$ —    | \$ —    | \$ 775,506       |
| Time deposits                                       | 344,415        | —  | 346,648 | —       | 346,648          |
| Borrowings  | 164,567        | —  | 157,138 | —       | 157,138          |
| Derivative liability - cash flow hedges             | 56             | —  | 56      | —       | 56               |
| Derivative liability - interest rate swaps on loans | 1,032          | —  | 1,032   | —       | 1,032            |
| Accrued interest payable                            | 703            | 703  | —       | —       | 703              |

The Corporation assumes interest rate risk (the risk that general interest rate levels will change) in the normal course of operations. As a result, the fair values of the Corporation's financial instruments will change when interest rate levels change and that change may be either favorable or unfavorable to the Corporation. Management attempts to match maturities of assets and liabilities to the extent believed necessary to balance minimizing interest rate risk and increasing net interest income in current market conditions. However, borrowers with fixed rate obligations are less likely to prepay in a rising rate environment and more likely to prepay in a falling rate environment. Conversely, depositors who are receiving fixed rates are more likely to withdraw funds before maturity in a rising rate environment and less likely to do so in a falling rate environment. Management monitors interest rates, maturities and repricing dates of assets and liabilities and attempts to manage interest rate risk by adjusting terms of new loans, deposits and borrowings and by investing in securities with terms that mitigate the Corporation's overall interest rate risk.

## NOTE 8: Business Segments

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

on mortgage loans held for sale. Revenues from Consumer Finance consist primarily of interest earned on purchased automobile retail installment sales contracts.

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

| (Dollars in thousands)               | Three Months Ended June 30, 2017 |                     |                     |          |              |              |
|--------------------------------------|----------------------------------|---------------------|---------------------|----------|--------------|--------------|
|                                      | Retail<br>Banking                | Mortgage<br>Banking | Consumer<br>Finance | Other    | Eliminations | Consolidated |
| Revenues:                            |                                  |                     |                     |          |              |              |
| Interest income                      | \$ 12,365                        | \$ 431              | \$ 11,197           | \$ —     | \$ (1,570)   | \$ 22,423    |
| Gains on sales of loans              | —                                | 2,619               | —                   | —        | —            | 2,619        |
| Other noninterest<br>income          | 2,762                            | 1,219               | 199                 | 490      | —            | 4,670        |
| Total operating income               | 15,127                           | 4,269               | 11,396              | 490      | (1,570)      | 29,712       |
| Expenses:                            |                                  |                     |                     |          |              |              |
| Provision for loan<br>losses         | 100                              | —                   | 3,000               | —        | —            | 3,100        |
| Interest expense                     | 1,495                            | 143                 | 1,998               | 279      | (1,570)      | 2,345        |
| Salaries and employee<br>benefits    | 6,420                            | 1,804               | 2,395               | 442      | —            | 11,061       |
| Other noninterest<br>expenses        | 4,435                            | 1,319               | 1,305               | 160      | —            | 7,219        |
| Total operating<br>expenses          | 12,450                           | 3,266               | 8,698               | 881      | (1,570)      | 23,725       |
| Income (loss) before<br>income taxes | 2,677                            | 1,003               | 2,698               | (391)    | —            | 5,987        |
| Income tax expense<br>(benefit)      | 578                              | 396                 | 1,062               | (188)    | —            | 1,848        |
| Net income (loss)                    | \$ 2,099                         | \$ 607              | \$ 1,636            | \$ (203) | \$ —         | \$ 4,139     |
| Total assets                         | \$ 1,302,634                     | \$ 62,728           | \$ 295,242          | \$ 5,925 | \$ (202,450) | \$ 1,464,079 |
| Goodwill                             | \$ 3,702                         | \$ —                | \$ 10,723           | \$ —     | \$ —         | \$ 14,425    |
| Capital expenditures                 | \$ 560                           | \$ 88               | \$ 52               | \$ —     | \$ —         | \$ 700       |

| (Dollars in thousands) | Three Months Ended June 30, 2016 |                     |                     |       |              |              |
|------------------------|----------------------------------|---------------------|---------------------|-------|--------------|--------------|
|                        | Retail<br>Banking                | Mortgage<br>Banking | Consumer<br>Finance | Other | Eliminations | Consolidated |

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|                                   |              |           |            |          |              |              |
|-----------------------------------|--------------|-----------|------------|----------|--------------|--------------|
| Revenues:                         |              |           |            |          |              |              |
| Interest income                   | \$ 11,434    | \$ 357    | \$ 11,805  | \$ —     | \$ (1,293)   | \$ 22,303    |
| Gains on sales of loans           | —            | 2,552     | —          | —        | —            | 2,552        |
| Other noninterest income          | 3,694        | 941       | 194        | 342      | —            | 5,171        |
| Total operating income            | 15,128       | 3,850     | 11,999     | 342      | (1,293)      | 30,026       |
| Expenses:                         |              |           |            |          |              |              |
| Provision for loan losses         | —            | —         | 3,600      | —        | —            | 3,600        |
| Interest expense                  | 1,422        | 84        | 1,717      | 288      | (1,293)      | 2,218        |
| Salaries and employee benefits    | 6,143        | 1,499     | 2,532      | 348      | —            | 10,522       |
| Other noninterest expenses        | 4,377        | 1,189     | 1,379      | 180      | —            | 7,125        |
| Total operating expenses          | 11,942       | 2,772     | 9,228      | 816      | (1,293)      | 23,465       |
| Income (loss) before income taxes | 3,186        | 1,078     | 2,771      | (474)    | —            | 6,561        |
| Income tax expense (benefit)      | 486          | 428       | 1,086      | (145)    | —            | 1,855        |
| Net income (loss)                 | \$ 2,700     | \$ 650    | \$ 1,685   | \$ (329) | \$ —         | \$ 4,706     |
| Total assets                      | \$ 1,244,227 | \$ 76,373 | \$ 302,445 | \$ 4,837 | \$ (213,654) | \$ 1,414,228 |
| Goodwill                          | \$ 3,702     | \$ —      | \$ 10,723  | \$ —     | \$ —         | \$ 14,425    |
| Capital expenditures              | \$ 527       | \$ 16     | \$ 107     | \$ —     | \$ —         | \$ 650       |



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| (Dollars in thousands)            | Six Months Ended June 30, 2017 |                  |                  |          |              |              |
|-----------------------------------|--------------------------------|------------------|------------------|----------|--------------|--------------|
|                                   | Retail Banking                 | Mortgage Banking | Consumer Finance | Other    | Eliminations | Consolidated |
| Revenues:                         |                                |                  |                  |          |              |              |
| Interest income                   | \$ 24,337                      | \$ 747           | \$ 22,403        | \$ —     | \$ (3,043)   | \$ 44,444    |
| Gains on sales of loans           | —                              | 4,562            | —                | —        | —            | 4,562        |
| Other noninterest income          | 5,262                          | 2,307            | 431              | 873      | —            | 8,873        |
| Total operating income            | 29,599                         | 7,616            | 22,834           | 873      | (3,043)      | 57,879       |
| Expenses:                         |                                |                  |                  |          |              |              |
| Provision for loan losses         | 200                            | —                | 7,300            | —        | —            | 7,500        |
| Interest expense                  | 2,960                          | 231              | 3,905            | 562      | (3,043)      | 4,615        |
| Salaries and employee benefits    | 12,656                         | 3,287            | 4,807            | 980      | —            | 21,730       |
| Other noninterest expenses        | 8,878                          | 2,598            | 2,558            | 361      | —            | 14,395       |
| Total operating expenses          | 24,694                         | 6,116            | 18,570           | 1,903    | (3,043)      | 48,240       |
| Income (loss) before income taxes | 4,905                          | 1,500            | 4,264            | (1,030)  | —            | 9,639        |
| Income tax expense (benefit)      | 984                            | 596              | 1,686            | (497)    | —            | 2,769        |
| Net income (loss)                 | \$ 3,921                       | \$ 904           | \$ 2,578         | \$ (533) | \$ —         | \$ 6,870     |
| Total assets                      | \$ 1,302,634                   | \$ 62,728        | \$ 295,242       | \$ 5,925 | \$ (202,450) | \$ 1,464,079 |
| Goodwill                          | \$ 3,702                       | \$ —             | \$ 10,723        | \$ —     | \$ —         | \$ 14,425    |
| Capital expenditures              | \$ 939                         | \$ 282           | \$ 65            | \$ 11    | \$ —         | \$ 1,297     |

| (Dollars in thousands)         | Six Months Ended June 30, 2016 |                  |                  |       |              |              |
|--------------------------------|--------------------------------|------------------|------------------|-------|--------------|--------------|
|                                | Retail Banking                 | Mortgage Banking | Consumer Finance | Other | Eliminations | Consolidated |
| Revenues:                      |                                |                  |                  |       |              |              |
| Interest income                | \$ 22,517                      | \$ 667           | \$ 23,616        | \$ 1  | \$ (2,533)   | \$ 44,268    |
| Gains on sales of loans        | —                              | 4,282            | —                | —     | —            | 4,282        |
| Other noninterest income       | 5,856                          | 1,684            | 426              | 638   | —            | 8,604        |
| Total operating income         | 28,373                         | 6,633            | 24,042           | 639   | (2,533)      | 57,154       |
| Expenses:                      |                                |                  |                  |       |              |              |
| Provision for loan losses      | —                              | —                | 8,200            | —     | —            | 8,200        |
| Interest expense               | 2,876                          | 146              | 3,420            | 571   | (2,533)      | 4,480        |
| Salaries and employee benefits | 12,151                         | 2,683            | 5,159            | 700   | —            | 20,693       |

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|                                   |              |           |            |          |              |              |
|-----------------------------------|--------------|-----------|------------|----------|--------------|--------------|
| Other noninterest expenses        | 8,809        | 2,190     | 2,707      | 338      | —            | 14,044       |
| Total operating expenses          | 23,836       | 5,019     | 19,486     | 1,609    | (2,533)      | 47,417       |
| Income (loss) before income taxes | 4,537        | 1,614     | 4,556      | (970)    | —            | 9,737        |
| Income tax expense (benefit)      | 508          | 642       | 1,789      | (392)    | —            | 2,547        |
| Net income (loss)                 | \$ 4,029     | \$ 972    | \$ 2,767   | \$ (578) | \$ —         | \$ 7,190     |
| Total assets                      | \$ 1,244,227 | \$ 76,373 | \$ 302,445 | \$ 4,837 | \$ (213,654) | \$ 1,414,228 |
| Goodwill                          | \$ 3,702     | \$ —      | \$ 10,723  | \$ —     | \$ —         | \$ 14,425    |
| Capital expenditures              | \$ 824       | \$ 185    | \$ 254     | \$ —     | \$ —         | \$ 1,263     |

The Retail Banking segment extends a warehouse line of credit to the Mortgage Banking segment, providing a portion of the funds needed to originate mortgage loans. The Retail Banking segment charges the Mortgage Banking segment interest at the daily FHLB advance rate plus 50 basis points. The Retail Banking segment also provides the Consumer Finance segment with a portion of the funds needed to purchase loan contracts by means of variable rate notes that carry interest at one-month LIBOR plus 200 basis points and fixed rate notes that carry interest rates ranging from 3.8 percent to 8.0 percent. The Retail Banking segment acquires certain residential real estate loans from the Mortgage Banking segment at prices similar to those paid by third-party investors. These transactions are eliminated to reach consolidated totals. Certain corporate overhead costs incurred by the Retail Banking segment are not allocated to the Mortgage Banking, Consumer Finance and Other segments.

NOTE 9: Commitments and Financial Instruments with Off-Balance-Sheet Risk

C&F Mortgage sells substantially all of the residential mortgage loans it originates to third-party counterparties (i.e., investors). As is customary in the industry, the agreements with these counterparties require C&F Mortgage to extend

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representations and warranties with respect to program compliance, borrower misrepresentation, fraud, and early payment performance. Under the agreements, the counterparties are entitled to make loss claims and repurchase requests of C&F Mortgage for loans that contain covered deficiencies. C&F Mortgage has obtained early payment default recourse waivers for a significant portion of its business. Recourse periods for early payment default for the remaining counterparties vary from 90 days up to one year. Recourse periods for borrower misrepresentation or fraud or underwriting error do not have a stated time limit. C&F Mortgage maintains an indemnification reserve for potential claims made under these recourse provisions. C&F Mortgage has adopted a reserve methodology whereby provisions are made to an expense account to fund a reserve maintained as a liability account on the balance sheet for potential losses. The loan performance data of sold loans is not made available to C&F Mortgage by the counterparties making the evaluation of potential losses inherently subjective as it requires estimates that are susceptible to significant revision as more information becomes available. A schedule of expected losses on loans with claims or indemnifications is maintained to ensure the reserve is adequate to cover estimated losses. Often times, claims are not factually validated and they are rescinded. Once claims are validated and the actual or potential loss is agreed upon with the counterparties, the reserve is charged and a cash payment is made to settle the claim. The following table presents the changes in the allowance for indemnification losses for the periods presented:

| (Dollars in thousands)               | Three Months Ended June 30, |          | Six Months Ended June 30, |          |
|--------------------------------------|-----------------------------|----------|---------------------------|----------|
|                                      | 2017                        | 2016     | 2017                      | 2016     |
| Allowance, beginning of period       | \$ 2,339                    | \$ 2,415 | \$ 2,303                  | \$ 2,363 |
| Provision for indemnification losses | 52                          | 88       | 88                        | 140      |
| Payments                             | —                           | —        | —                         | —        |
| Allowance, end of period             | \$ 2,391                    | \$ 2,503 | \$ 2,391                  | \$ 2,503 |

## NOTE 10: Derivative Financial Instruments

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

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

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

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

Loan swaps. The Bank also enters into interest rate swaps with certain qualifying commercial loan customers to meet their interest rate risk management needs. The Bank simultaneously enters into interest rate swaps with dealer counterparties, with identical notional amounts and terms. The net result of these interest rate swaps is that the customer pays a fixed rate of interest and the Corporation receives a floating rate. These back-to-back loan swaps qualify as financial

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derivatives with fair values reported in “Other Assets” and “Other Liabilities”. Changes in fair value are recorded in other noninterest expense and net to zero because of the identical amounts and terms of the swaps.

Interest rate lock commitments. C&F Mortgage enters into IRLCs with customers to originate loans for which the interest rates are determined prior to funding. C&F Mortgage then mitigates interest rate risk on these IRLCs and loans held for sale by (a) entering into forward loan sales contracts with investors for loans to be delivered on a best efforts basis or (b) entering into forward sales contracts of mortgage backed securities for loans to be delivered on a mandatory basis. At June 30, 2017, each loan held for sale by C&F Mortgage was subject to a forward sales agreement on a best efforts basis. The fair value of these derivative instruments is reported in “Other Assets.

The following tables summarize key elements of the Corporation’s derivative instruments as of June 30, 2017 and December 31, 2016, segregated by derivatives that are considered to be hedging instruments and those that are not:

| (Dollars in thousands)                        | June 30, 2017                |           |                     |                          | Collateral Pledged <sup>3</sup> |
|---|------------------------------|-----------|---------------------|--------------------------|---------------------------------|
|   | Notional Amount <sup>1</sup> | Positions | Assets <sup>2</sup> | Liabilities <sup>2</sup> |                                 |
| Cash flow hedges:                             |                              |           |                     |                          |                                 |
| Interest rate swaps:                          |                              |           |                     |                          |                                 |
| Pay variable rate swaps with counterparty     | \$ 25,000                    | 3         | \$ —                | \$ 59                    | \$ 313                          |
| Not designated as hedges:                     |                              |           |                     |                          |                                 |
| Customer-related interest rate contracts:     |                              |           |                     |                          |                                 |
| Matched interest rate swaps with borrower     | 32,069                       | 5         | 115                 | 826                      | —                               |
| Matched interest rate swaps with counterparty | 32,069                       | 5         | 826                 | 115                      | —                               |
| Other contracts:                              |                              |           |                     |                          |                                 |
| Interest rate lock commitments                | 141,485                      | 684       | 1,377               | —                        | —                               |

<sup>1</sup> Notional amounts are not recorded on the balance sheet and are generally used only as a basis on which interest and other payments are determined.

<sup>2</sup> Balances represent the fair value of derivative financial instruments.

<sup>3</sup> Collateral pledged may be comprised of cash or securities.

December 31, 2016

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| (Dollars in thousands)   | Notional<br>Amount <sup>1</sup> | Positions | Assets <sup>2</sup> | Liabilities <sup>2</sup> | Collateral<br>Pledged <sup>3</sup> |
|--|---------------------------------|-----------|---------------------|--------------------------|------------------------------------|
| Cash flow hedges:  |                                 |           |                     |                          |                                    |
| Interest rate swaps:   |                                 |           |                     |                          |                                    |
| Pay variable rate swaps with counterparty<br>Not designated as hedges: | \$ 25,000                       | 3         | \$ —                | \$ 56                    | \$ 323                             |
| Customer-related interest rate contracts:                              |                                 |           |                     |                          |                                    |
| Matched interest rate swaps with borrower                              | 25,151                          | 4         | —                   | 1,032                    | —                                  |
| Matched interest rate swaps with<br>counterparty                       | 25,151                          | 4         | 1,032               | —                        | —                                  |
| Other contracts:   |                                 |           |                     |                          |                                    |
| Interest rate lock commitments   | 106,612                         | 504       | 663                 | —                        | —                                  |

<sup>1</sup> Notional amounts are not recorded on the balance sheet and are generally used only as a basis on which interest and other payments are determined.

<sup>2</sup> Balances represent the fair value of derivative financial instruments.

<sup>3</sup> Collateral pledged may be comprised of cash or securities.

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## NOTE 11: Other Noninterest Expenses

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

| (Dollars in thousands)             | Three Months Ended June 30, |          | Six Months Ended<br>June 30, |          |
|------------------------------------|-----------------------------|----------|------------------------------|----------|
|                                    | 2017                        | 2016     | 2017                         | 2016     |
| Data processing expenses           | \$ 835                      | \$ 1,048 | \$ 1,693                     | \$ 2,003 |
| Professional fees                  | 575                         | 631      | 1,281                        | 1,142    |
| Marketing and advertising expenses | 438                         | 458      | 803                          | 834      |
| Travel and educational expenses    | 291                         | 274      | 577                          | 547      |
| Telecommunication expenses         | 316                         | 321      | 646                          | 555      |
| All other noninterest expenses     | 2,132                       | 2,028    | 4,142                        | 4,264    |
| Total other noninterest expenses   | \$ 4,587                    | \$ 4,760 | \$ 9,142                     | \$ 9,345 |

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

Cautionary Statement Regarding Forward-Looking Statements

This report contains statements concerning the Corporation’s expectations, plans, objectives, future financial performance and other statements that are not historical facts. These statements may constitute “forward-looking statements” as defined by federal securities laws and may include, but are not limited to, statements regarding future financial performance, liquidity, strategic business initiatives including personnel additions, expansion into new markets, development of our digital platform and the utilization of scorecard models, capital levels, the effect of future market and industry trends including competitive trends in the nonprime consumer finance markets, the Corporation’s and each business segment’s loan portfolio and business prospects related to each segment’s loan portfolio, asset quality and adequacy of the allowance for loan losses and the level of future charge-offs, trends regarding the provision for loan losses, trends regarding net loan charge-offs, trends with respect to the levels of nonperforming assets and troubled debt restructurings and expenses associated with nonperforming assets, and the effects of future interest rate levels and fluctuations, the amount and timing of accretion associated with the fair value accounting adjustments recorded in connection with the 2013 acquisition of Central Virginia Bankshares, Inc. (CVBK), adequacy of the allowance for indemnification losses, levels of noninterest income and expense, interest rates and yields including possible future rising interest rate environments, the deposit portfolio including trends in deposit maturities and rates, interest rate sensitivity, market risk, regulatory developments, monetary policy implemented by the Board of Governors of the Federal Reserve System (the Federal Reserve Board) including changes to the federal funds rate, capital requirements, growth strategy, hedging strategy and financial and other goals. These statements may address issues that involve estimates and assumptions made by management and risks and uncertainties. Actual results could differ materially from historical results or those anticipated or implied by such statements. Factors that could have a material adverse effect on the operations and future prospects of the Corporation include, but are not limited to, changes in:

- interest rates, such as volatility in yields on U.S. Treasury bonds and increases or volatility in mortgage rates
- general business conditions, as well as conditions within the financial markets
- general economic conditions, including unemployment levels
- the legislative/regulatory climate, including the Dodd-Frank Act and regulations promulgated thereunder, the Consumer Financial Protection Bureau (CFPB) and the regulatory and enforcement activities of the CFPB and the application of the Basel III capital standards to the Corporation and the Bank



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- monetary and fiscal policies of the U.S. Government, including policies of the U.S. Department of the Treasury and the Federal Reserve Board, and the effect of these policies on interest rates and business in our markets
  
- the value of securities held in the Corporation's investment portfolios
  
- demand for loan products
  - the quality or composition of the loan portfolios and the value of the collateral securing those loans
  
- the commercial and residential real estate markets
  
- the inventory level and pricing of new and used automobiles, including sales prices of repossessed vehicles
  
- the level of net charge-offs on loans and the adequacy of our allowance for loan losses
  
- deposit flows

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- demand in the secondary residential mortgage loan markets
- the level of indemnification losses related to mortgage loans sold
- the strength of the Corporation's counterparties and the economy in general
- competition from both banks and non-banks, including competition in the non-prime automobile finance markets
- demand for financial services in the Corporation's market area
- the Corporation's expansion and technology initiatives
- reliance on third parties for key services
- accounting principles, policies and guidelines and elections made by the Corporation thereunder

These risks and uncertainties, and the risks discussed in more detail in Item 1A, "Risk Factors", of the Corporation's Annual Report on Form 10-K for the year ended December 31, 2016, 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 management's most difficult, subjective or complex judgments affecting the application of these policies, and the likelihood that materially different amounts would be reported under different conditions, or using different assumptions, are described below.

Allowance for Loan Losses: We establish the allowance for loan losses through charges to earnings in the form of a provision for loan losses. Loan losses are charged against the allowance when we believe that the collection of the principal is unlikely. Subsequent recoveries of losses previously charged against the allowance are credited to the allowance. The allowance represents an amount that, in our judgment, will be adequate to absorb probable losses inherent in the loan portfolio. Our judgment in determining the level of the allowance is based on evaluations of the collectibility of loans while taking into consideration such factors as trends in delinquencies and charge-offs for relevant periods of time, changes in the nature and volume of the loan portfolio, current economic conditions that may affect a borrower's ability to repay and the value of collateral, overall portfolio quality and review of specific potential losses. This evaluation is inherently subjective because it requires estimates that are susceptible to significant revision as more information becomes available. For more information see the section titled "Asset Quality" within Part I, Item 2.

Allowance for Indemnifications: The allowance for indemnifications is established through charges to earnings in the form of a provision for indemnifications, which is included in other noninterest expenses. A loss is charged against the allowance for indemnifications when a purchaser of a loan (investor) sold by C&F Mortgage incurs a validated indemnified loss due to borrower misrepresentation, fraud, early default, or underwriting error. The allowance represents an amount that, in management's judgment, will be adequate to absorb any losses arising from valid indemnification requests. Management's judgment in determining the level of the allowance is based on the volume of loans sold, historical experience, current economic conditions and information provided by investors. This evaluation is inherently subjective, as it requires estimates that are susceptible to significant revision as more information becomes available.

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**Impairment of Loans:** We consider a loan impaired when it is probable that the Corporation will be unable to collect all interest and principal payments as scheduled in the loan agreement. We do not consider a loan impaired during a period of delay in payment if we expect the ultimate collection of all amounts due. We measure impairment on a loan-by-loan basis for commercial, construction and residential loans in excess of \$500,000 by either the present value of expected future cash flows discounted at the loan's effective interest rate, the loan's obtainable market price, or the fair value of the collateral if the loan is collateral dependent. Large groups of smaller balance homogeneous loans are collectively evaluated for impairment. We maintain a valuation allowance to the extent that the measure of the impaired loan is less than the recorded investment. TDRs are also considered impaired loans, even if the loan balance is less than \$500,000. A TDR occurs when we agree to significantly modify the original terms of a loan by granting a concession due to the deterioration in the financial condition of the borrower.

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

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

Subsequent to acquisition, we evaluate on a quarterly basis our estimate of cash flows expected to be collected. Estimates of cash flows for PCI loans require significant judgment. Subsequent decreases to the expected cash flows will generally result in a provision for loan losses resulting in an increase to the allowance for loan losses. Subsequent significant increases in cash flows may result in a reversal of post-acquisition provision for loan losses or a transfer from nonaccretable difference to accretable yield that increases interest income over the remaining life of the loan, or pool(s) of loans. Disposals of loans, which may include sale of loans to third parties, receipt of payments in full or in part from the borrower or foreclosure of the collateral, result in removal of the loan from the PCI loan portfolio at its carrying amount.

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

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

**Impairment of Securities:** Impairment of securities occurs when the fair value of a security is less than its amortized cost. For debt securities, impairment is considered other-than-temporary and recognized in its entirety in net income if either (i) we intend to sell the security or (ii) it is more-likely-than-not that we will be required to sell the security before recovery of its amortized cost basis. If, however, we do not intend to sell the security and it is not more-likely-than-not that we will be required to sell the security before recovery, we must determine what portion of the impairment is attributable to a credit loss, which occurs when the amortized cost basis of the security exceeds the present value of the cash flows expected to be collected from the security. If there is no credit loss, there is no other-than-temporary impairment. If there is a credit loss, other-than-temporary impairment exists, and the credit loss must be recognized in net income and the remaining portion of impairment must be recognized in other comprehensive income. For equity securities, impairment is considered to be other-than-temporary based on our ability and intent to hold the investment until a recovery of fair

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

**Other Real Estate Owned (OREO):** Assets acquired through, or in lieu of, loan foreclosure are held for sale and are initially recorded at the fair value less costs to sell at the date of foreclosure. Subsequent to foreclosure, management periodically performs valuations of the foreclosed assets based on updated appraisals, general market conditions, recent sales of similar properties, length of time the properties have been held, and our ability and intention with regard to continued ownership of the properties. The Corporation may incur additional write-downs of foreclosed assets to fair value less costs to sell if valuations indicate a further deterioration in market conditions.

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

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

**Derivative Financial Instruments:** The Corporation uses derivatives primarily to manage risk associated with changing interest rates and to assist customers with their risk management objectives. The Corporation's derivative financial instruments may include (1) interest rate lock commitments (IRLCs) on mortgage loans that will be held for sale and related forward sales commitments, (2) interest rate swaps with certain qualifying commercial loan customers and dealer counterparties and (3) interest rate swaps that qualify as cash flow hedges of the Corporation's trust preferred capital notes. The Corporation recognizes derivative financial instruments at fair value as either an other asset or other liability in the consolidated balance sheet. Because the IRLCs, forward sales commitments and interest rate swaps with loan customers and dealer counterparties are classified as free standing derivatives, adjustments to reflect unrealized gains and losses resulting from changes in fair value of these instruments are reported in the income

statement. The effective portion of the gain or loss on the Corporation's cash flow hedges is reported as a component of other comprehensive income, net of deferred income taxes, and is reclassified into earnings in the same period or periods during which the hedged transactions affect earnings.

**Income Taxes:** Determining the Corporation's effective tax rate requires judgment. The Corporation's net deferred tax asset is determined annually for differences between the financial statement and tax bases of assets and liabilities that will result in taxable or deductible amounts in the future based on enacted tax laws and rates applicable to the periods in which the differences are expected to affect taxable income. In addition, there may be transactions and calculations for which the ultimate tax outcomes are uncertain and the Corporation's tax returns are subject to audit by various tax authorities. Although we believe that the estimates are reasonable, no assurance can be given that the final tax outcome will not be materially different than that which is reflected in the income tax provision and accrual.

For further information concerning accounting policies, refer to Item 8, "Financial Statements and Supplementary Data," under the heading "Note 1: Summary of Significant Accounting Policies" in the Corporation's Annual Report on Form 10-K for the year ended December 31, 2016.

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OVERVIEW

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

Financial Performance Measures

Net income for the Corporation was \$4.1 million for the second quarter of 2017, or \$1.19 per common share assuming dilution, compared to net income of \$4.7 million for the second quarter of 2016, or \$1.36 per common share assuming dilution. Net income for the Corporation was \$6.9 million for the first half of 2017, or \$1.97 per common share assuming dilution, compared to net income of \$7.2 million for the first half of 2016, or \$2.08 per common share assuming dilution. Contributing to the earnings decline for the second quarter and first half of 2017, compared to the same periods of 2016, were one-time revenue items totaling \$822,000 after taxes that were recognized during the second quarter and first half of 2016 associated with a contract amendment for one of the Bank's debit card programs (\$237,000 after tax), the Bank's bank-owned life insurance (BOLI) program (\$493,000 after tax) and a gain on the sale of a Bank-owned property (\$92,000 after tax).

The Corporation's annualized ROE and ROA were 11.63 percent and 1.14 percent, respectively, for the second quarter of 2017, compared to 14.00 percent and 1.34 percent, respectively, for the second quarter of 2016. The Corporation's annualized ROE and ROA were 9.76 percent and 0.95 percent, respectively, for the first half of 2017, compared to 10.78 percent and 1.03 percent, respectively, for the first half of 2016. The decreases in ROE and ROA for the second quarter and first half of 2017, compared to the same periods in 2016, resulted from internal capital growth since June 30, 2016 and the decline in net income during 2017 resulting principally from the absence of one-time revenue items recognized in the second quarter and first half of 2016.

Principal Business Segments

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



Retail Banking: The Retail Banking segment reported net income of \$2.1 million for the second quarter of 2017, compared to net income of \$2.7 million for the second quarter of 2016. For the first half of 2017, the Retail Banking segment reported net income of \$3.9 million, compared to \$4.0 million for the first half of 2016.

As previously mentioned, if not for the one-time revenue items recognized during the second quarter of 2016, net income at the Retail Banking segment increased during the second quarter and first half of 2017, compared to the same periods of 2016. Positive factors influencing net income of the Retail Banking segment for the second quarter and first six months of 2017 include: (1) the effect of loan growth on interest income, as average loans at C&F Bank increased \$53.6 million or 8.4 percent during the second quarter 2017 and \$63.2 million or 10.0 percent during the first half of 2017 over the same periods of 2016 and (2) an increase in service charges on deposits. Partially offsetting these positive factors were (1) a decline in the yield on the investment portfolio as a result of replacing matured and called securities with lower-yielding securities, (2) a higher provision for loan losses resulting from loan growth and (3) higher operating expenses associated with strengthening C&F Bank's technology infrastructure, growing its commercial lending teams, implementing its digital initiatives and promoting brand awareness.

The results for the second quarter and first half of 2017 and 2016 for the Retail Banking segment include the acquisition accounting adjustments recorded in connection with the 2013 acquisition of CVB. The net accretion attributable to these adjustments recognized in the second quarter and first half of 2017 was \$153,000 and \$427,000, net of taxes, respectively, compared to \$294,000 and \$505,000, net of taxes for the second quarter and first half of 2016, respectively.

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C&F Bank's total nonperforming assets were \$8.9 million at June 30, 2017, compared to \$4.4 million at December 31, 2016. Nonperforming assets at June 30, 2017 included \$8.6 million in nonaccrual loans, compared to \$4.2 million at December 31, 2016, and \$284,000 in other real estate owned (OREO), compared to \$195,000 at December 31, 2016. The increase in nonaccrual loans was due primarily to two commercial relationships totaling \$6.5 million, which were classified as nonaccrual in the first quarter of 2017. Both of these relationships have been restructured in 2017, are reported in troubled debt restructurings (TDR) at June 30, 2017 and were previously classified as substandard loans. Specific reserves have also been established, which management believes are adequate to absorb probable losses on these loans. The OREO increase during the first half of 2017 was primarily due to the transfer of two residential properties to OREO, which was partially offset by OREO sales during the same period.

**Mortgage Banking:** The Mortgage Banking segment reported net income of \$607,000 for the second quarter of 2017, compared to net income of \$650,000 for the second quarter of 2016. For the first half of 2017, the Mortgage Banking segment reported net income of \$904,000, compared to net income of \$972,000 for the first half of 2016.

The Mortgage Banking segment began an expansion in Chesapeake, Virginia in the fourth quarter of 2016. This expansion contributed to higher loan production during the second quarter and first half of 2017, which increased 18.6 percent and 25.0 percent, respectively, over the same periods in 2016 and resulted in higher gains on sales of loans. The amount of loan originations during the second quarter of 2017 for refinancings and home purchases were \$22.9 million and \$185.9 million, respectively, compared to \$28.2 million and \$147.9 million, respectively, during the second quarter of 2016. The amount of loan production for the first half of 2017 for refinancings and home purchases were \$45.5 million and \$304.4 million, respectively, compared to \$53.2 million and \$226.8 million, respectively, during the first half of 2016. In addition, the Lender Solutions division, which provides certain mortgage origination services to third parties, produced fee income of \$50,000 and \$91,000 in the second quarter and first half of 2017, respectively, compared to \$27,000 in both the second quarter and first half of 2016. However, a decline in the margin on loans sold during 2017 and higher fixed personnel and overhead costs associated with the segment's expansion in Chesapeake resulted in a slight decline in earnings during the second quarter and first half of 2017.

The continued focus at the Mortgage Banking segment is higher loan production, and we continue to seek new growth opportunities. Management believes increasing future profitability at the Mortgage Banking segment is dependent on growth in loan originations due to the fixed costs of maintaining the personnel, compliance and technology infrastructure required to support mortgage banking activities.

**Consumer Finance:** The Consumer Finance segment reported net income of \$1.6 million for the second quarter of 2017, compared to net income of \$1.7 million for the second quarter of 2016. For the first half of 2017, the Consumer Finance segment reported net income of \$2.6 million, compared to \$2.8 million for the first half of 2016.

The decline in net income for the second quarter and first six months of 2017, compared to the same periods in 2016, was principally due to net interest margin compression attributable to (1) lower loan yields resulting from competition in the non-prime automobile loan business and the acquisition of loan contracts with higher credit metrics and (2) higher-cost variable-rate borrowings resulting from increases in short-term interest rates since March 31, 2016.

The results of the Consumer Finance segment included a \$3.0 million and a \$7.3 million provision for loan losses for the second quarter and first six months of 2017, compared to \$3.6 million and \$8.2 million for the second quarter and first six months of 2016. The annualized net charge-off ratio for the first six months of 2017 increased to 5.34 percent from 4.88 percent for the first six months of 2016 because of the higher level of charge-offs during 2017 resulting from the lower resale value of repossessed automobiles due to dealer levels of new and used car inventories. The allowance for loan losses to total loans increased to 8.49 percent at June 30, 2017, compared to 8.40 percent at December 31, 2016. At June 30, 2017, total delinquent loans as a percentage of total loans declined to 4.40 percent from 5.15 percent at December 31, 2016, and from 4.51 percent at June 30, 2016. At June 30, 2017, repossessed assets totaled \$2.2 million, compared to \$3.1 million at December 31, 2016, and \$2.5 million at June 30, 2016.

Other Segments: Other segments, which principally includes the Corporation's holding company operations and wealth management subsidiary, reported an aggregate net loss of \$203,000 for the second quarter of 2017, compared to a net loss

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of \$329,000 for the second quarter of 2016. For the first half of 2017, Other segments reported an aggregate net loss of \$533,000, compared to an aggregate net loss of \$578,000 for the first half of 2016. The lower net losses during 2017 resulted from lower operating expenses at the Corporation's holding company. Also contributing to the lower net loss for the second quarter of 2017, compared to the second quarter of 2016, was an increase in earnings at the Corporation's wealth management subsidiary, which added a new wealth management group in Williamsburg and Newport News, Virginia beginning in the fourth quarter of 2016.

Capital Management. Total shareholders' equity was \$144.9 million at June 30, 2017, compared to \$139.2 million at December 31, 2016. Capital growth resulted primarily from earnings for the first half of 2017, which was offset in part by dividends declared of 33 cents and 66 cents per share during the second quarter and first half of 2017, respectively. The second quarter dividend was paid on July 1, 2017 and equated to a payout ratio of 27.7 percent of second quarter income. The dividend payout ratio was 33.5 percent for the first half of 2017. The Board of Directors of the Corporation continually reviews the amount of cash dividends per share and the resulting dividend payout ratio in light of changes in economic conditions, current and future capital requirements and expected future earnings.

During the second quarter of 2017, the Corporation's Board of Directors reauthorized a share repurchase program for the Corporation's outstanding common stock (the Repurchase Program) to purchase up to \$5 million of the Corporation's common stock through May 2018. As of June 30, 2017, the Corporation had not used any of this authority and remained authorized to purchase up to \$5.0 million of the Corporation's common stock under the Repurchase Program. For more information about the Repurchase Program, see Part II, Item 2 "Unregistered Sales of Equity Securities and Use of Proceeds" under the heading "Issuer Purchases of Equity Securities" in this Quarterly Report on Form 10-Q.

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## RESULTS OF OPERATIONS

The following table presents the average balance sheets, the amounts of interest earned on earning assets, with related yields, and interest expense on interest-bearing liabilities, with related rates, for the three and six months ended June 30, 2017 and 2016. Loans include loans held for sale. Loans placed on a nonaccrual status are included in the balances and are included in the computation of yields, but had no material effect. Accretion and amortization of fair value purchase adjustments are included in the computation of yields on loans and investments and on the cost of borrowings acquired in connection with the purchase of CVB. The CVB accretion contributed approximately 13 basis points to the yield on loans and 10 basis points to both the yield on interest earning assets and the net interest margin for the second quarter of 2017, compared to approximately 24 basis points to the yield on loans and 18 basis points to both the yield on interest earning assets and the net interest margin for the second quarter of 2016. The CVB accretion contributed approximately 16 basis points to the yield on loans and 13 basis points to both the yield on interest earning assets and the net interest margin for the first six months of 2017, compared to approximately 22 basis points to the yield on loans and 16 basis points to both the yield on interest earning assets and the net interest margin for the first six months of 2016. Interest on tax-exempt loans and securities is presented on a taxable-equivalent basis (which converts the income on loans and investments for which no income taxes are paid to the equivalent yield as if income taxes were paid using the federal corporate income tax rate of 34 percent).

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

| (Dollars in thousands)                      | Three Months Ended June 30,<br>2017 |                    |                | 2016               |                    |                |
|---|-------------------------------------|--------------------|----------------|--------------------|--------------------|----------------|
|   | Average<br>Balance                  | Income/<br>Expense | Yield/<br>Rate | Average<br>Balance | Income/<br>Expense | Yield/<br>Rate |
| Assets                                      |                                     |                    |                |                    |                    |                |
| Securities:                                 |                                     |                    |                |                    |                    |                |
| Taxable                                     | \$ 115,040                          | \$ 631             | 2.19 %         | \$ 99,096          | \$ 570             | 2.30 %         |
| Tax-exempt                                  | 99,729                              | 1,238              | 4.97           | 111,514            | 1,447              | 5.19           |
| Total securities                            | 214,769                             | 1,869              | 3.48           | 210,610            | 2,017              | 3.83           |
| Total loans                                 | 1,030,699                           | 20,711             | 8.06           | 973,355            | 20,659             | 8.54           |
| Interest-bearing deposits in<br>other banks | 112,177                             | 278                | 0.99           | 119,699            | 143                | 0.48           |
| Total earning assets                        | 1,357,645                           | 22,858             | 6.75           | 1,303,664          | 22,819             | 7.04           |
| Allowance for loan losses                   | (36,163)                            |                    |                | (35,904)           |                    |                |
| Total non-earning assets                    | 132,890                             |                    |                | 133,222            |                    |                |
| Total assets                                | \$ 1,454,372                        |                    |                | \$ 1,400,981       |                    |                |
| Liabilities and Shareholders'<br>Equity     |                                     |                    |                |                    |                    |                |
| Time and savings deposits:                  |                                     |                    |                |                    |                    |                |

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|   |              |           |      |   |              |           |      |   |
|---|--------------|-----------|------|---|--------------|-----------|------|---|
| Interest-bearing demand deposits                        | \$ 214,391   | \$ 114    | 0.21 | % | \$ 211,081   | \$ 107    | 0.20 | % |
| Money market deposit accounts                           | 217,142      | 145       | 0.27 |   | 211,336      | 139       | 0.26 |   |
| Savings accounts  | 109,755      | 22        | 0.08 |   | 103,846      | 21        | 0.08 |   |
| Certificates of deposit, \$100 or more                  | 164,237      | 460       | 1.12 |   | 137,923      | 357       | 1.04 |   |
| Other certificates of deposit                           | 183,197      | 419       | 0.92 |   | 197,046      | 445       | 0.91 |   |
| Total time and savings deposits                         | 888,722      | 1,160     | 0.52 |   | 861,233      | 1,069     | 0.50 |   |
| Borrowings  | 165,285      | 1,185     | 2.87 |   | 172,103      | 1,149     | 2.64 |   |
| Total interest-bearing liabilities                      | 1,054,007    | 2,345     | 0.89 |   | 1,033,336    | 2,218     | 0.86 |   |
| Demand deposits   | 233,663      |           |      |   | 210,368      |           |      |   |
| Other liabilities                                       | 24,287       |           |      |   | 22,850       |           |      |   |
| Total liabilities                                       | 1,311,957    |           |      |   | 1,266,554    |           |      |   |
| Shareholders' equity                                    | 142,415      |           |      |   | 134,427      |           |      |   |
| Total liabilities and shareholders' equity              | \$ 1,454,372 |           |      |   | \$ 1,400,981 |           |      |   |
| Net interest income                                     |              | \$ 20,513 |      |   |              | \$ 20,601 |      |   |
| Interest rate spread                                    |              |           | 5.86 | % |              |           | 6.18 | % |
| Interest expense to average earning assets (annualized) |              |           | 0.69 | % |              |           | 0.68 | % |
| Net interest margin (annualized)                        |              |           | 6.06 | % |              |           | 6.36 | % |

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| (Dollars in thousands)                                     | Six Months Ended June 30,<br>2017 |                    |                | 2016               |                    |                |
|--|-----------------------------------|--------------------|----------------|--------------------|--------------------|----------------|
|  | Average<br>Balance                | Income/<br>Expense | Yield/<br>Rate | Average<br>Balance | Income/<br>Expense | Yield/<br>Rate |
| <b>Assets</b>  |                                   |                    |                |                    |                    |                |
| <b>Securities:</b>   |                                   |                    |                |                    |                    |                |
| Taxable  | \$ 111,091                        | \$ 1,212           | 2.18 %         | \$ 100,673         | \$ 1,172           | 2.33 %         |
| Tax-exempt   | 102,323                           | 2,545              | 4.97           | 112,110            | 2,932              | 5.23           |
| Total securities   | 213,414                           | 3,757              | 3.52           | 212,783            | 4,104              | 3.86           |
| Total loans  | 1,027,902                         | 41,093             | 8.06           | 957,749            | 40,889             | 8.59           |
| Interest-bearing deposits in<br>other banks                | 109,649                           | 487                | 0.90           | 129,868            | 320                | 0.50           |
| Total earning assets                                       | 1,350,965                         | 45,337             | 6.76           | 1,300,400          | 45,313             | 7.00           |
| Allowance for loan losses                                  | (36,322)                          |                    |                | (35,694)           |                    |                |
| Total non-earning assets                                   | 133,131                           |                    |                | 134,513            |                    |                |
| Total assets   | \$ 1,447,774                      |                    |                | \$ 1,399,219       |                    |                |
| <b>Liabilities and Shareholders' Equity</b>                |                                   |                    |                |                    |                    |                |
| <b>Time and savings deposits:</b>                          |                                   |                    |                |                    |                    |                |
| Interest-bearing demand<br>deposits                        | \$ 220,239                        | \$ 237             | 0.22 %         | \$ 215,094         | \$ 237             | 0.22 %         |
| Money market deposit<br>accounts                           | 217,487                           | 288                | 0.27           | 210,759            | 281                | 0.27           |
| Savings accounts   | 107,946                           | 43                 | 0.08           | 102,462            | 41                 | 0.08           |
| Certificates of deposit, \$100<br>or more                  | 162,128                           | 870                | 1.08           | 138,196            | 715                | 1.04           |
| Other certificates of deposit                              | 182,669                           | 857                | 0.95           | 198,053            | 896                | 0.91           |
| Total time and savings<br>deposits                         | 890,469                           | 2,295              | 0.52           | 864,564            | 2,170              | 0.50           |
| Borrowings   | 165,017                           | 2,320              | 2.81           | 173,833            | 2,310              | 2.63           |
| Total interest-bearing<br>liabilities                      | 1,055,486                         | 4,615              | 0.88           | 1,038,397          | 4,480              | 0.86           |
| Demand deposits  | 227,233                           |                    |                | 204,396            |                    |                |
| Other liabilities  | 24,335                            |                    |                | 23,049             |                    |                |
| Total liabilities  | 1,307,054                         |                    |                | 1,265,842          |                    |                |
| Shareholders' equity                                       | 140,720                           |                    |                | 133,377            |                    |                |
| Total liabilities and<br>shareholders' equity              | \$ 1,447,774                      |                    |                | \$ 1,399,219       |                    |                |
| Net interest income  |                                   | \$ 40,722          |                |                    | \$ 40,833          |                |
| Interest rate spread                                       |                                   |                    | 5.88 %         |                    |                    | 6.14 %         |
| Interest expense to average<br>earning assets (annualized) |                                   |                    | 0.69 %         |                    |                    | 0.69 %         |
| Net interest margin<br>(annualized)                        |                                   |                    | 6.08 %         |                    |                    | 6.32 %         |

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 period-to-period changes in the components of net interest income on a taxable-equivalent basis. The Corporation calculates the rate and volume variances using a formula prescribed by the SEC. Rate/volume variances, the third element in the calculation, are not shown separately in the table, but are allocated to the rate and volume variances in proportion to the relationship of the absolute dollar amounts of the change in each. Loans include both nonaccrual loans and loans held for sale.



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TABLE 2: Rate-Volume Recap

| (Dollars in thousands)                   | Three Months Ended<br>June 30, 2017 from 2016<br>Increase (Decrease) |          | Total<br>Increase<br>(Decrease) |
|--|--|----------|---------------------------------|
|  | Due to<br>Rate   | Volume   |                                 |
| Interest income:                         |  |          |                                 |
| Loans                                    | \$ (4,758)   | \$ 4,810 | \$ 52                           |
| Securities:                              |  |          |                                 |
| Taxable                                  | (150)  | 211      | 61                              |
| Tax-exempt                               | (61)   | (148)    | (209)                           |
| Interest-bearing deposits in other banks | 196  | (61)     | 135                             |
| Total interest income                    | (4,773)  | 4,812    | 39                              |
| Interest expense:                        |  |          |                                 |
| Time and savings deposits:               |  |          |                                 |
| Interest-bearing demand deposits         | 6  | 1        | 7                               |
| Money market deposit accounts            | 3  | 3        | 6                               |
| Savings accounts                         | (4)  | 5        | 1                               |
| Certificates of deposit, \$100 or more   | 30   | 73       | 103                             |
| Other certificates of deposit            | 23   | (49)     | (26)                            |
| Total time and savings deposits          | 58   | 33       | 91                              |
| Borrowings                               | 273  | (237)    | 36                              |
| Total interest expense                   | 331  | (204)    | 127                             |
| Change in net interest income            | \$ (5,104)   | \$ 5,016 | \$ (88)                         |

| (Dollars in thousands)                   | Six Months Ended<br>June 30, 2017 from 2016<br>Increase (Decrease) |          | Total<br>Increase<br>(Decrease) |
|--|--|----------|---------------------------------|
|  | Due to<br>Rate   | Volume   |                                 |
| Interest income:                         |  |          |                                 |
| Loans                                    | \$ (5,407)   | \$ 5,611 | \$ 204                          |
| Securities:                              |  |          |                                 |
| Taxable                                  | (169)  | 210      | 41                              |
| Tax-exempt                               | (139)  | (249)    | (388)                           |
| Interest-bearing deposits in other banks | 308  | (141)    | 167                             |
| Total interest income                    | (5,407)  | 5,431    | 24                              |
| Interest expense:                        |  |          |                                 |
| Time and savings deposits:               |  |          |                                 |

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|  |            |          |          |
|--|------------|----------|----------|
| Interest-bearing demand deposits       | (8)        | 8        | —        |
| Money market deposit accounts          | (8)        | 15       | 7        |
| Savings accounts                       | (2)        | 4        | 2        |
| Certificates of deposit, \$100 or more | 30         | 125      | 155      |
| Other certificates of deposit          | 81         | (120)    | (39)     |
| Total time and savings deposits        | 93         | 32       | 125      |
| Borrowings                             | 275        | (265)    | 10       |
| Total interest expense                 | 368        | (233)    | 135      |
| Change in net interest income          | \$ (5,775) | \$ 5,664 | \$ (111) |

Net interest income, on a taxable-equivalent basis, for the three months ended June 30, 2017 was \$20.5 million, compared to \$20.6 million for the three months ended June 30, 2016. Net interest income, on a taxable-equivalent basis, for the first half of 2017 was \$40.7 million, compared to \$40.8 million for the first half of 2016. Annualized net interest margin decreased 30 basis points to 6.06 percent for the second quarter of 2017, relative to the same period in 2016, and decreased 24 basis points to 6.08 percent for the first half of 2017, relative to the same period in 2016. The net interest margin declines resulted from declines in the yield on interest-earning assets of 29 and 24 basis points for the second quarter and first half of 2017, respectively, as compared to the same periods in 2016. The decline in yield on interest-earning assets for both the second quarter and first half of 2017 was primarily attributable to decreases in the yields on the loan and investment securities portfolios. These decreases were offset in part by earning asset growth of \$54.0 million and \$50.6 million for the second quarter and first half of 2017, respectively, and by a shift in the composition of earning assets as growth in the higher-yielding loan portfolio was funded in part by a decline in lower-yielding deposits in other banks.

Average loans, which includes both loans held for investment and loans held for sale, increased \$57.3 million to \$1.0 billion for the second quarter of 2017, compared to the same period in 2016. Average loans increased \$70.2 million to \$1.0

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billion for the first half of 2017, compared to the same period in 2016. Average loans held for investment of the Retail Banking segment increased \$53.6 million, or 8.4 percent, for the second quarter of 2017, compared to the same period in 2016, and increased \$63.2 million, or 10.0 percent, for the first half of 2017, compared to the same period in 2016. Average loans at the Retail Banking segment increased for both the second quarter and first half of 2017 because of growth in the commercial real estate and real estate mortgage segments of the loan portfolio, which was driven by successfully recruiting experienced commercial lending personnel over the past several years and the continued strong loan demand in the real estate development and construction sectors of our markets. Average loans held for investment at the Consumer Finance segment were basically level during the second quarters of 2017 and 2016 and increased \$4.8 million, or 1.6 percent, for the first half of 2017, compared to the same period of 2016, which was the result of organic loan growth since June 30, 2016. Average loans held for sale increased \$3.8 million, or 10.6 percent for the second quarter of 2017, compared to the same period in 2016, and increased \$2.5 million, or 7.7 percent for the first half of 2017, compared to the same period in 2016.

The overall yield on average loans decreased 48 basis points to 8.06 percent for the second quarter of 2017, compared to the same period of 2016, and decreased 53 basis points to 8.06 percent for the first half of 2017, compared to the same period of 2016. The decrease in the average loan yield was due to (1) lower-yielding loan growth at the Retail Banking segment outpacing higher-yielding loan growth at the Consumer Finance segment and (2) the decline in the average yield on loans at the Consumer Finance segment due to the continued competitive pressure on loan pricing strategies and a strategic decision to purchase loans with higher credit quality metrics, but lower yields.

Average securities available for sale increased \$4.2 million and \$631,000 for the second quarter and first half of 2017, compared to the same periods in 2016. The average yield on the securities portfolio decreased 35 basis points and 34 basis points for the second quarter and first half of 2017, respectively, compared to the same periods in 2016, due to the purchase of lower-yielding shorter-term securities to replace maturities and calls of longer-term, higher yielding securities. The Corporation has shortened the security portfolio's duration by investing in lower-yielding, short-term securities in order to mitigate interest-rate risk of a future rising interest rate environment.

Average interest-bearing deposits in other banks, consisting primarily of excess reserves maintained at the Federal Reserve Bank, decreased \$7.5 million and \$20.2 million during the second quarter and first half of 2017, compared to the same periods in 2016, because the Corporation used these funds to partially fund loan growth during 2016 and 2017. The average yield on these overnight funds increased 51 basis points and 40 basis points for the second quarter and first half of 2017, respectively, because of the Federal Reserve Bank's increases in the interest rate on excess reserve balances from 0.50 percent in December 2015 to 1.25 percent by the end of the second quarter of 2017.

Average interest-bearing time deposits increased \$12.5 million and \$8.5 million for the second quarter and first half of 2017, respectively, and average savings and interest-bearing demand deposits increased \$15.0 million and \$17.4 million for the second quarter and first half of 2017. Although interest rates have risen since June 30, 2016, the increase in the average cost of interest-bearing deposits was only two basis points during both the second quarter and first half of 2017 because growth in lower-cost non-term deposits exceeded growth in higher-cost time deposits.

Average borrowings decreased \$6.8 million and \$8.8 million for the second quarter and first half of 2017, compared to the same periods in 2016. The decrease resulted from the repayment during the third quarter of 2016 of the borrowings used to purchase a consumer finance loan portfolio at the end of the second quarter of 2015. The average cost of borrowings increased 23 basis points and 18 basis points during the second quarter and first half of 2017, as compared to the same periods in 2016, because of increases in one-month LIBOR, to which variable-rate borrowing at the Consumer Finance segment is indexed, resulting from the rising interest rate environment.

The Corporation believes that it will be challenging to maintain the Retail Banking segment's net interest margin at its current level, even with anticipated loan growth during 2017, because the current low interest rate environment has contributed to lower yields on both the loan and investment portfolios. In addition, the recent increase in the federal funds rate may provide stimulus for higher-costing deposits, which reprice faster than loans and investments when interest rates rise. The net interest margin at the Consumer Finance segment will be most affected by continued market competition and lower yields on higher-quality loans and the recent increase in the federal funds rate triggering higher-costing variable-rate borrowings.

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## Noninterest Income

TABLE 3: Noninterest Income

| (Dollars in thousands)  | Three Months Ended June 30, 2017 |                     |                     |                           | Total    |
|---|----------------------------------|---------------------|---------------------|---------------------------|----------|
|   | Retail<br>Banking                | Mortgage<br>Banking | Consumer<br>Finance | Other and<br>Eliminations |          |
| Gains on sales of loans                                       | \$ —                             | \$ 2,619            | \$ —                | \$ —                      | \$ 2,619 |
| Service charges on deposit accounts                           | 1,109                            | —                   | —                   | —                         | 1,109    |
| Other service charges and fees                                | 1,251                            | 1,034               | 2                   | —                         | 2,287    |
| Net gains on calls and sales of available for sale securities | 7                                | —                   | —                   | —                         | 7        |
| Wealth management services income                             | —                                | —                   | —                   | 428                       | 428      |
| BOLI income   | 84                               | —                   | —                   | —                         | 84       |
| Swap fee income   | 118                              | —                   | —                   | —                         | 118      |
| Other income  | 193                              | 185                 | 197                 | 62                        | 637      |
| Total noninterest income                                      | \$ 2,762                         | \$ 3,838            | \$ 199              | \$ 490                    | \$ 7,289 |

| (Dollars in thousands)  | Three Months Ended June 30, 2016 |                     |                     |                           | Total    |
|---|----------------------------------|---------------------|---------------------|---------------------------|----------|
|   | Retail<br>Banking                | Mortgage<br>Banking | Consumer<br>Finance | Other and<br>Eliminations |          |
| Gains on sales of loans                                       | \$ —                             | \$ 2,552            | \$ —                | \$ —                      | \$ 2,552 |
| Service charges on deposit accounts                           | 1,041                            | —                   | —                   | —                         | 1,041    |
| Other service charges and fees                                | 1,530                            | 830                 | 3                   | —                         | 2,363    |
| Net gains on calls and sales of available for sale securities | 44                               | —                   | —                   | —                         | 44       |
| Wealth management services income                             | —                                | —                   | —                   | 315                       | 315      |
| BOLI income   | 581                              | —                   | —                   | —                         | 581      |
| Swap fee income   | 245                              | —                   | —                   | —                         | 245      |
| Other income  | 253                              | 111                 | 191                 | 27                        | 582      |
| Total noninterest income                                      | \$ 3,694                         | \$ 3,493            | \$ 194              | \$ 342                    | \$ 7,723 |

| (Dollars in thousands)   | Six Months Ended June 30, 2017 |                     |                     |                           | Total     |
|--|--------------------------------|---------------------|---------------------|---------------------------|-----------|
|  | Retail<br>Banking              | Mortgage<br>Banking | Consumer<br>Finance | Other and<br>Eliminations |           |
| Gains on sales of loans  | \$ —                           | \$ 4,562            | \$ —                | \$ —                      | \$ 4,562  |
| Service charges on deposit accounts                              | 2,178                          | —                   | —                   | —                         | 2,178     |
| Other service charges and fees                                   | 2,395                          | 1,934               | 4                   | —                         | 4,333     |
| Net gains on calls and sales of available for<br>sale securities | 8                              | —                   | —                   | —                         | 8         |
| Wealth management services income                                | —                              | —                   | —                   | 750                       | 750       |
| BOLI income  | 168                            | —                   | —                   | —                         | 168       |
| Swap fee income  | 118                            | —                   | —                   | —                         | 118       |
| Other income   | 395                            | 373                 | 427                 | 123                       | 1,318     |
| Total noninterest income   | \$ 5,262                       | \$ 6,869            | \$ 431              | \$ 873                    | \$ 13,435 |

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| (Dollars in thousands)  | Six Months Ended June 30, 2016 |                  |                  |                        | Total     |
|---|--------------------------------|------------------|------------------|------------------------|-----------|
|   | Retail Banking                 | Mortgage Banking | Consumer Finance | Other and Eliminations |           |
| Gains on sales of loans                                       | \$ —                           | \$ 4,282         | \$ —             | \$ —                   | \$ 4,282  |
| Service charges on deposit accounts                           | 2,004                          | —                | —                | —                      | 2,004     |
| Other service charges and fees                                | 2,581                          | 1,460            | 6                | —                      | 4,047     |
| Net gains on calls and sales of available for sale securities | 45                             | —                | —                | —                      | 45        |
| Wealth management services income                             | —                              | —                | —                | 591                    | 591       |
| BOLI income   | 667                            | —                | —                | —                      | 667       |
| Swap fee income   | 245                            | —                | —                | —                      | 245       |
| Other income  | 314                            | 224              | 420              | 47                     | 1,005     |
| Total noninterest income                                      | \$ 5,856                       | \$ 5,966         | \$ 426           | \$ 638                 | \$ 12,886 |

Total noninterest income decreased \$434,000, or 5.6 percent, in the second quarter of 2017 and increased \$549,000, or 4.3 percent in the first half of 2017, compared to the same periods in 2016. The decrease in total noninterest income for the second quarter of 2017 was primarily due to decreases associated with one-time revenue items recognized at the Retail Banking segment in the second quarter of 2016, as previously described, which were offset in part by higher overdraft charges at the Retail Banking segment and higher gains on sales of loans and ancillary loan origination fees at the Mortgage Banking segment because of higher loan production. The increases in total noninterest income for the first half of 2017 were primarily due to higher (1) gains on sales of loans and ancillary loan origination fees at the Mortgage Banking segment because of higher loan production, (2) debit card interchange income at the Retail Banking segment, (3) overdraft charges at the Retail Banking segment and (4) wealth management income at C&F Wealth Management because of the addition of a new wealth management group in Williamsburg and Newport News, Virginia in the fourth quarter of 2016, which were offset in part at the Retail Banking segment by lower swap fee income and the one-time revenue items recognized in the second quarter of 2016.

## Noninterest Expense

TABLE 4: Noninterest Expense

| (Dollars in thousands)         | Three Months Ended June 30, 2017 |                  |                  |                        | Total     |
|--------------------------------|----------------------------------|------------------|------------------|------------------------|-----------|
|                                | Retail Banking                   | Mortgage Banking | Consumer Finance | Other and Eliminations |           |
| Salaries and employee benefits | \$ 6,420                         | \$ 1,804         | \$ 2,395         | \$ 442                 | \$ 11,061 |
| Occupancy expense              | 1,876                            | 479              | 260              | 17                     | 2,632     |
| OREO expenses                  | 41                               | —                | —                | —                      | 41        |

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|                                      |           |          |          |        |           |
|--------------------------------------|-----------|----------|----------|--------|-----------|
| Provision for indemnification losses | —         | 53       | —        | —      | 53        |
| Other expenses                       | 2,518     | 787      | 1,045    | 143    | 4,493     |
| Total noninterest expense            | \$ 10,855 | \$ 3,123 | \$ 3,700 | \$ 602 | \$ 18,280 |

| (Dollars in thousands)               | Three Months Ended June 30, 2016 |                  |                  |                        | Total     |
|--------------------------------------|----------------------------------|------------------|------------------|------------------------|-----------|
|                                      | Retail Banking                   | Mortgage Banking | Consumer Finance | Other and Eliminations |           |
| Salaries and employee benefits       | \$ 6,143                         | \$ 1,499         | \$ 2,532         | \$ 348                 | \$ 10,522 |
| Occupancy expense                    | 1,693                            | 454              | 216              | 2                      | 2,365     |
| OREO income                          | (44)                             | —                | —                | —                      | (44)      |
| Provision for indemnification losses | —                                | 88               | —                | —                      | 88        |
| Other expenses                       | 2,728                            | 647              | 1,163            | 178                    | 4,716     |
| Total noninterest expense            | \$ 10,520                        | \$ 2,688         | \$ 3,911         | \$ 528                 | \$ 17,647 |



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| (Dollars in thousands)               | Six Months Ended June 30, 2017 |                     |                     |                           | Total     |
|--------------------------------------|--------------------------------|---------------------|---------------------|---------------------------|-----------|
|                                      | Retail<br>Banking              | Mortgage<br>Banking | Consumer<br>Finance | Other and<br>Eliminations |           |
| Salaries and employee benefits       | \$ 12,656                      | \$ 3,287            | \$ 4,807            | \$ 980                    | \$ 21,730 |
| Occupancy expense                    | 3,734                          | 975                 | 510                 | 34                        | 5,253     |
| OREO expenses                        | 65                             | —                   | —                   | —                         | 65        |
| Provision for indemnification losses | —                              | 88                  | —                   | —                         | 88        |
| Other expenses                       | 5,079                          | 1,535               | 2,048               | 327                       | 8,989     |
| Total noninterest expense            | \$ 21,534                      | \$ 5,885            | \$ 7,365            | \$ 1,341                  | \$ 36,125 |

| (Dollars in thousands)               | Six Months Ended June 30, 2016 |                     |                     |                           | Total     |
|--------------------------------------|--------------------------------|---------------------|---------------------|---------------------------|-----------|
|                                      | Retail<br>Banking              | Mortgage<br>Banking | Consumer<br>Finance | Other and<br>Eliminations |           |
| Salaries and employee benefits       | \$ 12,151                      | \$ 2,683            | \$ 5,159            | \$ 700                    | \$ 20,693 |
| Occupancy expense                    | 3,420                          | 867                 | 409                 | 3                         | 4,699     |
| OREO expenses                        | 12                             | —                   | —                   | —                         | 12        |
| Provision for indemnification losses | —                              | 140                 | —                   | —                         | 140       |
| Other expenses                       | 5,377                          | 1,183               | 2,298               | 335                       | 9,193     |
| Total noninterest expense            | \$ 20,960                      | \$ 4,873            | \$ 7,866            | \$ 1,038                  | \$ 34,737 |

Total noninterest expenses increased \$633,000, or 3.6 percent, in the second quarter of 2017 and increased \$1.4 million, or 4.0 percent in the first half of 2017, compared to the same periods in 2016. The increase in noninterest expenses resulted primarily from higher personnel costs at (1) C&F Bank principally because of increased staff levels and support positions associated with growing C&F Bank's commercial loan portfolio, including its expansion into Charlottesville, Virginia in June 2016, (2) C&F Mortgage because of higher loan production and the Mortgage Banking segment's expansion in Chesapeake, Virginia, which began in the fourth quarter of 2016, and (3) the Corporation's wealth management subsidiary because of the addition of a new wealth management group in Williamsburg and Newport News, Virginia in the fourth quarter of 2016. Occupancy expense increased (1) at the Bank, C&F Mortgage, and at C&F Finance due to expenses associated with strengthening the technology infrastructure and (2) at the Bank, C&F Mortgage, and C&F Wealth Management due to higher rent expense for the addition of locations in Charlottesville, Chesapeake, and Williamsburg, respectively. These increases in noninterest expenses were offset in part at C&F Finance by lower (1) personnel costs due to fewer sales contracts purchased during 2017, (2) repossession expenses due to normal fluctuations in the timing of repossessed asset sales and (3) collection expenses due to additional costs associated with the transition to new systems in the first quarter of 2016.

## Income Taxes

Income tax expense for the second quarter of 2017 was \$1.8 million resulting in an effective tax rate of 30.9 percent, compared with \$1.9 million, or 28.3 percent, for the second quarter of 2016. Income tax expense for the first half of 2017 was \$2.8 million resulting in an effective tax rate of 28.7 percent, compared with \$2.5 million, or 26.2 percent, for the first half of 2016. The increase in the effective tax rate in the second quarter and first half of 2017, compared to the same periods in 2016, resulted at the Retail Banking segment from lower tax credits associated with its investment in qualified affordable housing projects, from the one-time tax-free proceeds associated with the Retail Banking segment's BOLI program recognized in the second quarter of 2016 and the decline in tax-exempt income on municipal securities.

## ASSET QUALITY

### Allowance for Loan Losses

The allowance for loan losses represents an amount that, in our judgment, will be adequate to absorb probable losses inherent in the loan portfolio. The provision for loan losses increases the allowance, and loans charged off, net of recoveries, reduce the allowance. Table 5 summarizes the allowance activity for the periods indicated:

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TABLE 5: Allowance for Loan Losses

| (Dollars in thousands)  | Three Months Ended June 30, |   |           |   |
|---|-----------------------------|---|-----------|---|
|   | 2017                        |   | 2016      |   |
| Allowance, beginning of period  | \$ 36,734                   |   | \$ 35,838 |   |
| Provision for loan losses:  |                             |   |           |   |
| Retail Banking segment  | 100                         |   | —         |   |
| Mortgage Banking segment  | —                           |   | —         |   |
| Consumer Finance segment  | 3,000                       |   | 3,600     |   |
| Total provision for loan losses   | 3,100                       |   | 3,600     |   |
| Loans charged off:  |                             |   |           |   |
| Real estate—residential mortgage  | (1)                         |   | (80)      |   |
| Commercial, financial and agricultural <sup>1</sup>   | (1)                         |   | —         |   |
| Consumer  | (68)                        |   | (60)      |   |
| Consumer finance  | (4,427)                     |   | (3,603)   |   |
| Total loans charged off   | (4,497)                     |   | (3,743)   |   |
| Recoveries of loans previously charged off:   |                             |   |           |   |
| Real estate—residential mortgage  | 24                          |   | 18        |   |
| Commercial, financial and agricultural <sup>1</sup>   | 4                           |   | 23        |   |
| Consumer  | 46                          |   | 37        |   |
| Consumer finance  | 1,085                       |   | 961       |   |
| Total recoveries  | 1,159                       |   | 1,039     |   |
| Net loans charged off   | (3,338)                     |   | (2,704)   |   |
| Allowance, end of period  | \$ 36,496                   |   | \$ 36,734 |   |
| Ratio of annualized net (recoveries) charge-offs to average total loans outstanding during period for Retail Banking <sup>2</sup> | —                           | % | 0.04      | % |
| Ratio of annualized net charge-offs to average total loans outstanding during period for Consumer Finance <sup>3</sup>            | 4.54                        | % | 3.60      | % |

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| (Dollars in thousands)   | Six Months Ended June 30, |   |           |   |
|--|---------------------------|---|-----------|---|
|  | 2017                      |   | 2016      |   |
| Allowance, beginning of period   | \$ 37,066                 |   | \$ 35,569 |   |
| Provision for loan losses:   |                           |   |           |   |
| Retail Banking segment   | 200                       |   | —         |   |
| Mortgage Banking segment   | —                         |   | —         |   |
| Consumer Finance segment   | 7,300                     |   | 8,200     |   |
| Total provision for loan losses  | 7,500                     |   | 8,200     |   |
| Loans charged off:   |                           |   |           |   |
| Real estate—residential mortgage   | (6)                       |   | (80)      |   |
| Commercial, financial and agricultural <sup>1</sup>  | (154)                     |   | (35)      |   |
| Equity lines   | —                         |   | (55)      |   |
| Consumer   | (130)                     |   | (131)     |   |
| Consumer finance   | (10,105)                  |   | (9,204)   |   |
| Total loans charged off  | (10,395)                  |   | (9,505)   |   |
| Recoveries of loans previously charged off:  |                           |   |           |   |
| Real estate—residential mortgage   | 38                        |   | 44        |   |
| Commercial, financial and agricultural <sup>1</sup>  | 11                        |   | 183       |   |
| Consumer   | 87                        |   | 164       |   |
| Consumer finance   | 2,189                     |   | 2,079     |   |
| Total recoveries   | 2,325                     |   | 2,470     |   |
| Net loans charged off  | (8,070)                   |   | (7,035)   |   |
| Allowance, end of period   | \$ 36,496                 |   | \$ 36,734 |   |
| Ratio of annualized net charge-offs (recoveries) to average total loans outstanding during period for Retail Banking | 0.04                      | % | (0.03)    | % |
| Ratio of net charge-offs to average total loans outstanding during period for Consumer Finance <sup>3</sup>          | 5.34                      | % | 4.88      | % |

<sup>1</sup>Includes the Corporation's commercial real estate lending, land acquisition and development lending, builder line lending and commercial business lending.

<sup>2</sup>The ratio of annualized net recoveries to average total loans outstanding during the second quarter of 2017 was less than one basis point for the Retail Banking segment.

<sup>3</sup>The consumer finance loan portfolio purchased during the second quarter of 2015 had the effect of decreasing the annualized net charge-off ratio by four basis points for the three months ended June 30, 2017 and increasing the annualized net charge-off ratio by 11 basis points for the six months ended June 30, 2017, and increasing the annualized net charge-off ratio by 35 basis points and 45 basis points for the three and six months ended June 30, 2016, respectively.



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Table 6 presents the allocation of the allowance for loan losses at June 30, 2017 and December 31, 2016.

TABLE 6: Allocation of Allowance for Loan Losses

| (Dollars in thousands)                    | June 30,<br>2017 |   | December 31,<br>2016 |   |
|---|------------------|---|----------------------|---|
| Allocation of allowance for loan losses:  |                  |   |                      |   |
| Real estate—residential mortgage          | \$ 2,547         |   | \$ 2,559             |   |
| Real estate—construction 1                | 451              |   | 816                  |   |
| Commercial, financial and agricultural 2  | 7,846            |   | 7,393                |   |
| Equity lines                              | 707              |   | 685                  |   |
| Consumer                                  | 209              |   | 261                  |   |
| Consumer finance                          | 24,736           |   | 25,352               |   |
| Total allowance for loan losses           | \$ 36,496        |   | \$ 37,066            |   |
| Ratio of loans to total period-end loans: |                  |   |                      |   |
| Real estate—residential mortgage          | 20               | % | 19                   | % |
| Real estate—construction 1                | 3                |   | 6                    |   |
| Commercial, financial and agricultural 2  | 42               |   | 39                   |   |
| Equity lines                              | 5                |   | 5                    |   |
| Consumer                                  | 1                |   | 1                    |   |
| Consumer finance                          | 29               |   | 30                   |   |
|   | 100              | % | 100                  | % |

<sup>1</sup> Includes the Corporation's real estate construction lending and consumer real estate lot lending.

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

## Credit Quality

Loans by credit quality indicators are presented in Table 7 below. The characteristics of these loan ratings are as follows:

Pass rated loans are to persons or business entities with an acceptable financial condition, appropriate collateral margins, appropriate cash flow to service the existing loan, and an appropriate leverage ratio. The borrower has paid all obligations as agreed and it is expected that this type of payment history will continue. When necessary, acceptable personal guarantors support the loan.

- Special mention loans have a specific, identified weakness in the borrower's operations and in the borrower's ability to generate positive cash flow on a sustained basis. The borrower's recent payment history is characterized by late payments. The Corporation's risk exposure is mitigated by collateral supporting the loan. The collateral is considered to be well-margined, well maintained, accessible and readily marketable.

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- Substandard loans are considered to have specific and well-defined weaknesses that jeopardize the viability of the Corporation's credit extension. The payment history for the loan has been inconsistent and the expected or projected primary repayment source may be inadequate to service the loan. The estimated net liquidation value of the collateral pledged and/or ability of the personal guarantor(s) to pay the loan may not adequately protect the Corporation. There is a distinct possibility that the Corporation will sustain some loss if the deficiencies associated with the loan are not corrected in the near term. A substandard loan would not automatically meet the Corporation's definition of impaired unless the loan is significantly past due and the borrower's performance and financial condition provide evidence that it is probable that the Corporation will be unable to collect all amounts due.
- Substandard nonaccrual loans have the same characteristics as substandard loans; however, they have a nonaccrual classification because it is probable that the Corporation will not be able to collect all amounts due.
- Doubtful rated loans have all the weaknesses inherent in a loan that is classified substandard but with the added characteristic that the weaknesses make collection or liquidation in full, on the basis of currently existing facts, conditions, and values, highly questionable and improbable. The possibility of loss is extremely high.
- Loss rated loans are not considered collectible under normal circumstances and there is no realistic expectation for any future payment on the loan. Loss rated loans are fully charged off.

TABLE 7: Credit Quality Indicators

Loans by credit quality indicators as of June 30, 2017 were as follows:

| (Dollars in thousands)                   | Pass       | Special<br>Mention | Substandard | Substandard<br>Nonaccrual | Total      |
|--|------------|--------------------|-------------|---------------------------|------------|
| Real estate – residential mortgage       | \$ 180,499 | \$ 1,990           | \$ 3,134    | \$ 1,329                  | \$ 186,952 |
| Real estate – construction 2             | 34,683     | —                  | —           | —                         | 34,683     |
| Commercial, financial and agricultural 3 | 386,537    | 4,088              | 18,265      | 6,559                     | 415,449    |
| Equity lines                             | 51,406     | 501                | 265         | 721                       | 52,893     |
| Consumer                                 | 12,003     | —                  | 330         | 1                         | 12,334     |
|  | \$ 665,128 | \$ 6,579           | \$ 21,994   | \$ 8,610                  | \$ 702,311 |

| (Dollars in thousands) | Performing | Non-<br>Performing | Total |
|------------------------|------------|--------------------|-------|
|------------------------|------------|--------------------|-------|



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|                  |            |        |            |
|------------------|------------|--------|------------|
| Consumer finance | \$ 290,760 | \$ 497 | \$ 291,257 |
|------------------|------------|--------|------------|

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<sup>1</sup> At June 30, 2017, the Corporation did not have any loans classified as Doubtful or Loss.

<sup>2</sup> Includes the Corporation's real estate construction lending and consumer real estate lot lending.

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

Included in the table above are loans purchased in connection with the 2013 acquisition of CVB of \$49.1 million pass rated, \$2.5 million special mention, \$2.6 million substandard and \$2.0 million substandard nonaccrual.

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Loans by credit quality indicators as of December 31, 2016 were as follows:

| (Dollars in thousands)                              | Pass       | Special<br>Mention | Substandard | Substandard<br>Nonaccrual | Total      |
|---|------------|--------------------|-------------|---------------------------|------------|
| Real estate – residential mortgage                  | \$ 181,814 | \$ 2,037           | \$ 2,761    | \$ 1,652                  | \$ 188,264 |
| Real estate – construction <sup>2</sup>             | 55,732     | —                  | —           | —                         | 55,732     |
| Commercial, financial and agricultural <sup>3</sup> | 356,301    | 7,469              | 24,868      | 1,750                     | 390,388    |
| Equity lines  | 51,186     | 480                | 177         | 757                       | 52,600     |
| Consumer  | 7,870      | 2                  | 409         | 118                       | 8,399      |
|   | \$ 652,903 | \$ 9,988           | \$ 28,215   | \$ 4,277                  | \$ 695,383 |

| (Dollars in thousands) | Performing | Non-<br>Performing | Total      |
|------------------------|------------|--------------------|------------|
| Consumer finance       | \$ 301,280 | \$ 565             | \$ 301,845 |

<sup>1</sup> At December 31, 2016, the Corporation did not have any loans classified as Doubtful or Loss.

<sup>2</sup> Includes the Corporation's real estate construction lending and consumer real estate lot lending.

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

Included in the table above are loans purchased in connection with the 2013 acquisition of CVB of \$54.1 million pass rated, \$2.6 million special mention, \$5.7 million substandard and \$196,000 substandard nonaccrual.

The Retail Banking segment's allowance for loan losses as of June 30, 2017 increased \$46,000 since December 31, 2016 as a result of a \$200,000 provision for loan losses during the first half of 2017 because of an increase in specific reserves related to nonaccrual loans as discussed below, which was offset in part by net charge-offs. The ratio of the allowance for loan losses to total loans, excluding purchased credit impaired loans, declined to 1.61 percent at June 30, 2017, compared to 1.63 percent at December 31, 2016 because of loan growth during the first half of 2017. We believe that the current level of the allowance for loan losses at the Retail Banking segment is adequate to absorb probable losses inherent in the loan portfolio, based on the relevant history of charge-offs and recoveries, current economic conditions, overall portfolio quality and review of specifically criticized loans. If loan concentrations within the Retail Banking segment's loan portfolio result in higher credit risk or if economic conditions deteriorate in future periods, a higher level of nonperforming loans may be experienced, which may then require a higher provision for

loan losses.

The Consumer Finance segment's allowance for loan losses decreased \$616,000 to \$24.7 million at June 30, 2017 from \$25.4 million at December 31, 2016, and its provision for loan losses decreased \$900,000 for the first half of 2017, compared to the same period in 2016. The decrease in the allowance and the lower provision resulted from declines in (1) outstanding loans and (2) delinquent loans as a percentage of total loans to 4.40 percent at June 30, 2017 from 5.15 percent at December 31, 2016 and from 4.51 percent at June 30, 2016. The annualized net charge-off ratio for the first half of 2017 increased to 5.34 percent from 4.88 percent for the first half of 2016 because of the higher level of charge-offs during 2017 resulting from the lower resale value of repossessed automobiles. The allowance for loan losses as a percentage of loans increased to 8.49 percent at June 30, 2017, from 8.40 percent at December 31, 2016. We believe that the current level of the allowance for loan losses at the Consumer Finance segment is adequate to absorb probable losses inherent in the loan portfolio.

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## Nonperforming Assets

Table 8 summarizes nonperforming assets at June 30, 2017 and December 31, 2016.

TABLE 8: Nonperforming Assets

## Retail Banking Segment

| (Dollars in thousands)   | June 30,<br>2017 | December 31,<br>2016 |        |   |
|--|------------------|----------------------|--------|---|
| Loans, excluding purchased loans   | \$ 642,545       | \$ 629,523           |        |   |
| Purchased performing loans <sup>1</sup>                                    | 49,485           | 53,329               |        |   |
| Purchased credit impaired loans <sup>1</sup>                               | 6,742            | 9,256                |        |   |
| Total loans  | \$ 698,772       | \$ 692,108           |        |   |
| Nonaccrual loans   | \$ 6,535         | \$ 4,039             |        |   |
| Purchased performing-nonaccrual loans <sup>2</sup>                         | 2,035            | 196                  |        |   |
| Total nonaccrual loans <sup>3</sup>  | 8,570            | 4,235                |        |   |
| OREO <sup>4</sup>  | 284              | 195                  |        |   |
| Total nonperforming assets <sup>5</sup>                                    | \$ 8,854         | \$ 4,430             |        |   |
| Accruing loans past due for 90 days or more <sup>6</sup>                   | \$ 211           | \$ 6                 |        |   |
| Troubled debt restructurings (TDRs) <sup>3</sup>                           | \$ 9,163         | \$ 4,964             |        |   |
| Purchased performing TDRs <sup>7</sup>                                     | \$ 2,702         | \$ 861               |        |   |
| Allowance for loan losses (ALL)  | \$ 11,161        | \$ 11,115            |        |   |
| Nonperforming assets to total loans and OREO                               | 1.27             | %                    | 0.64   | % |
| ALL to total loans, excluding purchased credit impaired loans <sup>8</sup> | 1.61             |                      | 1.63   |   |
| ALL to total nonaccrual loans  | 130.23           |                      | 262.46 |   |

<sup>1</sup> The loans acquired from CVB are tracked in two separate categories – “purchased performing” and “purchased credit impaired.” The remaining discount for the purchased performing loans was \$2.6 million at June 30, 2017 and \$2.9 million at December 31, 2016. The remaining discount for the purchased credit impaired loans was \$9.9 million at June 30, 2017 and \$10.5 million at December 31, 2016.

<sup>2</sup> Purchased performing-nonaccrual loans are presented net of the remaining interest and credit marks totaling \$188,000 at June 30, 2017 and \$137,000 at December 31, 2016.

<sup>3</sup>

Nonaccrual loans include nonaccrual TDRs of \$6.6 million at June 30, 2017 and \$2.0 million at December 31, 2016.

- <sup>4</sup> OREO is recorded at its estimated fair value less cost to sell.
- <sup>5</sup> As required by acquisition accounting, purchased credit impaired loans that were considered nonaccrual and TDRs prior to the acquisition lose these designations and are not included in post-acquisition nonperforming assets as presented in this table.
- <sup>6</sup> Accruing loans past due for 90 days or more include purchased credit impaired loans of \$188,000 as of June 30, 2017 and \$0 as of December 31, 2016.
- <sup>7</sup> Purchased performing TDRs are presented net of the remaining interest and credit marks totaling \$51 for nonaccrual TDRs and \$9 for accruing TDRs at June 30, 2017 and \$11 for accruing TDRs at December 31, 2016.
- <sup>8</sup> For the purpose of calculating this ratio, purchased performing loans are included in total loans. Purchased performing loans were marked to fair value on acquisition date; therefore, no allowance for loan losses was recorded at the acquisition date for these loans.

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## Mortgage Banking Segment

| (Dollars in thousands)          | June 30,<br>2017 |   | December 31,<br>2016 |   |
|---------------------------------|------------------|---|----------------------|---|
| Nonaccrual loans                | \$ 40            |   | \$ 41                |   |
| Total loans                     | \$ 3,539         |   | \$ 3,275             |   |
| ALL                             | \$ 598           |   | \$ 598               |   |
| Nonaccrual loans to total loans | 1.13             | % | 1.25                 | % |
| ALL to loans                    | 16.90            |   | 18.26                |   |
| ALL to nonaccrual loans         | 1,495.00         |   | 1,458.54             |   |

## Consumer Finance Segment

| (Dollars in thousands)  | June 30,<br>2017 |   | December 31,<br>2016 |   |
|---|------------------|---|----------------------|---|
| Nonaccrual loans  | \$ 497           |   | \$ 565               |   |
| Accruing loans past due for 90 days or more                       | \$ —             |   | \$ —                 |   |
| Total loans   | \$ 291,257       |   | \$ 301,845           |   |
| ALL   | \$ 24,737        |   | \$ 25,353            |   |
| Nonaccrual consumer finance loans to total consumer finance loans | 0.17             | % | 0.19                 | % |
| ALL to total consumer finance loans <sup>1</sup>                  | 8.49             |   | 8.40                 |   |

<sup>1</sup> The Consumer Finance loan portfolio purchased during the second quarter of 2015 had the effect of decreasing the allowance to total loans ratio by nine basis points at June 30, 2017 and 14 basis points at December 31, 2016.

Nonperforming assets of the Retail Banking segment totaled \$8.9 million at June 30, 2017, compared to \$4.4 million at December 31, 2016. The Retail Banking segment's nonperforming assets included \$8.6 million of nonaccrual loans at June 30, 2017, compared to \$4.2 million at December 31, 2016, and \$284,000 of OREO at June 30, 2017, compared to \$195,000 at December 31, 2016. The increase in nonaccrual loans was due primarily to two commercial relationships totaling \$6.5 million, which were classified as nonaccrual in the first quarter of 2017. Both of these relationships have been restructured in 2017, are reported in troubled debt restructurings (TDR) at June 30, 2017 and were previously classified as substandard loans. Reserves have also been established, which management believes are adequate to absorb probable losses on these loans. The OREO increase during the first half of 2017 was primarily due to the transfer of two residential properties to OREO, which was partially offset by OREO sales during the same period.

We believe we have provided adequate loan loss reserves at the Retail Banking segment based on our evaluations of the collectability of loans, which considers trends in delinquencies and charge-offs, changes in the nature and volume of the loan portfolio, current economic conditions that may affect borrowers' ability to repay and collateral values, overall portfolio quality and review of specific potential losses.

Nonaccrual loans at the Consumer Finance segment were \$497,000 at June 30, 2017, compared to \$565,000 at December 31, 2016. Nonaccrual consumer finance loans remain relatively low compared to the allowance for loan losses and the total consumer finance loan portfolio because the Consumer Finance segment generally initiates repossession of loan collateral once a loan is 60 days or more past due but before the loan reaches 90 days or more past due and is evaluated for nonaccrual status. Repossessed assets at June 30, 2017 were \$2.2 million, compared to \$3.1 million at December 31, 2016 and \$2.5 million at June 30, 2016.

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## Impaired 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 maintain a valuation allowance to the extent that the measure of the impaired loan is less than the recorded investment. TDRs occur when we agree to significantly modify the original terms of a loan by granting a concession due to the deterioration in the financial condition of the borrower. These concessions typically are made for loss mitigation purposes and could include reductions in the interest rate, payment extensions, forgiveness of principal, forbearance or other actions. TDRs are considered impaired loans.

TABLE 9: Impaired Loans

Impaired loans, which consisted solely of TDRs, and the related allowance at June 30, 2017, were as follows:

|  | Unpaid<br>Principal<br>Balance | Recorded<br>Investment<br>in Loans<br>without<br>Specific<br>Reserve | Recorded<br>Investment<br>in Loans<br>with<br>Specific<br>Reserve | Related<br>Allowance | Average<br>Balance-<br>Impaired<br>Loans | Interest<br>Income<br>Recognized |
|--|--------------------------------|--|---|----------------------|--|----------------------------------|
| (Dollars in thousands)                     |                                |  |   |                      |  |                                  |
| Real estate – residential mortgage         | \$ 3,504                       | \$ 1,257   | \$ 2,137  | \$ 304               | \$ 3,479                                 | \$ 87                            |
| Commercial, financial and<br>agricultural: |                                |  |   |                      |  |                                  |
| Commercial real estate lending             | 8,190                          | 1,065  | 6,932   | 963                  | 8,207                                    | 42                               |
| Commercial business lending                | 123                            | 60   | 61  | 33                   | 128                                      | 2                                |
| Equity lines                               | 32                             | —  | 31  | 31                   | 32                                       | 1                                |
| Consumer                                   | 321                            | —  | 322   | 3                    | 321                                      | 6                                |
| Total                                      | \$ 12,170                      | \$ 2,382   | \$ 9,483  | \$ 1,334             | \$ 12,167                                | \$ 138                           |

Impaired loans, which consisted solely of TDRs, and the related allowance at December 31, 2016, were as follows:



|  | Unpaid<br>Principal | Recorded<br>Investment<br>in Loans<br>without<br>Specific<br>Reserve | Recorded<br>Investment<br>in Loans<br>with<br>Specific<br>Reserve | Related<br>Allowance | Average<br>Balance-<br>Impaired<br>Loans | Interest<br>Income<br>Recognized |
|--|---------------------|--|---|----------------------|--|----------------------------------|
| (Dollars in thousands)                     | Balance             |  |   |                      |  |                                  |
| Real estate – residential mortgage         | \$ 3,539            | \$ 1,676   | \$ 1,732  | \$ 251               | \$ 3,446                                 | \$ 122                           |
| Commercial, financial and<br>agricultural: |                     |  |   |                      |  |                                  |
| Commercial real estate lending             | 1,967               | 430  | 1,272   | 261                  | 1,746                                    | 29                               |
| Commercial business lending                | 167                 | 89   | 74  | 46                   | 181                                      | 8                                |
| Equity lines                               | 32                  | 32   | —   | —                    | 32                                       | 1                                |
| Consumer                                   | 520                 | —  | 520   | 94                   | 521                                      | 8                                |
| Total                                      | \$ 6,225            | \$ 2,227   | \$ 3,598  | \$ 652               | \$ 5,926                                 | \$ 168                           |

TDRs at June 30, 2017 and December 31, 2016 were as follows:

TABLE 10: Troubled Debt Restructurings

|                              | June 30,<br>2017 | December 31,<br>2016 |
|------------------------------|------------------|----------------------|
| (Dollars in thousands)       |                  |                      |
| Accruing TDRs                | \$ 5,267         | \$ 3,851             |
| Nonaccrual TDRs <sup>1</sup> | 6,598            | 1,974                |
| Total TDRs <sup>2</sup>      | \$ 11,865        | \$ 5,825             |

<sup>1</sup> Included in nonaccrual loans in Table 8: Nonperforming Assets.

<sup>2</sup> Included in impaired loans in Table 9: Impaired Loans.

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While TDRs are considered impaired loans, not all TDRs are on nonaccrual status. If a loan was on nonaccrual status at the time of the TDR modification, the loan will remain on nonaccrual status following the modification and may be returned to accrual status based on the Corporation's policy for returning loans to accrual status. If a loan was accruing prior to being modified as a TDR and if management concludes that the borrower is able to make such modified payments, and there are no other factors or circumstances that would cause management to conclude otherwise, the TDR will remain on an accruing status.

## FINANCIAL CONDITION

At June 30, 2017, the Corporation had total assets of \$1.5 billion, which was an increase of \$12.1 million since December 31, 2016. The increase resulted primarily from deposit growth, which funded a \$3.0 million increase in investment securities and contributed to excess liquidity because of decreases of \$4.7 million in loans held for sale and \$3.1 million in loans held for investment.

## 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 loans held for investment at the dates indicated.

TABLE 11: Summary of Loans Held for Investment

| (Dollars in thousands)                    | June 30, 2017 |         |   | December 31, 2016 |         |   |
|---|---------------|---------|---|-------------------|---------|---|
|   | Amount        | Percent |   | Amount            | Percent |   |
| Real estate—residential mortgage          | \$ 186,952    | 20      | % | \$ 188,264        | 19      | % |
| Real estate—construction 1                | 34,683        | 3       |   | 55,732            | 6       |   |
| Commercial, financial, and agricultural 2 | 415,449       | 42      |   | 390,388           | 39      |   |
| Equity lines                              | 52,893        | 5       |   | 52,600            | 5       |   |
| Consumer                                  | 12,334        | 1       |   | 8,399             | 1       |   |
| Consumer finance                          | 291,257       | 29      |   | 301,845           | 30      |   |
| Total loans                               | 993,568       | 100     | % | 997,228           | 100     | % |
| Less allowance for loan losses            | (36,496)      |         |   | (37,066)          |         |   |
| Total loans, net                          | \$ 957,072    |         |   | \$ 960,162        |         |   |

<sup>1</sup> Includes the Corporation's real estate construction lending and consumer real estate lot lending.

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

#### Investment Securities

The investment portfolio plays a primary role in the management of the Corporation's interest rate sensitivity. In addition, the portfolio serves as a source of liquidity and is used as needed to meet collateral requirements. The investment portfolio consists of securities available for sale, which may be sold in response to changes in market interest rates, changes in prepayment risk, increases in loan demand, general liquidity needs and other similar factors. These securities are carried at estimated fair value. At June 30, 2017 and December 31, 2016, all securities in the Corporation's investment portfolio were classified as available for sale.

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

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TABLE 12: Securities Available for Sale

| (Dollars in thousands)                            | June 30, 2017 |         | December 31, 2016 |         |  |
|---|---------------|---------|-------------------|---------|--|
|   | Amount        | Percent | Amount            | Percent |  |
| U.S. government agencies and corporations         | \$ 16,742     | 7 %     | \$ 16,112         | 8 %     |  |
| Mortgage-backed securities                        | 84,298        | 40      | 76,816            | 36      |  |
| Obligations of states and political subdivisions  | 111,996       | 53      | 117,098           | 56      |  |
| Total available for sale securities at fair value | \$ 213,036    | 100 %   | \$ 210,026        | 100 %   |  |

For more information about the Corporation's securities available for sale, including a description of securities in an unrealized loss position at June 30, 2017 and December 31, 2016, see Part I, Item 1, "Financial Statements" under the heading "Note 2: Securities" in this Quarterly Report on Form 10-Q.

## Deposits

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

During the first half of 2017, deposits increased \$8.3 million to \$1.13 billion at June 30, 2017, compared to \$1.12 billion at December 31, 2016. This increase resulted primarily from a \$21.0 million increase in non-interest bearing demand deposits and a \$4.2 million increase in time deposits. Partially offsetting these increases was a \$16.9 million decrease in savings and interest-bearing demand deposits resulting primarily from the cyclical decline in municipal deposits.

The Corporation had \$2.4 million in brokered money market deposits outstanding at June 30, 2017. The source of these brokered deposits is uninvested cash balances held in third-party brokerage sweep accounts. The Corporation uses brokered deposits as a means of diversifying liquidity sources, as opposed to a long-term deposit gathering strategy.

## Borrowings

Borrowings increased to \$165.5 million at June 30, 2017 from \$164.6 million at December 31, 2016 as a result of repurchase arrangements with commercial deposit customers.

#### Off-Balance Sheet Arrangements

As of June 30, 2017, there have been no material changes to the off-balance sheet arrangements disclosed in Part II, Item 7, "Management's Discussion and Analysis," under the heading "Off-Balance-Sheet Arrangements" in the Corporation's Annual Report on Form 10-K for the year ended December 31, 2016.

#### Contractual Obligations

As of June 30, 2017, there have been no material changes outside the ordinary course of business to the contractual obligations disclosed in Part II, Item 7, "Management's Discussion and Analysis," under the heading "Contractual Obligations" in the Corporation's Annual Report on Form 10-K for the year ended December 31, 2016.

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The Corporation uses derivatives to manage exposure to interest rate risk through the use of interest rate swaps. Interest rate swaps involve the exchange of fixed and variable rate interest payments between two parties, based on a common notional principal amount and maturity date with no exchange of underlying principal amounts.

The Corporation has interest rate swaps that qualify as cash flow hedges. The Corporation's cash flow hedges effectively modify the Corporation's exposure to interest rate risk by converting variable rates of interest on \$15.0 million and \$10.0 million of the Corporation's trust preferred capital notes to fixed rates of interest until December 2019 and September 2020, respectively. The cash flow hedges' total notional amount is \$25.0 million. At June 30, 2017, the cash flow hedges had a fair value of (\$59,000), which is recorded in other liabilities. The cash flow hedges were fully effective at June 30, 2017. Therefore, the net gain on cash flow hedges was recognized as a component of other comprehensive income, net of deferred income taxes.

Pursuant to a program the Corporation initiated during 2016, the Corporation also enters into interest rate swaps with certain qualifying commercial loan customers to meet their interest rate risk management needs. The Corporation simultaneously enters into interest rate swaps with dealer counterparties, with identical notional amounts and terms. The net result of these interest rate swaps is that the customer pays a fixed rate of interest and the Corporation receives a floating rate. The total notional amount of the interest rate swaps on loans is \$64.1 million. At June 30, 2017, the interest rate swaps had a net fair value of zero, with \$941,000 recognized in other assets and \$941,000 recognized in other liabilities. These swaps are not designated as hedging instruments; therefore, changes in fair values are recorded in other noninterest expense.

## Liquidity

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

Liquid assets, which include cash and due from banks, interest-bearing deposits at other banks and nonpledged securities available for sale, totaled \$227.3 million at June 30, 2017, compared to \$199.1 million at December 31, 2016. The increase since December 31, 2016 is primarily the result of growth in deposits in excess of loan funding needs. The Corporation's funding sources at June 30, 2017 are presented in Table 13.

TABLE 13: Funding Sources

| (Dollars in thousands)               | June 30, 2017 |             |            |
|--------------------------------------|---------------|-------------|------------|
|                                      | Capacity      | Outstanding | Available  |
| Unsecured federal funds agreements   | \$ 65,000     | \$ —        | \$ 65,000  |
| Repurchase agreements                | 5,000         | 5,000       | —          |
| Repurchase lines of credit           | 50,000        | —           | 50,000     |
| Borrowings from FHLB                 | 139,393       | 47,000      | 92,393     |
| Borrowings from Federal Reserve Bank | 13,490        | —           | 13,490     |
| Revolving line of credit             | 120,000       | 75,029      | 44,971     |
| Total                                | \$ 392,883    | \$ 127,029  | \$ 265,854 |

We have no reason to believe these arrangements will not be renewed at maturity. Additional loans and securities are available that can be pledged as collateral for future borrowings from the Federal Reserve Bank or the FHLB above the current lendable collateral value. Our ability to maintain sufficient liquidity may be affected by numerous factors, including economic conditions nationally and in our markets. Depending on our liquidity levels, our capital position, conditions in the capital markets, our business operations and initiatives, and other factors, we may from time to time consider the issuance of debt, equity or other securities or other possible capital market transactions, the proceeds of which could provide additional liquidity for our operations.

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

## Capital Resources

The Corporation's and the Bank's actual regulatory capital amounts and ratios under currently applicable regulatory capital standards are presented in the following table.

| (Dollars in thousands)                                 | Actual     |        | Minimum Capital Requirements |       | Minimum To Be Well Capitalized Under Prompt Corrective Action Provisions |        |
|--|------------|--------|------------------------------|-------|--|--------|
|  | Amount     | Ratio  | Amount                       | Ratio | Amount   | Ratio  |
| As of June 30, 2017:                                   |            |        |                              |       |  |        |
| Total Capital (to Risk-Weighted Assets)                |            |        |                              |       |  |        |
| Corporation  | \$ 167,897 | 14.8 % | \$ 90,913                    | 8.0 % | N/A  | N/A    |
| C&F Bank   | 169,235    | 14.8   | 91,210                       | 8.0   | \$ 114,013   | 10.0 % |
| Tier 1 Capital (to Risk-Weighted Assets)               |            |        |                              |       |  |        |
| Corporation  | 153,360    | 13.5   | 68,184                       | 6.0   | N/A  | N/A    |
| C&F Bank   | 154,708    | 13.6   | 68,408                       | 6.0   | 91,210   | 8.0    |
| Common Equity Tier 1 Capital (to Risk-Weighted Assets) |            |        |                              |       |  |        |
| Corporation  | 128,493    | 11.3   | 51,138                       | 4.5   | N/A  | N/A    |
| C&F Bank   | 154,708    | 13.6   | 51,306                       | 4.5   | 74,108   | 6.5    |
| Tier 1 Capital (to Average Assets)                     |            |        |                              |       |  |        |
| Corporation  | 153,360    | 10.7   | 57,475                       | 4.0   | N/A  | N/A    |
| C&F Bank   | 154,708    | 10.8   | 57,522                       | 4.0   | 71,903   | 5.0    |
| As of December 31, 2016:                               |            |        |                              |       |  |        |
| Total Capital (to Risk-Weighted Assets)                |            |        |                              |       |  |        |
| Corporation  | \$ 159,525 | 13.9 % | \$ 91,695                    | 8.0 % | N/A  | N/A    |
| C&F Bank   | 160,971    | 14.0   | 91,772                       | 8.0   | \$ 114,716   | 10.0 % |
| Tier 1 Capital (to Risk-Weighted Assets)               |            |        |                              |       |  |        |
| Corporation  | 144,819    | 12.6   | 68,772                       | 6.0   | N/A  | N/A    |
| C&F Bank   | 146,307    | 12.8   | 68,829                       | 6.0   | 91,772   | 8.0    |



|  |         |      |        |     |        |     |
|--|---------|------|--------|-----|--------|-----|
| Common Equity Tier 1 Capital (to Risk-Weighted Assets) |         |      |        |     |        |     |
| Corporation  | 120,085 | 10.5 | 51,579 | 4.5 | N/A    | N/A |
| C&F Bank   | 146,307 | 12.8 | 51,622 | 4.5 | 74,565 | 6.5 |
| Tier 1 Capital (to Average Tangible Assets)            |         |      |        |     |        |     |
| Corporation  | 144,819 | 10.3 | 56,463 | 4.0 | N/A    | N/A |
| C&F Bank   | 146,307 | 10.2 | 57,097 | 4.0 | 71,371 | 5.0 |

The regulatory risk-based capital amounts presented above include: (1) common equity tier 1 capital (CET1) which consists principally of common stock (including surplus) and retained earnings with adjustments for goodwill, intangible assets and deferred tax assets; (2) Tier 1 capital which consists principally of CET1 plus the Corporation's "grandfathered" trust preferred securities; and (3) Tier 2 capital which consists principally of Tier 1 capital plus a limited amount of the allowance for loan losses. In addition, the Corporation has made the one-time irrevocable election to continue treating accumulated other comprehensive income (AOCI) under regulatory standards that were in place prior to the Basel III Final Rule in order to eliminate volatility of regulatory capital that can result from fluctuations in AOCI and the inclusion of

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AOCI in regulatory capital, as would otherwise be required under the Basel III Capital Rule. For additional information about the Basel III Final Rules, see “Item 1. Business” under the heading “Regulation and Supervision” and “Item 8. Financial Statements and Supplementary Data,” under the heading “Note 15: Regulatory Requirements and Restrictions” in the Corporation's Annual Report on Form 10-K for the year ended December 31, 2016.

In addition to the regulatory risk-based capital amounts presented above, the Corporation and the Bank must maintain a capital conservation buffer of additional total capital and CET1 as required by the Basel III Final Rule. The buffer began applying to the Corporation and the Bank on January 1, 2016, and is subject to phase-in from 2016 to 2019 in equal annual installments of 0.625%. Accordingly, at June 30, 2017, the Corporation and the Bank were required to maintain a capital conservation buffer of 1.25%. At June 30, 2017, the Corporation exceeded the total capital conservation buffer by 552 basis points, and the Bank exceeded the total capital conservation buffer by 559 basis points. Also at June 30, 2017, the Corporation and the Bank exceeded the CET1 capital conservation buffer by 556 basis points and 782 basis points, respectively.

The Corporation's capital resources may be further affected by the Corporation's Repurchase Program, which was reauthorized by the Corporation's Board of Directors during the second quarter of 2017. Under this program the Corporation is authorized to purchase up to \$5.0 million of its common stock. Repurchases under the program may be made through privately-negotiated transactions or open-market transactions, and shares repurchased will be returned to the status of authorized and unissued shares of common stock. The timing, number and purchase price of shares repurchased under the program will be determined by management in its discretion and will depend on a number of factors, including the market price of the shares, general market and economic conditions, applicable legal requirements and other conditions. The Repurchase Program is authorized through May 2018. As of June 30, 2017, \$5.0 million of the Corporation's common stock may be purchased under the Corporation's share repurchase program.

Effects of Inflation and Changing Prices

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

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

There have been no significant changes from the quantitative and qualitative disclosures about market risk made in the Corporation's Annual Report on Form 10-K for the year ended December 31, 2016.

#### ITEM 4.CONTROLS AND PROCEDURES

The Corporation's management, including the Corporation's Chief Executive Officer and the Chief Financial Officer, has evaluated the effectiveness of the Corporation's disclosure controls and procedures (as defined in Rule 13a-15(e) under the Securities Exchange Act of 1934, as amended (the Exchange Act) as of the end of the period covered by this report. Based on that evaluation, the Chief Executive Officer and the Chief Financial Officer have concluded that the Corporation's disclosure controls and procedures were effective as of June 30, 2017 to ensure that information required to be disclosed by the Corporation in reports that it files or submits under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in SEC rules and forms and that such information is accumulated and communicated to the Corporation's management, including the Corporation's Chief Executive Officer and Chief Financial Officer, as appropriate to allow timely decisions regarding required disclosure. Because of the inherent

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limitations in all control systems, no evaluation of controls can provide absolute assurance that the Corporation's disclosure controls and procedures will detect or uncover every situation involving the failure of persons within the Corporation or its subsidiary to disclose material information required to be set forth in the Corporation's periodic reports.

Management of the Corporation is also responsible for establishing and maintaining adequate internal control over financial reporting (as defined in Rule 13a-15(f) under the Exchange Act). There were no changes in the Corporation's internal control over financial reporting during the Corporation's second quarter ended June 30, 2017 that have materially affected, or are reasonably likely to materially affect, the Corporation's internal control over financial reporting.

PART II – OTHER INFORMATION

ITEM 1A.RISK FACTORS

There have been no material changes in the risk factors faced by the Corporation from those disclosed in the Corporation's Annual Report on Form 10-K for the year ended December 31, 2016.

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

Issuer Purchases of Equity Securities

As previously described, the Corporation has a Repurchase Program that was authorized through May 2018. As of June 30, 2017, \$5.0 million of the Corporation's common stock, which is the total amount authorized, may be purchased under the Repurchase Program.

There were no purchases of the Corporation's common stock during the three months ended June 30, 2017.



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ITEM 6.EXHIBITS

- 2.1 Agreement and Plan of Merger dated as of June 10, 2013 by and among C&F Financial Corporation, Special Purpose Sub, Inc. and Central Virginia Bankshares, Inc. (incorporated by reference to Exhibit 2.1 to Form 8-K filed June 14, 2013)
- 3.1 Articles of Incorporation of C&F Financial Corporation (incorporated by reference to Exhibit 3.1 to Form 10-KSB filed March 29, 1996)
- 3.1.1 Amendment to Articles of Incorporation of C&F Financial Corporation (incorporated by reference to Exhibit 3.1.1 to Form 8-K filed January 14, 2009)
- 3.2 Amended and Restated Bylaws of C&F Financial Corporation, as adopted February 23, 2016 (incorporated by reference to Exhibit 3.1 to Form 8-K filed February 29, 2016)
- 10.19.6 Sixth Amendment to Amended and Restated Loan and Security Agreement by and among Wells Fargo Bank, N.A., various financial institutions and C&F Finance Company dated as of June 28, 2017.
- 31.1 Certification of CEO pursuant to Rule 13a-14(a)
- 31.2 Certification of CFO pursuant to Rule 13a-14(a)
- 32 Certification of CEO/CFO pursuant to 18 U.S.C. Section 1350
- 101.INS XBRL Instance Document
- 101.SCH XBRL Taxonomy Extension Schema Document
- 101.CAL XBRL Taxonomy Extension Calculation Linkbase Document
- 101.DEF XBRL Taxonomy Extension Definition Linkbase Document
- 101.LAB XBRL Taxonomy Extension Label Linkbase Document
- 101.PRE XBRL Taxonomy Presentation Linkbase Document

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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  
(Registrant)

Date: August 8, 2017    By: /s/ Larry G. Dillon  
Larry G. Dillon  
Chairman and Chief Executive Officer  
(Principal Executive Officer)

Date: August 8, 2017    /s/ Jason E. Long  
Jason E. Long  
Senior Vice President and Chief Financial Officer  
(Principal Financial and Accounting Officer)