

C & F FINANCIAL CORP
Form 10-K
March 09, 2007
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K

(Mark One)

Annual Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
For the fiscal year ended December 31, 2006

or

Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
For the transition period from _____ to _____

Commission file number 000-23423

C&F FINANCIAL CORPORATION

(Exact name of registrant as specified in its charter)

Virginia
(State or other jurisdiction of
incorporation or organization)

802 Main Street

West Point, VA 23181

(Address of principal executive offices) (Zip Code)

54-1680165
(I.R.S. Employer
Identification No.)

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

Securities registered pursuant to Section 12(b) of the Act:

Common Stock, \$1.00 par value per share

Title of each class

The NASDAQ Stock Market LLC

Name of each exchange on which registered

Securities registered pursuant to Section 12(g) of the Act:

NONE

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes No

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 if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer Accelerated Filer Non-accelerated filer

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

The aggregate market value of voting and non-voting common stock held by non-affiliates of the registrant as of June 30, 2006 was \$117,063,726.

There were 3,188,111 shares of common stock outstanding as of February 26, 2007.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the definitive Proxy Statement dated March 15, 2007 to be delivered to shareholders in connection with the Annual Meeting of Shareholders to be held April 17, 2007, are incorporated by reference in Part III of this report.

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PART I

ITEM 1. BUSINESS

General

C&F Financial Corporation (the Corporation) is a bank holding company that was incorporated in March 1994 under the laws of the Commonwealth of Virginia. The Corporation owns all of the stock of its sole operating subsidiary, C&F Bank (Citizens and Farmers Bank, or the Bank), which is an independent commercial bank chartered under the laws of the Commonwealth of Virginia. The Bank originally opened for business under the name Farmers and Mechanics Bank on January 22, 1927. The Bank has the following five wholly-owned subsidiaries, all incorporated under the laws of the Commonwealth of Virginia:

C&F Mortgage Corporation and its wholly-owned subsidiaries Hometown Settlement Services LLC, Certified Appraisals LLC, Foundation Home Mortgage and C&F Reinsurance LTD

C&F Finance Company

C&F Investment Services, Inc.

C&F Insurance Services, Inc.

C&F Title Agency, Inc.

The Corporation operates in a decentralized manner in three principal business activities: (1) retail banking through C&F Bank, (2) mortgage banking through C&F Mortgage Corporation and (3) consumer finance through C&F Finance Company. The following general business discussion focuses on the activities within each of these segments.

In addition, the Corporation conducts brokerage activities through C&F Investment Services, Inc., insurance activities through C&F Insurance Services, Inc. and title insurance services through C&F Title Agency, Inc. The financial position and operating results of any one of these subsidiaries are not significant to the Corporation as a whole and are not considered principal activities of the Corporation at this time.

The Corporation also owns C&F Financial Statutory Trust I, a non-operating subsidiary that was formed in July 2005 for the purpose of issuing \$10.0 million of trust preferred capital securities in a private placement to an institutional investor. The Trust is an unconsolidated subsidiary of the Corporation and its principal asset is \$10.3 million of the Corporation's junior subordinated debt securities (referred to herein as trust preferred capital notes,) that are reported as a liability of the Corporation.

Retail Banking

We provide retail banking services at the Bank's main office in West Point, Virginia, and 17 Virginia branches located one each in Chester, Hampton, Mechanicsville, Midlothian, Newport News, Norge, Providence Forge, Quinton, Saluda, Sandston, West Point, Yorktown, two each in Williamsburg and three each in Richmond. These branches provide a wide range of banking services to individuals and businesses. These services include various types of checking and savings deposit accounts, as well as business, real estate, development, mortgage, home equity and installment loans. The Bank also offers ATMs, internet banking, credit card and trust services, as well as travelers' checks, safe deposit box rentals, collection, notary public, wire service and other customary bank services to its customers. Revenues from retail banking operations consist primarily of interest earned on loans and investment securities and fees related to deposit services. At December 31, 2006, assets of the Retail Banking segment totaled \$591.6 million. For the year ended December 31, 2006, income before income taxes for this segment totaled \$8.7 million.

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Mortgage Banking

We conduct mortgage banking activities through C&F Mortgage, which was organized in September 1995. C&F Mortgage provides mortgage loan origination services through 12 locations in Virginia, four in Maryland, two in North Carolina and one each in Newport, Delaware; Moorestown, New Jersey; and Exton, Pennsylvania. The Virginia offices are located one each in Charlottesville, Chester, Fredericksburg, Hanover, Lexington, Lynchburg, Midlothian, Richmond, Roanoke, Virginia Beach, Williamsburg, and Yorktown. The Maryland offices are located in Annapolis, Clarksville, Crofton and Waldorf. The North Carolina offices are located in Charlotte and Gastonia. C&F Mortgage offers a wide variety of residential mortgage loans, which are originated for sale to numerous investors. C&F Mortgage does not securitize loans. Purchasers of loans include, but are not limited to, Citimortgage, Inc.; Countrywide Home Loans, Inc.; Franklin American Mortgage Company; the Virginia Housing Development Authority; and Wells Fargo Home Mortgage. The Bank also purchases lot and permanent loans and home equity lines of credit from C&F Mortgage. C&F Mortgage originates conventional mortgage loans, mortgage loans insured by the Federal Housing Administration (the FHA), mortgage loans partially guaranteed by the Veterans Administration (the VA) and home equity loans. A majority of the conventional loans are conforming loans that qualify for purchase by the Federal National Mortgage Association (Fannie Mae) or the Federal Home Loan Mortgage Corporation (Freddie Mac). The remainder of the conventional loans are non-conforming loans that do not meet Fannie Mae or Freddie Mac guidelines. Through its subsidiaries, C&F Mortgage also provides ancillary mortgage loan origination services for loan settlement and residential appraisals. Revenues from mortgage banking operations consist principally of gains on sales of loans in the secondary mortgage market, loan origination fee income and interest earned on mortgage loans held for sale. At December 31, 2006, assets of the Mortgage Banking segment totaled \$60.0 million. For the year ended December 31, 2006, income before income taxes for this segment totaled \$3.8 million.

Consumer Finance

We conduct consumer finance activities through C&F Finance, which the Bank acquired on September 1, 2002. C&F Finance is a regional finance company providing automobile loans throughout Virginia and in portions of Kentucky, Maryland, North Carolina, Ohio, Tennessee and West Virginia. C&F Finance is an indirect lender that provides automobile financing through lending programs that are designed to serve customers in the non-prime market who have limited access to traditional automobile financing. C&F Finance generally purchases installment contracts from manufacturer-franchised dealerships with used-car operations and through selected independent dealerships. C&F Finance selects these dealers based on the types of vehicles sold. Specifically, C&F Finance prefers to finance later model, low mileage used vehicles and moderately priced new vehicles. C&F Finance's typical borrowers have experienced prior credit difficulties. Because C&F Finance serves customers who are unable to meet the credit standards imposed by most traditional automobile financing sources, C&F Finance typically charges interest at higher rates than those charged by traditional financing sources. As C&F Finance provides financing in a relatively high-risk market, it expects to experience a higher level of credit losses than traditional automobile financing sources. Revenues from consumer finance operations consist principally of interest earned on automobile loans. At December 31, 2006, assets of the Consumer Finance segment totaled \$140.0 million. For the year ended December 31, 2006, income before income taxes for this segment totaled \$5.0 million.

Employees

At December 31, 2006, we employed 501 full-time equivalent employees. We consider relations with our employees to be excellent.

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Competition

Retail Banking

In the Bank's market area, we compete with large national and regional financial institutions, savings associations and other independent community banks, as well as credit unions, mutual funds, brokerage firms and insurance companies. Increased competition has come from out-of-state banks through their acquisition of Virginia-based banks.

The banking business in Virginia, and in the Bank's primary service area in the Hampton to Richmond corridor, is highly competitive for both loans and deposits, and is dominated by a relatively small number of large banks with many offices operating over a wide geographic area. Among the advantages such large banks have over us are their ability to finance wide-ranging advertising campaigns and, by virtue of their greater total capitalization, to have substantially higher lending limits than the Bank.

Factors such as interest rates offered, the number and location of branches and the types of products offered, as well as the reputation of the institution affect competition for deposits and loans. We compete by emphasizing customer service and technology; establishing long-term customer relationships; building customer loyalty; and providing products and services to address the specific needs of our customers. Through the Bank, we target individual and small-to-medium size business customers.

No material part of the Bank's business is dependent upon a single or a few customers, and the loss of any single customer would not have a materially adverse effect upon the Bank's business.

Mortgage Banking

In recent years, several factors have caused rapid consolidation in the mortgage lending industry. First, the continuing evolution of the secondary mortgage market has led to more commodity-like mortgages. Second, increased regulation imposed on the industry has resulted in significant costs and the need for higher levels of specialization. Third, over the last decade interest rate volatility has risen markedly and resulted in an increase in mortgagors' propensity to refinance their mortgages. The combined result of these three factors, together with fluctuations in new home construction and sales, has been relatively large swings in the volume of loans originated from year to year and dramatically increased complexity in the business. To operate profitably in this environment, lenders must have a high level of operational and risk management skills, as well as technological expertise.

As a result, large, sophisticated financial institutions, primarily commercial banks through their mortgage banking subsidiaries, currently dominate the mortgage industry. Our mortgage subsidiary competes by offering a wide selection of products; providing consistently high quality customer service; and pricing its products at competitive rates.

No material part of C&F Mortgage's business is dependent upon a single or a few customers or investors, and the loss of any single customer or investor would not have a materially adverse effect upon C&F Mortgage's business.

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Consumer Finance

The non-prime automobile finance business is highly competitive. The automobile finance market is highly fragmented and is served by a variety of financial entities, including the captive finance affiliates of major automotive manufacturers, banks, savings associations, credit unions and independent finance companies. Many of these competitors have substantially greater financial resources and lower costs of funds than our finance subsidiary. In addition, competitors often provide financing on terms that are more favorable to automobile purchasers or dealers than the terms C&F Finance offers. Many of these competitors also have long-standing relationships with automobile dealerships and may offer dealerships or their customers other forms of financing, including dealer floor plan financing and leasing, which we do not.

Providers of automobile financing traditionally have competed on the basis of interest rates charged, the quality of credit accepted, the flexibility of loan terms offered and the quality of service provided to dealers and customers. To establish C&F Finance as one of the principal financing sources at the dealers it serves, we compete predominately through a high level of dealer service, strong dealer relationships and by offering flexible loan terms.

No material part of C&F Finance's business is dependent upon any single dealer relationship, and the loss of any single dealer relationship would not have a materially adverse effect upon C&F Finance's business.

Regulation and Supervision

General

Bank holding companies and banks are extensively regulated under both federal and state law. The following summary briefly describes the more significant provisions of applicable federal and state laws and certain regulations and the potential impact of such provisions on the Corporation and the Bank. This summary is not complete, and we refer you to the particular statutory or regulatory provisions or proposals for more information. Because federal regulation of financial institutions changes regularly and is the subject of constant legislative debate, we cannot forecast how federal regulation of financial institutions may change in the future and impact the Corporation's and the Bank's operations.

Regulation of the Corporation

The Corporation must file annual, quarterly and other periodic reports with the Securities and Exchange Commission (the SEC). The Corporation is directly affected by the corporate responsibility and accounting reform legislation signed into law on July 30, 2002, known as the Sarbanes-Oxley Act of 2002 (the SOX Act), and the related rules and regulations. The SOX Act includes provisions that, among other things: (1) require that periodic reports containing financial statements that are filed with the SEC be accompanied by chief executive officer and chief financial officer certifications as to their accuracy and compliance with law; (2) prohibit public companies, with certain limited exceptions, from making personal loans to their directors or executive officers; (3) require chief executive officers and chief financial officers to forfeit bonuses and profits if company financial statements are restated due to misconduct; (4) require audit committees to pre-approve all audit and non-audit services provided by an issuer's outside auditors, except for de minimis non-audit services; (5) protect employees of public companies who assist in investigations relating to violations of the federal securities laws from job discrimination; (6) require companies to disclose in plain English on a rapid and current basis material changes in their financial condition or operations, as well as certain other specified information; (7) require a public company's Section 16 insiders to make Form 4 filings with the SEC within two business days following the day on which purchases or sales of the company's equity securities were made; and (8) increase penalties for existing crimes and create

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new criminal offenses. While the Corporation has incurred additional expenses and we expect to continue to incur additional expenses in complying with the requirements of the SOX Act and related regulations adopted by the SEC and the Public Company Accounting Oversight Board, we anticipate that those expenses will not have a material effect on the Corporation's results of operations or financial condition.

The Corporation is also subject to regulation by the Board of Governors of the Federal Reserve System (the Federal Reserve Board). The Federal Reserve Board has jurisdiction to approve any bank or non-bank acquisition, merger or consolidation proposed by a bank holding company. The Bank Holding Company Act of 1956 (the BHCA) generally limits the activities of a bank holding company and its subsidiaries to that of banking, managing or controlling banks, or any other activity that is closely related to banking or to managing or controlling banks.

Since September 1995, the BHCA has permitted bank holding companies from any state to acquire banks and bank holding companies located in any other state, subject to certain conditions, including nationwide and state imposed concentration limits. Banks also are able to branch across state lines, provided certain conditions are met, including that applicable state laws expressly permit such interstate branching. Virginia permits branching across state lines, provided there is reciprocity with the state in which the out-of-state bank is based.

Federal law and regulatory policy impose a number of obligations and restrictions on bank holding companies and their depository institution subsidiaries to reduce potential loss exposure to the depositors and to the Federal Deposit Insurance Corporation (the FDIC) insurance funds. For example, a bank holding company must commit resources to support its subsidiary depository institutions. In addition, insured depository institutions under common control must reimburse the FDIC for any loss suffered or reasonably anticipated by the Deposit Insurance Fund (DIF) as a result of the default of a commonly controlled insured depository institution. The FDIC may decline to enforce the provisions if it determines that a waiver is in the best interest of the DIF. An FDIC claim for damage is superior to claims of stockholders of an insured depository institution or its holding company but is subordinate to claims of depositors, secured creditors and holders of subordinated debt, other than affiliates, of the commonly controlled insured depository institution.

The Federal Deposit Insurance Act (the FDIA) provides that amounts received from the liquidation or other resolution of any insured depository institution must be distributed, after payment of secured claims, to pay the deposit liabilities of the institution before payment of any other general creditor or stockholder. This provision would give depositors a preference over general and subordinated creditors and stockholders if a receiver is appointed to distribute the assets of the Bank.

The Corporation also is subject to regulation and supervision by the State Corporation Commission of Virginia.

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Capital Requirements

The Federal Reserve Board and the FDIC have issued substantially similar risk-based and leverage capital guidelines applicable to banking organizations they supervise. Under the risk-based capital requirements of these federal bank regulatory agencies, the Corporation and the Bank are required to maintain a minimum ratio of total capital to risk-weighted assets of at least 8 percent and a minimum ratio of Tier 1 capital to risk-weighted assets of at least 4 percent. At least half of the total capital must be Tier 1 capital, which includes common equity, retained earnings and qualifying perpetual preferred stock, less certain intangibles and other adjustments. The remainder may consist of Tier 2 capital, such as a limited amount of subordinated and other qualifying debt (including certain hybrid capital instruments), other qualifying preferred stock and a limited amount of the general loan loss allowance. At December 31, 2006, the total capital to risk-weighted asset ratio of the Corporation was 12.6 percent and the ratio of the Bank was 13.0 percent. At December 31, 2006, the Tier 1 capital to risk-weighted asset ratio was 11.3 percent for the Corporation and 11.8 percent for the Bank.

In addition, each of the federal regulatory agencies has established leverage capital ratio guidelines for banking organizations. These guidelines provide for a minimum Tier 1 leverage ratio of 4 percent for banks and bank holding companies. At December 31, 2006, the Tier 1 leverage ratio was 9.6 percent for the Corporation and 9.9 percent for the Bank. The guidelines also provide that banking organizations experiencing internal growth or making acquisitions must maintain capital positions substantially above the minimum supervisory levels, without significant reliance on intangible assets.

Limits on Dividends

The Corporation is a legal entity, separate and distinct from the Bank. A significant portion of the revenues of the Corporation result from dividends paid to it by the Bank. Both the Corporation and the Bank are subject to laws and regulations that limit the payment of dividends, including requirements to maintain capital at or above regulatory minimums. Banking regulators have indicated that Virginia banking organizations should generally pay dividends only (1) from net undivided profits of the bank, after providing for all expenses, losses, interest and taxes accrued or due by the bank and only (2) if the prospective rate of earnings retention appears consistent with the organization's capital needs, asset quality and overall financial condition. In addition, the FDIA prohibits insured depository institutions such as the Bank from making capital distributions, including the payment of dividends, if, after making such distribution, the institution would become undercapitalized as defined in the statute.

We do not expect that any of these laws, regulations or policies will materially affect the ability of the Corporation or the Bank to pay dividends. During the year ended December 31, 2006, the Bank declared \$4.0 million in dividends payable to the Corporation, and the Corporation declared \$3.7 million in dividends payable to shareholders.

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Regulation of the Bank and Other Subsidiaries

The Bank is subject to supervision, regulation and examination by the Virginia State Corporation Commission Bureau of Financial Institutions (VBFI) and the FDIC. The various laws and regulations administered by the regulatory agencies affect corporate practices, such as the payment of dividends, the incurrence of debt and the acquisition of financial institutions and other companies, and affect business practices, such as the payment of interest on deposits, the charging of interest on loans, the types of business conducted and the location of offices.

FDIA and Associated Regulations. Section 36 of the FDIA and associated regulations require management of every insured depository institution with total assets between \$500 million and \$1 billion at the beginning of a fiscal year to obtain an annual audit of its financial statements by an independent public accountant, report to the banking agencies on the institution's compliance with designated laws and regulations and establish an audit committee comprised of outside directors, a majority of whom must be independent of management. The Bank is subject to the annual audit, reporting and audit committee requirements of Section 36 of the FDIA.

Community Reinvestment Act. The Community Reinvestment Act (CRA) imposes on financial institutions an affirmative and ongoing obligation to meet the credit needs of their local communities, including low and moderate-income neighborhoods, consistent with the safe and sound operation of those institutions. A financial institution's efforts in meeting community credit needs are assessed based on 12 factors. These factors also are considered in evaluating mergers, acquisitions and applications to open a branch or facility. Following the Bank's most recent scheduled compliance examination in July 2006, it received a CRA performance evaluation of satisfactory.

Insurance of Accounts, Assessments and Regulation by the FDIC. The Bank's deposits are insured up to applicable limits by the DIF of the FDIC. The DIF is the successor to the Bank Insurance Fund and the Savings Association Insurance Fund, which were merged in 2006. The FDIC recently amended its risk-based assessment system for 2007 to implement authority granted by the Federal Deposit Insurance Reform Act of 2005 (FDIRA). Under the revised system, insured institutions are assigned to one of four risk categories based on supervisory evaluations, regulatory capital levels and certain other factors. An institution's assessment rate depends upon the category to which it is assigned. Unlike the other categories, Risk Category I, which contains the least risky depository institutions, contains further risk differentiation based on the FDIC's analysis of financial ratios, examination component ratings and other information. Assessment rates are determined by the FDIC and currently range from five to seven basis points for the healthiest institutions (Risk Category I) to 43 basis points of assessable deposits for the riskiest (Risk Category IV). The FDIC may adjust rates uniformly from one quarter to the next, except that no single adjustment can exceed three basis points.

FDIRA also provided for a one-time credit for eligible institutions based on their assessment base as of December 31, 1996. Subject to certain limitations with respect to institutions that are exhibiting weaknesses, credits can be used to offset assessments until exhausted. The Bank's one-time credit is expected to approximate \$298,000. FDIRA also provided for the possibility that the FDIC may pay dividends to insured institutions if the DIF reserve ratio equals or exceeds 1.35 percent of estimated insured deposits.

Federal Home Loan Bank of Atlanta. The Bank is a member of the Federal Home Loan Bank (FHLB) of Atlanta, which is one of 12 regional FHLBs that provide funding to their members for making housing loans as well as for affordable housing and community development loans. Each FHLB serves as a reserve, or central bank, for the members within its assigned region. Each is funded primarily from proceeds derived from the sale of consolidated obligations of the FHLB System. Each FHLB makes loans to

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members in accordance with policies and procedures established by the Board of Directors of the FHLB. As a member, the Bank must purchase and maintain stock in the FHLB. In 2004, the FHLB converted to its new capital structure, which established the minimum capital stock requirement for member banks as an amount equal to the sum of a membership requirement and an activity-based requirement. At December 31, 2006, the Bank owned \$2.1 million of FHLB stock.

USA Patriot Act. The USA Patriot Act, which became effective on October 26, 2001, amends the Bank Secrecy Act and is intended to facilitate information sharing among governmental entities and financial institutions for the purpose of combating terrorism and money laundering. Among other provisions, the USA Patriot Act permits financial institutions, upon providing notice to the United States Department of the Treasury (Treasury Department), to share information with one another in order to better identify and report to the federal government activities that may involve money laundering or terrorists' activities. The USA Patriot Act is considered a significant banking law in terms of information disclosure regarding certain customer transactions. Certain provisions of the USA Patriot Act impose the obligation to establish anti-money laundering programs, including the development of a customer identification program, and the screening of all customers against any government lists of known or suspected terrorists. Although it does create a reporting obligation and there is a cost of compliance, the USA Patriot Act does not materially affect the Bank's products, services or other business activities.

Reporting Terrorist Activities. The Federal Bureau of Investigation (FBI) has sent, and will send, banking regulatory agencies lists of the names of persons suspected of involvement in terrorist activities. The Bank has been requested, and will be requested, to search its records for any relationships or transactions with persons on those lists. If the Bank finds any relationships or transactions, it must file a suspicious activity report with the Treasury Department and contact the FBI.

The Office of Foreign Assets Control (OFAC), which is a division of the Treasury Department, is responsible for helping to insure that United States entities do not engage in transactions with enemies of the United States, as defined by various Executive Orders and Acts of Congress. OFAC has sent, and will send, banking regulatory agencies lists of names of persons and organizations suspected of aiding, harboring or engaging in terrorist acts. If the Bank finds a name on any transaction, account or wire transfer that is on an OFAC list, it must freeze such account, file a suspicious activity report with the Treasury Department and notify the FBI. The Bank has appointed an OFAC compliance officer to oversee the inspection of its accounts and the filing of any notifications. The Bank actively checks high-risk areas such as new accounts, wire transfers and customer files. The Bank performs these checks utilizing software that is updated each time a modification is made to the lists of Specially Designated Nationals and Blocked Persons provided by OFAC and other agencies.

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Mortgage Banking Regulation. In addition to certain of the Bank's regulations, the Corporation's Mortgage Banking segment is subject to the rules and regulations of, and examination by the Department of Housing and Urban Development (HUD), the FHA, the VA and state regulatory authorities with respect to originating, processing and selling mortgage loans. Those rules and regulations, among other things, establish standards for loan origination, prohibit discrimination, provide for inspections and appraisals of property, require credit reports on prospective borrowers and, in some cases, restrict certain loan features and fix maximum interest rates and fees. In addition to other federal laws, mortgage origination activities are subject to the Equal Credit Opportunity Act, Truth-in-Lending Act, Home Mortgage Disclosure Act, Real Estate Settlement Procedures Act, and Home Ownership Equity Protection Act, and the regulations promulgated under these acts. These laws prohibit discrimination, require the disclosure of certain basic information to mortgagors concerning credit and settlement costs, limit payment for settlement services to the reasonable value of the services rendered and require the maintenance and disclosure of information regarding the disposition of mortgage applications based on race, gender, geographical distribution and income level.

Consumer Financing Regulation. The Corporation's Consumer Finance segment also is regulated by the VBFI. The VBFI regulates and enforces laws relating to consumer lenders and sales finance agencies such as C&F Finance. Such rules and regulations generally provide for licensing of sales finance agencies; limitations on amounts, duration and charges, including interest rates, for various categories of loans; requirements as to the form and content of finance contracts and other documentation; and restrictions on collection practices and creditors' rights.

Consumer Protection. The Fair and Accurate Credit Transactions Act of 2003, which amended the Fair Credit Reporting Act, requires financial institutions to implement policies and procedures that track identity theft incidents; provide identity-theft victims with evidence of fraudulent transactions upon request; block from reporting to consumer reporting agencies credit information resulting from identity theft; notify customers of adverse information concerning the customer in consumer reporting agency reports; and notify customers when reporting negative information concerning the customer to a consumer reporting agency.

Other Safety and Soundness Regulations

Prompt Correction Action. The federal banking agencies have broad powers under current federal law to take prompt corrective action to resolve problems of insured depository institutions. The extent of these powers depends upon whether the institution in question is well capitalized, adequately capitalized, undercapitalized, significantly undercapitalized or critically undercapitalized. These terms are defined under uniform regulations issued by each of the federal banking agencies regulating these institutions. An insured depository institution which is less than adequately capitalized must adopt an acceptable capital restoration plan, is subject to increased regulatory oversight and is increasingly restricted in the scope of its permissible activities. As of December 31, 2006, the Bank was considered well capitalized.

Check Clearing for the 21st Century Act (Check 21). Check 21 gives substitute checks, such as a digital image of a check and copies made from that image, the same legal standing as the original paper check. The major provisions of Check 21 include: allowing check truncation without making it mandatory; demanding that every financial institution communicate to account holders in writing a description of its substitute check processing program and their rights under the law; legalizing substitutions for and replacements of paper checks without agreement from consumers; retaining in place the previously-mandated electronic collection and return of checks between financial institutions only when individual agreements are in place; requiring that when account holders request verification, financial institutions produce the original check (or a copy that accurately represents the original) and

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demonstrate that the account debit was accurate and valid; and requiring recrediting of funds to an individual's account on the next business day after a consumer proves that the financial institution has erred. This legislation will likely affect capital spending as many financial institutions assess whether technological or operational changes are necessary to stay competitive and take advantage of the new opportunities presented by Check 21.

Gramm-Leach-Bliley Act of 1999 (GLBA). The GLBA implemented major changes to the statutory framework for providing banking and other financial services in the United States. The GLBA, among other things, eliminated many of the restrictions on affiliations among banks and securities firms, insurance firms and other financial service providers. A bank holding company that qualifies and elects to be a financial holding company is permitted to engage in activities that are financial in nature or incident or complimentary to financial activities. The activities that the GLBA expressly lists as financial in nature include insurance underwriting, sales and brokerage activities, financial and investment advisory services, underwriting services and limited merchant banking activities.

To become eligible for these expanded activities, a bank holding company must qualify as a financial holding company. To qualify as a financial holding company, each insured depository institution controlled by the bank holding company must be well-capitalized, well-managed and have at least a satisfactory rating under the CRA. In addition, the bank holding company must file with the Federal Reserve a declaration of its intention to become a financial holding company. While the Corporation satisfies these requirements, the Corporation has not elected to be treated as a financial holding company under the GLBA.

The GLBA has not had a material adverse impact on the Corporation's or the Bank's operations. To the extent that it allows banks, securities firms and insurance firms to affiliate, the financial services industry may experience further consolidation. The GLBA may have the result of increasing competition that we face from larger institutions and other companies that offer financial products and services and that may have substantially greater financial resources than the Corporation or the Bank.

The GLBA and certain regulations issued by federal banking agencies also provide protections against the transfer and use by financial institutions of consumer nonpublic personal information. A financial institution must provide to its customers, at the beginning of the customer relationship and annually thereafter, the institution's policies and procedures regarding the handling of customers' nonpublic personal financial information. These privacy provisions generally prohibit a financial institution from providing a customer's personal financial information to unaffiliated third parties unless the institution discloses to the customer that the information may be so provided and the customer is given the opportunity to opt out of such disclosure.

Available Information

The Corporation's SEC filings are filed electronically and are available to the public over the Internet at the SEC's web site at <http://www.sec.gov>. In addition, any document filed by the Corporation with the SEC can be read and copied at the SEC's public reference facilities at 100 F Street, N.E., Room 1580, Washington, D.C. 20549. Copies of documents can be obtained at prescribed rates by writing to the Public Reference Section of the SEC at 100 F Street, N.E., Washington, D.C. 20549. The public may obtain information on the operation of the Public Reference Room by calling the SEC at 1-800-SEC-0330. The Corporation's SEC filings also are available through our web site at <http://www.cffc.com> as of the day they are filed with the SEC. Copies of documents also can be obtained free of charge by writing to the Corporation's secretary at P.O. Box 391, West Point, VA 23181 or by calling 804-843-2360.

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ITEM 1A. RISK FACTORS

We are subject to interest rate risk and fluctuations in interest rates may negatively affect our financial performance.

Our profitability depends in substantial part on our net interest margin, which is the difference between the interest earned on loans, securities and other interest-earning assets, and interest paid on deposits and borrowings. Changes in interest rates will affect our net interest margin in diverse ways, including the pricing of loans and deposits, the levels of prepayments and asset quality. We are unable to predict actual fluctuations of market interest rates because many factors influencing interest rates are beyond our control. We attempt to minimize our exposure to interest rate risk, but we are unable to eliminate it. Based on our asset/liability position at December 31, 2006, we are vulnerable to continued increases in short-term interest rates because of our liability-sensitive balance sheet profile for the one-year time period. However, these liabilities consist predominantly of deposits, the repricing of which historically lags behind the changes in short-term interest rates. We believe that our current interest rate exposure is manageable and does not indicate any significant exposure to interest rate changes.

Periods of rising interest rates or a decline in real estate values in our market will adversely affect our income from our mortgage company.

One of the components of our strategic plan is to generate significant noninterest income from our mortgage company, C&F Mortgage. In periods of rising interest rates, consumer demand for new mortgages and refinancings may decrease, which in turn could adversely impact our mortgage company. Because interest rates depend on factors outside of our control, we cannot eliminate the interest rate risk associated with our mortgage operations. In addition, there is speculation that current real estate prices in our markets may exceed the true values of the properties. If this is the case, or if the market generally perceives that this is the case, then real estate prices could become stagnant or decline, and there could be a significant reduction in real estate construction and housing starts. This could have a significant adverse affect on demand for loan products offered by our mortgage company.

Our business is subject to various lending and other economic risks that could adversely impact our results of operations and financial condition.

Changes in economic conditions, particularly an economic slowdown, could hurt our business. Our business is directly affected by general economic and market conditions; broad trends in industry and finance; legislative and regulatory changes; changes in governmental monetary and fiscal policies; and inflation, all of which are beyond our control. A deterioration in economic conditions, in particular an economic slowdown within our geographic region, could result in the following consequences, any of which could hurt our business materially: an increase in loan delinquencies; an increase in problem assets and foreclosures; a decline in demand for our products and services; and a deterioration in the value of collateral for loans made by our various business segments.

Our level of credit risk is increasing due to the concentration of our loan portfolio in commercial loans and in consumer finance loans.

At December 31, 2006, 44 percent of our loan portfolio consisted of commercial loans. These loans generally carry larger loan balances and involve a greater degree of financial and credit risk than home equity and residential loans. The increased financial and credit risk associated with these types of loans is a result of several factors, including the concentration of principal in a limited number of loans and to borrowers in similar lines of business, the size of loan balances, the effects of general economic conditions on income-producing properties and the increased difficulty of evaluating and monitoring these types of loans.

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At December 31, 2006, 25 percent of our loan portfolio consisted of consumer finance loans that provide automobile financing for customers in the non-prime market. During periods of economic slowdown or recession, delinquencies, defaults, repossessions and losses generally increase in this portfolio. These periods also may be accompanied by decreased consumer demand for automobiles and declining values of automobiles securing outstanding loans, which weakens collateral coverage and increases the amount of loss in the event of default. Significant increases in the inventory of used automobiles during periods of economic recession may also depress the prices at which we may sell repossessed automobiles or delay the timing of these sales. Because we focus on non-prime borrowers, the actual rates of delinquencies, defaults, repossessions and losses on these loans are higher than those experienced in the general automobile finance industry and could be dramatically affected by a general economic downturn. While we manage the higher risk inherent in loans made to non-prime borrowers through our underwriting criteria and collection methods, we cannot guarantee that these criteria or methods will ultimately provide adequate protection against these risks.

If our allowance for loan losses becomes inadequate, the results of our operations may be adversely affected.

Making loans is an essential element of our business. The risk of nonpayment is affected by a number of factors, including but not limited to: the duration of the credit; credit risks of a particular customer; changes in economic and industry conditions; and, in the case of a collateralized loan, risks resulting from uncertainties about the future value of the collateral. Although we seek to mitigate risks inherent in lending by adhering to specific underwriting practices, our loans may not be repaid. We attempt to maintain an appropriate allowance for loan losses to provide for potential losses in our loan portfolio. Our allowance for loan losses is determined by analyzing historical loan losses, current trends in delinquencies and charge-offs, plans for problem loan resolution, the opinions of our regulators, changes in the size and composition of the loan portfolio and industry information. Also included in our estimates for loan losses are considerations with respect to the impact of economic events, the outcome of which are uncertain. Because any estimate of loan losses is necessarily subjective and the accuracy of any estimate depends on the outcome of future events, we face the risk that charge-offs in future periods will exceed our allowance for loan losses and that additional increases in the allowance for loan losses will be required. Additions to the allowance for loan losses would result in a decrease of our net income. Although we believe our allowance for loan losses is adequate to absorb probable losses in our loan portfolio, we cannot predict such losses or that our allowance will be adequate in the future.

Competition from other financial institutions and financial intermediaries may adversely affect our profitability.

We face substantial competition in originating loans and in attracting deposits. Our competition in originating loans and attracting deposits comes principally from other banks, mortgage banking companies, consumer finance companies, savings associations, credit unions, brokerage firms, insurance companies and other institutional lenders and purchasers of loans. Additionally, banks and other financial institutions with larger capitalization and financial intermediaries not subject to bank regulatory restrictions have larger lending limits and are thereby able to serve the credit needs of larger clients. These institutions may be able to offer the same loan products and services that we offer at more competitive rates and prices. Increased competition could require us to increase the rates we pay on deposits or lower the rates we offer on loans, which could adversely affect our profitability.

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We rely heavily on our management team and the unexpected loss of key officers may adversely affect our operations.

We believe that our growth and future success will depend in large part on the skills of our executive officers. We also depend upon the experience of the officers of our subsidiaries and on their relationships with the communities they serve. The loss of the services of one or more of these officers could disrupt our operations and impair our ability to implement our business strategy, which could adversely affect our business, financial condition and results of operations.

The success of our growth strategy depends on our ability to identify and recruit individuals with experience and relationships in our primary markets.

The successful implementation of our business strategy will require us to continue to attract, hire, motivate and retain skilled personnel to develop new customer relationships as well as new financial products and services. The market for qualified management personnel is competitive. In addition, the process of identifying and recruiting individuals with the combination of skills and attributes required to carry out our strategy is often lengthy. Our inability to identify, recruit and retain talented personnel to manage new offices effectively and in a timely manner would limit our growth, which could materially adversely affect our business.

Our corporate culture has contributed to our success, and if we cannot maintain this culture as we grow, we could lose the beneficial aspects fostered by our culture, which could harm our business.

We believe that a critical contributor to our success has been our corporate culture, which focuses on building personal relationships with our customers. As our organization grows, and we are required to implement more complex organizational management structures, we may find it increasingly difficult to maintain the beneficial aspects of our corporate culture. This could negatively impact our future success.

ITEM 1B. UNRESOLVED STAFF COMMENTS

The Corporation has no unresolved comments from the SEC staff.

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ITEM 2. PROPERTIES

The following describes the location and general character of the principal offices and other materially important physical properties of the Corporation.

The Corporation owns a building located at Eighth and Main Streets in the business district of West Point, Virginia. The building, originally constructed in 1923, has three floors totaling 15,000 square feet. This building houses the Bank's Main Office, a branch office of C&F Investment Services and office space for certain of the Bank's administrative personnel.

The Corporation owns a building located at 3600 LaGrange Parkway in Toano, Virginia. The building was acquired in 2004 and has 85,000 square feet. Approximately 30,000 square feet were renovated in 2005 in order to house the Bank's operations center, which consists of the Bank's loan, deposit and administrative functions and staff.

The building previously used for the Bank's deposit operations at Seventh & Main Streets in West Point Virginia, which is a 14,000 square foot building remodeled by the Corporation in 1991, has been leased to the Economic Development Authority of the Town of West Point, Virginia (Development Authority) for the purpose of housing and operating incubator businesses under the supervision of the Development Authority. The building previously used for the Bank's loan operations at Sixth and Main Streets in West Point, Virginia, which is a 5,000 square foot building acquired and remodeled by the Corporation in 1998, will initially be retained as back-up facilities for the new operations center. Management has not yet determined the long-term utilization of these properties.

The Corporation owns a building located at 1400 Alverser Drive in Midlothian, Virginia. The building provides space for a branch office of the Bank and for a C&F Mortgage branch office, as well as C&F Mortgage's main administrative offices. This two-story building has 25,000 square feet and was constructed in 2001. Also at the Midlothian location, the Corporation owns an office condominium that houses a regional commercial lending office.

The Corporation owns 15 other Bank branch locations and leases one Bank branch location and one regional commercial lending office in Virginia. Rental expense for these leased locations totaled \$22,000 for the year ended December 31, 2006.

The Corporation has 18 leased loan production offices, 9 in Virginia, four in Maryland, two in North Carolina and one each in Delaware, New Jersey and Pennsylvania, for C&F Mortgage. Rental expense for these leased locations totaled \$874,000 for the year ended December 31, 2006.

The Corporation owns a building located at 4660 South Laburnum Avenue in Richmond, Virginia. The building was acquired in June 2005 and has approximately 8,800 square feet. The building houses C&F Finance's headquarters and provides space for its loan and administrative functions and staff. In connection with the opening of the Bank's Hampton branch in 2006, the Hampton office of C&F Finance was relocated from a leased facility to the second floor of the Bank branch building. The Corporation has one remaining leased office in Virginia for C&F Finance. Rental expense for these leased locations totaled \$15,000 for the year ended December 31, 2006.

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All of the Corporation's properties are in good operating condition and are adequate for the Corporation's present and anticipated future needs.

ITEM 3. LEGAL PROCEEDINGS

There are no material pending legal proceedings to which the Corporation or any of its subsidiaries is a party or to which the property of the Corporation or any of its subsidiaries is subject.

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

No matters were submitted during the fourth quarter of the fiscal year covered by this report to a vote of security holders of the Corporation through a solicitation of proxies or otherwise.

EXECUTIVE OFFICERS OF THE REGISTRANT

Name (Age) Present Position	Business Experience During Past Five Years
Larry G. Dillon (54) Chairman, President and Chief Executive Officer	Chairman, President and Chief Executive Officer of the Corporation and the Bank since 1989
Thomas F. Cherry (38) Executive Vice President, Chief Financial Officer and Secretary	Secretary of the Corporation and the Bank since 2002; Executive Vice President and Chief Financial Officer of the Corporation and the Bank since December 2004; Senior Vice President and Chief Financial Officer of the Corporation and the Bank from December 1998 to November 2004
Robert L. Bryant (56) Executive Vice President and Chief Operating Officer	Executive Vice President and Chief Operating Officer of the Corporation since February 2005; Executive Vice President and Chief Operating Officer of the Bank since December 2004; Senior Vice President and Chief Operating Officer of the Bank from May 2004 to November 2004; President of Renaissance Resources, a business consulting practice located in Richmond, Virginia, from 1996 to 2004
Bryan E. McKernon (50)	President and Chief Executive Officer of C&F Mortgage since 1995

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The Corporation's common stock is traded on the over-the-counter market and is listed for trading on the NASDAQ Global Select Market of the NASDAQ Stock Market under the symbol CFFI. As of February 27, 2007, there were approximately 2,300 shareholders of record. As of that date, the closing price of our common stock on the NASDAQ Global Select Stock Market was \$43.25. Following are the high and low closing sales prices as reported by the NASDAQ Stock Market, along with the dividends that were paid quarterly in 2006 and 2005.

Quarter	2006			2005		
	High	Low	Dividends	High	Low	Dividends
First	\$ 40.58	\$ 37.17	\$ 0.27	\$ 40.20	\$ 36.12	\$ 0.24
Second	41.49	38.09	0.29	40.44	34.81	0.24
Third	41.00	37.25	0.29	41.00	34.92	0.25
Fourth	42.50	38.50	0.31	40.15	37.02	0.27

Payment of dividends is at the discretion of the Corporation's board of directors and is subject to various federal and state regulatory limitations. For further information regarding payment of dividends, refer to Item 1, Business, under the heading Limits on Dividends and Item 8, Financial Statements and Supplementary Data, under the heading Note 13: Regulatory Requirements and Restrictions.

Issuer Purchases of Equity Securities

For the Quarter Ended December 31, 2006

	Total Number of Shares Purchased as Part of Publicly Announced Program ¹	Average Price Paid Per Share	Total Number of Shares Purchased	Maximum Number of Shares that May Yet Be Purchased Under the Program ¹
October 1-31, 2006		\$		143,561
November 1-30, 2006				150,000
December 1-31, 2006	135	39.72	135	149,865
Total	135	\$ 39.72	135	

¹ On November 4, 2005, the Corporation's board of directors authorized the purchase of up to 5 percent of the Corporation's common stock (approximately 156,783 shares) over the twelve months ending November 3, 2006. The Corporation purchased 13,222 shares of the Corporation's common stock during the twelve months ending November 3, 2006. Upon expiration of this program, the Corporation's board of directors authorized the purchase of up to an additional 150,000 shares of the Corporation's common stock over the twelve months ending November 3, 2007. The stock will be purchased in the open market and/or by privately negotiated transactions, as management and the board of directors deem prudent.

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FIVE YEAR FINANCIAL SUMMARY*(Dollars in thousands, except share and per share amounts)*

	2006	2005	2004	2003	2002
Selected Year-End Balances:					
Total assets	\$ 734,468	\$ 671,957	\$ 609,122	\$ 573,546	\$ 551,922
Total capital	68,006	60,086	69,899	65,384	56,233
Total loans (net)	517,843	465,039	394,471	350,170	328,634
Total deposits	532,835	495,438	447,134	427,635	383,533
Summary of Operations:					
Interest income	\$ 58,582	\$ 48,770	\$ 40,843	\$ 38,671	\$ 30,620
Interest expense	18,457	11,997	7,549	8,828	9,184
Net interest income	40,125	36,773	33,294	29,843	21,436
Provision for loan losses	4,625	5,520	4,026	3,167	1,141
Net interest income after provision for loan losses	35,500	31,253	29,268	26,676	20,295
Noninterest income	27,387	27,584	24,689	29,318	21,453
Noninterest expenses	45,328	41,868	37,753	36,748	27,846
Income before taxes	17,559	16,969	16,204	19,246	13,902
Income tax expense	5,430	5,181	5,006	6,327	4,137
Net income	\$ 12,129	\$ 11,788	\$ 11,198	\$ 12,919	\$ 9,765
Per share:					
Earnings per common share basic	\$3.85	\$3.49	\$3.14	\$3.58	\$2.73
Earnings per common share assuming dilution	3.71	3.36	3.00	3.42	2.67
Dividends	1.16	1.00	.90	.72	.62
Weighted average number of shares assuming dilution	3,273,429	3,507,912	3,729,128	3,781,843	3,652,668
Significant Ratios:					
Return on average assets	1.75%	1.82%	1.91%	2.35%	2.19%
Return on average equity	18.97	17.70	16.78	21.32	19.62
Dividend payout ratio	30.15	28.33	28.59	20.07	22.80
Average equity to average assets	9.21	10.30	11.38	11.01	11.15

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ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS
CAUTIONARY STATEMENT REGARDING FORWARD-LOOKING STATEMENTS

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

interest rates

general economic conditions

the legislative/regulatory climate

monetary and fiscal policies of the U.S. Government, including policies of the U.S. Treasury and the Federal Reserve Board

the quality or composition of the loan or investment portfolios

demand for loan products

deposit flows

competition

demand for financial services in the Corporation's market area

technology

reliance on third parties for key services

accounting principles, policies and guidelines

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

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

CRITICAL ACCOUNTING POLICIES

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

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

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

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

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

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

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

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.

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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:

- 1) return on average assets (ROA)
- 2) return on average equity (ROE)
- 3) growth in earnings

In addition to these financial performance measures, we track the performance of the Corporation's three principal business activities:

- 1) retail banking
- 2) mortgage banking
- 3) consumer finance

We also actively manage our capital through:

- 1) growth
- 2) stock purchases
- 3) dividends

Financial Performance Measures

For the Corporation, net income increased 2.9 percent to \$12.1 million in fiscal 2006. Earnings per share assuming dilution increased 10.4 percent to \$3.71 in the same period. Net income for 2006 included \$728,000, after taxes, attributable to the recovery of past due interest and a reduction in the Corporation's loan loss allowance in connection with the pay-off of previously nonperforming loans of one commercial relationship. Excluding the after-tax effect of this loan pay-off, the Corporation's adjusted earnings for 2006 were \$11.4 million, or \$3.48 per share assuming dilution, which represents a 3.6 percent increase in adjusted earnings per share assuming dilution over the same period in 2005. The improvement in adjusted earnings per share relative to the decrease in adjusted net income, excluding the effect of the commercial loan pay-off, was attributable to the accretive effect of the tender offer that concluded in the third quarter of 2005 and resulted in the Corporation's purchase of 427,186 of its outstanding shares. Factors influencing 2006 earnings included interest rate fluctuations, a decline in mortgage loan production, new borrowings to fund the Corporation's purchase of common stock and higher operating expenses to support growth. The degree to which these factors impacted each of our business segments varied and is discussed in "Principal Business Activities" below.

The Corporation's ROE and ROA were 18.97 percent and 1.75 percent, respectively, for the year ended December 31, 2006. Excluding the effect of the commercial loan pay-off, the Corporation's adjusted ROE was 17.83 percent for the year ended December 31, 2006, compared with 17.70 percent for 2005. The adjusted ROA, excluding the effect of the commercial loan pay-off, was 1.64 percent for 2006, compared with 1.82 percent for 2005. The increase in adjusted ROE for 2006 was attributable to the accretive effect of the Corporation's share purchase in July 2005. The decline in adjusted ROA for 2006 resulted from the decline in earnings, excluding the effect of the commercial loan pay-off, coupled with an increase in average assets, primarily loans held for investment and new facilities. We have continued to make significant investments in our retail branch network, operations facilities, technology and personnel in order to accommodate our strategic growth initiatives. These investments have increased our operating assets and expenses. However, we expect them to enhance long-term earnings, thus increasing shareholder value.

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We expect the following factors to influence the Corporation's financial performance in 2007:

Retail Banking: We expect changes in interest rates to affect the degree to which net interest margin compression occurs at C&F Bank. If interest rates stabilize or decline, we expect more pronounced net interest margin compression than if interest rates rise because yields on loans will stay constant or decline while deposits will continue to reprice at higher rates relative to their maturing rates. General economic trends, particularly an economic slowdown, in C&F Bank's markets can affect the quality of the loan portfolio. Managing the risks inherent in our loan portfolio will influence C&F Bank's performance during 2007. Our ability to achieve forecasted deposit and loan growth at our existing bank branches and in particular at our four new bank branches will be affected by both general economic conditions and the increasing level of competition in our markets.

Mortgage Banking: Interest rate volatility, the flat interest rate yield curve and the slowdown in the housing market will likely continue to negatively affect demand for home mortgage loans. This will result in lower production at C&F Mortgage, which directly impacts the profitability of C&F Mortgage. Production growth may become more dependent on our ability to open or acquire new production offices.

Consumer Finance: We expect changes in interest rates to be a primary factor influencing financial performance at C&F Finance in 2007. If interest rates rise, we expect net interest margin compression because the funding for C&F Finance's loan portfolio is indexed to short-term interest rates and reprices each month. If interest rates stabilize or decline, there will be less pressure on the net interest margin. In addition, if an economic slowdown occurs in C&F Finance's markets, we would expect more delinquencies and repossessions. There would also be the potential for a decrease in consumer demand for automobiles and a decline in the value of automobiles securing C&F Finance's loan portfolio, which would weaken collateral coverage and increase the amount of loss on the disposition of repossessions.

Principal Business Activities

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

Retail Banking: Pretax earnings for the Retail Banking segment were \$8.7 million for the year ended December 31, 2006, compared with \$8.1 million in 2005. Pretax earnings for 2006 included \$1.1 million of previously unrecorded interest and a reduction in the allowance for loan losses recognized in connection with the pay-off of previously nonperforming loans of one commercial relationship. Excluding this amount, the Retail Bank segment's adjusted pre-tax income for 2006 was \$7.6 million. Included in earnings for 2006 were the effects on operating expenses of the Peninsula and Richmond branch expansions and the operations center relocation, higher operational and administrative personnel costs to support growth, as well as interest expense on trust preferred securities, the proceeds of which were used to partially fund the large share purchase in mid-2005. Growth in the Retail Banking segment's operations and infrastructure have increased operating expenses, but over time we expect these expenditures will contribute to the Corporation's long-term profitability, improve efficiency and enhance customer service. Higher expenses for 2006 were offset in part by an increase in net interest income, which resulted from an increase in both the amount of and yield on earning assets, and an increase in service charges on deposit accounts. The Retail Banking segment's net interest margin has benefited in the short term as variable-rate loans have repriced as short-term interest rates have increased. However, future earnings of the Retail Banking segment could be affected by net interest margin compression if interest rates stabilize or decline and deposits continue to reprice at higher rates relative to their maturing rates.

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Mortgage Banking: Pretax earnings for the Mortgage Banking segment, which consists solely of C&F Mortgage Corporation, were \$3.8 million for the year ended December 31, 2006, compared with \$5.1 million in 2005. The decline in earnings of the Mortgage Banking segment resulted from reduced loan volume as demand for residential mortgage loans and refinancings has moderated as interest rates have increased and overall economic growth has slowed. Origination volume for the year declined 10.8 percent from the 2005 level. Gains on loan sales declined during 2006 due to lower volumes of loan sales resulting from the reduced origination volume. For 2006, loan originations at C&F Mortgage for refinancings declined to \$283 million from \$350 million in 2005. Loans originated for new and resale home purchases declined to \$661 million in 2006 from \$709 million in 2005. In addition to the decrease in loan volume, the Mortgage Banking segment experienced increased overhead resulting from new loan production offices opened during 2006 and 2005, and a decrease in net interest income resulting from a lower average balance of loans held for sale and the effect of the flat interest rate yield curve during 2006. We expect that future earnings for the Mortgage Banking segment may continue to be negatively affected if interest rate trends result in fewer new and resale home sales and loan refinancings. However, we plan to continue to expand in new and existing markets that provide the potential for increased loan production.

Consumer Finance: Pretax earnings for the Consumer Finance segment, which consists solely of C&F Finance, totaled \$5.0 million for the year ended December 31, 2006, compared with pre-tax earnings of \$3.7 million in 2005. The increase in 2006 resulted from a 16.1 percent increase in average consumer finance loans outstanding, which more than offset the decline in C&F Finance's net interest margin attributable to increases in the cost of borrowings resulting from rising interest rates and higher operating expenses to support growth. Operating results in 2006 benefited from the completion of C&F Finance's conversion to a new loan system, the consolidation and relocation of its operations center to a new location in Richmond, Virginia, and a change in the third-party lender for its secured revolving line of credit with financing terms that provide for a rate reduction from the prior terms and lower administration fees—all of which occurred in mid-2005. We believe that with these improvements, we have established a platform with the capacity to support current operations and future growth, which will enhance long-term earnings. In addition to earnings growth during 2006, nonaccrual consumer finance loans as a percentage of total consumer finance loans was less than one percent as of December 31, 2006 compared to 1.64 percent as of December 31, 2005, which reflected the effect of initiatives to reduce C&F Finance's nonperforming assets. As a result of the improvement in asset quality and a decline in net charge-offs during 2006, the provision for loan losses declined to \$4.9 million for 2006 from \$5.1 million for 2005. Future earnings at the Consumer Finance segment will be impacted by economic conditions including, but not limited to, the employment market, interest rate levels and the resale market for used automobiles.

Capital Management

We have managed our capital through growth in assets, stock purchases and increases in dividends as evidenced by the decline in the ratio of average equity to average total assets over the past three years. During 2006, total assets grew by 9.3 percent. A detailed discussion of the changes in our financial position since December 31, 2005 is included in the section Financial Condition. Dividends for 2006 were \$1.16, which is a 16 percent increase over 2005. The weighted average number of shares outstanding during 2006 was 3,151,860 compared to 3,375,153 during 2005. This decrease resulted from the purchase of 427,186 shares of the Corporation's common stock in mid-2005, which was accretive to earnings per share and ROE. In 2006, we purchased 13,257 shares of the Corporation's common stock under board-approved purchase programs. Through February 15, 2007, we have purchased an additional 101,200 shares of the Corporation's common stock at an average price of \$41.26 per share under the current board-approved program to purchase up to 150,000 shares. Shares purchased in 2007 are not reflected in 2006 results.

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RESULTS OF OPERATIONS

NET INTEREST INCOME

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

The following table shows the average balance sheets for each of the years ended December 31, 2006, 2005 and 2004. The table also shows the amounts of interest earned on earning assets, with related yields, and interest expense on interest-bearing liabilities, with related rates. 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. 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 if income taxes were paid using the federal corporate income tax rate of 35 percent in all three years presented).

	Average	2006	Yield/	Average	2005	Yield/	Average	2004	Yield/
	Balance	Income/ Expense	Rate	Balance	Income/ Expense	Rate	Balance	Income/ Expense	Rate
<i>(Dollars in thousands)</i>									
Assets									
Securities:									
Taxable	\$ 11,349	\$ 487	4.29%	\$ 12,989	\$ 527	4.06%	\$ 16,211	\$ 484	2.99%
Tax-exempt	55,932	3,802	6.80	56,092	4,020	7.17	54,532	4,058	7.44
Total securities	67,281	4,289	6.37	69,081	4,547	6.58	70,743	4,542	6.42
Loans, net	555,517	55,196	9.94	507,447	45,118	8.89	424,052	37,009	8.73
Interest-bearing deposits in other banks	9,271	454	4.90	17,168	523	3.05	43,564	527	1.21
Total earning assets	632,069	59,939	9.48	593,696	50,188	8.45%	538,359	42,078	7.82%
Allowance for loan losses	(13,617)			(12,213)			(9,675)		
Total non-earning assets	75,863			65,107			57,890		
Total assets	\$ 694,315			\$ 646,590			\$ 586,574		
Liabilities and Shareholders									
Equity									
Time and savings deposits:									
Interest-bearing deposits	\$ 87,074	946	1.09%	\$ 81,885	732	0.89%	\$ 80,055	495	0.62%
Money market deposit accounts	44,820	987	2.20	49,909	708	1.42	42,797	329	0.77
Savings accounts	49,644	353	0.71	54,656	388	0.71	55,856	328	0.59
Certificates of deposit, \$100 thousand or more	79,873	3,176	3.98	63,432	1,717	2.71	56,480	1,086	1.92
Other certificates of deposit	152,879	5,690	3.72	136,779	3,735	2.73	127,923	2,751	2.15
Total time and savings deposits	414,290	11,152	2.69	386,661	7,280	1.88	363,111	4,989	1.37
Borrowings	120,498	7,305	6.06	 					