C & F FINANCIAL CORP
Form 10-Q
November 08, 2012

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

FORM 10-Q

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

For the quarterly period ended September 30, 2012

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

For the transition period from to

Commission File Number: 000-23423

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

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

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

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

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). x Yes ¨ No

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

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

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

At November 1, 2012, the latest practicable date for determination, 3,233,059 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)

	September 30, 2012 (Unaudited)	December 31, 2011
ASSETS		
Cash and due from banks	$6,100	$ 5,787
Interest-bearing deposits in other banks	7,649	4,723
Federal funds sold	—	997
Total cash and cash equivalents	13,749	11,507
Securities-available for sale at fair value, amortized cost of $131,438 and $137,575, respectively	140,608	144,646
Loans held for sale, net	78,072	70,062
Loans, net of allowance for loan losses of $34,990 and $33,677, respectively	646,236	616,984
Federal Home Loan Bank stock, at cost	3,744	3,767
Corporate premises and equipment, net	27,627	28,462
Other real estate owned, net of valuation allowance of $4,547 and $3,927, respectively	4,621	6,059
Accrued interest receivable	5,594	5,242
Goodwill	10,724	10,724
Other assets	30,844	30,671
Total assets	$961,819	$ 928,124
LIABILITIES AND SHAREHOLDERS' EQUITY		
Deposits		
Noninterest-bearing demand deposits	$116,636	$ 95,556
Savings and interest-bearing demand deposits	254,976	242,917
Time deposits	292,600	307,943
Total deposits	664,212	646,416
Short-term borrowings	17,371	7,544
Long-term borrowings	132,987	132,987
Trust preferred capital notes	20,620	20,620
Accrued interest payable	921	1,111
Other liabilities	27,231	23,356
Total liabilities	863,342	832,034
Shareholders' equity		
Preferred stock ($1.00 par value, 3,000,000 shares authorized, 0 and 10,000 shares issued and outstanding, respectively)	—	10
Common stock ($1.00 par value, 8,000,000 shares authorized, 3,227,311 and 3,178,510 shares issued and outstanding, respectively)	3,134	3,091
Additional paid-in capital	4,861	13,438

Retained earnings	85,747	76,167
Accumulated other comprehensive income, net	4,735	3,384
Total shareholders' equity	98,477	96,090
Total liabilities and shareholders' equity	$961,819	$ 928,124

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

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	2011	2012	2011
Interest income				
Interest and fees on loans	$18,284	$17,611	$53,584	$51,000
Interest on money market investments	2	7	15	38
Interest and dividends on securities				
U.S. government agencies and corporations	49	50	158	156
Tax-exempt obligations of states and political subdivisions	1,141	1,222	3,514	3,641
Corporate bonds and other	29	28	88	84
Total interest income	19,505	18,918	57,359	54,919
Interest expense				
Savings and interest-bearing deposits	184	247	634	853
Certificates of deposit, $100 or more	452	677	1,639	2,013
Other time deposits	565	785	1,926	2,454
Borrowings	960	975	2,900	2,907
Trust preferred capital notes	250	247	747	736
Total interest expense	2,411	2,931	7,846	8,963
Net interest income	17,094	15,987	49,513	45,956
Provision for loan losses	2,965	4,075	8,550	10,285
Net interest income after provision for loan losses	14,129	11,912	40,963	35,671
Noninterest income				
Gains on sales of loans	6,203	4,282	15,024	11,778
Service charges on deposit accounts	823	915	2,449	2,609
Other service charges and fees	1,685	1,370	4,661	3,776
Net gains on calls of available for sale securities	3	1	11	1
Other income	856	572	2,537	1,550
Total noninterest income	9,570	7,140	24,682	19,714
Noninterest expenses				
Salaries and employee benefits	11,001	7,965	30,339	24,887
Occupancy expenses	1,701	1,644	5,099	4,781
Other expenses	4,285	4,314	11,833	11,932
Total noninterest expenses	16,987	13,923	47,271	41,600
Income before income taxes	6,712	5,129	18,374	13,785
Income tax expense	2,179	1,616	5,880	4,220
Net income	4,533	3,513	12,494	9,565
Effective dividends on preferred stock	—	458	311	1,037

Net income available to common shareholders	$4,533	$3,055	$12,183	$8,528
Per common share data				
Net income – basic	$1.41	$0.97	$3.80	$2.72
Net income – assuming dilution	$1.36	$0.96	$3.69	$2.69
Cash dividends declared	$0.27	$0.25	$0.79	$0.75
Weighted average number of shares – basic	3,220,906	3,141,926	3,206,739	3,132,332
Weighted average number of shares – assuming dilution	3,332,970	3,174,369	3,298,030	3,166,930

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

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CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
(Unaudited)
(In thousands)

	Three Months Ended September 30, 2012	Three Months Ended September 30, 2011	Nine Months Ended September 30, 2012	Nine Months Ended September 30, 2011
Net income	$4,533	$3,513	$12,494	$9,565
Other comprehensive income, net:				
Changes in defined benefit plan assets and benefit obligations, net	7	4	19	11
Unrealized loss on cash flow hedging instruments, net	(16)	(161)	(32)	(245)
Unrealized holding gains on securities, net of reclassification adjustment	459	1,694	1,364	3,840
Comprehensive income, net	$4,983	$5,050	$13,845	$13,171

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

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

	Preferred Stock	Common Stock	Additional Paid-In Capital	Retained Earnings	Accumulated Other Comprehensive Income, Net	Total Shareholders' Equity
Balance December 31, 2011	$10	$3,091	$13,438	$76,167	$ 3,384	$ 96,090
Comprehensive income:						
Net income	—	—	—	12,494	—	12,494
Other comprehensive income, net	—	—	—	—	1,351	1,351
Comprehensive income	—	—	—	—	—	13,845
Stock options exercised	—	36	763	—	—	799
Share-based compensation	—	—	365	—	—	365
Restricted stock vested	—	3	(3)	—	—	—
Preferred stock redemption	(10)	—	(9,990)	—	—	(10,000)
Accretion of preferred stock discount	—	—	172	(172)	—	—
Common stock issued	—	4	116	—	—	120
Cash dividends paid – common stock ($0.79 per share)	—	—	—	(2,539)	—	(2,539)
Cash dividends paid – preferred stock (5% per annum)	—	—	—	(203)	—	(203)
Balance September 30, 2012	$—	$3,134	$4,861	$85,747	$ 4,735	$ 98,477

	Preferred Stock	Common Stock	Additional Paid-In Capital	Retained Earnings	Accumulated Other Comprehensive Income, Net	Total Shareholders' Equity
Balance December 31, 2010	$20	$3,032	$22,112	$67,542	$ 71	$ 92,777
Comprehensive income:						
Net income	—	—	—	9,565	—	9,565
Other comprehensive income, net	—	—	—	—	3,606	3,606
Comprehensive income	—	—	—	—	—	13,171
Stock options exercised	—	8	134	—	—	142
Share-based compensation	—	—	251	—	—	251
Restricted stock vested	—	5	(5)	—	—	—
Preferred stock redemption	(10)	—	(9,990)	—	—	(10,000)
Accretion of preferred stock discount	—	—	311	(311)	—	—
Common stock issued	—	2	1	—	—	3
Cash dividends paid – common stock ($0.75 per share)	—	—	—	(2,347)	—	(2,347)

Cash dividends paid – preferred stock (5% per annum)	—	—	—	(725)	—	(725)
Balance September 30, 2011	$10	$3,047	$12,814	$73,724	$ 3,677	$ 93,272

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

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

	Nine Months Ended September 30, 2012	2011
Operating activities:		
Net income	$ 12,494	$ 9,565
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation	1,690	1,553
Provision for loan losses	8,550	10,285
Provision for indemnifications	955	552
Provision for other real estate owned losses	800	711
Share-based compensation	365	251
Accretion of discounts and amortization of premiums on securities, net	548	581
Net realized gain on calls of securities	(11)	(1)
Realized gain on sales of other real estate owned	(54)	(87)
Proceeds from sales of loans held for sale	611,449	458,486
Origination of loans held for sale	(619,459)	(427,710)
Change in other assets and liabilities:		
Accrued interest receivable	(352)	(77)
Other assets	(898)	(232)
Accrued interest payable	(190)	(40)
Other liabilities	2,896	(4,143)
Net cash provided by operating activities	18,783	49,694
Investing activities:		
Proceeds from maturities, calls and sales of securities available for sale	28,334	21,768
Purchases of securities available for sale	(22,733)	(27,958)
Redemption of Federal Home Loan Bank stock	23	89
Net increase in customer loans	(38,355)	(30,501)
Other real estate owned improvements	(205)	--
Proceeds from sales of other real estate owned	1,450	7,851
Purchases of corporate premises and equipment, net	(855)	(1,578)
Net cash used in investing activities	(32,341)	(30,329)
Financing activities:		
Net increase in demand, interest-bearing demand and savings deposits	33,139	9,674
Net (decrease) increase in time deposits	(15,343)	2,558
Net increase (decrease) in borrowings	9,827	(4,716)
Issuance of common stock	919	145
Redemption of preferred stock	(10,000)	(10,000)
Cash dividends	(2,742)	(3,072)
Net cash provided by (used in) financing activities	15,800	(5,411)
Net increase in cash and cash equivalents	2,242	13,954
Cash and cash equivalents at beginning of period	11,507	9,680
Cash and cash equivalents at end of period	$ 13,749	$ 23,634

Supplemental disclosure		
Interest paid	$ 8,036	$ 9,003
Income taxes paid	6,536	5,658
Supplemental disclosure of noncash investing and financing activities		
Unrealized gains on securities available for sale	$ 2,099	$ 5,908
Loans transferred to other real estate owned	553	4,039
Pension adjustment	27	16
Unrealized loss on cash flow hedging instrument	(51)	(398)

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

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

NOTE 1: Summary of Significant Accounting Policies

Principles of Consolidation: The accompanying unaudited consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America (U.S. GAAP) for interim financial reporting and with applicable quarterly reporting regulations of the Securities and Exchange Commission (the SEC). They do not include all of the information and notes required by U.S. GAAP for complete financial statements. Therefore, these consolidated financial statements should be read in conjunction with the consolidated financial statements and notes thereto included in the C&F Financial Corporation Annual Report on Form 10-K for the year ended December 31, 2011.

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

Nature of Operations: The Corporation is a bank holding company incorporated under the laws of the Commonwealth of Virginia. The Corporation owns all of the stock of its subsidiary, C&F Bank, which is an independent commercial bank chartered under the laws of the Commonwealth of Virginia. The Bank and its subsidiaries offer a wide range of banking and related financial services to both individuals and businesses.

The Bank has five wholly-owned subsidiaries: C&F Mortgage Corporation and Subsidiaries (C&F Mortgage), C&F Finance Company (C&F Finance), C&F Title Agency, Inc., C&F Investment Services, Inc. and C&F Insurance Services, Inc., all incorporated under the laws of the Commonwealth of Virginia. C&F Mortgage, organized in September 1995, was formed to originate and sell residential mortgages and through its subsidiaries, Hometown Settlement Services LLC and Certified Appraisals LLC, provides ancillary mortgage loan production services, such as loan settlements, title searches and residential appraisals. C&F Finance, acquired on September 1, 2002, is a regional finance company providing automobile loans. C&F Title Agency, Inc., organized in October 1992, primarily sells title insurance to the mortgage loan customers of the Bank and C&F Mortgage. C&F Investment Services, Inc., organized in April 1995, is a full-service brokerage firm offering a comprehensive range of investment services. C&F Insurance Services, Inc., organized in July 1999, owns an equity interest in an insurance agency that sells insurance products to customers of the Bank, C&F Mortgage and other financial institutions that have an equity interest in the agency. Business segment data is presented in Note 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, the valuation of derivative financial instruments and goodwill impairment. In the opinion of management, all adjustments, consisting only of normal recurring adjustments, which are necessary for a fair presentation of the results of operations in these financial statements, have been made. Certain reclassifications have been made to prior period amounts to conform to the current period presentation.

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

Share-Based Compensation: Compensation expense for the third quarter and first nine months of 2012 included net expense of $123,000 ($76,000 after tax) and $365,000 ($226,000 after tax), respectively, for restricted stock granted since 2007. As of September 30, 2012, there was $1.23 million of total unrecognized compensation expense related to unvested restricted stock that will be recognized over the remaining requisite service periods.

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A summary of activity for restricted stock awards during the first nine months of 2012 is presented below:

	Shares	Weighted-Average Grant Date Fair Value
Unvested, January 1, 2012	87,125	$ 22.59
Granted	11,775	$ 29.81
Vested	(3,650)	$ 19.82
Cancelled	(2,050)	$ 22.70
Unvested, September 30, 2012	93,200	$ 23.60

Stock option activity during the nine months ended September 30, 2012 and stock options outstanding at September 30, 2012 are summarized below:

	Shares	Exercise Price*	Remaining Contractual Life (in years)*	Intrinsic Value of Unexercised In-The Money Options (in 000's)
Options outstanding at January 1, 2012	325,067	$36.68	3.0	
Exercised	(35,235)	22.69		
Options outstanding and exercisable at September 30, 2012	289,832	$38.38	2.5	$ 454

* Weighted average

Recent Significant Accounting Pronouncements:

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

In May 2011, the FASB issued ASU 2011-04, Fair Value Measurement – Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs. This ASU is the result of joint efforts by the FASB and the International Accounting Standards Board to develop a single, converged fair value framework on how (not when) to measure fair value and what disclosures to provide about fair value measurements. The ASU is largely consistent with existing fair value measurement principles in U.S. GAAP (Topic 820), with many of the amendments made to eliminate unnecessary wording differences between U.S. GAAP and International Financial Reporting Standards. The amendments are effective for interim and annual periods beginning after December 15, 2011 with prospective application. Early application was not permitted. The Corporation has included the required disclosures in its consolidated financial statements.

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

In September 2011, the FASB issued ASU 2011-08, Intangible – Goodwill and Other – Testing Goodwill for Impairment. The amendments in this ASU permit an entity to first assess qualitative factors related to goodwill to determine whether it is more likely than not that the fair value of the reporting unit is less than its carrying amount as a basis for determining whether it is necessary to

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perform the two-step goodwill test described in Topic 350. The more-likely-than-not threshold is defined as having a likelihood of more than 50 percent. Under the amendments in this ASU, an entity is not required to calculate the fair value of a reporting unit unless the entity determines that it is more likely than not that its fair value is less than its carrying amount. The amendments in this ASU are effective for annual and interim goodwill impairment tests performed for fiscal years beginning after December 15, 2011. Early adoption is permitted, including for annual and interim goodwill impairment tests performed as of a date before September 15, 2011, if an entity's financial statements for the most recent annual or interim period have not yet been issued. The adoption of the new guidance did not have a material effect on the Corporation's consolidated financial statements.

In December 2011, the FASB issued ASU 2011-12, Comprehensive Income - Deferral of the Effective Date for Amendments to the Presentation of Reclassifications of Items Out of Accumulated Other Comprehensive Income in ASU 2011-05. The amendments are being made to allow the FASB time to redeliberate whether to present on the face of the financial statements the effects of reclassifications out of accumulated other comprehensive income on the components of net income and other comprehensive income for all periods presented. While the FASB is considering the operational concerns about the presentation requirements for reclassification adjustments and the needs of financial statement users for additional information about reclassification adjustments, entities should continue to report reclassifications out of accumulated other comprehensive income consistent with the presentation requirements in effect before ASU 2011-05. All other requirements in ASU 2011-05 are not affected by ASU 2011-12, including the requirement to report comprehensive income either in a single continuous financial statement or in two separate but consecutive financial statements. Public entities should apply these requirements for fiscal years, and interim periods within those years, beginning after December 15, 2011. The Corporation has included the required disclosures in its consolidated financial statements.

NOTE 2: Securities

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

	September 30, 2012			
(Dollars in thousands)	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
U.S. government agencies and corporations	$ 12,713	$ 22	$ (5)	$ 12,730
Mortgage-backed securities	2,385	79	—	2,464
Obligations of states and political subdivisions	116,313	9,114	(53)	125,374
Preferred stock	27	15	(2)	40
	$ 131,438	$ 9,230	$ (60)	$ 140,608

	December 31, 2011			
(Dollars in thousands)	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
U.S. government agencies and corporations	$ 15,248	$ 39	$ (4)	$ 15,283
Mortgage-backed securities	2,135	81	—	2,216
Obligations of states and political subdivisions	120,165	6,998	(84)	127,079
Preferred stock	27	41	—	68

	$	137,575		$	7,159		$	(88	)	$	144,646

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The amortized cost and estimated fair value of securities, all of which were classified as available for sale, at September 30, 2012, 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)	September 30, 2012 Amortized Cost	Estimated Fair Value
Due in one year or less	$ 23,396	$ 23,573
Due after one year through five years	38,985	40,971
Due after five years through ten years	45,386	49,685
Due after ten years	23,644	26,339
Preferred stock	27	40
	$ 131,438	$ 140,608

Proceeds from the maturities, calls and sales of securities available for sale for the nine months ended September 30, 2012 were $28.33 million.

The Corporation pledges securities primarily as collateral for public deposits and repurchase agreements. Securities with an aggregate amortized cost of $92.41 million and an aggregate fair value of $99.82 million were pledged at September 30, 2012. Securities with an aggregate amortized cost of $106.97 million and an aggregate fair value of $112.66 million were pledged at December 31, 2011.

Securities in an unrealized loss position at September 30, 2012, by duration of the period of the unrealized loss, are shown below.

	Less Than 12 Months		12 Months or More		Total	
(Dollars in thousands)	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss
U.S. government agencies and corporations	$3,320	$5	$—	$—	$3,320	$5
Obligations of states and political subdivisions	4,071	51	450	2	4,521	53
Subtotal – debt securities	7,391	56	450	2	7,841	58
Preferred stock	10	2	—	—	10	2
Total temporarily impaired securities	$7,401	$58	$450	$2	$7,851	$60

There are 25 debt securities with fair values totaling $7.84 million, and one equity security with a fair value of $10,000 considered temporarily impaired at September 30, 2012. The primary cause of the temporary impairments in the Corporation's investments in debt securities was fluctuations in interest rates. During the third quarter of 2012, the municipal bond sector, which is included in the Corporation's obligations of states and political subdivisions category of securities, experienced rising securities prices as investor demand for municipal bonds continued to be strong given attractive municipal bond yields relative to U.S. Treasuries, and the supply of municipal bonds has been relatively limited. The vast majority of the Corporation's municipal bond portfolio is made up of securities where the issuing municipalities have unlimited taxing authority to support their debt service obligations. At September 30, 2012, approximately 96 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 87 percent were rated, as measured by market value, "A" or better at September 30, 2012.

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 September 30, 2012 and no other-then-temporary impairment has been recognized.

Securities in an unrealized loss position at December 31, 2011, by duration of the period of the unrealized loss, are shown below.

	Less Than 12 Months		12 Months or More		Total	
(Dollars in thousands)	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss
U.S. government agencies and corporations	$2,064	$4	$—	$—	$2,064	$4
Obligations of states and political subdivisions	3,305	35	1,328	49	4,633	84
Total temporarily impaired securities	$5,369	$39	$1,328	$49	$6,697	$88

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The Corporation's investment in Federal Home Loan Bank (FHLB) stock totaled $3.74 million at September 30, 2012 and $3.77 million at December 31, 2011. FHLB stock is generally viewed as a long-term investment and as a restricted investment security, which is carried at cost, because there is no market for the stock, other than the FHLBs or member institutions. Therefore, when evaluating FHLB stock for impairment, its value is based on the ultimate recoverability of the par value rather than by recognizing temporary declines in value. The Corporation does not consider this investment to be other-than-temporarily impaired at September 30, 2012 and no impairment has been recognized. FHLB stock 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)	September 30, 2012	December 31, 2011
Real estate – residential mortgage	$ 148,934	$ 147,135
Real estate – construction 1	4,628	5,737
Commercial, financial and agricultural 2	216,770	212,235
Equity lines	33,787	33,192
Consumer	6,187	6,057
Consumer finance	270,920	246,305
	681,226	650,661
Less allowance for loan losses	(34,990)	(33,677)
Loans, net	$ 646,236	$ 616,984

1 Includes the Corporation's real estate construction lending and consumer real estate lot lending.
2 Includes the Corporation's commercial real estate lending, land acquisition and development lending, builder line lending and commercial business lending.

Consumer loans included $244,000 and $299,000 of demand deposit overdrafts at September 30, 2012 and December 31, 2011, respectively.

Loans on nonaccrual status were as follows:

(Dollars in thousands)	September 30, 2012	December 31, 2011
Real estate – residential mortgage	$ 1,101	$ 2,440
Real estate – construction:		
Construction lending	—	—
Consumer lot lending	—	—
Commercial, financial and agricultural:		
Commercial real estate lending	4,561	5,093
Land acquisition and development lending	7,460	—
Builder line lending	527	2,303
Commercial business lending	736	673
Equity lines	48	123

Consumer		375		—
Consumer finance		631		381
Total loans on nonaccrual status	$	15,439	$	11,013

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The past due status of loans as of September 30, 2012 was as follows:

(Dollars in thousands)	30-59 Days Past Due	60-89 Days Past Due	90+ Days Past Due	Total Past Due	Current	Total Loans	90+ Days Past Due and Accruing
Real estate – residential mortgage	$958	$1,149	$ 449	$2,556	$146,378	$148,934	$ 100
Real estate – construction:							
Construction lending	—	—	—	—	3,249	3,249	—
Consumer lot lending	—	—	—	—	1,379	1,379	—
Commercial, financial and agricultural:							
Commercial real estate lending	476	347	325	1,148	121,943	123,091	237
Land acquisition and development lending	1,844	—	2,031	3,875	33,532	37,407	—
Builder line lending	—	—	—	—	16,035	16,035	—
Commercial business lending	202	40	—	242	39,995	40,237	—
Equity lines	116	92	—	208	33,579	33,787	—
Consumer	4	—	377	381	5,806	6,187	1
Consumer finance	7,048	1,667	631	9,346	261,574	270,920	—
Total	$10,648	$3,295	$ 3,813	$17,756	$663,470	$681,226	$ 338

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

The past due status of loans as of December 31, 2011 was as follows:

(Dollars in thousands)	30-59 Days Past Due	60-89 Days Past Due	90+ Days Past Due	Total Past Due	Current	Total Loans	90+ Days Past Due and Accruing
Real estate – residential mortgage	$1,270	$1,445	$ 533	$3,248	$143,887	$147,135	$ 65
Real estate – construction:							
Construction lending	—	—	—	—	5,084	5,084	—
Consumer lot lending	—	—	—	—	653	653	—

Commercial, financial and agricultural:							
Commercial real estate lending	986	1,311	—	2,297	114,475	116,772	—
Land acquisition and development lending	—	—	—	—	32,645	32,645	—
Builder line lending	—	—	—	—	17,637	17,637	—
Commercial business lending	480	—	—	480	44,701	45,181	—
Equity lines	69	90	33	192	33,000	33,192	—
Consumer	13	—	—	13	6,044	6,057	3
Consumer finance	5,327	1,041	381	6,749	239,556	246,305	—
Total	$8,145	$3,887	$ 947	$12,979	$637,682	$650,661	$ 68

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

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Impaired loans, which included troubled debt restructurings (TDRs) of $17.85 million, and the related allowance at September 30, 2012, were as follows:

(Dollars in thousands)	Recorded Investment in Loans	Unpaid Principal Balance	Related Allowance	Average Balance-Impaired Loans	Interest Income Recognized
Real estate – residential mortgage	$ 2,249	$ 2,294	$ 438	$ 2,278	$ 30
Real estate – construction:					
Construction lending	—	—	—	—	—
Consumer lot lending	—	—	—	—	—
Commercial, financial and agricultural:					
Commercial real estate lending	8,710	8,982	1,737	9,159	62
Land acquisition and development lending	7,460	7,860	1,732	8,176	59
Builder line lending	511	1,411	—	1,589	—
Commercial business lending	627	631	55	638	3
Equity lines	—	—	—	—	—
Consumer	323	323	48	324	4
Total	$ 19,880	$ 21,501	$ 4,010	$ 22,164	$ 158

The Corporation has no obligation to fund additional advances on its impaired loans.

Impaired loans, which included TDRs of $17.09 million, and the related allowance at December 31, 2011 were as follows:

(Dollars in thousands)	Recorded Investment in Loans	Unpaid Principal Balance	Related Allowance	Average Balance Impaired Loans	Interest Income Recognized
Real estate – residential mortgage	$ 3,482	$3,698	$657	$ 3,723	$137
Real estate – construction:					
Construction lending	—	—	—	—	—
Consumer lot lending	—	—	—	—	—
Commercial, financial and agricultural:					
Commercial real estate lending	5,861	5,957	1,464	6,195	102
Land acquisition and development lending	5,490	5,814	1,331	6,116	372
Builder line lending	2,285	2,285	318	2,397	—
Commercial business lending	652	654	161	663	6
Equity lines	—	—	—	—	—
Consumer	324	324	49	324	14
Total	$ 18,094	$18,732	$3,980	$ 19,418	$631

Loan modifications that were classified as TDRs during the three and nine months ended September 30, 2012 and 2011 were as follows:

(Dollars in thousands)	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	2011	2012	2011
	$ —	$ 86	$ 122	$ 629

Real estate-residential mortgage-interest reduction								
Real estate-residential mortgage-interest rate concession		—		285		—		306
Commercial, financial and agricultural:								
Commercial real estate lending – interest reduction		—		—		—		176
Commercial real estate lending – interest rate concession		3,853		3,559		4,226		3,922
Builder line lending-interest rate concession		—		—		—		2,285
Commercial business lending-interest rate concession		—		99		—		99
Consumer-interest reduction		—		—		108		—
Total	$	3,853	$	4,029	$	4,456	$	7,417

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TDR payment defaults during three and nine months ended September 30, 2012 and 2011 were as follows:

(Dollars in thousands)	Three Months Ended September 30, 2012	Three Months Ended September 30, 2011	Nine Months Ended September 30, 2012	Nine Months Ended September 30, 2011
Real estate-residential mortgage	$83	$—	$83	$153
Commercial, financial and agricultural:				
Commercial real estate lending	—	—	363	—
Builder line lending	—	—	88	—
Consumer	—	—	—	5
Total	$83	$—	$534	$158

For purposes of this disclosure, 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.

NOTE 4: Allowance for Loan Losses

The following table presents the changes in the allowance for loan losses by major classification during the nine months ended September 30, 2012.

(Dollars in thousands)	Real Estate Residential Mortgage	Real Estate Construction	Commercial, Financial and Agricultural	Equity Lines	Consumer	Consumer Finance	Total
Allowance for loan losses:							
Balance at December 31, 2011	$2,379	$ 480	$ 10,040	$ 912	$319	$19,547	$33,677
Provision charged to operations	714	(94)	1,219	130	116	6,465	8,550
Loans charged off	(780)	—	(1,874)	(120)	(245)	(6,731)	(9,750)
Recoveries of loans previously charged off	27	—	120	79	155	2,132	2,513
Balance at September 30, 2012	$2,340	$ 386	$ 9,505	$ 1,001	$345	$21,413	$34,990

The following table presents the changes in the allowance for loan losses by major classification during the nine months ended September 30, 2011.

(Dollars in thousands)	Real Estate Residential Mortgage	Real Estate Construction	Commercial, Financial and Agricultural	Equity Lines	Consumer	Consumer Finance	Total
Allowance for loan losses:							
Balance December 31,	$1,442	$ 581	$ 8,688	$ 380	$307	$17,442	$28,840

2010							
Provision charged to operations	1,446	153	2,508	539	139	5,500	10,285
Loans charged off	(648)	—	(2,541)	(9)	(247)	(5,210)	(8,655)
Recoveries of loans previously charged off	90	—	149	—	71	1,810	2,120
Balance September 30, 2011	$2,330	$ 734	$ 8,804	$ 910	$270	$19,542	$32,590

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The following table presents, as of September 30, 2012, the total allowance for loan losses, the allowance by impairment methodology (individually evaluated for impairment or collectively evaluated for impairment), total loans, and loans by impairment methodology (individually evaluated for impairment or collectively evaluated for impairment).

(Dollars in thousands)	Real Estate Residential Mortgage	Real Estate Construction	Commercial, Financial and Agricultural	Equity Lines	Consumer	Consumer Finance	Total
Allowance for loan losses:							
Balance at September 30, 2012	$2,340	$ 386	$ 9,505	$ 1,001	$345	$21,413	$34,990
Ending balance: individually evaluated for impairment	$438	$ —	$ 3,524	$ —	$48	$—	$4,010
Ending balance: collectively evaluated for impairment	$1,902	$ 386	$ 5,981	$ 1,001	$297	$21,413	$30,980
Loans:							
Balance September 30, 2012	$148,934	$ 4,628	$ 216,770	$ 33,787	$6,187	$270,920	$681,226
Ending balance: individually evaluated for impairment	$2,249	$ —	$ 17,308	$ —	$323	$—	$19,880
Ending balance: collectively evaluated for impairment	$146,685	$ 4,628	$ 199,462	$ 33,787	$5,864	$270,920	$661,346

The following table presents, as of December 31, 2011, the total allowance for loan losses, the allowance by impairment methodology (individually evaluated for impairment or collectively evaluated for impairment), total loans, and loans by impairment methodology (individually evaluated for impairment or collectively evaluated for impairment).

(Dollars in thousands)	Real Estate Residential Mortgage	Real Estate Construction	Commercial, Financial and Agricultural	Equity Lines	Consumer	Consumer Finance	Total
Allowance for loan losses:							
Balance at December 31, 2011	$2,379	$ 480	$ 10,040	$ 912	$319	$19,547	$33,677
Ending balance: individually	$657	$ —	$ 3,274	$ —	$49	$—	$3,980

evaluated for impairment							
Ending balance: collectively evaluated for impairment	$1,722	$ 480	$ 6,766	$ 912	$270	$19,547	$29,697
Loans:							
Balance at December 31, 2011	$147,135	$ 5,737	$ 212,235	$ 33,192	$6,057	$246,305	$650,661
Ending balance: individually evaluated for impairment	$3,482	$ —	$ 14,288	$ —	$324	$—	$18,094
Ending balance: collectively evaluated for impairment	$143,653	$ 5,737	$ 197,947	$ 33,192	$5,733	$246,305	$632,567

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Loans by credit quality indicators as of September 30, 2012 were as follows:

(Dollars in thousands)	Pass	Special Mention	Substandard	Substandard Nonaccrual	Total1
Real estate – residential mortgage	$143,871	$1,131	$2,831	$1,101	$148,934
Real estate – construction:					
Construction lending	382	—	2,867	—	3,249
Consumer lot lending	1,379	—	—	—	1,379
Commercial, financial and agricultural:					
Commercial real estate lending	105,228	2,430	10,872	4,561	123,091
Land acquisition and development lending	20,211	9,221	515	7,460	37,407
Builder line lending	12,821	1,542	1,145	527	16,035
Commercial business lending	36,875	1,816	810	736	40,237
Equity lines	31,578	1,322	839	48	33,787
Consumer	5,443	—	369	375	6,187
	$357,788	$17,462	$20,248	$14,808	$410,306

(Dollars in thousands)	Performing	Non-Performing	Total
Consumer finance	$270,289	$ 631	$270,920

1 At September 30, 2012, the Corporation did not have any loans classified as Doubtful or Loss.

Loans by credit quality indicators as of December 31, 2011 were as follows:

(Dollars in thousands)	Pass	Special Mention	Substandard	Substandard Nonaccrual	Total1
Real estate – residential mortgage	$140,304	$1,261	$3,130	$2,440	$147,135
Real estate – construction:					
Construction lending	2,214	—	2,870	—	5,084
Consumer lot lending	653	—	—	—	653
Commercial, financial and agricultural:					
Commercial real estate lending	96,773	5,413	9,493	5,093	116,772
Land acquisition and development lending	13,605	9,939	9,101	—	32,645
Builder line lending	12,480	1,434	1,420	2,303	17,637
Commercial business lending	41,590	2,001	917	673	45,181
Equity lines	31,935	298	836	123	33,192
Consumer	5,271	10	776	—	6,057
	$344,825	$20,356	$28,543	$10,632	$404,356

(Dollars in thousands)	Performing	Non-Performing	Total
Consumer finance	$245,924	$ 381	$246,305

1 At December 31, 2011, the Corporation did not have any loans classified as Doubtful or Loss.

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NOTE 5: Stockholders' Equity and Earnings Per Common Share

Stockholders' Equity - Other Comprehensive Income

The following table presents the cumulative balances of the components of other comprehensive income, net of deferred tax assets of $2.52 million and $1.95 million as of September 30, 2012 and 2011, respectively.

(Dollars in thousands)	September 30, 2012	September 30, 2011
Net unrealized gains on securities	$ 5,960	$ 4,341
Net unrecognized loss on cash flow hedges	(346)	(336)
Net unrecognized losses on defined benefit pension plan	(879)	(328)
Total cumulative other comprehensive income	$ 4,735	$ 3,677

The following tables present the changes in accumulated other comprehensive income, by category, net of tax.

(Dollars in thousands)	Unrealized Loss on Cash Flow Hedging Instruments	Unrealized Holding Gains on Securities	Defined Benefit Pension Plan Assets and Benefit Obligations	Total
Balance December 31, 2011	$ (314)	$ 4,596	$ (898)	$ 3,384
Net change for the nine months ended September 30, 2012	(32)	1,364	19	1,351
Balance at September 30, 2012	$ (346)	$ 5,960	$ (879)	$ 4,735

(Dollars in thousands)	Unrealized Loss on Cash Flow Hedging Instruments	Unrealized Holding Gains on Securities	Defined Benefit Pension Plan Assets and Benefit Obligations	Total
Balance December 31, 2010	$ (91)	$ 501	$ (339)	$ 71
Net change for the nine months ended September 30, 2011	(245)	3,840	11	3,606
Balance at September 30, 2011	$ (336)	$ 4,341	$ (328)	$ 3,677

The following tables present the change in each component of other comprehensive income on a pre-tax and after-tax basis for the nine months ended September 30, 2012 and 2011.

(Dollars in thousands)	Nine Months Ended September 30, 2012		
	Pre-Tax	Tax Expense (Benefit)	Net-of-Tax
Defined benefit pension plan:			
Net loss	$ 80	$ 28	$ 52
Amortization of prior service costs	(51)	(18)	(33)
	29	10	19

Defined benefit pension plan assets and benefit obligations, net			
Unrealized loss on cash flow hedging instruments	(51)	(19)	(32)
Unrealized holding gains on securities	2,099	735	1,364
Total increase in other comprehensive income	$ 2,077	$ 726	$ 1,351

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(Dollars in thousands)	Nine Months Ended September 30, 2011		
	Pre-Tax	Tax Expense (Benefit)	Net-of-Tax
Defined benefit pension plan:			
Net loss	$ 71	$ 25	$ 46
Amortization of prior service costs	(51)	(18)	(33)
Amortization of net obligation at transition	(3)	(1)	(2)
Defined benefit pension plan assets and benefit obligations, net	17	6	11
Unrealized loss on cash flow hedging instruments	(399)	(154)	(245)
Unrealized holding gains on securities	5,909	2,069	3,840
Total increase in other comprehensive income	$ 5,527	$ 1,921	$ 3,606

The Corporation had $11,000 and less than $1,000 of net gains from securities reclassified from other comprehensive income to earnings for the nine months ended September 30, 2012 and 2011.

Earnings Per Common Share

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

(Dollars in thousands)	Three Months Ended September 30,	
	2012	2011
Net income	$ 4,533	$ 3,513
Accumulated dividends on Series A Preferred Stock	—	(225)
Accretion of Series A Preferred Stock discount	—	(233)
Net income available to common shareholders	$ 4,533	$ 3,055
Weighted average number of common shares used in earnings per common share – basic	3,220,906	3,141,926
Effect of dilutive securities:		
Stock option awards and Warrant	112,064	32,443
Weighted average number of common shares used in earnings per common share – assuming dilution	3,332,970	3,174,369

(Dollars in thousands)	Nine Months Ended September 30,	
	2012	2011
Net income	$ 12,494	$ 9,565
Accumulated dividends on Series A Preferred Stock	(139)	(725)
Accretion of Series A Preferred Stock discount	(172)	(312)
Net income available to common shareholders	$ 12,183	$ 8,528
Weighted average number of common shares used in earnings per common share – basic	3,206,739	3,132,332
Effect of dilutive securities:		
Stock option awards and Warrant	91,291	34,598
Weighted average number of common shares used in earnings per common share – assuming dilution	3,298,030	3,166,930

Potential common shares that may be issued by the Corporation for its stock option awards and Warrant (defined below) are determined using the treasury stock method. Approximately 69,700 and 343,000 shares issuable upon exercise of options were not included in computing diluted earnings per common share for the three months ended September 30, 2012 and 2011, respectively, and approximately 207,567 and 333,000 shares issuable upon exercise of options were not included in computing diluted earnings per common share for the nine months ended September 30, 2012 and 2011, respectively, because they were anti-dilutive.

In January 2009, the Corporation issued to the United States Department of the Treasury (Treasury) under the Capital Purchase Program (CPP) $20.00 million of its Fixed Rate Cumulative Perpetual Preferred Stock, Series A (the Preferred Stock) and a warrant to

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purchase 167,504 shares of the Corporation's common stock (the Warrant). On July 27, 2011, the Corporation redeemed $10.00 million of the Preferred Stock, and on April 12, 2012, the Corporation redeemed the remaining $10.00 million of the Preferred Stock. As a result of this redemption, the Corporation will pay no future dividends on the Preferred Stock. Further, in connection with this redemption, the Corporation accelerated the accretion of the remaining preferred stock discount during April 2012, which reduced net income available to common shareholders by approximately $151,000.

NOTE 6: Employee Benefit Plans

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
(Dollars in thousands)	2012	2011	2012	2011
Service cost	$ 159	$ 153	$ 477	$ 459
Interest cost	99	109	296	327
Expected return on plan assets	(158)	(145)	(475)	(435)
Amortization of net obligation at transition	—	(1)	—	(3)
Amortization of prior service cost	(17)	(17)	(51)	(51)
Amortization of net loss	26			