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)

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

802 Main Street

West Point, VA 23181

(Address of principal executive offices) (Zip Code)

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	**The NASDAQ Stock Market LLC**
Title of each class	**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 x

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 x

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 x 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. x

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 x 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 x

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.

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 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.

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 l leverage ratio of 4 percent for banks and bank holding companies. At December 31, 2006, the Tier l 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.

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 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 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 productions 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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PART II

ITEM 5. MARKET FOR REGISTRANT S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES

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.

	2006			2005		
Quarter	**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	**Average Price Paid Per Share**	**Total Number of Shares Purchased as Part of Publicly Announced Program[1]**	**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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ITEM 6. SELECTED FINANCIAL DATA

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.

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).

	2006			**2005**			**2004**		
	Average	**Income/**	**Yield/**	**Average**	**Income/**	**Yield/**	**Average**	**Income/**	**Yield/**
(Dollars in thousands)	**Balance**	**Expense**	**Rate**	**Balance**	**Expense**	**Rate**	**Balance**	**Expense**	**Rate**
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**	101,355	4,717	4.65	74,011	2,560	3.46
Total interest-bearing liabilities	**534,788**	**18,457**	**3.45**	488,016	11,997	2.46%	437,122	7,549	1.73%
Demand deposits	**79,472**			76,172			69,281		
Other liabilities	**16,106**			15,808			13,432		
Total liabilities	**630,366**			579,996			519,835		
Shareholders equity	**63,949**			66,594			66,739		

Total liabilities and shareholders equity	**$ 694,315**	$ 646,590	$ 586,574
Net interest income	**$ 41,482**	$ 38,191	$ 34,529
Interest rate spread	**6.03%**	5.99%	6.09%
Interest expense to average earning assets	**2.92%**	2.02%	1.40%
Net interest margin	**6.56%**	6.43%	6.41%

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TABLE 2: Rate-Volume Recap

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

	2006 from 2005			**2005 from 2004**		
	Increase(Decrease) Due to		**Total Increase**	**Increase(Decrease) Due to**		**Total Increase**
(Dollars in thousands)	**Rate**	**Volume**	**(Decrease)**	**Rate**	**Volume**	**(Decrease)**
Interest income:						
Loans	**$ 5,560**	**$ 4,518**	**$ 10,078**	$ 706	$ 7,403	$ 8,109
Securities:						
Taxable	**29**	**(69)**	**(40)**	152	(109)	43
Tax-exempt	**(207)**	**(11)**	**(218)**	(151)	113	(38)
Interest-bearing deposits in other banks	**235**	**(304)**	**(69)**	454	(458)	(4)
Total interest income	**5,617**	**4,134**	**9,751**	1,161	6,949	8,110
Interest expense:						
Time and savings deposits:						
Interest-bearing deposits	**165**	**49**	**214**	225	12	237
Money market deposit accounts	**357**	**(78)**	**279**	317	62	379
Savings accounts	**1**	**(36)**	**(35)**	66	(6)	60
Certificates of deposit, $100M or more	**940**	**519**	**1,459**	486	145	631
Other certificates of deposit	**1,476**	**479**	**1,955**	786	198	984
Total time and savings deposits	**2,939**	**933**	**3,872**	1,880	411	2,291
Other borrowings	**1,593**	**995**	**2,588**	1,042	1,115	2,157
Total interest expense	**4,532**	**1,928**	**6,460**	2,922	1,526	4,448
Change in net interest income	**$ 1,085**	**$ 2,206**	**$ 3,291**	$ (1,761)	$ 5,423	$ 3,662

2006 Compared to 2005

Net interest income, on a taxable equivalent basis, for the year ended December 31, 2006 was $41.5 million, compared to $38.2 million for 2005. The net interest margin of 6.56 percent for 2006 included $870,000 of nonaccrued and default interest attributable to the repayment of previously nonperforming loans of one commercial relationship. Excluding the effect of the commercial loan pay-off, the adjusted net interest margin was 6.43 percent for 2006, which was level with the net interest margin for 2005. An increase of 103 basis points in the yield on interest-earning assets during 2006 was offset by an increase of 99 basis points in the rate on interest-bearing liabilities.

Average loans held for investment increased $62.7 million during 2006. The Retail Banking segment s average loan portfolio increased $46.2 million compared to 2005. This increase was mainly attributable to higher loan production in the Virginia Peninsula market and residential construction loan growth. The Consumer Finance segment s average loan portfolio increased $16.5 million during 2006. This increase was attributable to overall growth at existing locations and, more recently, the expansion into new markets. Average loans held for sale at the Mortgage Banking segment decreased $14.6 million during 2006. Mortgage interest rate trends over the last twelve months have resulted in a 10.8 percent decline in loan origination volume at the Mortgage Banking segment during 2006. The yield on loans held for investment and loans held for sale increased as a result of a general increase in interest rates since mid-2004.

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Average securities available for sale decreased $1.8 million during 2006. In addition, their average yield declined 21 basis points. The decline in the average balance resulted from the utilization of proceeds from maturities and calls to partially fund the increase in loan demand. The yield decreases reflected the impact of the flat yield curve on long-term interest rates and thus the yield on securities purchased throughout 2006.

Average interest-bearing deposits at other banks, primarily the FHLB, decreased $7.9 million during 2006. Fluctuations in the average balance of these low-yielding deposits occurred in response to loan demand. The average yield on interest-earning deposits at other banks increased 185 basis points during 2006. The higher yields were due to increases beginning in mid-2004 in short-term interest rates.

Although average time and savings deposits increased $27.6 million during 2006, the increase in interest on deposits was influenced to a greater extent by the increase in deposit rates. The average cost of deposits increased 81 basis points for 2006 due to the increase in short-term interest rates, coupled with the repricing of maturing deposits at higher interest rates.

Average borrowings increased $19.1 million during 2006 partially due to a new line of credit and the issuance of trust preferred capital securities in the third quarter of 2005 to fund the Corporation s purchase of 427,186 shares of its common stock in mid-2005. The increase in average borrowings during 2006 was also attributable to loan growth at the Consumer Finance segment, which was funded in part by a line of credit. The increase in interest on borrowings was influenced to a greater extent by a higher cost of funds, which increased 141 basis points during 2006. The majority of the Corporation s borrowings are indexed to short-term interest rates and reprice as short-term interest rates change.

Excluding the effect of the commercial loan pay-off, the adjusted net interest margin remained constant during 2006. The increase in the yield on loans has been able to offset the effect of the increase in the cost of deposits and borrowings. However, we expect that net interest margin compression is likely to occur if interest rates stabilize or decline and deposits continue to reprice at higher rates relative to their maturing rates.

2005 Compared to 2004

Net interest income, on a taxable equivalent basis, for the year ended December 31, 2005 was $38.2 million compared to $34.5 million for 2004. The higher net interest income resulted primarily from an increase of 10.3 percent in the average balance of interest-earning assets and an increase in net interest margin to 6.43 percent in 2005 from 6.41 percent in 2004. The slight increase in the net interest margin was a result of a 63 basis point increase in yield on interest-earning assets that was offset in part by a 73 basis point increase in the rate on interest-bearing liabilities.

All of the Corporation s principal business segments experienced loan growth during 2005. Average loans increased $53.7 million in the Retail Banking segment, $17.2 million in the Consumer Finance segment and $12.5 million in the Mortgage Banking segment. The increase in loans in the Retail Banking segment was mainly attributable to loan production in the Virginia Peninsula market and residential construction loan growth. The increase in loans held for sale at the Mortgage Banking segment resulted from

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higher production volume. The increase in loans at the Consumer Finance segment was mainly attributable to overall growth at existing locations. The yield on loans held for investment and loans held for sale increased as a result of a general increase in interest rates since mid-2004.

Average securities available for sale decreased slightly during 2005; however, their average yield increased by 16 basis points. The decline in the average balance resulted from the utilization of proceeds from maturities and calls to fund the increase in loan demand. The yield increase was the result of a change in the mix of investments. The percentage of shorter-term, lower-yielding investments decreased in 2005 as compared to 2004.

Average interest-bearing deposits at other banks, primarily the FHLB, decreased $26.4 million during 2005; however, their average yield increased 184 basis points. The decline in the average balance resulted from the liquidation of these low-yielding deposits to fund the increase in loan demand. The yield increase was due to increases beginning in mid-2004 in short-term interest rates.

Although average time and savings deposits increased $23.6 million during 2005, the increase in interest on deposits was influenced to a greater extent by the increase in deposit rates. The average cost of deposits increased 51 basis points during 2005 due to an increase in short-term interest rates. Generally, deposit interest rate increases lag behind the increase in loan interest rates. Although short-term interest rates increased 200 basis points in 2005, deposits will reprice more gradually as existing certificates of deposit mature in future periods.

Average borrowings increased $27.3 million during 2005. This was a result of an increase in borrowings from a third-party lender to fund the increase in loans at the Consumer Finance segment and an increase in short-term advances from the FHLB to fund the increase in loan production at the Mortgage Banking segment. Borrowings increased further as a result of a line of credit from a third-party lender and the issuance of trust preferred capital securities to fund the Corporation s purchase of 427,186 shares of its common stock in the third quarter of 2005. The majority of these borrowings are indexed to short-term interest rates and reprice as short-term interest rates change. Accordingly, the average cost of borrowings increased 119 basis points during 2005.

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NONINTEREST INCOME

TABLE 3: Noninterest Income

(Dollars in thousands)	Retail Banking	Mortgage Banking	Consumer Finance	Other	Total
	Year Ended December 31, 2006				
Gains on sales of loans	**$**	**$ 17,149**	**$**	**$ (51)**	**$ 17,098**
Service charges on deposit accounts	**3,471**				**3,471**
Other service charges and fees	**1,200**	**3,656**	**245**		**5,101**
Gains on calls of available for sale securities	**105**				**105**
Other income	**393**	**22**	**294**	**903**	**1,612**
Total noninterest income	**$ 5,169**	**$ 20,827**	**$ 539**	**$ 852**	**$ 27,387**

(Dollars in thousands)	Retail Banking	Mortgage Banking	Consumer Finance	Other	Total
	Year Ended December 31, 2005				
Gains on sales of loans	$	$ 18,193	$	$ 1	$ 18,194
Service charges on deposit accounts	2,812				2,812
Other service charges and fees	1,054	3,509	232		4,795
Gains on calls of available for sale securities	105				105
Other income	371	210	185	912	1,678
Total noninterest income	$ 4,342	$ 21,912	$ 417	$ 913	$ 27,584

(Dollars in thousands)	Retail Banking	Mortgage Banking	Consumer Finance	Other	Total
	Year Ended December 31, 2004				
Gains on sales of loans	$	$ 16,572	$	$ 3	$ 16,575
Service charges on deposit accounts	2,699				2,699
Other service charges and fees	857	3,208			4,065
Gains on calls of available for sale securities	69				69
Other income	154	18	71	1,038	1,281
Total noninterest income	$ 3,779	$ 19,798	$ 71	$ 1,041	$ 24,689

2006 Compared to 2005

Total noninterest income declined slightly to $27.4 million during 2006. A $1.1 million decrease at the Mortgage Banking segment resulted primarily from a decline in gains on loan sales due to lower sales volume resulting from reduced loan demand. The decrease in noninterest income at the Mortgage Banking segment was almost entirely offset by increases of $827,000 at the Retail Banking and $122,000 at the Consumer Finance segments during 2006 because of (1) higher service charges and fees on deposit accounts at the Retail Banking segment resulting from deposit account growth, coupled with the expansion of our overdraft protection services and (2) higher service charges and fees at the Consumer Finance segment resulting from fees generated from loan processing and collection.

2005 Compared to 2004

Total noninterest income increased $2.9 million, or 11.7 percent, to $27.6 million for the year ended December 31, 2005. The increase in 2005 was attributable to (1) higher service charges and fees on deposit accounts at the Retail Banking segment resulting from deposit account growth, higher gains on calls of securities and a gain on the sale of land located adjacent to one of the Bank branches, (2) higher gains on sales of loans and other service charges at the Mortgage Banking segment resulting from an increase in the volume of loans closed and sold and (3) higher income at the Consumer Finance segment resulting from fees generated from loan originations.

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NONINTEREST EXPENSE

TABLE 4: Noninterest Expense

(Dollars in thousands)	Year Ended December 31, 2006 Retail Banking	Mortgage Banking	Consumer Finance	Other	Total
Salaries and employee benefits	**$ 13,001**	**$ 12,137**	**$ 3,146**	**$ 723**	**$ 29,007**
Occupancy expense	**3,109**	**1,671**	**282**	**25**	**5,087**
Other expenses	**4,801**	**4,550**	**1,767**	**116**	**11,234**
Total noninterest expense	**$ 20,911**	**$ 18,358**	**$ 5,195**	**$ 864**	**$ 45,328**

(Dollars in thousands)	Year Ended December 31, 2005 Retail Banking	Mortgage Banking	Consumer Finance	Other	Total
Salaries and employee benefits	$ 11,368	$ 13,457	$ 2,766	$ 686	$ 28,277
Occupancy expense	2,292	1,356	198	25	3,871
Other expenses	4,303	3,656	1,601	160	9,720
Total noninterest expense	$ 17,963	$ 18,469	$ 4,565	$ 871	$ 41,868

(Dollars in thousands)	Year Ended December 31, 2004 Retail Banking	Mortgage Banking	Consumer Finance	Other	Total
Salaries and employee benefits	$ 9,982	$ 12,624	$ 2,162	$ 465	$ 25,233
Occupancy expense	2,144	1,167	220	25	3,556
Other expenses	3,662	3,066	2,077	159	8,964
Total noninterest expense	$ 15,788	$ 16,857	$ 4,459	$ 649	$ 37,753

2006 Compared to 2005

Total noninterest expense increased $3.5 million, or 8.3 percent, to $45.3 million during 2006. The Retail Banking and the Consumer Finance segments reported increases in total noninterest expense that were primarily attributable to higher personnel and operating expenses to support growth and technology enhancements at both segments. Noninterest expense of the Retail Banking segment included costs associated with our new Hampton and Yorktown retail banking branches on the Virginia Peninsula, both of which opened in 2006, our new operations center, which opened in late 2005, and staffing and training personnel for our two new retail banking branches opening in 2007. Noninterest expenses of the Consumer Finance segment included costs associated with building depth in our sales force, entering new markets and increasing the administrative staff to support the increase in the loan portfolio. Total noninterest expense declined during 2006 for the Mortgage Banking segment because of lower production-based personnel costs due to lower origination volume in 2006. The decrease in personnel expenses was offset in part by higher overhead, including occupancy and other expenses, associated with opening new loan production offices in 2006 and 2005. Noninterest expenses of the Mortgage Banking segment in 2006 included $108,000 of expenses, in excess of the Corporation s insurance coverage, associated with a $2.2 million embezzlement perpetrated by two former employees of C&F Mortgage.

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2005 Compared to 2004

Total noninterest expense increased $4.1 million, or 10.9 percent, to $41.9 million for the year ended December 31, 2005. The Retail Banking and the Consumer Finance segments reported increases in total noninterest expenses that were primarily attributable to higher personnel and operating expenses to support growth in both segments and technology enhancements at the Consumer Finance segment. Start-up costs associated with the Bank s expansion efforts continued throughout 2005 with the ongoing construction of two new retail branches on the Virginia Peninsula, the acquisition of two retail branch buildings in the Richmond area and the relocation of the Bank s operations departments to a new facility in the fourth quarter of 2005. In addition, the Consumer Finance segment relocated its loan and administrative functions and staff to a new facility owned by the Bank in the third quarter of 2005. The Retail Banking segment will continue to incur additional expenses associated with its new facilities throughout 2006. An increase in noninterest expenses for the Mortgage Banking segment was attributable to higher production-based compensation and operating expenses due to an increase in production.

INCOME TAXES

Applicable income taxes on 2006 earnings amounted to $5.4 million, resulting in an effective tax rate of 30.9 percent, compared with $5.2 million, or 30.5 percent, in 2005 and $5.0 million, or 30.9 percent, in 2004. We do not consider these fluctuations in effective tax rates to be significant.

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ASSET QUALITY

Allowance and Provision for Loan Losses

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

TABLE 5: Allowance for Loan Losses

	Year Ended December 31,				
(Dollars in thousands)	**2006**	**2005**	**2004**	**2003**	**2002**
Allowance, beginning of period	**$ 13,064**	$ 11,144	$ 8,657	$ 6,722	$ 3,684
Provision for loan losses:					
Retail Banking and Mortgage Banking	**(250)**	400	200	525	500
Consumer Finance	**4,875**	5,120	3,826	2,642	641
Total provision for loan losses	**4,625**	5,520	4,026	3,167	1,141
Loans charged off:					
Real estate residential	**32**				
Commercial, financial and agricultural	**97**	20	7	15	161
Consumer	**229**	227	96	86	326
Consumer Finance	**4,735**	4,738	2,592	1,844	573
Total loans charged off	**5,093**	4,985	2,695	1,945	1,060
Recoveries of loans previously charged off:					
Real estate residential	**1**				
Commercial, financial and agricultural	**69**	49	68	34	47
Consumer	**146**	57	39	33	21
Consumer Finance	**1,404**	1,279	1,049	646	196
Total recoveries	**1,620**	1,385	1,156	713	264
Net loans charged off	**3,473**	3,600	1,539	1,232	796
Acquisition of C&F Finance Company					2,693
Allowance, end of period	**$ 14,216**	$ 13,064	$ 11,144	$ 8,657	$ 6,722
Ratio of net charge-offs to average total loans outstanding during period for Retail Banking and Mortgage Banking	**.03%**	.03%		.01%	.13%
Ratio of net charge-offs to average total loans outstanding during period for Consumer Finance	**2.76%**	3.33%	1.78%	1.60%	1.65%

During 2006, there was a $392,000 decline in the allowance for loan losses at the combined Retail Banking and Mortgage Banking segments compared to December 31, 2005. The Bank s nonperforming and accruing loans past due 90 days or more at December 31, 2005 consisted primarily of one commercial relationship to which we had allocated $865,000 of the allowance for loan losses. In May 2006, the borrower sold the real estate collateral for these loans and the loans were repaid in full from the sale proceeds. The decline in the allowance for loan losses resulting from the resolution of this nonperforming loan relationship was offset in part by the allocation of additional amounts in the loan loss allowance to loans downgraded during 2006 and increased allocations for certain loans based on risks associated with industry concentrations. We believe that the current level of the allowance for loan losses at the combined Retail and Mortgage Banking segments is adequate to absorb any losses on existing loans that may become uncollectible.

The Consumer Finance segment, consisting solely of C&F Finance, accounted for the majority of the activity in the allowance for loan losses during 2006. The decline in the provision for loan losses during 2006 resulted from lower net charge-offs as a result of the improvement in asset quality described below. We believe that the current level of the allowance for loan losses at the Consumer Finance segment is adequate to absorb any losses on existing loans that may become uncollectible.

Loan Loss Allowance Methodology-Retail and Mortgage Banking. We conduct an analysis of the loan portfolio on a regular basis. We use this analysis to assess the sufficiency of the allowance for loan losses and to determine the necessary provision for loan losses. The review process generally begins with loan officers identifying problem loans to be reviewed on an individual basis for impairment. In addition to these loans, all commercial loans are considered for individual impairment testing. Impairment testing includes consideration of the current collateral value for each loan, as well as any known internal or external factors that may affect collectibility. When we identify a loan as impaired, we may establish a specific allowance based on the difference between the carrying value of the loan and its computed fair value. We segregate the loans meeting the criteria for special mention, substandard, doubtful and loss, as well as impaired loans, from performing loans within the portfolio. We then group loans by loan type (e.g., commercial, consumer) and by risk rating (e.g., substandard, doubtful). We assign each loan type an allowance factor based on the associated risk, complexity and size of the individual loans within the particular loan category. We assign classified loans a higher allowance factor than non-rated loans within a particular loan type based on our concerns regarding collectibility or our knowledge of particular elements surrounding the borrower. Our allowance factors increase with the severity of classification. Allowance factors used for unclassified loans are based on our analysis of charge-off history and our judgment based on the overall analysis of the lending environment including the general economic conditions. The allowance for loan losses is the aggregate of specific allowances, the calculated allowance required for classified loans by category and the general allowance for each portfolio type.

In conjunction with the methodology described above, we consider the following risk elements that are inherent in the loan portfolio:

- Residential real estate loans and equity lines of credit carry risks associated with the continued credit-worthiness of the borrower and changes in the value of the collateral.

- Construction loans carry risks that the project will not be finished according to schedule, the project will not be finished according to budget and the value of the collateral may at any point in time be less than the principal amount of the loan. Construction loans also bear the risk that the general contractor, who may or may not be a Bank loan customer, is unable to finish the construction project as planned because of financial pressure unrelated to the project.

- Commercial real estate loans may carry risks associated with the successful operation of a business or a real estate project, in addition to other risks associated with the ownership of real estate, because the repayment of these loans may be dependent upon the profitability and cash flows of the business or project.

- Commercial business loans carry risks associated with the successful operation of a business, which is usually the source of loan repayment, and the value of the collateral, which may depreciate over time and cannot be appraised with as much precision as real estate.

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Consumer loans carry risks associated with the continued credit-worthiness of the borrower and the value of the collateral (e.g., rapidly-depreciating assets such as automobiles), or lack thereof. Consumer loans are more likely than real estate loans to be immediately adversely affected by job loss, divorce, illness or personal bankruptcy.

Loan Loss Allowance Methodology Consumer Finance. The Consumer Finance segment s loans consist of non-prime automobile loans. These loans carry risks associated with (1) the continued credit-worthiness of borrowers who are unable to meet the credit standards imposed by most traditional automobile financing sources and (2) the value of rapidly-depreciating collateral. These loans do not lend themselves to a classification process because of the short duration of time between delinquency and repossession. Therefore, the loan loss allowance review process generally focuses on the rates of delinquencies, defaults, repossessions and losses. Allowance factors also include an analysis of charge-off history and our judgment based on the overall analysis of the lending environment.

The allocation of the allowance at December 31 for the years indicated and the ratio of related outstanding loan balances to total loans are as follows:

TABLE 6: Allocation of Allowance for Loan Losses

(Dollars in thousands)	**2006**	**2005**	**2004**	**2003**	**2002**
Allocation of allowance for loan losses, end of year:					
Real estate residential mortgage	**$ 502**	$ 402	$ 337	$ 615	$ 573
Real estate construction	**136**	202	129	112	107
Commercial, financial and agricultural[1]	**3,031**	3,776	3,736	3,175	2,670
Equity lines	**134**	124	92	98	94
Consumer	**326**	214	166	256	287
Consumer finance	**9,890**	8,346	6,684	4,401	2,957
Unallocated	**197**				34
Balance, December 31	**$ 14,216**	$ 13,064	$ 11,144	$ 8,657	$ 6,722
Ratio of loans to total year-end loans:					
Real estate residential mortgage	**22%**	20%	21%	22%	23%
Real estate construction	**2**	4	3	3	3
Commercial, financial and agricultural[1]	**44**	45	46	46	47
Equity lines	**5**	5	5	4	4
Consumer	**2**	2	2	3	3
Consumer finance	**25**	24	23	22	20
	100%	100%	100%	100%	100%

1 Includes loans secured by real estate

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Nonperforming Assets

Table 7 summarizes nonperforming assets at December 31, of each of the past five years.

TABLE 7: Nonperforming Assets

Retail and Mortgage Banking					
(Dollars in thousands)	**2006**	**2005**	**2004**	**2003**	**2002**
Nonaccrual loans	**$ 955**	$ 4,083	$ 4,336	$ 1,993	$ 1,656
Real estate owned				8	703
Total nonperforming assets	**$ 955**	$ 4,083	$ 4,336	$ 2,001	$ 2,359
Accruing loans past due for 90 days or more	**$ 1,629**	$ 3,826	$ 1,580	$ 1,092	$ 69
Allowance for loan losses	**$ 4,326**	$ 4,718	$ 4,460	$ 4,256	$ 3,765
Nonperforming assets to total loans* and real estate owned	**0.24%**	1.11%	1.39%	.72%	.88%
Allowance for loan losses to total loans* and real estate owned	**1.08**	1.29	1.43	1.52	1.40
Allowance for loan losses to nonperforming assets	**452.98**	115.56	102.88	212.69	159.60

* Total loans above does not include consumer finance loans at C&F Finance, which are shown directly below.

Consumer Finance					
(Dollars in thousands)	**2006**	**2005**	**2004**	**2003**	**2002**
Nonaccrual loans	**$ 880**	$ 1,819	$ 1,330	$ 1,149	$ 688
Accruing loans past due for 90 days or more	**$ 8**	$ 26	$ 481	$ 233	$ 293
Allowance for loan losses	**$ 9,890**	$ 8,346	$ 6,684	$ 4,401	$ 2,957
Nonaccrual consumer finance loans to total consumer finance loans	**0.66%**	1.64%	1.42%	1.44%	1.02%
Allowance for loan losses to total consumer finance loans	**7.44%**	7.51%	7.15%	5.52%	4.40%

Nonperforming assets and accruing loans past due 90 days or more of the combined Retail and Mortgage Banking segments at December 31, 2005 consisted primarily of one commercial relationship. As previously described, these loans were repaid in full in May 2006, which accounted for the majority of the decline in nonperforming assets in 2006.

Nonaccrual loans of the Consumer Finance segment as a percentage of total consumer finance loans declined to less than one percent since December 31, 2005. Despite the improvement in asset quality, we have maintained the ratio of the allowance for loan losses to total loans at 7.44 percent because of cyclical behavior in consumer finance delinquency trends and an increase in the amount of delinquent payment deferrals.

In accordance with its policies and guidelines and consistent with industry practices, C&F Finance, at times, offers payment deferrals to borrowers, whereby the borrower is allowed to move up to two payments within a twelve-month rolling period to the end of the loan, generally by paying a fee. An account for which all delinquent payments are deferred is classified as current at the time the deferment is granted and therefore is not included as a delinquent account. Thereafter, such an account is aged based on the timely payment of future installments in the same manner as any other account. We evaluate the results of this deferment strategy based upon the amount of cash installments that are collected on accounts after they have been deferred versus the extent to which the collateral underlying the deferred accounts has depreciated over the same period of time. Based on this evaluation, we believe that payment deferrals granted according to our policies and guidelines are an effective portfolio management technique and result in higher ultimate cash collections from the portfolio. Payment deferrals may affect the ultimate timing of when an account is charged off. Increased use of deferrals may result in a lengthening of the loss confirmation period, which would increase expectations of credit losses inherent in the portfolio and therefore increase the allowance for loan losses and related provision for loan losses.

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During periods of economic slowdown or recession, delinquencies, defaults, repossessions and losses generally increase at the Consumer Finance segment. 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 a 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 C&F Finance focuses 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 more dramatically affected by a general economic downturn. While we manage the higher risk inherent in loans made to non-prime borrowers through the underwriting criteria and collection methods employed by C&F Finance, we cannot guarantee that these criteria or methods will afford adequate protection against these risks. However, we believe that the current allowance for loan losses is adequate to absorb any losses on existing Consumer Finance segment loans that may become uncollectible.

We generally place loans at the Retail Banking, Mortgage Banking and Consumer Finance segments on nonaccrual status when the collection of principal or interest is 90 days or more past due, or earlier, if collection is uncertain based on an evaluation of the net realizable value of the collateral and the financial strength of the borrower. Loans greater than 90 days past due may remain on accrual status if we determine we have adequate collateral to cover the principal and interest. For those loans that are carried on nonaccrual status, payments are first applied to principal outstanding. As previously discussed, interest income for 2006 included $870,000 of nonaccrued and default interest collected on one nonperforming commercial relationship when the loans were repaid in full in May 2006. Excluding this transaction, we would have recorded additional gross interest income of $70,000 for 2006, $270,000 for 2005 and $202,000 for 2004 if nonaccrual loans had been current throughout these periods. Interest received on nonaccrual loans was $41,000 in 2006, $193,000 in 2005 and $55,000 in 2004.

At the Consumer Finance segment, automobiles securing the loans are generally repossessed after a loan becomes more than 60 days delinquent. Repossessions are handled by independent repossession firms engaged by C&F Finance and must be approved by a collections officer. After the prescribed waiting period, the repossessed automobile is sold by a third-party auctioneer. We credit the proceeds from the sale of the automobile, and any other recoveries, against the balance of the loan. Proceeds from the sale of the repossessed vehicle and other recoveries are usually not sufficient to cover the outstanding balance of the loan, and the resulting deficiency is charged off. The charge-off represents the difference between the actual net sale proceeds and the amount of the delinquent loan. C&F Finance pursues collection of deficiencies when it deems such action to be appropriate.

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 we 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 collectibility 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. The balance of impaired loans at December 31, 2006 was $781,000 for which no specific valuation allowance was deemed necessary. At December 31, 2005, the balance of impaired loans was $4.2 million for which a specific valuation

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allowance of $865,000 was provided. In May 2006, the borrowers sold the real estate collateral for these loans and paid the loans in full from the sale proceeds. The average balance of impaired loans was $2.24 million for 2006, $4.2 million for 2005 and $3.5 million for 2004.

FINANCIAL CONDITION

SUMMARY

A financial institution s primary sources of revenue are generated by its earning assets, while its major expenses are produced by the funding of those assets with interest-bearing liabilities. Effective management of these sources and uses of funds is essential in attaining a financial institution s maximum profitability while maintaining an acceptable level of risk.

At December 31, 2006, the Corporation had total assets of $734.5 million compared to $672.0 million at December 31, 2005. The increase was principally a result of an increase in loans held for sale, loans held for investment and corporate premises and equipment, which was offset in part by a decline in interest-bearing deposits in other banks. Growth in loan demand was funded by reducing the amount the Corporation placed in lower-yielding overnight funds and increasing its borrowings. The increase in corporate premises resulted from expenditures associated with the completion of the Bank s Hampton and Yorktown branches, which opened in 2006, the Bank s Patterson Avenue branch in Richmond, which opened in January 2007, and the ongoing renovation of one branch building acquired in 2005 and located in the Richmond, Virginia area. Asset growth in 2005 was principally a result of increases in loans held for investment and corporate premises.

LOAN PORTFOLIO

General

Through the Retail Banking segment, we engage in a wide range of lending activities, which include the origination, primarily in the Banking segment s market area, of (1) one-to-four family and multi-family residential mortgage loans, (2) commercial real estate loans, (3) construction loans, (4) land acquisition and development loans, (5) consumer loans and (6) commercial business loans. We engage in non-prime automobile lending through the Consumer Finance segment and in residential mortgage lending through the Mortgage Banking segment with loans sold to third-party investors. At December 31, 2006, the Corporation s loans held for investment in all categories totaled $532.1 million and loans held for sale totaled $53.5 million.

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Tables 8 and 9 present information pertaining to the composition of loans and maturity/repricing of loans.

TABLE 8: Summary of Loans Held for Investment

	December 31,				
(Dollars in thousands)	**2006**	**2005**	**2004**	**2003**	**2002**
Real estate residential mortgage	**$ 115,557**	$ 96,423	$ 85,080	$ 77,878	$ 75,684
Real estate construction	**13,650**	20,222	13,315	9,591	8,572
Commercial, financial, and agricultural[1]	**236,157**	216,081	185,646	167,207	158,350
Equity lines	**24,880**	24,662	18,490	13,044	12,181
Consumer	**8,951**	9,574	9,620	11,405	13,375
Consumer finance	**132,864**	111,141	93,464	79,702	67,194
Total loans	**532,059**	478,103	405,615	358,827	335,356
Less allowance for loan losses	**(14,216)**	(13,064)	(11,144)	(8,657)	(6,722)
Total loans, net	**$ 517,843**	$ 465,039	$ 394,471	$ 350,170	$ 328,634

[1] *Includes loans secured by real estate*

TABLE 9: Maturity/Repricing Schedule of Loans

	December 31, 2006	
(Dollars in thousands)	**Commercial, Financial, and Agricultural**	**Real Estate Construction**
Variable Rate:		
Within 1 year	**$ 36,832**	**$ 1,559**
1 to 5 years	**48,496**	
After 5 years	**21,474**	
Fixed Rate:		
Within 1 year	**99,988**	**12,091**
1 to 5 years	**27,959**	
After 5 years	**1,408**	

The increase in loans held for investment occurred predominantly in (1) the variable-rate categories of real estate and commercial loans and (2) the fixed-rate category of consumer loans at C&F Finance. Typically, growth in the variable-rate categories will favorably affect net interest margin in a rising rate environment. Fixed-rate consumer loans at C&F Finance are predominantly funded by variable rate borrowings; therefore, net interest margin will be negatively impacted in a rising interest rate environment.

Credit Policy

The Corporation s credit policy establishes minimum requirements and provides for appropriate limitations on overall concentration of credit within the Corporation. The policy provides guidance in general credit policies, underwriting policies and risk management, credit approval, and administrative and problem asset management policies. The overall goal of the Corporation s credit policy is to ensure that loan growth is accompanied by acceptable asset quality with uniform and consistently applied approval, administration, and documentation practices and standards.

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Residential Mortgage Lending   Held for Sale

The Mortgage Banking segment s guidelines for underwriting conventional conforming loans comply with the underwriting criteria established by Fannie Mae and/or Freddie Mac. The guidelines for non-conforming conventional loans are based on the requirements of private investors and information provided by third-party investors. The guidelines used by C&F Mortgage to originate FHA-insured and VA-guaranteed loans comply with the criteria established by HUD and the VA. The conventional loans that C&F Mortgage originates or purchases that have loan-to-value ratios greater than 80 percent at origination are generally insured by private mortgage insurance. The borrower pays the cost of the insurance.

Residential Mortgage Lending   Held for Investment

The Retail Banking segment originates residential mortgage loans secured by properties located in its primary market area in southeastern and central Virginia. The Bank offers various types of residential mortgage loans in addition to traditional long-term, fixed-rate loans. Such loans include 10 and 15 year amortizing mortgage loans with fixed rates of interest and fixed-rate mortgage loans with terms of 20, 25 and 30 years but subject to call after five years at the option of the Bank.

Loans associated with residential mortgage lending are included in the real estate residential mortgage category in Table 8.

Construction Lending

The Retail Banking segment has an active construction lending program. The Bank makes loans primarily for the construction of one-to-four family residences and, to a lesser extent, multi-family dwellings. The Bank also makes construction loans for office and warehouse facilities and other nonresidential projects, generally limited to borrowers that present other business opportunities for the Bank.

The amounts, interest rates and terms for construction loans vary, depending upon market conditions, the size and complexity of the project, and the financial strength of the borrower and any guarantors of the loan. The term for the Bank s typical construction loan ranges from nine months to 15 months for the construction of an individual residence and from 15 months to a maximum of three years for larger residential or commercial projects. The Bank does not typically amortize its construction loans, and the borrower pays interest monthly on the outstanding principal balance of the loan. The interest rates on the Bank s construction loans are fixed and variable. The Bank does not generally finance the construction of commercial real estate projects built on a speculative basis. For residential builder loans, the Bank limits the number of models and/or speculative units allowed depending on market conditions, the builder s financial strength and track record and other factors. Generally, the maximum loan-to-value ratio for one-to-four family residential construction loans is 80 percent of the property s fair market value, or 85 percent of the property s fair market value if the property will be the borrower s primary residence. The fair market value of a project is determined on the basis of an appraisal of the project conducted by an appraiser acceptable to the Bank. For larger projects where unit absorption or leasing is a concern, the Bank may also obtain a feasibility study or other acceptable information from the borrower or other sources about the likely disposition of the property following the completion of construction.

Construction loans for nonresidential projects and multi-unit residential projects are generally larger and involve a greater degree of risk to the Bank than residential mortgage loans. The Bank attempts to minimize such risks (1) by making construction loans in accordance with the Bank s underwriting standards and to established customers in its primary market area and (2) by monitoring the quality, progress and cost of construction. Generally, the maximum loan-to-value ratio established by the Bank for non-residential projects and multi-unit residential projects is 80 percent; however, this maximum can be waived for particularly strong borrowers on an exception basis.

Loans associated with construction lending are included in the real estate construction category in Table 8.

Consumer Lot Lending

Consumer lot loans are loans made to individuals for the purpose of acquiring an unimproved building site for the construction of a residence that generally will be occupied by the borrower. Consumer lot loans are made only to individual borrowers, and each borrower generally must certify to the Bank his intention to build and occupy a single-family residence on the lot generally within three or five years of the date of origination of the loan. These loans typically have a maximum term of either three or five years with a balloon payment of the entire balance of the loan being due in full at the end of the initial term. The interest rate for these loans is fixed or variable at a rate that is slightly higher than prevailing rates for one-to-four family residential mortgage loans. We do not believe consumer lot loans bear as much risk as land acquisition and development loans because such loans are not made for the construction of residences for immediate resale, are not made to developers and builders, and are not concentrated in any one subdivision or community. In 2004, the Bank began purchasing lot loans originated by C&F Mortgage. These loans must satisfy the Bank s underwriting criteria, including loan-to-value and credit score guidelines.

Loans associated with consumer lot lending are included in the real estate construction category in Table 8.

Commercial Real Estate Lending

The Bank s commercial real estate loans are primarily secured by the value of real property and the income arising from such property. The proceeds of commercial real estate loans are generally used by the borrower to finance or refinance the cost of acquiring and/or improving a commercial property. The properties that typically secure these loans are office and warehouse facilities, hotels, retail facilities, restaurants and other commercial properties. The Bank s present policy is generally to restrict the making of commercial real estate loans to borrowers who will occupy or use the financed property in connection with their normal business operations. However, the Bank also will consider making commercial real estate loans under the following two conditions. First, the Bank will consider making commercial real estate loans for other purposes if the borrower is in strong financial condition and presents a substantial business opportunity for the Bank. Second, the Bank will consider making commercial real estate loans to creditworthy borrowers who have substantially pre-leased the improvements to high-caliber tenants.

The Bank s commercial real estate loans are usually amortized over a period of time ranging from 15 years to 25 years and usually have a term to maturity ranging from five years to 15 years. These loans normally have provisions for interest rate adjustments after the loan is three to five years old. The Bank s maximum loan-to-value ratio for a commercial real estate loan is 80 percent; however, this maximum can be waived for particularly strong borrowers on an exception basis. Most commercial real estate loans are further secured by one or more unconditional personal guarantees.

In recent years, the Bank has structured some of its commercial real estate loans as mini-permanent loans. The amortization period, term and interest rates for these loans vary based on borrower preferences and the Bank s assessment of the loan and the degree of risk involved. If the borrower prefers a fixed rate of interest, the Bank usually offers a loan with a fixed rate of interest for a term of three to five years with an amortization period of up to 25 years. The remaining balance of the loan is due and payable in a single balloon payment at the end of the initial term. We believe that shorter maturities for commercial real estate loans are necessary to give the Bank some protection from changes in the borrower s business and income as well as changes in general economic conditions. In the case of fixed-rate commercial real estate loans, shorter maturities also provide the Bank with an opportunity to adjust the interest rate on this type of interest-earning asset in accordance with the Bank s asset and liability management strategies.

Loans secured by commercial real estate are generally larger and involve a greater degree of risk than residential mortgage loans. Because payments on loans secured by commercial real estate are usually dependent on successful operation or management of the properties securing such loans, repayment of such loans is subject to changes in both general and local economic conditions and the borrower s business and income. As a result, events beyond the control of the Bank, such as a downturn in the local economy, could adversely affect the performance of the Bank s commercial real estate loan portfolio. The Bank seeks to minimize these risks by lending to established customers and generally restricting its commercial real estate loans to its primary market area. Emphasis is placed on the income producing characteristics and capacity of the collateral.

Loans associated with commercial real estate lending are included in the commercial, financial and agricultural category in Table 8.

Land Acquisition and Development Lending

Land acquisition and development loans are made to builders and developers for the purpose of acquiring unimproved land to be developed for residential building sites, residential housing subdivisions, multi-family dwellings and a variety of commercial uses. The Bank s policy is to make land acquisition loans to borrowers for the purpose of acquiring developed lots for single-family, townhouse or condominium construction. The Bank will make both land acquisition and development loans to residential builders, experienced developers and others in strong financial condition to provide additional construction and mortgage lending opportunities for the Bank.

The Bank underwrites and processes land acquisition and development loans in much the same manner as commercial construction loans and commercial real estate loans. For land acquisition and development loans, the Bank uses lower loan-to-value ratios, which are a maximum of 65 percent for raw land, 75 percent for land development and improved lots and 80 percent of the discounted appraised value of the property as determined in accordance with the Bank s appraisal policies for developed lots for single-family or townhouse construction. The Bank can waive the maximum loan-to-value ratio for particularly strong borrowers on an exception basis. The term of land acquisition and development loans ranges from a maximum of two years for loans relating to the acquisition of unimproved land to, generally, a maximum of three years for other types of projects. All land acquisition and development loans generally are further secured by one or more unconditional personal guarantees. Because these loans are usually in a larger amount and involve more risk than consumer lot loans, the Bank carefully evaluates the borrower s assumptions and projections about market conditions and absorption rates in the community in which the property is located and the borrower s ability to carry the loan if the borrower s assumptions prove inaccurate.

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Loans associated with land acquisition and development lending are included in the commercial, financial and agricultural category in Table 8.

Commercial Business Lending

Commercial business loan products include revolving lines of credit to provide working capital, term loans to finance the purchase of vehicles and equipment, letters of credit to guarantee payment and performance, and other commercial loans. In general, these credit facilities carry the unconditional guaranty of the owners and/or stockholders.

Revolving and operating lines of credit are typically secured by all current assets of the borrower, provide for the acceleration of repayment upon any event of default, are monitored monthly or quarterly to ensure compliance with loan covenants, and are re-underwritten or renewed annually. Interest rates generally will float at a spread tied to the Bank s prime lending rate. Term loans are generally advanced for the purchase of, and are secured by, vehicles and equipment and are normally fully amortized over a term of two to five years, on either a fixed or floating rate basis.

Loans associated with commercial business lending are included in the commercial, financial and agricultural category in Table 8.

Home Equity and Second Mortgage Lending

The Bank offers its customers home equity lines of credit and second mortgage loans that enable customers to borrow funds secured by the equity in their homes. Currently, home equity lines of credit are offered with adjustable rates of interest that are generally priced at the prime lending rate plus a spread. Second mortgage loans are offered with fixed and adjustable rates. Call option provisions are included in the loan documents for some longer-term, fixed-rate second mortgage loans, and these provisions allow the Bank to make interest rate adjustments for such loans. Second mortgage loans are granted for a fixed period of time, usually between five and 20 years, and home equity lines of credit are made on an open-end, revolving basis. Home equity loans, second mortgage loans and other consumer loans secured by a personal residence generally do not present as much risk to the Bank as other types of consumer loans. In 2004, the Bank began purchasing home equity lines of credit and second mortgage loans originated by C&F Mortgage. These loans must satisfy the Bank s underwriting criteria, including loan-to-value and credit score guidelines.

Loans associated with home equity and second mortgage lending are included in the equity lines category in Table 8.

Consumer Lending

The Bank offers a variety of consumer loans, including automobile, personal secured and personal unsecured, credit card, and loans secured by savings accounts or certificates of deposit. The shorter terms and generally higher interest rates on consumer loans help the Bank maintain a profitable spread between its average loan yield and its cost of funds. Consumer loans secured by collateral other than a personal residence generally involve more credit risk than residential mortgage loans because of the type and nature of the collateral or, in certain cases, the absence of collateral. However, the Bank believes the higher yields generally earned on such loans compensate for the increased credit risk associated with such loans.

Loans associated with consumer lending are included in the consumer category in Table 8.

Automobile Sales Finance

C&F Finance has an extensive automobile dealer network through which it purchases installment contracts throughout its markets. Branch personnel have a specific credit authority based upon their experience and historical loan portfolio results, as well as established underwriting criteria. Although the credit approval process is decentralized, C&F Finance s application processing system includes controls designed to ensure that credit decisions comply with its underwriting policies and procedures.

Finance contract application packages completed by prospective borrowers are submitted by the automobile dealers electronically through a third-party online automotive sales and finance platform to C&F Finance s automated origination and application scoring system, which processes the credit bureau report, generates all relevant loan calculations and recommends the contract structure. C&F Finance personnel with credit authority review the system-generated recommendations and determine whether to approve or deny the application. The credit decision is based primarily on the applicant s credit history with emphasis on prior auto loan history, current employment status, income, collateral type and mileage, and the contract-to-value ratio.

C&F Finance s underwriting and collateral guidelines form the basis for the credit decision. Exceptions to credit policies and authorities must be approved by a designated credit officer. C&F Finance s typical borrowers have experienced prior credit difficulties or have modest income. Because C&F Finance serves customers who are unable to meet the credit standards imposed by most traditional automobile financing sources, we expect C&F Finance to sustain a higher level of credit losses than traditional automobile financing sources. However, C&F Finance generally charges interest at higher rates than those charged by traditional financing sources. These higher rates should more than offset the increase in the provision for loan losses for this segment of the Corporation s loan portfolio.

Loans associated with automobile sales finance are included in the consumer finance category in Table 8.

SECURITIES

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

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

(Dollars in thousands)	**December 31, 2006**		**December 31, 2005**	
	Amount	**Percent**	**Amount**	**Percent**
U.S. government agencies and corporations	**$ 6,222**	**9%**	$ 6,118	9%
Mortgage-backed securities	**2,208**	**3**	2,562	4
Obligations of states and political subdivisions	**55,027**	**82**	52,524	81
Total debt securities	**63,457**	**94**	61,204	94
Preferred stock	**4,127**	**6**	4,097	6
Total available for sale securities	**$ 67,584**	**100%**	$ 65,301	100%

Table 10 presents additional information pertaining to the composition of the securities portfolio by contractual maturity.

TABLE 10: Maturity of Securities

	Year Ended December 31,					
	2006		**2005**		**2004**	
(Dollars in thousands)	**Amortized Cost**	**Weighted Average Yield**	**Amortized Cost**	**Weighted Average Yield**	**Amortized Cost**	**Weighted Average Yield**
U.S. government agencies and corporations:						
Maturing within 1 year	**$ 498**	**2.97%**	$	%	$ 6,508	3.12%
Maturing after 1 year, but within 5 years	**2,747**	**4.46**	2,740	4.25	2,244	3.44
Maturing after 5 years, but within 10 years	**2,443**	**5.55**	3,495	5.01	1,994	4.60
Maturing after 10 years	**625**	**6.82**				
Total U.S. government agencies and corporations	**6,313**	**5.00**	6,235	4.68	10,746	3.46
Mortgage backed securities:						
Maturing within 1 year	**38**	**3.39**	348	5.91		
Maturing after 1 year, but within 5 years	**2,198**	**4.77**	2,240	4.70	3,039	4.87
Total mortgage backed securities	**2,236**	**4.75**	2,588	4.86	3,039	4.87
States and municipals:[1]						
Maturing within 1 year	**1,213**	**4.38**	1,103	4.85	732	7.96
Maturing after 1 year, but within 5 years	**16,254**	**6.06**	11,192	6.03	6,654	6.29
Maturing after 5 years, but within 10 years	**24,017**	**6.75**	22,592	6.92	21,744	7.00
Maturing after 10 years	**12,437**	**6.41**	16,242	6.64	21,935	6.77
Total states and municipals	**53,921**	**6.41**	51,129	6.60	51,065	6.82
Total securities:[2]						
Maturing within 1 year	**1,749**	**3.95**	1,451	5.10	7,240	3.61
Maturing after 1 year, but within 5 years	**21,199**	**5.71**	16,172	5.53	11,937	5.38
Maturing after 5 years, but within 10 years	**26,460**	**6.64**	26,087	6.67	23,738	6.80

Maturing after 10 years	**13,062**	**6.42**	16,242	6.64	21,935	6.77
Total securities	**$ 62,470**	**6.21%**	$ 59,952	6.33%	$ 64,850	6.18%

[1] *Yields on tax-exempt securities have been computed on a taxable-equivalent basis.*

[2] *Total securities excludes preferred stock at amortized cost of $3.9 million at December 31, 2006; $4.1 million at December 31, 2005 and $4.9 million at December 31, 2004 (estimated fair value of $4.1 million at December 31, 2006; $4.1 million at December 31, 2005 and $5.3 million at December 31, 2004).*

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DEPOSITS

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

Deposits totaled $532.8 million at December 31, 2006, compared to $495.4 million at December 31, 2005. This increase was primarily attributable to (1) the increase in noninterest-bearing demand deposits, which totaled $90.3 million at December 31, 2006, compared to $78.9 million at December 31, 2005 and (2) the increase in time deposits, which totaled $254.1 million at December 31, 2006, compared to $221.3 million at December 31, 2005, which were offset in part by the decrease in savings and interest-bearing demand deposits from $195.2 million at December 31, 2005 to $188.5 million at December 31, 2006. The increase in noninterest-bearing deposits resulted from an increase in municipal deposit accounts. The increase in time deposits resulted from the effect of our competitive rate-setting strategies. Total deposits at December 31, 2005 increased $48.3 million, or 10.8 percent, over December 31, 2004. Deposit growth in 2005 occurred in all of the Bank s market regions and, in particular, at the Bank s newest branches at the time in Newport News and Mechanicsville.

Table 11 presents the average deposit balances and average rates paid for the years 2006, 2005 and 2004. Table 12 details maturities of certificates of deposit with balances of $100,000 or more at December 31, 2006.

TABLE 11: Average Deposits and Rates Paid

	Year Ended December 31,					
	2006		2005		2004	
(Dollars in thousands)	Average Balance	Average Rate	Average Balance	Average Rate	Average Balance	Average Rate
Non-interest-bearing demand deposits	**$ 79,472**		$ 76,172		$ 69,281	
Interest-bearing transaction accounts	**87,074**	**1.09%**	81,885	0.89%	80,055	0.62%
Money market deposit accounts	**44,820**	**2.20**	49,909	1.42	42,797	0.77
Savings accounts	**49,644**	**0.71**	54,656	0.70	55,856	0.59
Certificates of deposit, $100M or more	**79,873**	**3.98**	63,432	2.71	56,480	1.92
Other certificates of deposit	**152,879**	**3.72**	136,779	2.74	127,923	2.15
Total interest-bearing deposits	**414,290**	**2.69%**	386,661	1.88%	363,111	1.37%
Total deposits	**$ 493,762**		$ 462,833		$ 432,392	

TABLE 12: Maturities of Certificates of Deposit with Balances of $100,000 or More

(Dollars in thousands)	December 31, 2006
3 months or less	**$ 12,415**
3-6 months	**20,331**
6-12 months	**53,751**
Over 12 months	**8,683**
Total	**$ 95,180**

BORROWINGS

In addition to deposits, the Corporation utilizes short-term borrowings from the FHLB to fund its day-to-day operations. Short-term borrowings also include securities sold under agreements to repurchase, which are secured transactions with customers and generally mature the day following the day sold, as well as a short-term line of credit with a third-party lender for general corporate purposes. Long-term borrowings consist of advances from the FHLB and advances under a non-recourse revolving bank line of credit. All FHLB advances are secured by a blanket floating lien on all qualifying real estate loans. The bank line of credit is non-recourse and is secured by loans at C&F Finance. In July 2005, C&F Financial Statutory Trust I, a wholly-owned subsidiary of the Corporation, was formed for the purpose of issuing trust preferred capital securities to partially fund the Corporation s purchase of 427,186 shares of its common stock. (For further information concerning our share purchase, refer to Capital Resources on page 46.) On July 21, 2005, the Trust issued $10.0 million of trust preferred capital securities in a private placement to an institutional investor and $310,000 in common equity to the Corporation. The principal asset of the Trust is $10.3 million of the Corporation s junior subordinated debt securities (referred to herein as trust preferred capital notes). For further information concerning the Corporation s borrowings, refer to Item 8, Financial Statements and Supplementary Data, under the heading Note 7: Borrowings.

OFF-BALANCE-SHEET ARRANGEMENTS

To meet the financing needs of customers, the Corporation is a party, in the normal course of business, to financial instruments with off-balance-sheet risk. These financial instruments include commitments to extend credit, commitments to sell loans and standby letters of credit. These instruments involve elements of credit and interest rate risk in addition to the amount on the balance sheet. The Corporation s exposure to credit loss in the event of nonperformance by the other party to the financial instrument for commitments to extend credit and standby letters of credit written is represented by the contractual amount of these instruments. We use the same credit policies in making these commitments and conditional obligations as we do for on-balance-sheet instruments. We obtain collateral based on our credit assessment of the customer in each circumstance.

Loan commitments are agreements to extend credit to a customer provided that there are no violations of the terms of the contract prior to funding. Commitments have fixed expiration dates or other termination clauses and may require payment of a fee by the customer. Since many of the commitments may expire without being completely drawn upon, the total commitment amounts do not necessarily represent future cash requirements. The total amount of unused loan commitments was $93.3 million at December 31, 2006 and $97.9 million at December 31, 2005.

Standby letters of credit are written conditional commitments issued by the Bank to guarantee the performance of a customer to a third party. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loans to customers. The total contract amount of standby letters of credit, whose contract amounts represent credit risk, was $8.8 million at December 31, 2006 and $9.7 million at December 31, 2005.

At December 31, 2006, C&F Mortgage had rate lock commitments to originate mortgage loans aggregating $23.8 million and loans held for sale of $53.5 million. C&F Mortgage has entered into corresponding commitments with third party investors to sell loans of approximately $77.3 million. These commitments to sell loans are designed to eliminate C&F Mortgage s exposure to fluctuations in interest rates in connection with rate lock commitments and loans held for sale.

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C&F Mortgage sells substantially all of the residential mortgage loans it originates to third-party investors, some of whom require the repurchase of loans in the event of early default or faulty documentation. Mortgage loans and their related servicing rights are sold under agreements that define certain eligibility criteria for the mortgage loans. Recourse periods vary from 90 days up to one year and conditions for repurchase vary with the investor. We include recourse considerations in our calculation of the Corporation s capital adequacy. Payments made under these recourse provisions were $62,000 in 2006, $29,000 in 2005 and $75,000 in 2004. Risks also arise from the possible inability of counterparties to meet the terms of their contracts. C&F Mortgage has procedures in place to evaluate the credit risk of investors and does not expect any counterparty to fail to meet its obligations.

LIQUIDITY

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

Liquid assets, which include cash and due from banks, interest-bearing deposits at other banks and nonpledged securities available for sale, totaled $54.8 million at December 31, 2006. The Corporation s funding sources consist of (1) an established federal funds line with a regional correspondent bank that had no outstanding balance under a total line of $14.0 million as of December 31, 2006, (2) an established line with the FHLB that had $15.0 million outstanding under a total line of $131.4 million as of December 31, 2006, (3) a revolving line of credit with a third-party bank that had $77.3 million outstanding under a total line of $100 million as of December 31, 2006 and (4) a revolving line of credit with a third-party bank that had $7.0 million outstanding under a total line of $7.0 million as of December 31, 2006. We have no reason to believe these arrangements will not be renewed at maturity.

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Certificates of deposit of $100,000 or more maturing in less than a year totaled $86.5 million at December 31, 2006; certificates of deposit of $100,000 or more maturing in more than one year totaled $8.7 million. The following table presents the Corporation s contractual obligations and scheduled payment amounts due at various intervals over the next five years and beyond as of December 31, 2006:

CONTRACTUAL OBLIGATIONS

(Dollars in thousands)		**Payments Due by Period**			
	Total	**Less than 1 Year**	**1-3 Years**	**3-5 Years**	**More than 5 Years**
Bank lines of credit	$ 84,284	$ 7,000	$	$ 77,284	$
FHLB advances[1]	15,000				15,000
Trust preferred capital notes	10,310				10,310
Securities sold under agreements to repurchase	5,462	5,462			
Operating leases	2,165	877	894	394	
Total	$ 117,221	$ 13,339	$ 894	$ 77,678	$ 25,310

[1] The FHLB advances include an early conversion option for the FHLB, at its discretion, to convert the existing fixed-rate advances into three-month LIBOR-based floating rate advances. The conversion options for the $15.0 million advances due in more than five years can be exercised in 2007. We can elect to repay the advances on the conversion dates, but may incur a prepayment penalty depending on actions taken by the FHLB with regard to the conversion options.

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

CAPITAL RESOURCES

The assessment of capital adequacy depends on such factors as asset quality, liquidity, earnings performance, and changing competitive conditions and economic forces. We regularly review the adequacy of the Corporation s capital. We maintain a structure that will assure an adequate level of capital to support anticipated asset growth and to absorb potential losses.

During 2006, we purchased 13,257 shares of the Corporation s common stock in open-market transactions at an average price of $39.08 per share under stock purchase programs authorized by the Corporation s board of directors. On July 27, 2005, the Corporation completed a tender offer and purchased 427,186 shares at $41 per share. The total cost of the share purchase, including transaction costs, approximated $17.6 million. In December 2005, we purchased 100 shares in an open-market transaction at $37.27 per share under a board-approved stock purchase program. The board of directors authorized these stock purchases because the Corporation s capital level exceeded its ongoing operational needs and regulatory requirements. While we will continue to look for opportunities to invest capital in profitable growth, share purchases are another tool that facilitates improving shareholder return, as measured by ROE and earnings per share.

Through February 15, 2007, we have purchased 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. For further information concerning the Corporation s share purchases, refer to Item 5, Market for Registrant s Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities.

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The Corporation s capital position continues to exceed regulatory minimum requirements. The primary indicators relied on by bank regulators in measuring the capital position are the Tier I capital, total risk-based capital, and leverage ratios, as previously described in the Regulation and Supervision section of Item 1. The Corporation s Tier I capital ratio was 11.3 percent at December 31, 2006, compared with 11.0 percent at December 31, 2005. The total capital ratio was 12.6 percent at December 31, 2006, compared with 12.2 percent at December 31, 2005. The leverage ratio was 9.6 percent at December 31, 2006, compared with 8.9 percent at December 31, 2005. These ratios are in excess of the mandated minimum requirements. The trust preferred securities issued in connection with the July 2005 tender offer are treated as Tier 1 capital for regulatory capital adequacy determination purposes.

Shareholders equity was $68.0 million at year-end 2006 compared with $60.1 million at year-end 2005. The dividend payout ratio was 30.2 percent in 2006, 28.3 percent in 2005 and 28.6 percent in 2004. During 2006, the Corporation declared dividends of $1.16 per share, up 16 percent from $1.00 per share in 2005.

We are not aware of any current recommendations by any regulatory authorities that, if implemented, would have a material effect on the Corporation s liquidity, capital resources or results of operations.

RECENT ACCOUNTING PRONOUNCEMENTS

Recent accounting pronouncements affecting the Corporation are described in Item 8, Financial Statements and Supplementary Data, under the heading Note 1: Summary of Significant Accounting Policies-Recent Accounting Pronouncements.

EFFECTS OF INFLATION

The effect of changing prices is typically different for financial institutions than for other entities because a financial institution s assets and liabilities are monetary in nature. Interest rates are significantly impacted by inflation, but neither the timing nor the magnitude of the changes is directly related to price-level indices. The consolidated financial statements reflect the impacts of inflation on interest rates, loan demands and deposits.

USE OF CERTAIN NON-GAAP FINANCIAL MEASURES

In addition to results presented in accordance with United States generally accepted accounting principles (GAAP), we have presented certain non-GAAP financial measures for the year ended December 31, 2006 throughout this Form 10-K, which are reconciled to GAAP financial measures below. We believe these non-GAAP financial measures provide information useful to investors in understanding the Corporation s performance trends and facilitate comparisons with its peers. Specifically, we believe the exclusion of a significant recovery of income recognized in a single accounting period permits a comparison of results for ongoing business operations, and it is on this basis that we internally assess the Corporation s performance for 2006 and establish goals for future periods. Although we believe the non-GAAP financial measures presented in this Form 10-K enhance investors understandings of the Corporation s performance, these non-GAAP financial measures should not be considered a substitute for GAAP financial measures.

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Reconciliation of Certain Non-GAAP Financial Measures

(Dollars in thousands, except for per share data)

	*	For the Year Ended December 31, 2006	2005
Net Income and Earnings Per Share			
Net income (GAAP)	A	$ 12,129	$ 11,788
Nonaccrual and default interest attributable to loan transaction, net of income taxes (GAAP)		(565)	
Reduction in loan loss allowance attributable to loan transaction, net of income taxes (GAAP)		(163)	
Net income, excluding nonaccrual and default interest and reduction in loan loss allowance attributable to loan transaction	B	$ 11,401	$ 11,788
Weighted average shares assuming dilution (GAAP)	C	3,273	3,508
Weighted average shares basic (GAAP)	D	3,152	3,375
Earnings per share assuming dilution GAAP	A/C	$ 3.71	$ 3.36
Excluding nonaccrual and default interest and reduction in loan loss allowance attributable to loan transaction	B/C	$ 3.48	$ 3.36
Earnings per share basic GAAP	A/D	$ 3.85	$ 3.49
Excluding nonaccrual and default interest and reduction in loan loss allowance attributable to loan transaction	B/D	$ 3.62	$ 3.49
Return on Average Assets			
Average assets (GAAP)	E	$ 694,315	$ 646,590
Return on average assets GAAP	A/E	1.75%	1.82%
Excluding nonaccrual and default interest and reduction in loan loss allowance attributable to loan transaction	B/E	1.64%	1.82%
Return on Average Equity			
Average equity (GAAP)	F	$ 63,949	$ 66,594
Return on average equity GAAP	A/F	18.97%	17.70%
Excluding nonaccrual and default interest and reduction in loan loss allowance attributable to loan transaction	B/F	17.83%	17.70%
Retail Banking Segment Net Income			
Pretax income (GAAP)		$ 8,731	$ 8,124
Nonaccrual and default interest attributable to loan transaction, net of income taxes (GAAP)		(870)	
Reduction in loan loss allowance attributable to loan transaction, net of income taxes (GAAP)		(250)	
Pretax income, excluding nonaccrual and default interest and reduction in loan loss allowance attributable to loan transaction		$ 7,611	$ 8,124

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Reconciliation of Certain Non-GAAP Financial Measures (Continued)

(Dollars in thousands, except for per share data)

	*	For the Year Ended December 31, 2006	2005
Net Interest Income and Net Interest Margin			
Net interest income (GAAP)		$ 40,125	$ 36,773
Taxable-equivalent adjustment		1,357	1,418
Taxable-equivalent net interest income (GAAP)	G	41,482	38,191
Nonaccrual and default interest attributable to loan transaction (GAAP)		(870)	
Taxable-equivalent net interest income, excluding nonaccrual and default interest attributable to loan transaction	H	$ 40,612	$ 38,191
Average interest-earning assets (GAAP)	I	$ 632,069	$ 593,696
Net interest margin (GAAP)	G/I	6.56%	6.43%
Net interest margin, excluding nonaccrual and default Interest attributable to loan transaction	H/I	6.43%	6.43%

* The letters included in this column are provided to show how the various ratios presented in the Reconciliation of Certain Non-GAAP Financial Measures are calculated.

ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

The Corporation s primary component of market risk is interest rate volatility. Fluctuations in interest rates will impact the amount of interest income and expense the Corporation receives or pays on almost all of its assets and liabilities and the market value of its interest-earning assets and interest-bearing liabilities, excluding those which have a very short term until maturity. The Corporation does not subject itself to foreign currency exchange rate risk or commodity price risk due to the current nature of its operations. The Corporation did not have any outstanding hedging transactions, such as interest rate swaps, floors or caps, at December 31, 2006.

The primary objective of the Corporation s asset/liability management process is to maximize current and future net interest income within acceptable levels of interest rate risk while satisfying liquidity and capital requirements. Management recognizes that a certain amount of interest rate risk is inherent and appropriate. Thus the goal of interest rate risk management is to maintain a balance between risk and reward such that net interest income is maximized while risk is maintained at an acceptable level.

The Corporation assumes interest rate risk as a result of its normal operations. The fair values of the Corporation s financial instruments will change when interest rates change and that change may be either favorable or unfavorable to the Corporation. Management attempts to match maturities of assets and liabilities to the extent believed necessary to minimize interest rate risk. However, borrowers with fixed rate obligations are less likely to prepay in a rising rate environment and more likely to prepay in a falling rate environment. Conversely, depositors who are receiving fixed rates are more likely to withdraw funds before maturity in a rising rate environment and less likely to do so in a falling rate environment. Management monitors rates and maturities of assets and liabilities and attempts to minimize interest rate risk by adjusting terms of new loans and deposits and by investing in securities with terms that mitigate the Corporation s overall interest rate risk.

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We use simulation analysis to assess earnings at risk and economic value of equity (EVE) analysis to assess economic value at risk. These methods allow management to regularly monitor both the direction and magnitude of the Corporation s interest rate risk exposure. These modeling techniques involve assumptions and estimates that inherently cannot be measured with complete precision. Key assumptions in the analyses include maturity and repricing characteristics of both assets and liabilities, prepayments on amortizing assets, other embedded options, non-maturity deposit sensitivity and loan and deposit pricing. These assumptions are inherently uncertain due to the timing, magnitude and frequency of rate changes and changes in market conditions and management strategies, among other factors. However, the analyses are useful in quantifying risk and provide a relative gauge of the Corporation s interest rate risk position over time.

Simulation analysis evaluates the potential effect of upward and downward changes in market interest rates on future net interest income. The analysis involves changing the interest rates used in determining net interest income over the next twelve months. The resulting percentage change in net interest income in various rate scenarios is an indication of the Corporation s shorter-term interest rate risk. The analysis utilizes a static balance sheet approach, which assumes changes in interest rates without any management response to change the composition of the balance sheet. The measurement date balance sheet composition is maintained over the simulation time period with maturing and repayment dollars being rolled back into like instruments for new terms at current market rates. Additional assumptions are applied to modify volumes and pricing under the various rate scenarios. These include prepayment assumptions on mortgage assets, the sensitivity of non-maturity deposit rates, and other factors that management deems significant.

The simulation analysis results are presented in the table below. These results, based on a measurement date balance sheet as of December 31, 2006, indicate that the Corporation would expect net interest income to increase over the next twelve months by .10 percent assuming an immediate downward shift in market interest rates of 200 basis points (BP) and to decrease by 2.20 percent if rates shifted upward in the same manner.

1-Year Net Interest Income Simulation ***(dollars in thousands)***

	Hypothetical Change in Net Interest Income for the Year Ended December 31, 2007	
Assumed Market Interest Rate Shift	**Dollars**	**Percentage**
-200 BP shock	$ 43	0.10%
+200 BP shock	(977)	(2.20)

The EVE analysis provides information on the risk inherent in the balance sheet that might not be taken into account in the simulation analysis due to the shorter time horizon used in that analysis. The EVE of the balance sheet is defined as the discounted present value of expected asset cash flows minus the discounted present value of the expected liability cash flows. The analysis involves changing the interest rates used in determining the expected cash flows and in discounting the cash flows. The resulting percentage change in net present value in various rate scenarios is an indication of the longer term repricing risk and options embedded in the balance sheet.

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The EVE analysis results are presented in the table below. These results as of December 31, 2006 indicate that the EVE would increase 1.25 percent assuming an immediate downward shift in market interest rates of 200 BP and would decrease 5.96 percent if rates shifted upward in the same manner.

Static EVE Change ***(dollars in thousands)***

Assumed Market Interest Rate Shift	Hypothetical Change in EVE Dollars	Percentage
-200 BP shock	$ 1,314	1.25%
+200 BP shock	(6,255)	(5.96)

At our Mortgage Company, we enter into commitments to originate residential mortgage loans whereby the interest rate on the loan is determined prior to funding (i.e., rate lock commitments). The period of time between issuance of a loan commitment and closing and sale of the loan generally ranges from 15 days to 90 days. The Corporation protects itself from changes in interest rates by entering into loan purchase agreements with third party investors that provide for the investor to purchase loans at the same terms (including interest rate) as committed to the borrower. Under the contractual relationship with the purchaser of each loan, the Corporation is obligated to sell the loan to the purchaser only if the loan closes. No other obligation exists. As a result of these contractual relationships with purchasers of loans, the Corporation is not exposed to losses nor will it realize gains related to its rate lock commitments due to changes in interest rates.

We believe that our current interest rate exposure is manageable and does not indicate any significant exposure to interest rate changes.

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ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

CONSOLIDATED BALANCE SHEETS

(Dollars in thousands, except for share and per share amounts)

	December 31, 2006	December 31, 2005
Assets		
Cash and due from banks	**$ 11,496**	$ 13,316
Interest-bearing deposits in other banks	**17,010**	29,562
Total cash and cash equivalents	**28,506**	42,878
Securities available for sale at fair value, amortized cost of $66,407 and $64,021, respectively	**67,584**	65,301
Loans held for sale, net	**53,504**	39,677
Loans, net of allowance for loan losses of $14,216 and $13,064, respectively	**517,843**	465,039
Federal Home Loan Bank stock	**2,093**	1,876
Corporate premises and equipment, net	**33,189**	29,147
Accrued interest receivable	**4,432**	3,664
Goodwill	**10,724**	10,724
Other assets	**16,593**	13,651
Total assets	**$ 734,468**	$ 671,957
Liabilities		
Deposits		
Non-interest-bearing demand deposits	**$ 90,260**	$ 78,934
Savings and interest-bearing demand deposits	**188,450**	195,211
Time deposits	**254,125**	221,293
Total deposits	**532,835**	495,438
Short-term borrowings	**12,462**	13,529
Long-term borrowings	**92,284**	78,475
Trust preferred capital notes	**10,310**	10,310
Accrued interest payable	**1,915**	1,306
Other liabilities	**16,656**	12,813
Total liabilities	**666,462**	611,871
Commitments and contingent liabilities		
Shareholders Equity		
Preferred stock ($1.00 par value, 3,000,000 shares authorized)		
Common stock ($1.00 par value, 8,000,000 shares authorized, 3,182,411 and 3,140,868 shares issued and outstanding, respectively)	**3,159**	3,141
Additional paid-in capital	**324**	183
Retained earnings	**64,402**	55,930
Accumulated other comprehensive income, net	**121**	832
Total shareholders equity	**68,006**	60,086
Total liabilities and shareholders equity	**$ 734,468**	$ 671,957

See notes to consolidated financial statements.

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CONSOLIDATED STATEMENTS OF INCOME

(Dollars in thousands, except per share amounts)

	Year Ended December 31,		
	2006	**2005**	**2004**
Interest income			
Interest and fees on loans	**$ 55,112**	$ 45,035	$ 37,120
Interest on money market investments	**454**	523	528
Interest and dividends on securities			
U.S. government agencies and corporations	**255**	281	351
Tax-exempt obligations of states and political subdivisions	**2,335**	2,379	2,386
Corporate bonds and other	**426**	552	458
Total interest income	**58,582**	48,770	40,843
Interest expense			
Savings and interest-bearing deposits	**2,287**	1,828	1,152
Certificates of deposit, $100M or more	**3,176**	1,717	1,086
Other time deposits	**5,690**	3,735	2,751
Borrowings	**6,640**	4,447	2,560
Trust preferred capital notes	**664**	270	
Total interest expense	**18,457**	11,997	7,549
Net interest income	**40,125**	36,773	33,294
Provision for loan losses	**4,625**	5,520	4,026
Net interest income after provision for loan losses	**35,500**	31,253	29,268
Noninterest income			
Gains on sales of loans	**17,098**	18,194	16,575
Service charges on deposit accounts	**3,471**	2,812	2,699
Other service charges and fees	**5,101**	4,795	4,065
Gain on calls of available for sale securities	**105**	105	69
Other income	**1,612**	1,678	1,281
Total noninterest income	**27,387**	27,584	24,689
Noninterest expenses			
Salaries and employee benefits	**29,007**	28,277	25,233
Occupancy expenses	**5,087**	3,871	3,556
Other expenses	**11,234**	9,720	8,964
Total noninterest expenses	**45,328**	41,868	37,753
Income before income taxes	**17,559**	16,969	16,204
Income tax expense	**5,430**	5,181	5,006
Net income	**$ 12,129**	$ 11,788	$ 11,198
Earnings per common share basic	**$ 3.85**	$ 3.49	$ 3.14

Earnings per common share assuming dilution	**$**	**3.71**	$	3.36	$	3.00

See notes to consolidated financial statements.

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CONSOLIDATED STATEMENTS OF SHAREHOLDERS EQUITY

(Dollars in thousands, except per share amounts)

	Common Stock	Additional Paid-In Capital	Comprehensive Income	Retained Earnings	Accumulated Other Comprehensive Income	Total
Balance December 31, 2003	$ 3,612	$ 1,010		$ 58,487	$ 2,275	$ 65,384
Purchase of common stock	(89)	(1,172)		(2,160)		(3,421)
Stock options exercised	16	242				258
Comprehensive income						
Net income			$ 11,198	11,198		11,198
Other comprehensive income, net of tax						
Unrealized holding losses arising during the period net of tax benefit of $171			(318)		(318)	(318)
Comprehensive income			$ 10,880			
Cash dividends ($.90 per share)				(3,202)		(3,202)
Balance December 31, 2004	3,539	80		64,323	1,957	69,899
Purchase of common stock	(427)	(371)		(16,842)		(17,640)
Stock options exercised	29	474				503
Comprehensive income						
Net income			$ 11,788	11,788		11,788
Other comprehensive income, net of tax						
Unrealized holding losses arising during the period net of tax benefit of $606			(1,125)		(1,125)	(1,125)
Comprehensive income			$ 10,663			
Cash dividends ($1.00 per share)				(3,339)		(3,339)
Balance December 31, 2005	3,141	183		55,930	832	60,086
Purchase of common stock	**(14)**	**(504)**				**(518)**
Stock options exercised	**32**	**548**				**580**
Stock-based compensation		**97**				**97**
Comprehensive income						
Net income			**$ 12,129**	**12,129**		**12,129**
Other comprehensive income, net of tax						
Unrealized holding losses arising during the period net of tax benefit of $36			**(67)**		**(67)**	**(67)**
Comprehensive income			**$ 12,062**			
Adjustment to initially apply SFAS 158, net of tax benefit of $346					**(644)**	**(644)**
Cash dividends ($1.16 per share)				**(3,657)**		**(3,657)**

Balance December 31, 2006	**$ 3,159**	**$ 324**	**$ 64,402**	**$ 121**	**$ 68,006**

Disclosure of reclassification amount for the year ended December 31:

	2006	**2005**	**2004**
Unrealized net holding (losses) gains arising during period	**$ 1**	$ (1,057)	$ (273)
Less: reclassification adjustment for gains included in net income	**68**	68	45
Net unrealized losses on securities	**$ (67)**	$ (1,125)	$ (318)

See notes to consolidated financial statements.

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CONSOLIDATED STATEMENTS OF CASH FLOWS

(Dollars in thousands)

	Year Ended December 31,		
	2006	**2005**	**2004**
Operating activities:			
Net income	**$ 12,129**	$ 11,788	$ 11,198
Adjustments to reconcile net income to net cash provided by (used in) operating activities:			
Depreciation	**2,007**	1,549	1,446
Deferred income taxes	**(970)**	(1,115)	(1,373)
Provision for loan losses	**4,625**	5,520	4,026
Stock-based compensation	**97**		
Accretion of discounts and amortization of premiums on securities, net	**35**	12	151
Net realized gain on securities	**(105)**	(105)	(69)
Origination of loans held for sale	**(944,300)**	(1,058,804)	(912,657)
Sale of loans	**930,473**	1,067,693	893,824
Change in other assets and liabilities:			
Accrued interest receivable	**(768)**	(623)	(451)
Other assets	**(2,580)**	2,393	(2,380)
Accrued interest payable	**609**	692	31
Other liabilities	**3,843**	(377)	979
Net cash provided by (used in) operating activities	**5,095**	28,623	(5,275)
Investing activities:			
Proceeds from maturities and calls of securities available for sale	**7,671**	11,990	48,411
Purchase of securities available for sale	**(9,987)**	(6,142)	(18,719)
Purchase of FHLB stock	**(5,932)**	(3,234)	(638)
Redemption of FHLB stock	**5,715**	3,388	680
Investment in statutory trust		(310)	
Net increase in customer loans	**(57,429)**	(76,088)	(48,327)
Purchase of corporate premises and equipment	**(6,120)**	(12,461)	(4,408)
Disposal of corporate premises and equipment	**71**	69	25
Net cash used in investing activities	**(66,011)**	(82,788)	(22,976)
Financing activities:			
Net increase in demand, interest-bearing demand and savings deposits	**4,565**	9,516	23,214
Net increase (decrease) in time deposits	**32,832**	38,788	(3,715)
Net increase in borrowings	**12,742**	13,719	10,552
Issuance of trust preferred capital notes		10,310	
Purchase of common stock	**(518)**	(17,640)	(3,421)
Proceeds from exercise of stock options	**580**	503	258
Cash dividends	**(3,657)**	(3,339)	(3,202)
Net cash provided by financing activities	**46,544**	51,857	23,686
Net decrease in cash and cash equivalents	**(14,372)**	(2,308)	(4,565)
Cash and cash equivalents at beginning of year	**42,878**	45,186	49,751
Cash and cash equivalents at end of year	**$ 28,506**	$ 42,878	$ 45,186

Supplemental disclosure

Interest paid	**$ 17,848**	$ 11,305	$ 7,518
Income taxes paid	**5,935**	6,653	5,798

See notes to consolidated financial statements.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1: Summary of Significant Accounting Policies

Principles of Consolidation: The accompanying consolidated financial statements include the accounts of C&F Financial Corporation and its wholly owned subsidiary, Citizens and Farmers 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, an unconsolidated subsidiary. The subordinated debt owed to the trust is reported as a liability of the Corporation. The accounting and reporting policies of C&F Financial Corporation and subsidiary (the Corporation) conform to accounting principles generally accepted in the United States of America and to predominant practices within the banking industry.

Nature of Operations: C&F Financial Corporation is a bank holding company incorporated under the laws of the Commonwealth of Virginia. The Corporation owns all of the stock of its subsidiary, Citizens and Farmers Bank (the 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, Certified Appraisals LLC, Foundation Home Mortgage and C&F Reinsurance LTD, provides ancillary mortgage loan production services for loan settlement and residential appraisals. C&F Finance, acquired on September 1, 2002, is a regional finance company providing automobile loans throughout Virginia and in portions of Tennessee, Maryland, North Carolina, Ohio, Kentucky and West Virginia. 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 16.

Use of Estimates: The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America 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 projected benefit obligation under the defined benefit plan, the valuation of deferred taxes and goodwill impairment.

Significant Group Concentrations of Credit Risk: Substantially all of the Corporation s lending activities are with customers located in Virginia, Maryland and portions of Tennessee. Note 3 discusses the Corporation s lending activities. The Corporation invests in a variety of securities, principally obligations of U.S. government agencies and obligations of states and political subdivisions. Note 2 presents the Corporation s investment activities. The Corporation does not have any significant concentrations in any one industry or to any one customer.

Cash and Cash Equivalents: For purposes of the consolidated statements of cash flows, cash and cash equivalents include cash, balances due from banks and interest-bearing deposits in banks, all of which mature within 90 days.

Securities: Investments in debt and equity securities with readily determinable fair values are classified as either held to maturity, available for sale, or trading, based on management s intent. Currently all of the Corporation s investment securities are classified as available for sale. Available for sale securities are carried at estimated fair value with the corresponding unrealized gains and losses excluded from earnings and reported in other comprehensive income. Gains or losses are recognized in earnings on the trade date using the amortized cost of the specific security sold.

Loans Held for Sale: Loans held for sale are carried at the lower of cost or estimated fair value, determined in the aggregate. Fair value considers commitment agreements with investors and prevailing market prices. Substantially all loans originated by C&F Mortgage are held for sale to outside investors.

Loans: The Corporation makes mortgage, commercial and consumer loans to customers. Loans that management has the intent and ability to hold for the foreseeable future or until maturity or pay-off generally are reported at their unpaid principal balances adjusted for charges-offs, unearned discount, any deferred fees or costs on originated loans, and the allowance for loan losses. Interest on loans is credited to operations based on the principal amount outstanding. Unearned discounts on certain installment loans are recognized as income over the terms of the loans by a method that approximates the effective interest method. Loan fees and origination costs are deferred and the net amount is amortized as an adjustment of the related loan s yield using the level-yield method. The Corporation is amortizing these amounts over the contractual life of the related loans.

Loans are generally placed on nonaccrual status when the collection of principal or interest is 90 days or more past due, or earlier, if collection is uncertain based on an evaluation of the net realizable value of the collateral and the financial strength of the borrower. Loans greater than 90 days past due may remain on accrual status if management determines it has adequate collateral to cover the principal and interest. For those loans that are carried on nonaccrual status, payments are first applied to principal outstanding.

The Corporation considers 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. A loan is not considered impaired during a period of delay in payment if the ultimate collectibility of all amounts due is expected. Impairment is measured on a loan by loan basis for commercial and construction loans by either the present value of expected future cash flows discounted at the loan s effective interest rate, the loan s obtainable market price, or the fair value of the collateral if the loan is collateral dependent. Large groups of smaller balance homogeneous loans are collectively evaluated for impairment. Accordingly, the Corporation does not separately identify individual consumer and residential loans for impairment disclosures. Consistent with the Corporation s method for nonaccrual loans, payments on impaired loans are first applied to principal outstanding.

Allowance for Loan Losses: The allowance for loan losses is established through charges to earnings in the form of a provision for loan losses. Loan losses are charged against the allowance for loan losses when management believes that the collectibility of the principal is unlikely. Subsequent recoveries, if any, are credited to the allowance.

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

The allowance consists of specific and general components. The specific component relates to loans that are classified as loss, doubtful, substandard or special mention. For such loans that are also classified as impaired, an allowance is established when the discounted cash flows (or collateral value or observable market price) of the impaired loan is lower than the carrying value of that loan. The general component covers non-classified loans and is based on historical loss experience adjusted for qualitative factors.

Off-Balance-Sheet Credit Related Financial Instruments: In the ordinary course of business, the Corporation has entered into commitments to extend credit and standby letters of credit. Such financial instruments are recorded when they are funded.

Rate Lock Commitments: The Corporation enters into commitments to originate residential mortgage loans whereby the interest rate on the loan is determined prior to funding (i.e., rate lock commitments). The period of time between issuance of a loan commitment and closing and sale of the loan generally ranges from 15 to 90 days. The Corporation protects itself from changes in interest rates by entering into loan purchase agreements with third party investors that provide for the investor to purchase loans at the same terms (including interest rate) as committed to the borrower. Under the contractual relationship with the purchaser of each loan, the Corporation is obligated to sell the loan to the purchaser only if the loan closes. No other obligation exists. As a result of these contractual relationships with purchasers of loans, the Corporation is not exposed to losses nor will it realize gains related to its rate lock commitments due to changes in interest rates.

Federal Home Loan Bank Stock: Federal Home Loan Bank (FHLB) stock is carried at cost. No ready market exists for this stock and it has no quoted market value. For presentation purposes, such stock is assumed to have a market value that is equal to cost. In addition, such stock is not considered a debt or equity security in accordance with Statement of Financial Accounting Standards (SFAS) No. 115, *Accounting for Certain Investments in Debt and Equity Securities*.

Other Real Estate Owned: Assets acquired through, or in lieu of, loan foreclosure are held for sale and are initially recorded at fair value at the date of foreclosure, establishing a new cost basis. Subsequent to foreclosure, management periodically performs valuations and the assets are carried at the lower of carrying amount or fair value less cost to sell. Revenue and expenses from operations and changes in the valuation allowance are included in net expenses from foreclosed assets.

Corporate Premises and Equipment: Land is carried at cost. Buildings and equipment are carried at cost less accumulated depreciation computed using a straight-line method over the estimated useful lives of the assets. Estimated useful lives range from ten to forty years for buildings and from three to ten years for equipment, furniture and fixtures. Maintenance and repairs are charged to expense as incurred and major improvements are capitalized. Upon sale or retirement of depreciable properties, the cost and related accumulated depreciation are netted against proceeds and any resulting gain or loss is reflected in income.

Goodwill: The Corporation adopted SFAS No. 142, *Goodwill and Other Intangible Assets*, effective January 1, 2002. Accordingly, goodwill is no longer subject to amortization over its estimated useful life, but is subject to at least an annual assessment for impairment by applying a fair value based test. Additionally, under SFAS 142, acquired intangible assets (such as core deposit intangibles) are separately recognized if the benefit of the asset can be sold, transferred, licensed, rented or exchanged, and are amortized over their useful life.

Sale of Loans: Transfers of loans are accounted for as sales when control over the loans has been surrendered. Control over transferred loans is deemed to be surrendered when (1) the loans have been isolated from the Corporation, (2) the transferee obtains the right (free of conditions that constrain it from taking advantage of that right) to pledge or exchange the transferred loans and (3) the Corporation does not maintain effective control over the transferred loans through an agreement to repurchase them before their maturity.

Income Taxes: The Corporation determines deferred income tax assets and liabilities using the liability (or balance sheet) method. Under this method, the net deferred tax asset or liability is determined annually for differences between the financial statement and tax bases of assets and liabilities that will result in taxable or deductible amounts in the future based on enacted tax laws and rates applicable to the periods in which the differences are expected to affect taxable income. Income tax expense is the tax payable or refundable for the period plus or minus the change during the period in deferred tax assets and liabilities.

Retirement Plan: The compensation cost of an employee s pension benefit is recognized on the projected unit credit method over the employee s approximate service period. The aggregate cost method is utilized for funding purposes.

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

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the benefit obligation is the accumulated postretirement benefit obligation. SFAS 158 also requires an employer to measure the funded status of a plan as of the date of its year-end statement of financial position. SFAS 158 also requires additional disclosure in the notes to financial statements about certain effects on net periodic benefit cost for the next fiscal year that arise from delayed recognition of the gains or losses, prior service costs or credits, and transition asset or obligation. The Corporation is required to initially recognize the funded status of a defined benefit postretirement plan and to provide the required disclosures as of the end of the fiscal year ending after December 15, 2006. The requirement to measure plan assets and benefit obligations as of the date of the employers fiscal year-end statement of financial position is effective for fiscal years ending after December 15, 2008.

The Corporation s wholly-owned subsidiary, Citizens and Farmers Bank, has a non-contributory, defined benefit pension plan, which is subject to the provisions of SFAS 158. A valuation of the Bank s plan was performed as of October 1, 2006 and it was determined that the plan was underfunded. As a result, the Bank made a $1.18 million contribution to the plan, which fully funded the plan s projected benefit obligation as of the valuation date. Further, in connection with the implementation of SFAS 158, the Corporation recognized $644,000 as a component of accumulated other comprehensive income.

Stock Compensation Plans: At December 31, 2006, the Corporation has three stock-based compensation plans, which are described more fully in Note 12. Effective January 1, 2006, the Corporation adopted the provisions of SFAS No. 123(R), *Share-Based Payment*, which requires that the Corporation recognize expense related to the fair value of share-based compensation awards in net income.

Prior to January 1, 2006, the Corporation accounted for its share-based compensation plans under the recognition and measurement principles of APB Opinion No. 25, *Accounting for Stock Issued to Employees*, and related Interpretations. Accordingly, stock compensation expense was not recognized in net income because all options granted under these plans had an exercise price equal to the fair market value of the underlying common stock on the date of grant. However, notes to prior financial statements included pro forma disclosures of the effect on net income and earnings per share as if the Corporation had applied the fair value recognition provision of SFAS No. 123, *Accounting for Stock-Based Compensation*, to share-based compensation. The following table presents the pro forma disclosures for the years ended December 31, 2005 and 2004.

(Dollars in thousands, except per share amounts)	**Year Ended December 31,**	
	2005	**2004**
Net income, as reported	$ 11,788	$ 11,198
Total stock-based compensation expense determined under fair value based method for all awards	(2,305)	(605)
Pro forma net income	$ 9,483	$ 10,593
Earnings per share:		
Basic - as reported	$ 3.49	$ 3.14
Basic - pro forma	$ 2.81	$ 2.97
Diluted - as reported	$ 3.36	$ 3.00
Diluted - pro forma	$ 2.70	$ 2.84

The Corporation has elected to follow the modified prospective transition method allowed by SFAS 123(R). Under the modified prospective transition method, compensation expense is recognized prospectively for all unvested options outstanding at January 1, 2006 and for all awards modified or granted after that date. On December 20, 2005, the Corporation accelerated the vesting of all unvested stock options outstanding under the Corporation s three share-based compensation plans. The board of directors accelerated the vesting of these options in order to eliminate the Corporation s recognition of compensation expense associated with these options under the SFAS 123(R) modified prospective transition method. Because there were no unvested options outstanding at January 1, 2006, no share-based compensation expense has been recognized in 2006 for options granted prior to January 1, 2006.

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Compensation expense for grants of restricted shares is accounted for using the fair market value of the Corporation s common stock on the date the restricted shares are awarded. Compensation expense for grants of stock options is accounted for using the Black-Scholes option-pricing model. Compensation expense for restricted shares and stock options is charged to income ratably over the vesting period. Compensation expense for the year ended December 31, 2006 included $97,000 ($60,000 after tax) for options and restricted stock granted during 2006. As of December 31, 2006, there was $929,000 of total unrecognized compensation expense related to unvested stock options and restricted stock that will be recognized over the remaining vesting periods. SFAS 123(R) requires the Corporation to estimate forfeitures when recognizing compensation expense and that this estimate of forfeitures be adjusted over the requisite service period or vesting schedule based on the extent to which actual forfeitures differ from such estimates. Changes in estimated forfeitures in future periods, if any, will be recognized through a cumulative catch-up adjustment in the period of change, which will impact the amount of estimated unamortized compensation expense to be recognized in future periods.

Earnings Per Common Share: Basic earnings per share represents income available to common shareholders divided by the weighted average number of common shares outstanding during the period. Diluted earnings per share reflects additional common shares that would have been outstanding if potentially-dilutive common shares had been issued, as well as any adjustment to income that would result from the assumed issuance. Potential common shares that may be issued by the Corporation relate to outstanding stock options and unvested restricted shares and are determined using the treasury stock method. Earnings per share calculations are presented in Note 8.

Comprehensive Income: Accounting principles generally require that recognized revenue, expenses, gains and losses be included in net income. Although certain changes in assets and liabilities, such as unrealized gains and losses on available for sale securities, are reported as a separate component of the equity section of the balance sheet, such items, along with net income, are components of comprehensive income. These components are presented in the Corporation s Consolidated Statements of Shareholders Equity.

Shareholders Equity: During 2006, the Corporation purchased 13,257 shares of its common stock in open-market transactions. Purchases of 135 shares at prices between $39.50 and $39.99 per share were made in accordance with a board-approved stock purchase program, which will expire in November 2007. Purchases of 13,122 shares at prices between $37.75 and $40.00 per share were made in accordance with a board-approved stock purchase program, which expired in November 2006.

On July 27, 2005, the Corporation completed a tender offer and purchased 427,186 shares of its common stock at $41 per share. The total cost of the share purchase, including transaction costs, approximated $17.64 million. Refer to Note 7 for a discussion of the issuance of trust preferred capital securities and the Corporation s related issuance of trust preferred capital notes to partially fund this purchase. In December 2005, the Corporation purchased 100 shares in an open-market transaction at $37.27 per share under the previously-mentioned stock purchase program.

During 2004, the Corporation purchased 26,200 shares of its common stock in privately negotiated transactions and 62,850 shares in open-market transactions at prices between $35.00 and $41.50 per share. The purchases in 2004 were made in accordance with a board-approved stock purchase program, which expired in January 2005.

Recent Accounting Pronouncements:

In September 2006, the Securities and Exchange Commission (SEC) released Staff Accounting Bulletin (SAB) No. 108. SAB 108 expresses the SEC staff s views regarding the process of quantifying financial statement misstatements. SAB 108 expresses the SEC staff s view that a registrant s materiality evaluation of an identified unadjusted error should quantify the effects of the error on each financial statement and related financial statement disclosures and that prior year misstatements should be considered in quantifying misstatements in current year financial statements. SAB 108 also states that correcting prior year financial statements for immaterial errors would not require previously filed reports to be amended. Such correction may be made the next time the registrant files the prior year financial statements. The cumulative effect of the initial application should be reported in the carrying amounts of assets and liabilities as of the beginning of that fiscal year and the offsetting adjustment should be made to the opening balance of retained earnings for that year. Registrants should disclose the nature and amount of each individual error being corrected in the cumulative adjustment. The SEC staff encourages early application of the guidance in SAB 108 for interim periods of the first fiscal year ending after November 15, 2006**.** The implementation of SAB 108 did not have a material effect on the Corporation s financial statements.

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

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

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

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

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

In September 2006, the Emerging Issues Task Force issued EITF 06-5, *Accounting for Purchases of Life Insurance-Determining the Amount That Could Be Realized in Accordance with FASB Technical Bulletin No. 85-4.* This consensus concludes that a policyholder should consider any additional amounts included in the contractual terms of the insurance policy other than the cash surrender value in determining the amount that could be realized under the insurance contract. A consensus also was reached that a policyholder should determine the amount that could be realized under the life insurance contract assuming the surrender of an individual-life by individual-life policy (or certificate by certificate in a group policy). The consensuses are effective for fiscal years beginning after December 15, 2006. The Corporation is currently evaluating the effect that EITF No. 06-5 will have on its financial statements when implemented.

NOTE 2: Securities

Debt and equity securities are summarized as follows:

(Dollars in thousands)	December 31, 2006			
		Gross	Gross	
Available for Sale	**Amortized Cost**	**Unrealized Gains**	**Unrealized Losses**	**Estimated Fair Value**
U.S. government agencies and corporations	**$ 6,313**	**$ 3**	**$ (94)**	**$ 6,222**
Mortgage-backed securities	**2,236**	**6**	**(34)**	**2,208**
Obligations of states and political subdivisions	**53,921**	**1,165**	**(59)**	**55,027**
Preferred stock	**3,937**	**219**	**(29)**	**4,127**
	$ 66,407	**$ 1,393**	**$ (216)**	**$ 67,584**

(Dollars in thousands)	December 31, 2005			
		Gross	Gross	
Available for Sale	**Amortized Cost**	**Unrealized Gains**	**Unrealized Losses**	**Estimated Fair Value**
U.S. government agencies and corporations	$ 6,235	$ 3	$ (120)	$ 6,118
Mortgage-backed securities	2,588	11	(37)	2,562
Obligations of states and political subdivisions	51,129	1,453	(58)	52,524
Preferred stock	4,069	251	(223)	4,097
	$ 64,021	$ 1,718	$ (438)	$ 65,301

The amortized cost and estimated fair value of securities at December 31, 2006, by contractual 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)	December 31, 2006	
Available for Sale	**Amortized Cost**	**Estimated Fair Value**
Due in one year or less	**$ 1,749**	**$ 1,735**
Due after one year through five years	**21,199**	**21,276**
Due after five years through ten years	**26,460**	**27,071**
Due after ten years	**13,062**	**13,375**
Preferred stock	**3,937**	**4,127**
	$ 66,407	**$ 67,584**

Proceeds from the maturities and calls of securities available for sale in 2006 were $7.67 million, resulting in gross realized gains of $105,000. Securities with an aggregate amortized cost of $40.47 million and an aggregate fair value of $41.27 million were pledged at December 31, 2006 to secure public deposits, Federal Reserve Bank treasury, tax and loan deposits and repurchase agreements.

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Proceeds from the maturities and calls of securities available for sale in 2005 were $11.99 million, resulting in gross realized gains of $105,000. Proceeds from the maturities and calls of securities available for sale in 2004 were $48.41 million, resulting in gross realized gains of $69,000.

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

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

The primary cause of the temporary impairments in the Corporation s investment in debt securities was the decline in prices as interest rates have risen. There are 33 securities totaling $13.62 million in the Corporation s debt securites portfolio considered temporarily impaired at December 31, 2006. Because the Corporation has the ability and intent to hold these investments until a recovery of fair value, which may be maturity, the Corporation does not consider these investments to be other-than-temporarily impaired at December 31, 2006. The temporary impairments in the Corporation s investment in preferred stock have declined to $29,000 at December 31, 2006 from $223,000 at December 31, 2005. The primary cause of the temporary impairment in the Corporation s investment in preferred stock at December 31, 2005 was one holding in an energy company, which suffered a liquidity crisis as a result of damage to electric and gas facilities by Hurricanes Katrina and Rita. The fair value of the Corporation s investment in this company recovered almost entirely during 2006.

Securities in an unrealized loss position at December 31, 2005, by duration of the period of the unrealized loss, are shown below. No impairment has been recognized on any of the securities in a loss position because of management s intent and demonstrated ability to hold securities to scheduled maturity or call dates.

(Dollars in thousands)	Less Than 12 Months		12 Months or More		Total	
	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss
U.S government agencies and corporations	$ 2,463	$ 36	$ 3,158	$ 84	$ 5,621	$ 120
Mortgage-backed securities	1,002	10	535	27	1,537	37
Obligations of states and political subdivisions	5,094	32	1,529	26	6,623	58
Subtotal-debt securities	8,559	78	5,222	137	13,781	215
Preferred stock	592	218	523	5	1,115	223
Total temporarily impaired securities	$ 9,151	$ 296	$ 5,745	$ 142	$ 14,896	$ 438

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NOTE 3: Loans

Major classifications of loans are summarized as follows:

(Dollars in thousands)	December 31, 2006	2005
Real estate - mortgage	**$ 115,885**	$ 96,850
Real estate - construction	**13,650**	20,222
Commercial, financial and agricultural	**236,157**	216,081
Equity lines	**24,880**	24,662
Consumer	**8,951**	9,574
Consumer finance	**132,864**	111,141
	532,387	478,530
Less unearned loan fees	**(328)**	(427)
	532,059	478,103
Less allowance for loan losses	**(14,216)**	(13,064)
	$ 517,843	$ 465,039

Loans on nonaccrual status were $1.84 million and $5.90 million at December 31, 2006 and 2005, respectively. If interest income had been recognized on nonaccrual loans at their stated rates during fiscal years 2006, 2005 and 2004, interest income would have increased by approximately $70,000, $270,000 and $202,000, respectively. Accruing loans past due for 90 days or more were $1.64 million and $3.85 million at December 31, 2006 and 2005, respectively. The balance of impaired loans at December 31, 2006 was $781,000. The most significant component of nonaccrual and 90-day delinquent accruing loans at December 31, 2005 was one commercial relationship, which also comprised the balance of impaired loans of $4.22 million at December 31, 2005 and for which a specific valuation allowance of $865,000 was provided. In May 2006, the borrowers sold the real estate collateral for these loans and paid the loans in full from the sale proceeds. The average balances of impaired loans for 2006, 2005 and 2004 were $2.24 million, $4.22 million and $3.47 million, respectively.

NOTE 4: Allowance for Loan Losses

Changes in the allowance for loan losses were as follows:

(Dollars in thousands)	Year Ended December 31, 2006	2005	2004
Balance at the beginning of year	**$ 13,064**	**$ 11,144**	$ 8,657
Provision charged to operations	**4,625**	**5,520**	4,026
Loans charged off	**(5,093)**	**(4,985)**	(2,695)
Recoveries of loans previously charged off	**1,620**	**1,385**	1,156
Balance at the end of year	**$ 14,216**	**$ 13,064**	$ 11,144

NOTE 5: Corporate Premises and Equipment

Major classifications of corporate premises and equipment are summarized as follows:

(Dollars in thousands)	December 31, 2006	2005

Land	**$ 6,776**	$ 6,776
Buildings	**25,642**	21,764
Equipment, furniture and fixtures	**18,641**	16,705
	51,059	45,245
Less accumulated depreciation	**(17,870)**	(16,098)
	$ 33,189	$ 29,147

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NOTE 6: Time Deposits

Time deposits are summarized as follows:

(Dollars in thousands)	December 31, 2006	December 31, 2005
Certificates of deposit, $100 thousand or more	**$ 95,180**	$ 72,572
Other time deposits	**158,945**	148,721
	$ 254,125	$ 221,293

Remaining maturities on time deposits at December 31, 2006 are as follows *(dollars in thousands)*:

2007	**$ 220,194**
2008	**18,474**
2009	**6,612**
2010	**5,455**
2011	**2,935**
Thereafter	**455**
	$ 254,125

NOTE 7: Borrowings

Short-term borrowings include securities sold under agreements to repurchase, which are secured transactions with customers and generally mature the day following the day sold. Balances outstanding under repurchase agreements were $5.46 million on December 31, 2006 and $6.53 million on December 31, 2005. Short-term borrowings also include a variable-rate, unsecured line of credit with a third-party lender that matures in June 2007. The balance outstanding under this line of credit was $7.00 million on December 31, 2006 and December 31, 2005. Short-term borrowings also include advances from the FHLB, which are secured by a blanket floating lien on all qualifying real estate loans. There were no short-term advances from the FHLB outstanding on December 31, 2006 or December 31, 2005.

The table below presents selected information on short-term borrowings:

(Dollars in thousands)	December 31, 2006	December 31, 2005
Balance outstanding at year end	**$ 12,462**	$ 13,529
Maximum balance at any month end during the year	**$ 42,165**	$ 63,455
Average balance for the year	**$ 25,236**	$ 20,924
Weighted average rate for the year	**4.80%**	2.68%
Weighted average rate on borrowings at year end	**4.56%**	3.39%
Estimated fair value at year end	**$ 12,462**	$ 13,529

Long-term borrowings at December 31, 2006 consist of: advances from the FHLB, which are secured by a blanket floating lien on all qualifying real estate loans; and advances under a non-recourse revolving bank line of credit secured by loans at C&F Finance. Advances from the FHLB at December 31, 2006 consist of $10.00 million at 3.24% and $5.00 million at 3.25%, both of which mature in 2012 with a call provision in 2007. The interest rate on the revolving bank line of credit floats at the one-month LIBOR rate plus 175 basis points, and the outstanding balance as of December 31, 2006 was $77.28 million, which matures in 2010. C&F Finance s revolving bank line of credit agreement contains covenants regarding C&F Finance s capital adequacy, credit quality, adequacy of the allowance for loan losses and interest expense coverage. C&F Finance satisfied all such covenants during 2006.

The contractual maturities of long-term borrowings, excluding call provisions, at December 31, 2006 are as follows:

(Dollars in thousands)	Fixed Rate	Floating Rate	Total
2007	$	$	$
2008			
2009			
2010		77,284	77,284
2011			
Thereafter	15,000		15,000
	$ 15,000	$ 77,284	$ 92,284

The Corporation s unused lines of credit for future borrowings total approximately $153.10 million at December 31, 2006, which consists of $116.38 million available from the FHLB, $22.72 million on the revolving bank line of credit and $14.00 million under a federal funds agreement with a third party financial institution.

In July 2005, C&F Financial Statutory Trust I (the Trust), a wholly-owned non-operating subsidiary of the Corporation, was formed for the purpose of issuing trust preferred capital securities to partially fund the Corporation s purchase of 427,186 shares of its common stock. On July 21, 2005, the Trust issued $10.00 million of trust preferred capital securities in a private placement to an institutional investor. The Trust issued $310,000 in common equity to the Corporation in exchange for cash. The securities mature in September 2035, are redeemable at the Corporation s option beginning after five years, and require quarterly distributions by the Trust to the holder of the securities at a fixed rate of 6.07% as to $5.00 million of the securities and at a rate equal to the three-month LIBOR rate plus 1.57% as to the remaining $5.00 million, which rate was 6.93% at December 31, 2006. The fixed rate portion of the securities converts to the three-month LIBOR rate plus 1.57% in September 2010. The principal asset of the Trust is $10.31 million of the Corporation s junior subordinated debt securities or trust preferred capital notes with like maturities and like interest rates to the trust preferred capital securities. The interest payments by the Corporation on the debt securities will be used by the Trust to pay the quarterly distributions payable by the Trust to the holders of the trust preferred capital securities.

Subject to certain exceptions and limitations, the Corporation may elect from time to time to defer interest payments on the junior subordinated debt securities, which would result in a deferral of distribution payments on the related capital securities.

NOTE 8: Earnings Per Share

The Corporation calculates its basic and diluted earnings per share (EPS) in accordance with SFAS No. 128, *Earnings Per Share*. The components of the Company s EPS calculations are as follows:

		December 31,	
(Dollars in thousands)	2006	2005	2004
Net income available to common shareholders	$ 12,129	$ 11,788	$ 11,198
Weighted average number of common shares used in earnings per common share-basic	3,151,860	3,375,153	3,567,284
Effect of dilutive securities:			
Stock-based awards	121,569	132,759	161,844
Weighted average number of common shares used in earnings per common share-assuming dilution	3,273,429	3,507,912	3,729,128

Options on approximately 133,000, 157,000 and 79,000 shares were not included in computing diluted earnings per common share for the years ended December 31, 2006, 2005 and 2004, respectively, because they were anti-dilutive.

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NOTE 9: Income Taxes

Principal components of income tax expense as reflected in the consolidated statements of income are as follows:

	Year Ended December 31,		
(Dollars in thousands)	2006	2005	2004
Current taxes	**$ 6,400**	$ 6,296	$ 6,379
Deferred taxes	**(970)**	(1,115)	(1,373)
	$ 5,430	$ 5,181	$ 5,006

The income tax provision is less than would be obtained by application of the statutory federal corporate tax rate to pre-tax accounting income as a result of the following items:

	Year Ended December 31,					
(Dollars in thousands)	2006	Percent of Pre-tax Income	2005	Percent of Pre-tax Income	2004	Percent of Pre-tax Income
Income tax computed at federal statutory rates	**$ 6,146**	**35.0%**	$ 5,939	35.0%	$ 5,671	35.0%
Tax effect of exclusion of interest income on obligations of states and political subdivisions	**(876)**	**(5.0)**	(888)	(5.2)	(910)	(5.6)
Reduction of interest expense incurred to carry tax- exempt assets	**84**	**.5**	59	.3	41	.3
State income taxes, net of federal tax benefit	**302**	**1.7**	339	2.0	347	2.1
Tax effect of dividends-received deduction on preferred stock	**(48)**	**(.3)**	(75)	(.5)	(80)	(.5)
Tax credits	**(98)**	**(.6)**	(74)	(.4)		
Other	**(80)**	**(.4)**	(119)	(.7)	(63)	(.4)
	$ 5,430	**30.9%**	$ 5,181	30.5%	$ 5,006	30.9%

Other assets include net deferred income taxes of $5.57 million and $4.56 million at December 31, 2006 and 2005, respectively. The tax effects of each type of significant item that gave rise to deferred taxes are:

	December 31,	
(Dollars in thousands)	2006	2005
Deferred tax asset		
Allowance for loan losses	**$ 5,409**	$ 4,618
Deferred compensation	**1,367**	1,214
Interest on nonaccrual loans	**28**	97
Other	**272**	194
Deferred tax asset	**7,076**	6,123
Deferred tax liability		
Depreciation	**(63)**	(222)
Accrued pension		(183)
Goodwill and other intangible assets	**(952)**	(643)

Other	**(79)**	(63)
Net unrealized gain on securities available for sale	**(412)**	(448)
Deferred tax liability	**(1,506)**	(1,559)
Net deferred tax asset	**$ 5,570**	$ 4,564

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NOTE 10: Employee Benefit Plans

The Bank maintains a Defined Contribution Profit-Sharing Plan (the Profit-Sharing Plan) sponsored by the Virginia Bankers Association. The Profit-Sharing Plan includes a 401(k) savings provision that authorizes a maximum voluntary salary deferral of up to 95% of compensation (with a partial company match), subject to statutory limitations. The Profit-Sharing Plan provides for an annual discretionary contribution to the account of each eligible employee based in part on the Bank s profitability for a given year and on each participant s yearly earnings. All salaried employees who have attained the age of eighteen and have at least three months of service are eligible to participate. Contributions and earnings may be invested in various investment vehicles offered through the Virginia Bankers Association. An employee is 20% vested after two years of service, 40% after three years, 60% after four years, 80% after five years and fully vested after six years in the Bank s contributions. The amounts charged to expense under this plan were $564,000, $515,000 and $372,000 in 2006, 2005 and 2004, respectively.

C&F Mortgage maintains a Defined Contribution 401(k) Savings Plan that authorizes a voluntary salary deferral of from 1% to 100% of compensation (with a discretionary company match), subject to statutory limitations. Substantially all employees who have attained the age of eighteen are eligible to participate on the first day of the next month following employment date. The plan provides for an annual discretionary contribution to the account of each eligible employee based in part on C&F Mortgage s profitability for a given year, and on each participant s contributions to the plan. Contributions may be invested in various investment funds offered under the plan. An employee is vested 25% after two years of service, 50% after three years of service, 75% after four years of service, and fully vested after five years in the employer s contributions. The amounts charged to expense under this plan were $211,000, $101,000 and $455,000 for 2006, 2005 and 2004, respectively.

In 2005, C&F Finance adopted a Defined Contribution Profit-Sharing Plan sponsored by the Virginia Bankers Association with plan features similar to the Profit-Sharing Plan of the Bank. The amounts charged to expense under this plan were $99,000 in 2006 and $86,000 in 2005. In prior years, C&F Finance had a profit sharing plan for the benefit of all eligible employees. Eligible employees included all full time employees that had at least six months of service on the enrollment dates of July 1 or January 1. Contributions were discretionary. The allocation of the contribution was based upon a percentage of eligible employee salaries. An employee was 20% vested after two years of service, 40% after three years, 60% after four years, 80% after five years and fully vested after six years in C&F Finance s contributions. The amount charged to expense under this plan was $72,000 in 2004.

Individual performance bonuses are awarded annually to certain members of management under a management incentive bonus policy adopted by the Bank effective January 1, 1987 and the Management Incentive Plan adopted by the Corporation on February 25, 2005. The Corporation s Compensation Committee recommends to the Corporation s board of directors the bonuses to be paid to the Chief Executive Officer, the Chief Financial Officer and the Chief Operating Officer of the Corporation, and recommends to the Bank s board of directors bonuses to be paid to certain other senior Bank officers. In addition, the Chief Executive Officer recommends bonuses to be paid to other officers of the Bank. In determining the awards, performance, including the Corporation s growth rate, returns on average assets and equity, and absolute levels of income are considered. In addition, the Bank s board considers the individual performance of the members of management who may receive awards. The expense for these bonus awards is accrued in the year of performance. Expenses under these plans were $683,000, $586,000 and $392,000 in 2006, 2005 and 2004, respectively. In accordance with employment agreements for certain senior officers of C&F Mortgage, performance bonuses of $1.08 million, $1.46 million and $1.37 million were expensed in 2006, 2005 and 2004, respectively. Performance used in determining the awards is directly related to the profitability of C&F Mortgage.

The Corporation has a non-qualified defined contribution plan for certain executives. The plan allows for elective salary and bonus deferrals. The plan also allows for employer contributions to make up for limitations on covered compensation imposed by the Internal Revenue Code with respect to the Bank s Profit Sharing Plans and to enhance retirement benefits by providing supplemental contributions from time to time. Expenses under this plan were $79,000, $62,000 and $58,000 in 2006, 2005 and 2004, respectively. Investments for this plan are held in a Rabbi trust. These investments are included in other assets and the related liability is included in other liabilities.

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The Bank has a non-contributory, defined benefit pension plan for full-time employees over twenty-one years of age. Benefits are generally based upon years of service and average compensation for the five highest-paid consecutive years of service. The Bank funds pension costs in accordance with the funding provisions of the Employee Retirement Income Security Act. The following table summarizes the projected benefit obligations, plan assets, funded status and rate assumptions associated with the Bank s pension plan based upon actuarial valuations prepared as of October 1, 2006 and 2005.

(Dollars in thousands)	**Plan Year Ended September 30, 2006**	**2005**
Change in benefit obligation		
Projected benefit obligation, beginning	**$ 6,029**	$ 4,925
Service cost	**752**	550
Interest cost	**345**	294
Actuarial (loss) gain	**(460)**	306
Benefits paid	**(228)**	(46)
Projected benefit obligation, ending	**$ 6,438**	$ 6,029
Change in plan assets		
Fair value of plan assets, beginning	**$ 5,084**	$ 4,549
Actual return on plan assets	**400**	553
Employer contributions[(1)]	**1,182**	28
Benefits paid	**(228)**	(46)
Fair value of plan assets, ending	**$ 6,438**	$ 5,084
Funded status	**$**	$ (945)
Unrecognized net actuarial loss		1,409
Unrecognized net obligation at transition		(32)
Unrecognized prior service cost		92
Prepaid benefit cost	**$**	$ 524
Amounts recognized in accumulated other comprehensive income		
Net loss	**$ 932**	N/A
Net obligation at transition	**(27)**	N/A
Prior service cost	**85**	N/A
Total recognized in accumulated other comprehensive income	**$ 990**	N/A
Weighted-average assumptions for benefit obligation as of October 1		
Discount rate	**6.0%**	5.8%
Expected return on plan assets	**8.5**	8.5
Rate of compensation increase	**4.0**	4.0

(1) Employer contributions of $1.18 million and $28,000 were made in December 2006 and 2005, respectively, and were based on amounts determined in conjunction with the actuarial valuations prepared as of October 1, 2006 and 2005.

The accumulated benefit obligation was $4.20 million and $3.87 million as of the actuarial valuation dates of October 1, 2006 and 2005, respectively.

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(Dollars in thousands)	Year Ended December 31, 2006	2005	2004
Components of net periodic benefit cost			
Service cost	**$ 752**	$ 550	$ 422
Interest cost	**345**	294	255
Expected return on plan assets	**(428)**	(346)	(233)
Amortization of prior service cost	**7**	7	7
Amortization of net obligation at transition	**(5)**	(5)	(6)
Recognized net actuarial loss	**45**	45	36
Net periodic benefit cost	**716**	545	481
Other changes in plan assets and benefit obligations recognized in other comprehensive income			
Net loss	**932**		
Net obligation at transition	**(27)**		
Prior service cost	**85**		
Total recognized in other comprehensive income	**990**		
Total recognized in net periodic benefit cost and other comprehensive income	**$ 1,706**	$ 545	$ 481

The estimated net loss, net obligation at transition and prior service cost that will be amortized from (accreted to) accumulated other comprehensive income into net periodic benefit cost over the next year are $16,000, ($5,000) and $7,000, respectively.

Weighted-average assumptions for net periodic benefit cost as of October 1 [1]			
Discount rate	**5.8%**	6.0%	6.5%
Expected return on plan assets	**8.5**	8.5	8.5
Rate of compensation increase	**4.0**	4.0	4.0

[1] Net periodic benefit cost for the current year is based on assumptions determined at the October 1 valuation date of the prior year.

The Corporation adopted the recognition provisions of SFAS 158 in its December 31, 2006 financial statements. The following table illustrates the incremental effect of applying SFAS 158 on individual line items in the Corporation s financial statements.

(Dollars in thousands)	Before Application of SFAS 158	Adjustments	After Application of SFAS 158
Prepaid pension	$ 990	$ (990)	$ -
Deferred income taxes	5,224	346	5,570
Total assets	735,112	(644)	734,468
Accumulated other comprehensive income	765	(644)	121
Total shareholders equity	68,650	(644)	68,006

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The benefits expected to be paid by the plan in the next ten years are as follows *(dollars in thousands)*:

2007	$ 60
2008	75
2009	103
2010	111
2011	146
2012 2016	1,600
	$ 2,095

The Bank selects the expected long-term rate-of-return-on-assets in consultation with its investment advisors and actuary. This rate is intended to reflect the average rate of earnings expected to be earned on the funds invested or to be invested to provide plan benefits. Historical performance is reviewed, especially with respect to real rates of return (net of inflation), for the major asset classes held or anticipated to be held by the trust and for the trust itself. Undue weight is not given to recent experience, which may not continue over the measurement period. Higher significance is placed on current forecasts of future long-term economic conditions.

Because assets are held in a qualified trust, anticipated returns are not reduced for taxes. Further, solely for this purpose, the plan is assumed to continue in force and not terminate during the period during which assets are invested. However, consideration is given to the potential impact of current and future investment policy, cash flow into and out of the trust, and expenses (both investment and non-investment) typically paid from plan assets (to the extent such expenses are not explicitly within periodic costs).

The Corporation s defined benefit plan s weighted average asset allocations as of September 30 by asset category are as follows:

	2006	**2005**
Mutual funds-fixed income	**30%**	34%
Mutual funds-equity	**56**	66
Cash and equivalents	**14**	
	100%	100%

The trust fund is sufficiently diversified to maintain a reasonable level of risk without imprudently sacrificing return, with a targeted asset allocation of 40% fixed income and 60% equities. The investment advisor selects investment fund managers with demonstrated experience and expertise, and funds with demonstrated historical performance, for the implementation of the plan s investment strategy. The investment manager will consider both actively and passively managed investment strategies and will allocate funds across the asset classes to develop an efficient investment structure.

It is the responsibility of the trustee to administer the investments of the trust within reasonable costs, being careful to avoid sacrificing quality. These costs include, but are not limited to, management and custodial fees, consulting fees, transaction costs and other administrative costs chargeable to the trust.

NOTE 11: Related Party Transactions

Loans outstanding to directors and executive officers totaled $1.22 million and $1.23 million at December 31, 2006 and 2005, respectively. New advances to directors and officers totaled $483,000 and repayments totaled $489,000 in the year ended December 31, 2006. These loans were made in the ordinary course of business on substantially the same terms and conditions, including interest rates and collateral, as those prevailing at the same time for comparable transactions with unrelated persons, and, in the opinion of management, do not involve more than normal risk or present other unfavorable features.

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NOTE 12: Share-Based Plans

On April 20, 2004, the Corporation s shareholders approved the C&F Financial Corporation 2004 Incentive Stock Plan (the 2004 Plan). Under the 2004 Plan, options to purchase common stock and/or grants of restricted shares of common stock may be awarded to certain key employees of the Corporation. Options are issued to employees at a price equal to the fair market value of common stock at the date granted. Restricted shares are accounted for using the fair market value of the Corporation s common stock on the date the restricted shares are awarded. The maximum aggregate number of shares that may be issued pursuant to awards made under the 2004 Plan is 500,000. As a result of the accelerated vesting of all unvested options on December 20, 2005 and because no options were granted under the 2004 Plan in 2006, all options outstanding under the 2004 Plan on December 31, 2006 are exercisable. All options expire ten years from the grant date.

Prior to the approval of the 2004 Plan, the Corporation granted options to purchase common stock under the Amended and Restated C&F Financial Corporation 1994 Incentive Stock Plan (the 1994 Plan). The 1994 Plan expired on April 30, 2004. The maximum aggregate number of shares that could be issued pursuant to awards made under the 1994 Plan was 500,000. Options were issued to employees at a price equal to the fair market value of common stock at the date granted. As a result of the accelerated vesting of all unvested options on December 20, 2005, all options outstanding under the 1994 Plan on December 31, 2006 are exercisable. All options expire ten years from the grant date.

In 1998, the Board of Directors authorized 25,000 shares of common stock for issuance under the C&F Financial Corporation 1998 Non-Employee Director Stock Compensation Plan (the Director Plan). In 1999, the Director Plan was amended to authorize a total of 150,000 shares for issuance. Under the Director Plan, options to purchase common stock may be awarded to non-employee directors of the Bank. Options are issued to non-employee directors at a price equal to the fair market value of common stock at the date granted. As a result of the accelerated vesting of all unvested options on December 20, 2005, all options outstanding under the Director Plan on December 31, 2006, except for those granted in 2006, are exercisable. All options expire ten years from the grant date.

In 1999, the Board of Directors authorized 25,000 shares of common stock for issuance under the C&F Financial Corporation 1999 Regional Director Stock Compensation Plan (the Regional Director Plan). Under this plan, options to purchase common stock are granted to non-employee regional directors of the Bank. Options are issued to non-employee regional directors at a price equal to the fair market value of common stock at the date granted. As a result of the accelerated vesting of all unvested options on December 20, 2005 and because no options were granted under the Regional Director Plan in 2006, all options outstanding under the Regional Director Plan on December 31, 2006 are exercisable. All options expire ten years from the grant date.

Stock option transactions under the various plans for the periods indicated were as follows:

(Dollars in thousands, except for per share amounts)	2006			2005		2004	
	Shares	Exercise Price*	Intrinsic Value	Shares	Exercise Price*	Shares	Exercise Price*
Outstanding at beginning of year	**564,067**	**$ 30.65**		473,667	$ 27.58	406,368	$ 23.62
Granted	**13,500**	**39.60**		137,900	37.72	114,800	39.04
Exercised	**(32,000)**	**16.46**		(29,600)	15.35	(15,033)	15.32
Canceled	**(15,400)**	**37.13**		(17,900)	29.29	(32,468)	24.17
Outstanding at end of year	**530,167**	**$ 31.54**	**$ 4,511**	564,067	$ 30.65	473,667	$ 27.58

* *Weighted average*

	2006			2005		2004	
Options exercisable at year-end	**516,667**		**$ 4,509**	564,067		147,417	
Weighted-average fair value of options granted during the year	**$ 10.10**			$ 8.96		$ 9.72	

The total intrinsic value of in-the-money options exercised in 2006 was $737,000. Cash received from option exercises during 2006 was $527,000. The Corporation has a policy of issuing new shares to satisfy the exercise of stock options.

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The fair value of each option grant is estimated on the date of grant using the Black-Scholes option-pricing model with the following weighted-average assumptions:

	Year Ended December 31,		
	2006	**2005**	**2004**
Dividend yield	**2.9%**	3.4%	2.9%
Dividend growth rate	**5.0**	8.0	7.1%
Expected life (years)	**8**	8	8
Expected volatility	**25.0%**	25.0%	25.0%
Risk-free interest rate	**5.2%**	4.5%	4.2%

The dividend yield and growth rate assumptions are based on the Corporation s history and expectation of dividend payouts. The expected life is based on historical exercise experience. The expected volatility is based on historical volatility. The risk-free interest rates for periods within the contractual life of the awards are based on the U.S. Treasury yield curve in effect at the time of grant.

The following table summarizes information about stock options outstanding at December 31, 2006:

	Options Outstanding			Options Exercisable	
Range of Exercise Prices	Number Outstanding at December 31, 2006	Remaining Contractual Life	Exercise Price*	Number Exercisable at December 31, 2006	Exercise Price
$12.50	7,200	1.0	$ 12.50	7,200	$ 12.50
$15.75 to $23.49	194,017	4.4	19.27	194,017	19.27
$35.20 to $39.60	250,400	8.5	38.38	236,900	38.31
$40.50 to $46.20	78,550	6.9	41.80	78,550	41.80
$12.50 to $46.20	530,167	6.7	$ 31.54	516,667	$ 31.33

* *Weighted average*

As permitted under the 2004 Plan, the Corporation awarded 22,800 shares of restricted stock to employees on December 19, 2006. These restricted shares are subject to a five-year vesting period. Compensation is accounted for using the fair market value of the Corporation s common stock on the date the restricted shares are awarded, which was $39.01 per share for restricted stock issued in 2006. Compensation expense is charged to income ratably over the vesting period.

NOTE 13: Regulatory Requirements and Restrictions

The Corporation and the Bank are subject to various regulatory capital requirements administered by the federal banking agencies. Failure to meet minimum capital requirements can initiate certain mandatory, and possibly additional discretionary, actions by regulators that, if undertaken, could have a direct material effect on the Corporation s and the Bank s financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, the Corporation and the Bank must meet specific capital guidelines that involve quantitative measures of the Corporation s and the Bank s assets, liabilities, and certain off-balance-sheet items as calculated under regulatory accounting practices. The Corporation s and the Bank s capital amounts and classification are subject to qualitative judgments by the regulators about components, risk weightings, and other factors. Prompt corrective action provisions are not applicable to bank holding companies.

Quantitative measures established by regulation to ensure capital adequacy require the Corporation and the Bank to maintain minimum amounts and ratios (set forth in the table below) of total and Tier I capital to risk-weighted

assets and of Tier I capital to average assets (all as defined in the regulations). For both the Corporation and the Bank, Tier I capital consists of shareholders equity excluding any net unrealized gain (loss) on securities available for sale, amounts resulting from the adoption and application of SFAS 158 and goodwill, and total capital consists of Tier I capital and a portion of the allowance for loan losses. For the Corporation only, Tier I and total capital include trust preferred securities. Risk-weighted assets for the Corporation and the Bank were $592.67 million and $587.40 million, respectively, at December 31, 2006 and $533.84 million and $528.64 million, respectively, at December 31, 2005. Management believes, as of December 31, 2006, that the Corporation and the Bank met all capital adequacy requirements to which they are subject.

As of December 31, 2006, the most recent notification from the Federal Deposit Insurance Corporation (FDIC) categorized the Bank as well capitalized under the regulatory framework for prompt corrective action. To be categorized as well capitalized, the Bank must maintain minimum total risk-based, Tier I risk-based and Tier I leverage ratios as set forth in the table below. There are no conditions or events since that notification that management believes have changed the Bank s category.

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

	Actual		Minimum Capital Requirements		Minimum To Be Well Capitalized Under Prompt Corrective Action Provisions	
(Dollars in thousands)	**Amount**	**Ratio**	**Amount**	**Ratio**	**Amount**	**Ratio**
As of December 31, 2006:						
Total Capital (to Risk-Weighted Assets)						
Corporation	**$ 74,646**	**12.6%**	**$ 47,413**	**8.0%**	**N/A**	**N/A**
Bank	**76,571**	**13.0**	**46,992**	**8.0**	**$ 58,740**	**10.0%**
Tier I Capital (to Risk-Weighted Assets)						
Corporation	**67,161**	**11.3**	**23,707**	**4.0**	**N/A**	**N/A**
Bank	**69,144**	**11.8**	**23,496**	**4.0**	**35,244**	**6.0**
Tier I Capital (to Average Tangible Assets)						
Corporation	**67,161**	**9.6**	**28,123**	**4.0**	**N/A**	**N/A**
Bank	**69,144**	**9.9**	**27,918**	**4.0**	**34,897**	**5.0**
As of December 31, 2005						
Total Capital (to Risk-Weighted Assets)						
Corporation	$ 65,295	12.2%	$ 42,707	8.0%	N/A	N/A
Bank	67,144	12.7	42,291	8.0	$ 52,864	10.0%
Tier I Capital (to Risk-Weighted Assets)						
Corporation	58,531	11.0	21,354	4.0	N/A	N/A
Bank	60,463	11.4	21,146	4.0	31,718	6.0
Tier I Capital (to Average Tangible Assets)						
Corporation	58,531	8.9	26,270	4.0	N/A	N/A
Bank	60,463	9.3	26,025	4.0	32,531	5.0

The capital ratios presented above for the Corporation include the effect of the Corporation s purchase of 427,186 shares of its common stock at $41 per share on July 27, 2005. On July 21, 2005, the Corporation issued $10.00 million of trust preferred securities through a statutory business trust to partially fund the purchase. The trust preferred securities may be treated as Tier 1 capital for regulatory capital adequacy determination purposes up to 25% of Tier 1 capital after its inclusion. Accordingly, the entire $10.00 million of the Corporation s trust preferred securities is included in Tier 1 capital in the Corporation s capital ratios presented above.

Federal and state banking regulations place certain restrictions on dividends paid and loans or advances made by the Bank to the Corporation. The total amount of dividends that may be paid at any date is generally limited to the retained earnings of the Bank, and loans or advances are limited to 10 percent of the Bank s capital stock and surplus on a secured basis.

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NOTE 14: Commitments and Financial Instruments with Off-Balance-Sheet Risk

The Corporation is a party to financial instruments with off-balance-sheet risk in the normal course of business to meet the financing needs of its customers. These financial instruments include commitments to extend credit, commitments to sell loans, and standby letters of credit. These instruments involve elements of credit and interest rate risk in excess of the amount on the balance sheet. The contract amounts of these instruments reflect the extent of involvement the Bank has in particular classes of financial instruments.

The Bank s exposure to credit loss in the event of nonperformance by the other party to the financial instrument for commitments to extend credit and standby letters of credit written is represented by the contractual amount of these instruments.

The Bank uses the same credit policies in making commitments and conditional obligations as it does for on-balance-sheet instruments. Collateral is obtained based on management s credit assessment of the customer.

Loan commitments are agreements to extend credit to a customer provided that there are no violations of the terms of the contract prior to funding. Commitments have fixed expiration dates or other termination clauses and may require payment of a fee by the customer. Since many of the commitments may expire without being completely drawn upon, the total commitment amounts do not necessarily represent future cash requirements. The Bank evaluates each customer s creditworthiness on a case-by-case basis. The total amount of loan commitments was $93.26 million and $97.85 million at December 31, 2006 and 2005, respectively.

Standby letters of credit are written conditional commitments issued by the Bank to guarantee the performance of a customer to a third party. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loans to customers. The total contract amount of standby letters of credit, whose contract amounts represent credit risk, was $8.79 million and $9.74 million at December 31, 2006 and 2005, respectively.

At December 31, 2006, C&F Mortgage had rate lock commitments to originate mortgage loans amounting to approximately $23.77 million and loans held for sale of $53.50 million. C&F Mortgage has entered into corresponding commitments with third party investors to sell loans of approximately $77.27 million. Under the contractual relationship with these investors, C&F Mortgage is obligated to sell the loans only if the loans close. No other obligation exists. As a result of these contractual relationships with these investors, C&F Mortgage is not exposed to losses nor will it realize gains related to its rate lock commitments due to changes in interest rates.

C&F Mortgage sells substantially all of the residential mortgage loans it originates to third-party investors, some of whom require the repurchase of loans in the event of early default or faulty documentation. Mortgage loans and their related servicing rights are sold under agreements that define certain eligibility criteria for the mortgage loans. Recourse periods vary from 90 days up to one year and conditions for repurchase vary with the investor. Risks also arise from the possible inability of counterparties to meet the terms of their contracts. C&F Mortgage has procedures in place to evaluate the credit risk of investors and does not expect any counterparty to fail to meet its obligations.

The Corporation is committed under noncancelable operating leases for certain office locations. Rent expense associated with these operating leases was $911,000, $786,000 and $649,000, for the years ended December 31, 2006, 2005 and 2004, respectively.

Future minimum lease payments due under these leases as of December 31, 2006 are as follows *(dollars in thousands)*:

2007	$ 877
2008	602
2009	292
2010	196
2011	198
Thereafter	
	$ 2,165

As of December 31, 2006, the Corporation had $22.63 million in deposits in financial institutions in excess of amounts insured by the FDIC, the majority of which was on deposit at the FHLB.

NOTE 15: Fair Market Value of Financial Instruments and Interest Rate Risk

The estimated fair value amounts have been determined by the Corporation using available market information and appropriate valuation methodologies. However, considerable judgment is required to interpret market data to develop the estimates of fair value. Accordingly, the estimates presented herein are not necessarily indicative of the amounts the Corporation could realize in a current market exchange. The use of different market assumptions and/or estimation methodologies may have a material effect on the estimated fair value amounts.

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

Securities. The fair value of investment securities is based on quoted market prices.

Loans. The estimated fair value of the loan portfolio is based on present values using applicable spreads to the U.S. Treasury yield curve.

Loans held for sale. The fair value of loans held for sale is estimated based on commitments into which individual loans will be delivered.

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

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

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

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

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	December 31,			
	2006		2005	
(Dollars in thousands)	**Carrying Amount**	**Estimated Fair Value**	**Carrying Amount**	**Estimated Fair Value**
Financial assets:				
Cash and short-term investments	**$ 28,506**	**$ 28,506**	$ 42,878	$ 42,878
Securities	**67,584**	**67,584**	65,301	65,301
Net loans	**517,843**	**517,000**	465,039	468,458
Loans held for sale, net	**53,504**	**54,913**	39,677	41,277
Accrued interest receivable	**4,432**	**4,432**	3,664	3,664
Financial liabilities:				
Demand deposits	**278,710**	**277,310**	274,145	273,157
Time deposits	**254,125**	**255,360**	221,293	221,479
Borrowings	**115,056**	**113,869**	102,314	100,898
Accrued interest payable	**1,915**	**1,915**	1,306	1,306
Off-balance-sheet items:				
Letters of credit	**8,794**		9,744	
Unused portions of lines of credit	**93,263**		97,853	

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

NOTE 16: Business Segments

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

The Corporation s other segments include:

- an investment company that derives revenues from brokerage services,
- an insurance company that derives revenues from insurance services, and
- a title company that derives revenues from title insurance services.

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

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(Dollars in thousands)	Retail Banking	Mortgage Banking	Consumer Finance	Other	Eliminations	Consolidated
	Year Ended December 31, 2006					
Revenues:						
Interest income	**$ 37,743**	**$ 2,737**	**$ 21,384**	**$**	**$ (3,282)**	**$ 58,582**
Gains on sales of loans		**17,149**			**(51)**	**17,098**
Other noninterest income	**5,169**	**3,678**	**539**	**903**		**10,289**
Total operating income	**42,912**	**23,564**	**21,923**	**903**	**(3,333)**	**85,969**
Expenses:						
Interest expense	**13,520**	**1,428**	**6,849**		**(3,340)**	**18,457**
Salaries and employee benefits	**13,001**	**12,137**	**3,146**	**668**	**55**	**29,007**
Other noninterest expenses	**7,660**	**6,221**	**6,924**	**141**		**20,946**
Total operating expenses	**34,181**	**19,786**	**16,919**	**809**	**(3,285)**	**68,410**
Income before income taxes	**$ 8,731**	**$ 3,778**	**$ 5,004**	**$ 94**	**$ (48)**	**$ 17,559**
Total assets	**$ 591,573**	**$ 60,022**	**$ 140,024**	**$ 51**	**$ (57,202)**	**$ 734,468**
Goodwill	**$**	**$**	**$ 10,724**	**$**	**$**	**$ 10,724**
Capital expenditures	**$ 5,485**	**$ 425**	**$ 207**	**$ 3**	**$**	**$ 6,120**

(Dollars in thousands)	Retail Banking	Mortgage Banking	Consumer Finance	Other	Eliminations	Consolidated
	Year Ended December 31, 2005					
Revenues:						
Interest income	$ 30,857	$ 3,178	$ 17,799	$	$ (3,064)	$ 48,770
Gains on sales of loans		18,193			1	18,194
Other noninterest income	4,342	3,719	417	912		9,390
Total operating income	35,199	25,090	18,216	912	(3,063)	76,354
Expenses:						
Interest expense	8,712	1,532	4,880		(3,127)	11,997
Salaries and employee benefits	11,368	13,457	2,766	568	118	28,277
Other noninterest expenses	6,995	5,012	6,919	185		19,111
Total operating expenses	27,075	20,001	14,565	753	(3,009)	59,385
Income before income taxes	$ 8,124	$ 5,089	$ 3,651	$ 159	$ (54)	$ 16,969
Total assets	$ 571,091	$ 47,574	$ 119,113	$ 19	$ (65,840)	$ 671,957
Goodwill	$	$	$ 10,724	$	$	$ 10,724
Capital expenditures	$ 11,830	$ 459	$ 172	$	$	$ 12,461

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	Year Ended December 31, 2004					
(Dollars in thousands)	Retail Banking	Mortgage Banking	Consumer Finance	Other	Eliminations	Consolidated
Revenues:						
Interest income	$ 25,208	$ 2,373	$ 15,113	$	$ (1,851)	$ 40,843
Gains on sales of loans		16,572			3	16,575
Other noninterest income	3,779	3,226	71	1,038		8,114
Total operating income	28,987	22,171	15,184	1,038	(1,848)	65,532
Expenses:						
Interest expense	5,703	569	3,133		(1,856)	7,549
Salaries and employee benefits	9,982	12,624	2,162	408	57	25,233
Other noninterest expenses	6,006	4,233	6,123	184		16,546
Total operating expenses	21,691	17,426	11,418	592	(1,799)	49,328
Income before income taxes	$ 7,296	$ 4,745	$ 3,766	$ 446	$ (49)	$ 16,204
Total assets	$ 523,035	$ 56,845	$ 103,654	$ 17	$ (74,429)	$ 609,122
Goodwill	$	$	$ 10,228	$	$	$ 10,228
Capital expenditures	$ 4,029	$ 295	$ 84	$	$	$ 4,408

The Retail Banking segment extends a warehouse line of credit to the Mortgage Banking segment, providing the funds needed to originate mortgage loans. The Retail Banking segment charges the Mortgage Banking segment interest at the daily FHLB advance rate plus 50 basis points. The Retail Banking segment also provides the Consumer Finance segment with a portion of the funds needed to originate loans and charges the Consumer Finance segment interest at LIBOR plus 175 basis points. The Retail Banking segment acquires certain lot and permanent loans, second mortgage loans and home equity lines of credit from the Mortgage Banking segment at prices similar to those paid by third-party investors. These transactions are eliminated to reach consolidated totals. Certain corporate overhead costs incurred by the Retail Banking segment are not allocated to the Mortgage Banking, Consumer Finance and Other segments.

NOTE 17: Parent Company Condensed Financial Information

Financial information for the parent company is as follows:

(Dollars in thousands)	December 31,	
Balance Sheets	**2006**	**2005**
Assets		
Cash	**$ 122**	$ 247
Securities available for sale	**4,127**	4,097
Other assets	**1,343**	1,156
Investments in subsidiary	**79,865**	72,000
Total assets	**$ 85,457**	$ 77,500
Liabilities and shareholders equity		
Short-term borrowings	**$ 7,000**	$ 7,000
Trust preferred capital notes	**10,310**	10,310
Other liabilities	**141**	104
Shareholders equity	**68,006**	60,086
Total liabilities and shareholders equity	**$ 85,457**	$ 77,500

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(Dollars in thousands)	Year Ended December 31,		
Statements of Income	**2006**	**2005**	**2004**
Interest income on securities	**$ 194**	$ 306	$ 325
Interest income on loans		27	29
Interest expense on borrowings	**(1,106)**	(448)	
Dividends received from bank subsidiary	**4,038**	2,492	5,590
Equity in undistributed net income of subsidiary	**8,681**	9,354	5,367
Other income	**518**	227	23
Other expenses	**(196)**	(170)	(136)
Net income	**$ 12,129**	$ 11,788	$ 11,198

(Dollars in thousands)	Year Ended December 31,		
Statements of Cash Flows	**2006**	**2005**	**2004**
Operating activities:			
Net income	**$ 12,129**	$ 11,788	$ 11,198
Adjustments to reconcile net income to net cash provided by operating activities:			
Equity in undistributed earnings of subsidiary	**(8,681)**	(9,354)	(5,367)
Stock-based compensation	**97**		
Net gain on securities	**(19)**	(36)	(2)
Increase in other assets	**(187)**	(100)	(246)
Decrease in other liabilities	**(21)**	(38)	(24)
Net cash provided by operating activities	**3,318**	2,260	5,559
Investing activities:			
Proceeds from maturities and calls of securities	**152**	1,077	676
Purchase of securities		(185)	(462)
Investment in statutory trust		(310)	
Net cash provided by investing activities	**152**	582	214
Financing activities:			
Proceeds from borrowing		7,000	
Issuance of trust preferred capital notes		10,310	
Purchase of common stock	**(518)**	(17,640)	(3,421)
Cash dividends	**(3,657)**	(3,339)	(3,202)
Proceeds from exercise of stock options	**580**	503	258
Net cash used in financing activities	**(3,595)**	(3,166)	(6,365)
Net decrease in cash and cash equivalents	**(125)**	(324)	(592)
Cash at beginning of year	**247**	571	1,163
Cash at end of year	**$ 122**	$ 247	$ 571

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NOTE 18: Quarterly Condensed Statements of Income Unaudited

Dollars in thousands (except per share amounts)	2006 Quarter Ended March 31	June 30	September 30	December 31
Total interest income	**$ 13,493**	**$ 15,050**	**$ 14,763**	**$ 15,276**
Net interest income after provision for loan losses	**8,285**	**9,682**	**8,793**	**8,740**
Other income	**5,986**	**6,882**	**7,189**	**7,330**
Other expenses	**10,630**	**11,139**	**11,434**	**12,125**
Income before income taxes	**3,641**	**5,425**	**4,548**	**3,945**
Net income	**2,526**	**3,726**	**3,112**	**2,765**
Earnings per common share - assuming dilution*	**.77**	**1.14**	**.95**	**.84**
Dividends per common share	**.27**	**.29**	**.29**	**.31**

Dollars in thousands (except per share amounts)	2005 Quarter Ended March 31	June 30	September 30	December 31
Total interest income	$ 11,092	$ 11,613	$ 12,968	$ 13,097
Net interest income after provision for loan losses	7,755	7,741	8,017	7,740
Other income	5,747	6,895	8,175	6,767
Other expenses	9,740	10,253	11,286	10,589
Income before income taxes	3,762	4,383	4,906	3,918
Net income	2,607	3,008	3,413	2,760
Earnings per common share - assuming dilution*	.71	.82	1.01	.84
Dividends per common share	.24	.24	.25	.27

* The total of quarterly EPS amounts differs from EPS for the years ended December 31, 2006 and 2005 due to rounding.

NOTE 19: Subsequent Event

On February 7, 2007, the Corporation purchased 100,000 shares of its common stock for $41.25 per share. This purchase is not reflected in 2006 results.

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Shareholders and Board of Directors

C&F Financial Corporation

West Point, Virginia

We have audited the accompanying consolidated balance sheets of C&F Financial Corporation and Subsidiary as of December 31, 2006 and 2005, and the related consolidated statements of income, shareholders equity, and cash flows for the years ended December 31, 2006, 2005 and 2004. We also have audited management s assessment, included in the accompanying Management s Report on Internal Control over Financial Reporting, that C&F Financial Corporation maintained effective internal control over financial reporting as of December 31, 2006, based on criteria established in *Internal Control Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). C&F Financial Corporation and Subsidiary s management is responsible for these financial statements, for maintaining effective internal control over financial reporting, and for its assessment of the effectiveness of internal control over financial reporting. Our responsibility is to express an opinion on these financial statements, an opinion on management s assessment, and an opinion on the effectiveness of the Corporation s internal control over financial reporting based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement and whether effective internal control over financial reporting was maintained in all material respects. Our audit of financial statements included examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. Our audit of internal control over financial reporting included obtaining an understanding of internal control over financial reporting, evaluating management s assessment, testing and evaluating the design and operating effectiveness of internal control, and performing such other procedures as we considered necessary in the circumstances. We believe that our audits provide a reasonable basis for our opinions.

A corporation s internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A corporation s internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the corporation; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the corporation are being made only in accordance with authorizations of management and directors of the corporation; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the corporation s assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of C&F Financial Corporation and Subsidiary as of December 31, 2006 and 2005, and the results of their operations and their cash flows for the years ended December 31, 2006, 2005 and 2004 in conformity with accounting principles generally accepted in the United States of America. Also in our opinion, management s assessment that C&F Financial Corporation and Subsidiary maintained effective internal control over financial reporting as of December 31, 2006, is fairly stated, in all material respects, based on criteria established in *Internal Control Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Furthermore, in our opinion, C&F Financial Corporation and Subsidiary maintained, in all material respects, effective internal control over financial reporting as of December 31, 2006, based on criteria established in *Internal Control Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO).

As described in Note 1 to the consolidated financial statements, on December 31, 2006, C&F Financial Corporation changed its method of accounting for its pension plan to adopt FASB Statement No. 158, *Employers Accounting for Defined Benefit Pension and Other Postretirement Plans*.

/s/ Yount, Hyde & Barbour, P.C.

Winchester, Virginia

February 20, 2007

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ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

None.

ITEM 9A. CONTROLS AND PROCEDURES

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

Management s Report on Internal Control over Financial Reporting. Management of the Corporation is responsible for establishing and maintaining effective internal control over financial reporting as defined in Rule 13a-15(f) under the Securities Exchange Act of 1934. The Corporation s internal control over financial reporting is designed to provide reasonable assurance to the Corporation s management and board of directors regarding the preparation and fair presentation of published financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Therefore, even those systems determined to be effective can provide only reasonable assurance with respect to financial statement preparation and presentation.

Management assessed the effectiveness of the Corporation s internal control over financial reporting as of December 31, 2006. In making this assessment, management used the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) in *Internal Control Integrated Framework*. Based on our assessment, we believe that, as of December 31, 2006, the Corporation s internal control over financial reporting was effective based on those criteria.

Management s assessment of the effectiveness of internal control over financial reporting as of December 31, 2006 has been audited by Yount, Hyde & Barbour, P.C., the independent registered public accounting firm who also audited the Corporation s consolidated financial statements included in this Annual Report on Form 10-K. Yount, Hyde & Barbour, P.C. s attestation report on management s assessment of the Corporation s internal control over financial reporting appears on pages 82 through 83 hereof.

Changes in Internal Controls. There were no changes in the Corporation s internal control over financial reporting during the Corporation s fourth quarter ended December 31, 2006 that have materially affected, or are reasonably likely to materially affect, the Corporation s internal control over financial reporting.

ITEM 9B. OTHER INFORMATION

Item 1.01 Entry into a Material Definitive Agreement.
On March 7, 2007, the Compensation Committee of the Board of Directors approved the 2007 target bonuses and performance goals for the Corporation s named executive officers under the Corporation s Management Incentive Plan.

Short-Term Cash Awards. Depending on the Corporation s weighted measure of ROE and ROA for 2007 in relation to a peer group of Southeastern and Virginia-based banks selected by the Compensation Committee, the Chief Executive Officer may earn a short-term cash bonus up to 90.0 percent of his annual base salary as of January 1, 2007, and the Chief Financial Officer and the Chief Operating Officer may earn a short-term cash bonus up to 70.0 percent of their annual base salaries as of January 1, 2007. Short-term cash awards for the President of C&F Mortgage are determined in accordance with his employment agreement and are related directly to the profitability of C&F Mortgage.

Equity-Based Awards. If the Corporation achieves a certain level of five-year total shareholder return for 2007 in relation to a peer group of banks selected by the Compensation Committee, the Chief Executive Officer may earn an equity-based award of 90.0 percent of his annual base salary as of January 1, 2007, and the Chief Financial Officer and the Chief Operating Officer may earn an equity-based award of 70.0 percent of their annual base salaries as of January 1, 2007. Equity awards for the President of C&F Mortgage are based on a recommendation by the Chief Executive Officer based on the performance of C&F Mortgage.

The Corporation s Management Incentive Plan was attached as Exhibit 10.8 to Form 10-K for 2005.

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PART III

ITEM 10. DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE

The information with respect to the directors of the Corporation is contained on pages 3 through 4 of the 2007 Proxy Statement under the caption, Election of Directors, and is incorporated herein by reference. The information regarding the Section 16(a) reporting requirements of the directors and executive officers is contained on page 26 of the 2007 Proxy Statement under the caption, Section 16(a) Beneficial Ownership Reporting Compliance, and is incorporated herein by reference. The information concerning executive officers of the Corporation is included after Item 4 of this Form 10-K under the caption, Executive Officers of the Registrant. The Corporation has adopted a Code of Business Conduct and Ethics that applies to its directors, executives and employees including the principal executive officer, principal financial officer, principal accounting officer and controller. The Corporation s Code is attached hereto as Exhibit 14.

The board of directors of the Corporation has a standing Audit Committee, which is comprised of three directors who satisfy all of the following criteria: (i) meet the independence requirements of the NASDAQ Stock Market s (NASDAQ) listing standards, (ii) have not accepted directly or indirectly any consulting, advisory, or other compensatory fee from the Corporation or any of its subsidiaries, (iii) are not an affiliated person of the Corporation or any of its subsidiaries and (iv) are competent to read and understand financial statements. In addition, at least one member of the Audit Committee has past employment experience in finance or accounting or comparable experience that results in the individual s financial sophistication. The members of the Audit Committee are Messrs. J. P. Causey Jr., Barry R. Chernack and William E. O Connell, Jr. The board of directors has determined that the chairman of the Audit Committee, Mr. Barry R. Chernack, qualifies as an audit committee financial expert within the meaning of applicable regulations of the SEC, promulgated pursuant to the SOX Act. Mr. Chernack is independent of management based on the independence requirements set forth in the NASDAQ s listing standards definition of independent director.

The Corporation provides an informal process for security holders to send communications to its board of directors. Security holders who wish to contact the board of directors or any of its members may do so by addressing their written correspondence to C&F Financial Corporation, Board of Directors, c/o Corporate Secretary, P.O. Box 391, West Point, Virginia 23181. Correspondence directed to an individual board member will be referred, unopened, to that member. Correspondence not directed to a particular board member will be referred, unopened, to the Chairman of the Board.

ITEM 11. EXECUTIVE COMPENSATION

The information contained on pages 9 through 18 of the 2007 Proxy Statement under the captions, Compensation Committee Interlocks and Insider Participation, Executive Compensation and Compensation Committee Report is incorporated herein by reference. The information regarding director compensation contained on pages 7 through 8 of the 2007 Proxy Statement under the caption, Director Compensation, is incorporated herein by reference.

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ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS

The information contained on pages 2 through 3 of the 2007 Proxy Statement under the caption, Security Ownership of Certain Beneficial Owners and Management, is incorporated herein by reference.

The following table sets forth information as of December 31, 2006 with respect to compensation plans under which equity securities of the Corporation are authorized for issuance:

Equity Compensation Plan Information

Plan Category	Number of securities to be issued upon exercise of outstanding options (a)	Weighted-average exercise price of outstanding options (b)	Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in column (a)) (c)
Equity compensation plans approved by shareholders (1)	520,000	$ 31.61	307,550(3)
Equity compensation plan not approved by shareholders (2)	10,167	$ 27.83	13,000(4)
Total	530,167	$ 31.54	320,550

(1) This plan category consists of (1) the C&F Financial Corporation 2004 Incentive Stock Plan (2004 Incentive Plan), (2) the Amended and Restated C&F Financial Corporation 1994 Incentive Stock Plan, which expired on April 30, 2004, and (3) the C&F Financial Corporation 1998 Non-Employee Director Stock Compensation Plan (Director Plan).

(2) This plan category consists solely of the C&F Financial Corporation 1999 Regional Director Stock Compensation Plan (Regional Director Plan). The Board of Directors of the Corporation adopted the Regional Director Plan on October 19, 1999. This plan will expire on October 18, 2009, unless sooner terminated by the Corporation s Board of Directors. The Regional Director Plan makes available up to 25,000 shares of common stock for awards to eligible members of the regional boards of the Bank, or any other regional board of the Corporation, the Bank, any other division of the Bank or any other affiliate of the Corporation approved for participation in the Regional Director Plan, in the form of stock options. The purpose of the Regional Director Plan is to promote a greater identity of interest between regional directors and the Corporation s shareholders by increasing the ownership of the regional directors in the Corporation s equity securities through the receipt of awards in the form of options. All regional directors who are not employees or directors of the Corporation, the Bank or any other affiliate of the Corporation are eligible for awards under the Regional Director Plan. This plan is administered by the Corporation s Compensation Committee, which acts as a Stock Option Committee.

(3) Includes 271,300 shares available to be granted in the form of options, stock appreciation rights or restricted stock under the 2004 Incentive Plan and 36,250 shares available to be granted in the form of options under the Director Plan.

(4) Includes 13,000 shares available to be granted in the form of options under the Regional Director Plan.

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ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS, AND DIRECTOR INDEPENDENCE

The information contained on pages 8 through 9 of the 2007 Proxy Statement under the caption, Interest of Management in Certain Transactions, is incorporated herein by reference. The information contained on pages 4 through 5 of the 2007 Proxy Statement under the caption, Director Independence, is incorporated herein by reference.

ITEM 14. PRINCIPAL ACCOUNTANT FEES AND SERVICES

The information contained on pages 25 through 26 of the 2007 Proxy Statement under the captions, Principal Accountant Fees and Audit Committee Pre-Approval Policy, is incorporated herein by reference.

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PART IV

ITEM 15. EXHIBITS, FINANCIAL STATEMENT SCHEDULES

(a) Exhibits:

3.1	Articles of Incorporation of C&F Financial Corporation (incorporated by reference to Exhibit 3.1 to Form 10-KSB filed March 29, 1996)
3.2	Bylaws of C&F Financial Corporation (incorporated by reference to Exhibit 3.2 to Form 10-KSB filed March 29, 1996)

Certain instruments relating to trust preferred securities not being registered have been omitted in accordance with Item 601(b)(4)(iii) of Regulation S-K. The registrant will furnish a copy of any such instrument to the Securities and Exchange Commission upon its request.

*10.1	Change in Control Agreement dated December 16, 1997 between C&F Financial Corporation and Larry G. Dillon (incorporated by reference to Exhibit 10 to Form 10-K filed March 23, 1998)
*10.1.1	Amendment to Change in Control Agreement dated July 23, 2003 between C&F Financial Corporation and Larry G. Dillon (incorporated by reference to Exhibit 10.1.1 to Form 10-Q filed November 13, 2003)
*10.3	Amended and Restated Change in Control Agreement dated February 15, 2005 between C&F Financial Corporation and Thomas F. Cherry (incorporated by reference to Exhibit 10.3 to Form 10-K filed March 3, 2005)
*10.4	VBA Executive s Deferred Compensation Plan for C&F Financial Corporation (incorporated by reference to Exhibit 10.3 to Form 10-K filed March 15, 2002)
*10.4.1	Amendment to Adoption Agreement for the VBA Executive s Deferred Compensation Plan for C&F Financial Corporation dated as of December 17, 2006
*10.4.2	Amendment to Attachment to the Adoption Agreement for the VBA Executive s Deferred Compensation Plan for C&F Financial Corporation dated as of March 7, 2007
*10.5	Amended and Restated C&F Financial Corporation 1994 Incentive Stock Plan (incorporated by reference to Exhibit 4.3 to Form S-8 filed May 1, 2000)
*10.6	C&F Financial Corporation 1998 Non-Employee Director Stock Compensation Plan (incorporated by reference to Exhibit 4.3 to Form S-8 filed September 18, 1998)
*10.7	C&F Financial Corporation 1999 Regional Director Stock Compensation Plan (incorporated by reference to Exhibit 4.3 to Form S-8 filed October 22, 1999)
*10.8	C&F Financial Corporation Management Incentive Plan dated February 25, 2005, as previously amended March 6, 2006 (incorporated by reference to Exhibit 10.8 to Form 10-K filed March 9, 2006)
*10.9	C&F Financial Corporation 2004 Incentive Stock Plan (incorporated by reference to Exhibit 10.9 to Form 10-Q filed May 6, 2004)
*10.10	Form of C&F Financial Corporation Incentive Stock Option Agreement (incorporated by reference to Exhibit 10.2 to Form 8-K filed December 29, 2004)

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*10.11	Employment Agreement dated April 16, 2002 between C&F Mortgage Corporation and Bryan McKernon, as amended December 19, 2006
*10.12	Amended and Restated Change in Control Agreement dated February 15, 2005 between C&F Financial Corporation and Robert L. Bryant (incorporated by reference to Exhibit 10.12 to Form 10-K filed March 3, 2005)
*10.13	Amended and Restated Change in Control Agreement dated February 15, 2005 between C&F Financial Corporation and Bryan McKernon (incorporated by reference to Exhibit 10.13 to Form 10-K filed March 3, 2005)
*10.14	Schedule of C&F Financial Corporation Non-Employee Directors Annual Compensation (incorporated by reference to Exhibit 10.14 to Form 10-K filed March 3, 2005)
*10.15	Base Salaries for Named Executive Officers of C&F Financial Corporation
*10.16	Form of C&F Financial Corporation Restricted Stock Agreement (incorporated by reference to Exhibit 10.16 to Form 8-K filed December 18, 2006)
10.19	Loan and Security Agreement by and between Wells Fargo Financial Preferred Capital, Inc. and C&F Finance Company dated as of August 1, 2005 (incorporated by reference to Exhibit 10.19 to Form 10-Q filed August 5, 2005)
10.20	First Amendment to the Loan and Security Agreement by and between Wells Fargo Financial Preferred Capital, Inc. and C&F Finance Company dated as of December 1, 2006
14	C&F Financial Corporation Code of Business Conduct and Ethics
21	Subsidiaries of the Registrant
23	Consent of Yount, Hyde & Barbour, P.C.
31. 1	Certification of CEO pursuant to Rule 13a-14(a)
31. 2	Certification of CFO pursuant to Rule 13a-14(a)
32	Certification of CEO/CFO pursuant to 18 U.S.C. Section 1350

* Indicates management contract

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SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized:

C&F FINANCIAL CORPORATION
(Registrant)

Date: March 7, 2007

By: /s/ Larry G. Dillon
Larry G. Dillon
Chairman, President and Chief Executive Officer
(Principal Executive Officer)

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated:

/s/ Larry G. Dillon Larry G. Dillon, Chairman, President and Chief Executive Officer (Principal Executive Officer)	Date: March 7, 2007
/s/ Thomas F. Cherry Thomas F. Cherry, Executive Vice President, Chief Financial Officer and Secretary (Principal Financial and Accounting Officer)	Date: March 7, 2007
/s/ J. P. Causey Jr. J. P. Causey Jr., Director	Date: March 7, 2007
/s/ Barry R. Chernack Barry R. Chernack, Director	Date: March 7, 2007
/s/ James H. Hudson III James H. Hudson III, Director	Date: March 7, 2007
/s/ Joshua H. Lawson Joshua H. Lawson, Director	Date: March 7, 2007
/s/ William E. O Connell Jr. William E. O Connell Jr., Director	Date: March 7, 2007
/s/ Paul C. Robinson Paul C. Robinson, Director	Date: March 7, 2007