Air Transport Services Group, Inc.
Form 10-K
March 08, 2011

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

FORM 10-K
x ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(D)
OF THE SECURITIES EXCHANGE ACT OF 1934
For the fiscal year ended December 31, 2010
Commission file number 000-50368

(Exact name of registrant as specified in its charter)

Delaware	26-1631624
(State of Incorporation)	(I.R.S. Employer Identification No.)

145 Hunter Drive, Wilmington, OH 45177
(Address of principal executive offices)
937-382-5591
(Registrant's telephone number, including area code)

Securities registered pursuant to Section 12(b) of the Act:
Common Stock, Par Value $.01 per share
Preferred Stock Purchase Rights
(Title of class)
Name of each exchange on which registered: NASDAQ Stock Market LLC
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 o 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 o 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 o
Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulations S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). YES o NO o
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. o
Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer o	Accelerated filer x
	Smaller reporting company o

Non-accelerated filer o (Do not check if a smaller reporting
company)

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

The aggregate market value of the voting and non-voting common equity held by non-affiliates computed by reference to the price at which the common equity was last sold, as of the last business day of the registrant’s most recently completed second fiscal quarter: $221,491,700. As of March 8, 2011, 63,652,228 shares of the registrant’s common stock, par value $0.01, were outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the Proxy Statement for the Annual Meeting of Stockholders scheduled to be held May 10, 2011 are incorporated by reference into Part III.

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FORWARD LOOKING STATEMENTS

Statements contained in this annual report on Form 10-K, including "Management's Discussion and Analysis of Financial Condition and Results of Operations," in Item 7, that are not historical facts are considered forward-looking statements (as that term is defined in the Private Securities Litigation Reform Act of 1995). Words such as "projects," "believes," "anticipates," "will," "estimates," "plans," "expects," "intends" and similar words and expressions are intended to i forward-looking statements. These forward-looking statements are based on expectations, estimates and projections as of the date of this filing, and involve risks and uncertainties that are inherently difficult to predict. Actual results may differ materially from those expressed in the forward-looking statements for any number of reasons, including those described in "Risk Factors" starting on page 9 and "Outlook" starting on page 22.

Filings with the Securities and Exchange Commission

The Securities and Exchange Commission maintains an Internet site that contains reports, proxy and information statements and other information regarding Air Transport Services Group, Inc. at www.sec.gov. Additionally, our filings with the Securities and Exchange Commission, including annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and amendments to these reports, are available free of charge from our website at www.atsginc.com as soon as reasonably practicable after filing with the SEC.

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AIR TRANSPORT SERVICES GROUP, INC. AND SUBSIDIARIES
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PART I

ITEM 1. BUSINESS

General Business Development

Air Transport Services Group, Inc. (“ATSG”), provides aircraft for lease, airline operations, aircraft maintenance and other related services primarily to the shipping and transportation industries. Through several subsidiaries, the Company offers a wide range of capabilities serving delivery companies, freight forwarders, airlines and government customers. ATSG wholly owns three independent airlines, ABX Air, Inc. (“ABX”), Capital Cargo International Airlines, Inc. (“CCIA”), and Air Transport International, LLC (“ATI”), each of which is certificated by the U.S. Department of Transportation. These airlines primarily transport cargo within the United States and include operations in Europe, Asia, the Middle East and throughout the Americas. ATSG includes an aircraft leasing subsidiary, Cargo Aircraft Management, Inc. (“CAM”), which leases its fleet of Boeing 767, 757, 727 and McDonnell Douglas DC-8 aircraft to ATSG’s airlines and to external customers.

ABX is based in Wilmington, Ohio and operates a fleet of Boeing 767 cargo aircraft. Between 1980 and August 2003, ABX was an affiliate of Airborne, Inc. (“Airborne”), a publicly traded, integrated delivery service provider. On August 15, 2003, ABX was separated from Airborne, and became an independent publicly traded company, in conjunction with the acquisition of Airborne by an indirect wholly-owned subsidiary of DHL Worldwide Express, B.V. ("DHL"). ATI, based in Little Rock, Arkansas, began operations in 1979 and was an affiliate of BAX Global, Inc. (“BAX/Schenker”) prior to 2006. ATI operates McDonnell Douglas DC-8 and Boeing 767 aircraft and provides airlift to BAX/Schenker, the U.S. Military and various other customers. CCIA obtained its airline operating certificate in 1996 and currently operates Boeing 727 and 757 aircraft, primarily providing air freight transportation for BAX/Schenker and DHL.

ATSG is incorporated in Delaware and its headquarters is in Wilmington, Ohio. ATSG’s common shares are publicly traded on the NASDAQ Stock Market under the symbol ATSG. ATSG was formed on December 31, 2007 from the reorganization of ABX for the purpose of creating a holding company structure. On December 31, 2007, ATSG completed the acquisition of CAM, ATI and CCIA which were together owned by a group of private investors. ATSG acquired all of the outstanding stock, stock options and warrants of these companies for a combination of cash, shares of ATSG and debt repayment. The overall transaction value was approximately $340 million, which ATSG partially financed through a $270 million unsubordinated term loan.

ATSG’s other subsidiaries are summarized below. (When the context requires, we may use the terms “Company” and “ATSG” in this report to refer to the business of ATSG and its subsidiaries on a consolidated basis.)

Airborne Maintenance and Engineering Services, Inc. (“AMES”), an aircraft maintenance and repair organization;

AMES Material Services, Inc. ("AMS"), which markets and sells aircraft parts;

ABX Cargo Services, Inc. ("ACS"), which operates mail sorting centers for the U.S Postal Service ("USPS");

LGSTX Services, Inc (“LGSTX”) which provides contract maintenance, ground support equipment rentals and fuel management for airlines.

We believe that offering a range of complementary solutions to shippers, freight forwarders and other airlines provides a competitive advantage for growth and diversification. Customers who lease our aircraft typically need related services, such as scheduled aircraft maintenance, line maintenance and crew training which our subsidiaries can provide. In 2010, we formed Airborne Global Solutions, Inc. ("AGS") to assist our subsidiaries in effectuating their sales and marketing plans. Through AGS, we can better leverage our customer relationships on additional business opportunities and market our aviation knowledge and the broad capabilities of our subsidiaries. AGS works with our customers in identifying their business and operational requirements and then works with our subsidiaries in forming a bundled solution of aircraft leases and related services to meet customer needs. AGS assists in marketing the capabilities of our three airlines to provide scalable airlift to a wide range of international locations.

The Company has a concentrated base of leading customers who have diverse lines of international cargo traffic. The three largest customers, DHL, BAX/Schenker and the U.S. Military, totaled 79% of the Company's consolidated revenues in 2010. Information about the Company's revenues and accounts receivable with these customers is presented

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in Note B to the accompanying consolidated financial statements.

Background

The Company, through ABX, has had long term contracts with DHL since August 16, 2003. Beginning in August 2003, ABX operated primarily under two commercial agreements with DHL; an aircraft, crew, maintenance and insurance agreement (“DHL ACMI agreement”) and a hub services agreement (“Hub Services agreement”) both of which had become effective in conjunction with DHL's acquisition of Airborne. Under these agreements, ABX and DHL generally operated under a cost-plus pricing structure. ABX provided staff to conduct package sorting, as well as airport, facilities and equipment maintenance services for DHL under the Hub Services agreement. In 2008, DHL began to restructure its U.S. operations due to continued losses. Pursuant to its restructuring plans, DHL discontinued intra-U.S. domestic pickup and delivery services and now provides only international services to and from the U.S. In the third quarter of 2009, ABX ceased all remaining sort operations for DHL and the Hub Services agreement expired. Additionally, in the third quarter of 2009, DHL assumed management of aircraft fueling services for its U.S. network previously provided by ABX. The hub services operations and the aircraft fueling operations have been reported as discontinued operations since that time.

ABX continued to provide airlift for DHL’s international delivery services in the U.S. through ABX’s Boeing 767 aircraft under the DHL ACMI agreement until March 2010. At that point, the Company and DHL terminated the DHL ACMI agreement and executed new follow-on agreements effective March 31, 2010. Under the new agreements, DHL committed to lease13 Boeing 767 freighter aircraft from CAM and ABX was separately contracted to operate those aircraft for DHL under a five year crew, maintenance and insurance agreement ("CMI agreement"). As of December 31, 2010, DHL was leasing 11 of the 13 aircraft from CAM, all of which ABX operates for DHL under the CMI agreement. Two additional Boeing 767 aircraft are scheduled for lease to DHL before the end of the second quarter of 2011.

Description of Business

The Company has two reportable segments, "CAM" and “ACMI Services." Due to the similarities among the Company's airline operations, including the CMI agreement with DHL, the airline operations were aggregated into a single reportable segment, ACMI Services, in 2010. The Company’s other business operations, including aircraft maintenance and modification services, aircraft part sales, equipment leasing and maintenance, mail handling for the USPS and specialized services for aircraft fuel management, do not constitute reportable segments due to their size. Financial information about our segments and geographical revenues is presented in Note P to the accompanying consolidated financial statements.

CAM

CAM’s fleet consists of Boeing 767, Boeing 757, Boeing 727 and McDonnell Douglas DC-8 aircraft. CAM leases aircraft to ATSG airlines and to external customers, usually under multi-year contracts with a schedule of fixed monthly payments. Under a typical lease arrangement, the customer maintains the aircraft in serviceable condition at its own cost. At the end of the lease term, the customer typically is required to return the aircraft in approximately the same maintenance condition, as measured by airframe and engine time until the next scheduled maintenance event, as existed at the inception of the lease. CAM examines the credit worthiness of potential customers, their short and long-term growth prospects, their financial condition and backing, the experience of their management, and the impact of governmental regulation when determining the lease rate that is offered to the customer. In addition, CAM monitors the customer’s business and financial status throughout the term of the lease.

Through CAM, we plan to expand the Company's combined fleet of aircraft. Information about the Company's commitments for aircraft expenditures is included in Note I to the accompanying consolidated financial statements.

ACMI Services

Through its three airline subsidiaries, the Company provides airline operations to DHL, BAX/Schenker, other airlines, freight forwarders and the U.S. Military. A typical operating agreement requires the ATSG airline to supply, at a specific rate per block hour and/or per month, the aircraft, crew, maintenance and insurance for specified cargo operations, while the customer is responsible for substantially all other aircraft operating expenses, including fuel,

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landing fees, parking fees and ground and cargo handling expenses. Charter agreements, including U.S. Military agreements, usually require the airline to provide full service, including fuel and other operating expenses, in addition to aircraft, crew, maintenance and insurance for a fixed, all-inclusive price.

In March 2010, the Company and DHL terminated the DHL ACMI agreement and executed new follow-on agreements. Through the new agreements, effective March 31, 2010, ABX operates aircraft that DHL either leased from CAM or owns itself. The new CMI agreement with DHL has an initial term of five years.

CCIA and ATI each have contracts to provide airlift to BAX/Schenker under ACMI agreements. BAX/Schneker provides freight transportation and supply chain management services, specializing in the heavy freight market for business-to-business shipping. The BAX/Schenker central hub is located in Toledo, Ohio. CCIA and ATI have the exclusive right to supply all main deck freighter airlift in BAX/Schenker's U.S. domestic network through December 31, 2011.

ATI provides airlift to the Air Mobility Command ("AMC"), which is organized under the U.S. Military. ATI contracts its unique fleet of McDonnell Douglas DC-8 combi aircraft to the AMC. The combi aircraft are capable of carrying passengers and cargo containers on the main flight deck. AMC awards flights to U.S. certificated airlines through annual contracts. For the government fiscal year 2011, AMC awarded ATI three international routes for combi aircraft. These routes are for destinations that are not within the areas of the Middle East conflicts. Additionally, ATI often operates temporary "expansion" routes for the AMC using its McDonnell Douglas DC-8 combi and freighter aircraft.

The Company has limited exposure to fluctuations in the price of aviation fuel under our contracts with DHL, BAX/Schenker and the U.S. Military. ATI procures the aircraft fuel for BAX/Schenker's U.S. domestic network and is reimbursed by BAX/Schenker for the price paid for fuel used. The charter agreements with the U.S. Military are based on a preset pegged fuel price and include a subsequent true-up to the actual fuel prices within two cents per gallon. DHL, like most of our ACMI customers, procures the aircraft fuel and fueling services necessary for their flights.

U.S. Postal Service

Since September 2004, the Company has provided mail sorting services under contracts with the USPS. Our subsidiary, ACS, manages USPS mail sort centers in Indianapolis, Indiana, Dallas, Texas and Memphis, Tennessee. Under each of these three contracts, ACS is compensated at a firm price for fixed costs and an additional amount based on the volume of mail handled at each sort center. Each contract was renewed in 2010 and has a two-year term, with expiration dates in either September or October 2012.

Cargo and Transportation Services

The Company provides brokerage services for airlift by arranging charters for customers using third party airlines as well as ATSG owned airlines.

Aircraft Maintenance and Modification Services

The Company provides aircraft maintenance and modification services to other airlines through its ABX and AMES subsidiaries. In May 2009, much of the aircraft maintenance, component repair and engineering business operations of ABX were transferred to a newly formed ATSG subsidiary, AMES. Organizing the aircraft maintenance and engineering capabilities separately from ABX was intended to facilitate a cost structure and marketing organization which can better compete in the aircraft maintenance industry.

ABX and AMES have technical expertise related to aircraft modifications as a result of ABX's long history in aviation. They own many Supplemental Type Certificates ("STCs"). An STC is granted by the FAA and represents an ownership right, similar to an intellectual property right, which authorizes the alteration of an airframe, engine or component. ABX provides digital aircraft manuals for customers in conjunction with the modification of aircraft from passenger to cargo configuration.

AMES operates a Federal Aviation Administration ("FAA") certificated 145 repair station, in Wilmington, Ohio, including hangars, a component shop and engineering capabilities. AMES is AS9100 quality certified for the aerospace industry. AMES markets its capabilities by identifying aviation-related maintenance and modification opportunities

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and matching them to its capabilities. AMES's marketable capabilities include the installation of avionics systems and flat panel displays for Boeing 757 and Boeing 767 cockpits. The flat panel display modernizes aircraft avionics equipment and reduces maintenance costs by combining multiple display units into a single instrumentation panel. AMES has the capabilities to perform line maintenance and heavy maintenance on DC-9, Boeing 767, 757, 737 and 727 aircraft. AMES has the capabilities to refurbish airframe components, including approximately 60% of the components for Boeing 767 aircraft.

Aircraft Parts Sales and Brokerage

AMS, which holds a certificate relating to free trade zone rights, is an Aviation Suppliers Association 100 Certified reseller and broker of aircraft parts. AMS carries an inventory of DC-8, DC-9 and Boeing 767 spare parts and also maintains inventory on consignment from original equipment manufacturers, resellers, lessors and other airlines. AMS customers include the commercial air cargo industry, passenger airlines, aircraft manufacturers and contract maintenance companies serving the commercial aviation industry, as well as other resellers.

Equipment and Facility Maintenance

LGSTX, formerly named ABX Equipment and Facility Services, Inc., provides contract services for aviation support and facility services throughout the U.S. LGSTX has a large inventory of ground support equipment, such as power units, airstarts, deicers and pushback vehicles that it rents to airports, airlines or other customers. LGSTX is also licensed to resell aircraft fuel. LGSTX arranges fueling services for customers and can provide fuel for aircraft charter customers.

Flight Crew Training

ABX and CCIA are FAA-certificated to offer flight crew training to customers and rent usage of their flight simulators for outside training programs. The Company has five flight simulators in operation, including one Boeing 767, one DC-8, one Boeing 727 and two DC-9 flight simulators. The Company's Boeing 767, its Boeing 727 and one of its DC-9 flight simulators are level C certified. The level C flight simulators allow the Company to qualify flight crewmembers under FAA requirements without performing check flights in an aircraft. The DC-8 and the other DC-9 flight simulators are level B certified, which allows the Company to qualify flight crewmembers by performing a minimum number of flights in an aircraft.

Airline Operations

Flight Operations and Control

Airline flight operations, including aircraft dispatching, flight tracking and crew scheduling, are planned and controlled by personnel within each airline. All Company airline operations are conducted pursuant to authority granted to them by the FAA. ABX staffs aircraft dispatching and flight tracking 24 hours per day, 7 days per week from Wilmington, Ohio. CCIA flight operations, including flight tracking and crew scheduling, are controlled by on-duty personnel from CCIA's operations center in Orlando, Florida, and the same functions for ATI are controlled from ATI's operations center in Little Rock, Arkansas.

Maintenance

Our airlines' operations are regulated by the FAA for aircraft safety and maintenance. Each airline performs routine inspections and airframe maintenance, including Airworthiness Directive and Service Bulletin compliance on all of their aircraft. The airlines' maintenance and engineering personnel coordinate routine and non-routine maintenance requirements. Each airline's maintenance program includes tracking the maintenance status of each aircraft, consulting with manufacturers and suppliers about procedures to correct irregularities and training maintenance personnel on the requirements of its FAA-approved maintenance program. The airlines contract with maintenance repair organizations ("MROs"), including AMES, to perform heavy airframe maintenance on airframes and engines. Each airline owns a supply of spare aircraft engines, auxiliary power units, aircraft parts and consumable items. The number of spare items maintained is based on the fleet size, engine type operated, and the reliability history of the item types.

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Insurance

Our airline subsidiaries are required by the Department of Transportation (“DOT”) to carry liability insurance on each of their aircraft. Their aircraft leases, loan agreements and ACMI agreements also require them to carry such insurance. The Company currently maintains public liability and property damage insurance, and our airline subsidiaries currently maintain aircraft hull and liability insurance and war risk insurance for their respective aircraft fleets in amounts consistent with industry standards. CAM’s customers are also required to maintain similar insurance levels.

Employees

As of December 31, 2010, ATSG and its subsidiaries had approximately 2,065 employees, including 1,790 full-time employees and 275 part-time employees. ATSG employs approximately 600 flight crewmembers, 910 aircraft maintenance technicians and flight support personnel, 315 warehousing, sorting and logistics personnel, 65 employees for airport maintenance and logistics, 25 employees for sales and marketing and 150 employees for administrative functions. On December 31, 2009, the Company had approximately 2,020 employees.

Labor Agreements

The Company’s flight crewmembers are unionized employees. The table below summarizes the representation of the Company’s flight crewmembers at December 31, 2010.

Airline	Labor Agreement Unit	Contract Amendable Date	Approximate Number of Employees Represented	
ABX	International Brotherhood of Teamsters	12/31/2014	12.4	%
ATI	Airline Pilots Association	5/1/2004	10.1	%
CCIA	Airline Pilots Association	7/31/2013	6.4	%

Under the Railway Labor Act (“RLA”), as amended, the crewmember labor agreements do not expire, so the existing contract remains in effect throughout any negotiation process. If required, mediation under the RLA is conducted by the National Mediation Board, which has the sole discretion as to how long mediation can last and when it will end. In addition to direct negotiations and mediation, the RLA includes a provision for potential arbitration of unresolved issues and a 30-day “cooling-off” period before either party can resort to self-help, including, but not limited to, work stoppage.

Training

The flight crewmembers are required to be licensed in accordance with Federal Aviation Regulation (“FAR”), with specific ratings for the aircraft type to be flown, and to be medically certified as physically fit to fly aircraft. Licenses and medical certifications are subject to recurrent requirements as set forth in the FARs to include recurrent training and minimum amounts of recent flying experience.

The FAA mandates initial and recurrent training for most flight, maintenance and engineering personnel. Mechanics and quality control inspectors must also be licensed and qualified to perform maintenance on the Company operated and maintained aircraft. Our airline subsidiaries pay for all of the recurrent training required for their flight crewmembers and provide training for their ground service and maintenance personnel. Their training programs have received all required FAA approvals.

Industry

The primary competitive factors in the air cargo industry are price, fuel efficiency, geographic coverage, flight frequency, aircraft reliability and capacity. Our airline subsidiaries compete for domestic cargo volume principally with other cargo airlines and passenger airlines which have substantial belly cargo capacity. Other cargo airlines include Amerijet International, Inc., Astar USA, Inc. (“Astar”), Atlas Air Worldwide Holdings, Inc., National Airlines, Evergreen International, Inc., and World Airways, Inc. The industry is capital intensive and highly competitive. Cargo volumes are highly dependent on the economic conditions and the level of commercial activity. Generally,

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time-critical delivery needs, such as just-in-time inventory management, increase the demand for air cargo delivery, while higher costs of jet fuel generally reduces the demand for air delivery services. When jet fuel prices increase, shippers will consider using ground transportation if the delivery time allows. Historically, the cargo industry has experienced higher volumes during the fourth calendar quarter of each year due to increased shipments during the holiday season.

The scheduled delivery industry is dominated by integrated door-to-door carriers including DHL, the USPS, FedEx Corporation, BAX/Schenker and United Parcel Service, Inc. Although the volume of our business is impacted by competition among these integrated carriers, we do not usually compete directly with them.

Competition for aircraft leasing is generally effected by aircraft type, aircraft availability and lease rates. We target our leases to cargo airlines and delivery companies seeking medium widebody airlift.

The aircraft maintenance industry is labor intensive and typically competes based on cost, capabilities and reputation for quality. U.S. airlines may contract for aircraft maintenance with MROs in other countries or geographies with a lower labor wage base, making the industry highly cost competitive.

Intellectual Property

The Company owns a small number of U.S. patents that have nominal commercial value. The Company also owns many STCs issued by the FAA. The Company uses these STCs mainly in support of its own fleets; however, AMES has marketed certain STCs to other airlines.

Information Systems

The Company has invested significant management and financial resources in the development of information systems to facilitate cargo, flight and maintenance operations. The Company utilizes its systems to maintain records about the maintenance status and history of each major aircraft component, as required by FAA regulations. Using its systems, the Company tracks and controls inventories and costs associated with each maintenance task, including the personnel performing those tasks. In addition, the Company’s flight operations systems coordinate flight schedules and crew schedules. It has developed and procured systems to track crewmember flight and duty time, and crewmember training status.

Regulation

Our subsidiaries’ airline operations are generally regulated by the DOT, the FAA and the TSA. Those operations must comply with numerous security and environmental laws, ordinances and regulations. In addition, they must also comply with various other federal, state, local and foreign laws and regulations.

Environment

Under current federal, state and local environmental laws, ordinances and regulations, a current or previous owner or operator of real property may be liable for the costs of removal or clean-up of hazardous or toxic substances on, under, or in such property. Such laws often impose liability whether or not the owner or operator knew of, or was responsible for, the presence of such hazardous or toxic substances. In addition, the presence of contamination from hazardous or toxic substances, or the failure to properly clean up such contaminated property, may adversely affect the ability of the owner of the property to use such property as collateral for a loan or to sell such property. Environmental laws also may impose restrictions on the manner in which a property may be used or transferred or in which businesses may be operated and may impose remediation or compliance costs. Under its expired air park sublease with DHL, ABX and DHL are required to defend, indemnify and hold each other harmless from and against certain environmental claims associated with the Air Park in Wilmington, Ohio.

Our subsidiaries’ aircraft currently meet all known requirements for engine emission levels. However, under the Clean Air Act, individual states or the U.S. Environmental Protection Agency may adopt regulations requiring reduction in emissions for one or more localities based on the measured air quality at such localities. Such regulations may seek to limit or restrict emissions by restricting the use of emission-producing ground service equipment or aircraft auxiliary power units.

In addition, the European Commission has approved the extension of the European Union Emissions Trading

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Scheme ("ETS") for greenhouse gas emissions to the airline industry. Under this decision, all Company airline subsidiary flights to and from any airport in any member state of the European Union will be covered by the ETS requirements beginning in 2012, and each year we will be required to submit emission allowances in an amount equal to the carbon dioxide emissions from such flights.

The federal government generally regulates aircraft engine noise at its source. However, local airport operators may, under certain circumstances, regulate airport operations based on aircraft noise considerations. The Airport Noise and Capacity Act of 1990 provides that, in the case of Stage 3 aircraft (all of our operating aircraft satisfy Stage 3 noise compliance requirements), an airport operator must obtain the carriers' consent to or the government's approval of the rule prior to its adoption. We believe the operation of our airline subsidiaries' aircraft either complies with or is exempt from compliance with currently applicable local airport rules. However, some airport authorities have adopted local noise regulations, and, to the extent more stringent aircraft operating regulations are adopted on a widespread basis, our airline subsidiaries may be required to spend substantial funds, make schedule changes or take other actions to comply with such local rules.

The U.S. government, working through the International Civil Aviation Organization, has in the past adopted more stringent aircraft engine emissions regulations with regard to newly certificated engines and aircraft noise regulations applicable to newly certificated aircraft. Although these rules will not apply to any of our airline subsidiaries' existing aircraft, additional rules could be adopted in the future that would either apply these more stringent noise and emissions standards to aircraft already in operation or require that some portion of the fleet be converted over time to comply with these new standards.

Department of Transportation

The DOT maintains authority over certain aspects of domestic air transportation, such as requiring a minimum level of insurance and the requirement that a person be "fit" to hold a certificate to engage in air transportation. In addition, the DOT continues to regulate many aspects of international aviation, including the award of international routes. The DOT has separately issued to ABX, CCIA and ATI Domestic All-Cargo Air Service Certificates for air cargo transportation between all points within the U.S., the District of Columbia, Puerto Rico, and the U.S. Virgin Islands. Additionally, the DOT has issued ABX, CCIA and ATI Certificates of Public Convenience and Necessity authorizing each of them to engage in scheduled foreign air transportation of cargo and mail between the U.S. and over 88 foreign countries. By maintaining these certificates, the Company, through its airline subsidiaries, can conduct all-cargo charter operations worldwide. Prior to issuing such certificates, and periodically thereafter, the DOT examines a company's managerial competence, financial resources and plans, compliance, disposition and citizenship in order to determine whether the carrier is fit, willing and able to engage in the transportation services it has proposed to undertake.

The DOT has the authority to impose civil penalties, or to modify, suspend or revoke our certificates for cause, including failure to comply with federal law or DOT regulations. A corporation holding either of such certificates must qualify as a U.S. citizen, which requires that (1) it be organized under the laws of the U.S. or a state, territory or possession thereof, (2) that its president and at least two-thirds of its Board of Directors and other managing officers be U.S. citizens, (3) that less than 25% of its voting interest be owned or controlled by non-U.S. citizens, and (4) that it not otherwise be subject to foreign control. Neither type of certificate confers proprietary rights on the holder, and the DOT may impose conditions or restrictions on such certificates. We believe we possess all necessary DOT-issued certificates and authorities to conduct our current operations and continue to qualify as a U.S. citizen.

Federal Aviation Administration

The FAA regulates aircraft safety and flight operations generally, including equipment, ground facilities, maintenance, flight dispatch, training, communications, the carriage of hazardous materials and other matters affecting air safety. The FAA issues operating certificates and operations specifications to carriers that possess the technical competence to conduct air carrier operations. In addition, the FAA issues certificates of airworthiness to each aircraft that meets the requirements for aircraft design and maintenance. ABX, CCIA and ATI believe they hold all airworthiness and other FAA certificates and authorities required for the conduct of their business and the operation of their aircraft, although the FAA has the power to suspend, modify or revoke such certificates for cause, or to impose civil penalties for any failure to comply with federal law and FAA regulations.

The FAA has the authority to issue airworthiness directives and other mandatory orders relating to, among other

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things, the inspection and maintenance of aircraft and the replacement of aircraft structures, components and parts, based on the age of the aircraft and other factors. For example, the FAA has required ABX to perform inspections of its Boeing 767 aircraft to determine if certain of the aircraft structures and components meet all aircraft certification requirements. If the FAA were to determine that the aircraft structures or components are not adequate, it could order operators to take certain actions, including but not limited to, grounding aircraft, reducing cargo loads, strengthening any structure or component shown to be inadequate, or making other modifications to the aircraft. New mandatory directives could also be issued requiring the Company’s airline subsidiaries to inspect and replace aircraft components based on their age or condition. As a routine matter, the FAA issues airworthiness directives applicable to the aircraft operated by our airline subsidiaries, and our airlines comply, sometimes at considerable cost, as part of their aircraft maintenance program. In addition to the FAA practice of issuing airworthiness directives as conditions warrant, the FAA has adopted new policies to address issues involving older, but still economically viable aircraft, on a more systematic basis. New FAA regulations mandate that aircraft manufacturers establish limits on aircraft flight cycles before which widespread fatigue damage might occur. Once these limits are established, carriers must then incorporate them into their maintenance programs over time. Once the limits are reached, airlines will be unable to continue to operate the aircraft without the FAA first granting an extension of time to the operator. As the manufacturers have not yet set the new limits, the Company cannot yet estimate the impact of the new rule on any of its airline subsidiaries.

The FAA has amended its policy regarding the proper application of airport rates and charges imposed on airlines. The amended policy provides greater flexibility to airport operators to impose charges that would allow for the imposition of “congestion fees” rather than uniform airport fees. If airports in the U.S. seek to use the flexibility offered by this new policy, it could have an impact on the cost of conducting our flight operations.

The FAA requires each of the airline subsidiaries to implement a drug and alcohol testing program with respect to all employees that engage in safety sensitive functions. Each of the airlines comply with these regulations.

Transportation Security Administration

The Transportation Security Administration (“TSA”), an administration within the Department of Homeland Security, is responsible for the screening of passengers, baggage and cargo and the security of aircraft and airports. Our airline subsidiaries comply with all applicable aircraft and cargo security requirements. The TSA has adopted cargo security-related rules that have imposed additional burdens on our airlines and our customers. Among other things, the TSA requires each airline to perform criminal history background checks on all employees. In addition, we may be required to reimburse the TSA for the cost of security services it may provide to the Company’s airline subsidiaries in the future.

Other Regulations

Various regulatory authorities have jurisdiction over significant aspects of our business, and it is possible that new laws or regulations or changes in existing laws or regulations or the interpretations thereof could have a material adverse effect on our operations. In addition to the above, other laws and regulations to which we are subject, and the agencies responsible for compliance with such laws and regulations, include the following:

- The labor relations of our airline subsidiaries are generally regulated under the Railway Labor Act, which vests in the National Mediation Board certain regulatory powers with respect to disputes between airlines and labor unions arising under collective bargaining agreements;
- The Federal Communications Commission regulates our airline subsidiaries’ use of radio facilities pursuant to the Federal Communications Act of 1934, as amended;
- U.S. Customs and Border Protection inspects cargo imported from our subsidiaries’ international operations;
- Our airlines must comply with U.S. Citizenship and Immigration Services regulations regarding the citizenship of our employees;
- The Company and its subsidiaries must comply with wage, work conditions and other regulations of the Department of Labor regarding our employees.

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Security and Safety

Security

The Company’s subsidiaries have instituted various security procedures to comply with FAA and TSA regulations and comply with the directives outlined in the federal Domestic Security Integration Program. The airline subsidiaries’ customers are required to inform them in writing of the nature and composition of any freight which is classified as “Dangerous Goods” by the DOT. In addition, the Company and its subsidiaries conduct background checks on our respective employees, restrict access to aircraft, inspect aircraft for suspicious persons or cargo, and inspect all dangerous goods. Notwithstanding these procedures, our airline subsidiaries could unknowingly transport contraband or undeclared hazardous materials for customers, which could result in fines and penalties and possible damage to the aircraft.

Safety and Inspections

Management is committed to the safe operation of its aircraft. In compliance with FAA regulations, our subsidiaries’ aircraft are subject to various levels of scheduled maintenance or “checks” and periodically go through phased overhauls. In addition, a comprehensive internal review and evaluation program is in place and active. Our subsidiaries’ aircraft maintenance efforts are monitored closely by the FAA. They also conduct extensive safety checks on a regular basis.

ITEM 1A. RISK FACTORS

The risks described below could adversely affect our financial condition or results of operations. The risks below are not the only risks that the Company faces. Additional risks that are currently unknown to us or that we currently consider immaterial or unlikely could also adversely affect the Company.

The economic conditions in the U.S. and throughout the globe may negatively impact the demand for the Company’s aircraft and services.

Air cargo transportation volumes are strongly correlated to general economic conditions, including the price of aviation fuel. An economic downturn could reduce the demand for delivery services offered by DHL, BAX/Schenker and other delivery businesses, in particular expedited services shipped via aircraft. Accordingly, an economic downturn could reduce the demand for airlift and cargo aircraft leases. During an economic slowdown, customers generally prefer to use ground-based delivery services instead of more expensive air delivery services. If the price of aviation fuel rises significantly, the demand for cargo aircraft and air delivery services may decline further.

Our cost of providing airline services could be more than the contractual revenues generated.

The airlines each develop business plans for ACMI, charter and other operating contracts by projecting operating costs, crew productivity and maintenance expenses. Projections contain key assumptions, including flight hours, aircraft reliability, crewmember productivity and crewmember compensation and benefits. We may overestimate revenues, the level of crewmember productivity, and/or underestimate the actual costs of providing services when preparing for new business opportunities. If actual costs are higher than projected or aircraft reliability is less than expected, future operating results may be negatively impacted.

The Company’s three airlines rely on crews that are unionized. The respective collective bargaining agreements for ABX and CCIA were recently renegotiated and the collective bargaining agreement for ATI is scheduled for a ratification vote in mid-March 2011. If collective bargaining agreements increase our costs and we cannot recover the increases in costs, we may decide to terminate customer contracts or curtail planned growth. If disagreements arise, airline operations could be interrupted and business could be adversely affected until agreements are reached with the crewmembers.

Our airline operating agreements include on-time reliability requirements which can impact the Company's operating results and financial condition.

The airline operating agreements with DHL and BAX/Schenker contain monetary penalties if aircraft reliability falls below certain monthly thresholds. An airline could be found in default of an agreement if it does not maintain minimum thresholds over an extended period of time. The airline operating agreements also contain monthly incentive payments for reaching specific on-time reliability thresholds. As a result, our operating revenues can vary from period

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to period depending on the achievement of those monthly incentives.

If ABX fails to maintain aircraft reliability above a minimum threshold in DHL's U.S. domestic network for two consecutive calendar months or three months in a rolling twelve month period, ABX would be in default of the CMI agreement with DHL. In that event, DHL may elect to terminate the CMI agreement, unless ABX maintains the minimum reliability threshold during a sixty-day cure period. If DHL terminates the CMI agreement due to an ABX event of default, ABX would be subject to a monetary penalty payable to DHL. The penalty at March 31, 2011 would be $15 million and will reduce to $10 million on March 31, 2012, and will remain at that amount through the initial term of the CMI agreement.

Under provisions of the CMI and lease agreements with DHL, DHL can terminate the CMI or lease agreements subject to early termination provisions.

DHL may terminate the CMI agreement for convenience at any time during the initial five-year term (other than the first twelve-months thereof) on the date that it ceases operating or causing to be operated the aircraft on air routes for which the origin and destination are within the United States, subject to providing six months notice and paying to ABX a termination fee. This termination fee will start at $70 million on March 31, 2011and amortize to zero during the remaining four year initial term of the CMI agreement. DHL may terminate one or more of the aircraft leases for convenience at any time after the first 24 months of the respective terms thereof, upon providing six months notice and paying to CAM a lump sum amount equal to six months rent. DHL may also terminate one or more aircraft leases at any time after the first 54 months of the term of the CMI agreement, in the event that DHL desires to transfer operational control of such aircraft, but is restricted from doing so by the terms of the collective bargaining agreement between ABX and its pilots' union providing that members of the pilots' union have the right to follow the aircraft to another operator, subject to providing six months notice and paying to CAM a lump sum amount equal to two months rent.

BAX/Schenker may reduce airlift requirements or contract for airlift with other providers.

CCIA and ATI have the exclusive right to supply all main deck freighter airlift in BAX/Schenker's U.S. domestic network. However, BAX/Schenker can remove an ATI or CCIA aircraft from service at the time an aircraft or engine on that aircraft requires a heavy maintenance event. ATI and CCIA's exclusive rights to supply airlift to BAX/Schenker is scheduled to expire on December 31, 2011, and BAX/Schenker has the right to terminate the exclusivity period before that date by paying a termination charge that declines ratably to zero through December 31, 2011.

AMC may not renew our contracts or may reduce the number of routes that we operate.

Our contracts with the AMC (an organization within the U.S. Military) are typically for one year and are not required to be renewed. The AMC may terminate the contracts for convenience or for an event of default, such as reliability. The number and frequency of AMC routes is sensitive to changes in military priorities and U.S. defense budgets.

Our business could be negatively impacted by adverse audit findings by the U.S. government.

Our U.S. Military contracts are subject to audit by government agencies, including with respect to performance, costs, internal controls and compliance with applicable laws and regulations. If an audit uncovers improprieties, we may be subject to civil or criminal penalties, including termination of such contracts, forfeiture of profits, fines and suspension from doing business with the U.S. Military.

Proposed rules from the Department of Transportation, the U.S. Federal Aviation Administration and the Transportation Security Administration would increase the Company's costs of operations and could reduce customers' utilization of airfreight.

In September 2010, the FAA proposed new rules for Flightcrew Member Duty and Rest Requirements (FMDRR). If implemented, the new rules would require a pilot to have nine hours for the opportunity to rest before reporting to flight duty and place other restrictions on the number of duty hours in particular time periods. If enacted, these rules could have a significant impact on ATSG airlines' costs of operation. The airlines would attempt to pass such additional costs onto their customers in the form of price increases. Customers, as a result, may seek to reduce their utilization of aircraft in favor of less expensive transportation alternatives. The ATSG airlines are each studying the proposed rules and evaluating the effect that the rules could have on their flight resources and costs.

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The Company continues to make significant investments in additional aircraft which may impact the Company's operating results and financial condition.

We plan to make capital investments to modify additional Boeing 767 standard freighter aircraft for service through 2011. We are also considering the development of a Boeing 757 combi variant. The actual demand for the Boeing 767 and 757 may be less than we anticipate. The actual lease rates for new modified aircraft may be less than we projected, or new leases may start later than we expect. Further, other airlines and lessors may be in a position to provide aircraft to the market before our aircraft are available for service.

The Company's future operating results and financial condition will depend in part on our subsidiaries' ability to successfully deploy these aircraft in operations that provide a positive return on investment. Our success will depend, in part, on their ability to obtain and operate additional cargo volumes with customers other than DHL and BAX/Schenker, including international markets. Deploying aircraft in international markets can pose additional risks, regulatory requirements and costs.

The concentration of aircraft types and engines in the Company's airlines could adversely affect our operating and financial results.

The combined aircraft fleet is concentrated in four aircraft types. If any of theses aircraft types encounter technical difficulties that resulted in significant FAA Airworthiness Directives or grounding, our ability to lease the aircraft would be adversely impacted, as would our airlines' operations. The market growth in demand for the Boeing 767 and 757 aircraft types and configurations may be less than we anticipate. Customers may develop preferences for the Airbus A300-600 and A330 aircraft which provide capabilities similar to the Boeing 767 aircraft.

We rely on third parties to modify aircraft and provide aircraft and engine maintenance. If service providers do not deliver the level of service expected by our business, future operating results may be negatively impacted.

We rely on certain third party service providers that have expertise or resources that we do not have. An unexpected termination or delay involving such service providers could have a material adverse effect on our operations and financial results. We must effectively manage such third parties to meet aircraft modification schedules and maintenance events. A delay in an aircraft modification could adversely impact our revenues and our ability to place the aircraft in the market.

The Company could violate debt covenants.

The Company's Credit Agreement and aircraft loans contain covenants, including, among other things, limitations on certain additional indebtedness, guarantees of indebtedness and the level of annual capital expenditures. The Credit Agreement and aircraft loans cross default. The Credit Agreement and loans stipulate events of default, including unspecified events that may have material adverse effects on the Company. If an event of default occurs, the Company's cost of borrowings could increase, and the contractual repayment of debt may accelerate. Additionally, the Company's ability to modify and deploy aircraft could be limited as a result.

Our access to liquidity could be less than we need for our expected growth plans and our cost of debt could increase.

The Company's existing Credit Agreement expires in December 2012. At that time, a balloon payment of $139.1 million is due to the consortium of banks that finance the Company's term loan, plus any draws on the revolving credit facility that may be outstanding on December 31, 2012. We are exploring alternatives which may secure longer term debt financing before the balloon payment is due. Alternatives which we may consider include amending and extending the current Credit Agreement beyond 2012, terminating and replacing the current Credit Agreement with a new bank facility as well as other alternatives. A new, follow-on credit agreement, assuming one can be obtained before 2012, may contain more restrictive covenants, dividend limitations, tighter restrictions on capital spending and higher costs of interest than the existing Credit Agreement. As of December 31, 2010, the Company had $3.6 million of capitalized loan origination costs and $4.6 million of unrealized losses from the hedging of interest payments that could adversely impact future operating results if the Credit Agreement is terminated early.

The ability to use net operating loss carryforwards to offset future taxable income for U.S. federal income tax purposes may be further limited.

Limitations imposed on the ability to use net operating losses ("NOLs") to offset future taxable income could cause U.S. federal income taxes to be paid earlier than otherwise would be paid if such limitations were not in effect and

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could cause such NOLs to expire unused, in each case reducing or eliminating the benefit of such NOLs. Similar rules and limitations may apply for state income tax purposes.

Significant ownership changes could limit our ability to use NOLs to offset future taxable income. In general, under Section 382 of the Internal Revenue Code of 1986, as amended (the “Code”), a corporation that undergoes an “ownership change” is subject to limitations on its ability to utilize its pre-change NOLs to offset future taxable income. In general, an ownership change occurs if the aggregate stock ownership of significant stockholders increases by more than 50 percentage points over such stockholders’ lowest percentage ownership during the testing period (generally three years).

We may need to reduce the carrying value of the Company’s assets.

The Company owns a significant amount of aircraft, aircraft parts and related equipment. Additionally, the balance sheet reflects assets for income tax carryforwards and other deferred tax assets. The removal of aircraft from service or continual losses from aircraft operations could require the Company to evaluate the recoverability of the carrying value of those aircraft, related parts and equipment in accordance with Financial Accounting Standards Board Accounting Standards Codification (“FASB ASC”) Topic 360-10, Property, Plant, and Equipment, and result in an impairment charge.

We have recorded significant amounts of goodwill and intangibles related to acquisitions. If we are unable to achieve the projected levels of operating results and these assets are impaired, it may be necessary to record a non-cash charge to earnings.

If the Company incurs operating losses or our estimates of expected future earnings indicate a decline, it may be necessary to reassess the need for a valuation allowance for some or all of the Company’s net deferred tax assets.

Penalties, fines and sanctions levied by governmental agencies or the costs of complying with government regulations could negatively affect our results of operations.

The operations of the Company’s subsidiaries are subject to complex aviation, transportation, security, environmental, labor, employment and other laws and regulations. These laws and regulations generally require our subsidiaries to maintain and comply with a wide variety of certificates, permits, licenses and other approvals. Their inability to maintain required certificates, permits or licenses, or to comply with applicable laws, ordinances or regulations could result in substantial fines or, in the case of DOT and FAA requirements, possible suspension or revocation of their authority to conduct operations.

The costs of maintaining the aircraft in compliance with government regulations could negatively affect our results of operations.

All aircraft in the Company’s airline subsidiaries’ in-service fleets were manufactured prior to 1990. Manufacturer Service Bulletins and the FAA Airworthiness Directives issued under its “Aging Aircraft” program cause operators of such aged aircraft to be subject to extensive aircraft examinations and require such aircraft to undergo structural inspections and modifications to address problems of corrosion and structural fatigue at specified times. The FAA may issue Airworthiness Directives that could require significant inspections and major modifications to such aircraft.

The FAA may issue Airworthiness Directives that could limit the usability of certain aircraft types. The FAA is currently considering the issuance of an airworthiness directive that may require the replacement of the aft pressure bulkhead on Boeing 767-200 aircraft based on a certain number of landing cycles. If such an Airworthiness Directive is issued, all of the Boeing 767s within the Company will be affected over approximately a seven year period. The cost of compliance is estimated to be $1.0 million per aircraft.

In addition, new FAA regulations require that aircraft manufacturers must establish limits on an aircraft flight cycle as described in Item 1, under Federal Aviation Administration Regulation of this report. These regulations may increase our maintenance costs and eventually limit the use of our aircraft.

Failure to maintain the operating certificates and authorities of ABX, ATI and CCIA would adversely affect our business.

The airline subsidiaries have the necessary authority to conduct flight operations pursuant to the economic authority issued by the DOT and the safety based authority issued by the FAA. The continued effectiveness of such authority is subject to their compliance with applicable statutes and DOT, FAA and TSA rules and regulations, including any new rules and regulations that may be adopted in the future. The loss of such authority by an airline subsidiary could cause

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a default of covenants within the Credit Agreement and would materially and adversely affect its airline operations, effectively eliminating the airline's ability to operate air services.

The Company may be affected by global climate change or by legal, regulatory or market responses to such potential climate change.

The Company is subject to the regulations of the U.S. Environmental Protection Agency and state and local governments regarding air quality and other matters. In part, because of the highly industrialized nature of many of the locations at which the Company operates, there can be no assurance that we have discovered all environmental contamination for which the Company may be responsible.

Concern over climate change, including the impact of global warming, has led to significant federal, state and international legislative and regulatory efforts to limit greenhouse gas emissions. The European Commission has mandated the extension of the European Union Emissions Trading Scheme ("ETS") for greenhouse gas emissions to the airline industry. Under this decision, all Company airline subsidiary flights to and from any airport in any member state of the European Union will be covered by the ETS requirements beginning in 2012, and each year we will be required to submit emission allowances in an amount equal to the carbon dioxide emissions from such flights. The U.S. Congress has considered the regulation of greenhouse gas emissions. Also, the U.S. Environmental Protection Agency could regulate greenhouse gas emissions, especially aircraft engine emissions. The cost to comply with potential new laws and regulations could be substantial for the Company. These costs could include an increase in the cost of the fuel and capital costs associated with updating aircraft. Until the timing, scope and extent of any future regulation becomes known, we cannot predict its effect on the Company’s cost structure or operating results.

ITEM 1B. UNRESOLVED STAFF COMMENTS

None.

ITEM 2. PROPERTIES

The Company leases portions of the air park in Wilmington, Ohio under a lease agreement with a regional port authority, the term of which expires in May of 2019. The lease includes corporate offices, 210,000 square feet of maintenance hangars and a 100,000 square foot component repair shop at the air park. ABX also has the non-exclusive right to use the airport, which includes one active runway, taxi ways and ramp space. .

As of December 31, 2010, the Company and its subsidiaries owned 54 aircraft, leased six aircraft under capital leases and four aircraft under operating leases, for a total of 64 aircraft in service condition. All of the aircraft were previously owned and operated. Once acquired, the aircraft were modified for cargo operations, except for one Boeing 767 aircraft that remains in passenger configuration. These aircraft are generally described as having medium to medium wide-body cargo capabilities. The cargo aircraft carry gross payloads ranging from approximately 48,000 to 119,500 pounds. These aircraft are well suited for intra-continental flights and medium range inter-continental flights. Because an airline's flight operations can be hindered by inclement weather, sophisticated landing systems and other equipment are utilized to minimize the effect that weather may have on flight operations. For example, ABX’s Boeing 767-200 aircraft are operated for Category III landings. This allows their crews to land under weather conditions with runway visibility of only 600 feet at airports with Category III Instrument Landing Systems.

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The table below shows the combined in-service fleet of aircraft.

	Number of Aircraft as of December 31, 2010						
Aircraft Type	Total	Owned	Capital lease	Operating lease	Year of Manufacture	Gross Payload (Lbs.)	Still Air Range (Nautical Miles)
767-200 SF (1)	32	30	-	2	1982 - 1987	67,000 - 91,000	1,800 - 4,400
767-200 ER (3)	1	1	-	-	1985		5,000
767-300 SF (1)	1	-	-	1	1989	119,500	1,800 - 4,400
DC-8-F (1)	11	11	-	-	1967 - 1969	96,000 - 108,800	1,800 - 4,400
DC-8-CF (2)	4	4	-	-	1968 - 1970	80,000 - 85,000	1,800 - 4,400
727-200 SF (1)	13	6	6	1	1973 - 1981	52,300 - 61,000	1,200 - 2,100
757-200 SF (1)	2	2	-	-	1984 - 1986	48,000 - 68,000	2,700 - 4,000
Total in-service	64	54	6	4			

In addition, as of December 31, 2010, CAM had two Boeing 767-200 aircraft and one Boeing 767-300 aircraft, not reflected in the table above, that were undergoing modification to a standard freighter configuration. CAM also had four Boeing 767-200 aircraft and two Boeing 767-300, not reflected in the table above, that were scheduled to undergo modification to standard freighter configuration. At December 31, 2010, the Company had three spare airframes that had been removed from service. The engines and rotables from these aircraft are being used to support other aircraft in the combined fleet. Provisions of the Company's credit agreement require that the aircraft are maintained in airworthy condition. Exceptions to the requirement are made on a case-by-case basis with the consent of the lead agent to the credit facility. Such exceptions were granted by the lead agent for the spare airframes and the aircraft undergoing modification.

As of December 31, 2010, ABX operated 24 Boeing 767-200 aircraft and one Boeing 767-300 aircraft (11 of the 767-200 aircraft were leased by CAM to DHL and operated by ABX); ATI operated three Boeing 767-200 aircraft, 11 DC-8 freighter aircraft and four DC-8 combi aircraft; and CCIA operated 13 Boeing 727 aircraft and two Boeing 757 aircraft. CAM's Boeing 767 passenger aircraft is scheduled to begin an Atlantic operation in April 2011. In addition to these aircraft, CAM leased five Boeing 767-200 aircraft to other airlines.

We believe that our existing facilities, aircraft fleet and planned aircraft investments as described in Note I to the accompanying financial statements, are appropriate for our current operations and growth plans. We may make additional investments in aircraft and facilities if we identify favorable opportunities in the markets that we serve.

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(1) These aircraft are configured for standard cargo containers, including large standard main deck cargo doors.
(2) These aircraft are configured as "combi" aircraft capable of carrying passenger and cargo containers on the main flight deck.
(3) Passenger configured aircraft.

ITEM 3. LEGAL PROCEEDINGS

Department of Transportation ("DOT") Continuing Fitness Review

ABX filed a notice of substantial change with the DOT arising from its separation from Airborne, Inc., in August of 2003. The filing was initially made in mid-July of 2003 and thereafter updated in April of 2005, September of 2007, December of 2007 and March of 2010, with respect to subsequent events relevant to the DOT's analysis, including the reorganization of ABX under a holding company structure and the acquisition of Cargo Holdings International, Inc.

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The DOT was required to determine whether ABX continues to be a U.S. citizen and is fit, willing and able to engage in air transportation of cargo. On January 24, 2011, the DOT issued an order dismissing its notice, dated August 6, 2003, requesting public comments on the procedures to be employed in reviewing the impact of the proposed substantial changes in ownership and operations on the citizenship of ABX. On March 4, 2011, the DOT notified ABX that, based on its review of the previously filed and updated information, it appears that ABX continues to be a U.S citizen and remains fit to conduct air transportation operations as a U.S. certificated air carrier.

Civil Action Alleging Violations of Immigration Laws

On December 31, 2008, a former ABX employee filed a complaint against ABX, a total of four current and former executives and managers of ABX, Garcia Labor Company of Ohio, and three former executives of the Garcia Labor companies, in the U.S. District Court for the Southern District of Ohio. The case was filed as a putative class action against the defendants, and asserts violations of the Racketeer Influenced and Corrupt Practices Act (RICO). The complaint, which was later amended to include a second former employee plaintiff, seeks damages in an unspecified amount and alleges that the defendants engaged in a scheme to hire illegal immigrant workers to depress the wages paid to hourly wage employees during the period from December 1999 to January 2005. On March 18, 2010, the Court issued a decision in response to a motion filed by ABX and the other ABX defendants, dismissing three of the five claims constituting the basis of Plaintiffs' complaint. Most recently, the Court issued a decision on October 7, 2010, permitting the plaintiffs' to amend their complaint for the purpose of reinstating one of their dismissed claims. On October 26, 2010, ABX and the other ABX defendants filed an answer denying the allegations contained in plaintiffs' second amended complaint.

The complaint is similar to a prior complaint filed by another former employee in April 2007. The prior complaint was subsequently dismissed without prejudice at the plaintiff's request on November 3, 2008.

FAA Enforcement Actions

The Company's airline operations are subject to complex aviation and transportation laws and regulations that are continually enforced by the DOT and FAA. The Company's airlines receive letters of investigation ("LOIs") from the FAA from time to time in the ordinary course of business. The LOIs generally provide that some action of the airline may have been contrary to the FAA's regulations. The airlines respond to the LOIs and if the response is not satisfactory to the FAA, it can seek to impose a civil penalty for the alleged violations. Airlines are entitled to a hearing before an Administrative Law Judge or a Federal District Court Judge, depending on the amount of the penalty being sought, before any penalty order is deemed final.

The FAA issued LOIs to CCIA arising from a focused inspection of that airline's operations during the fourth quarter of 2009 which could result in the FAA seeking monetary penalties against CCIA. ABX received an LOI from the FAA alleging that ABX failed to comply with an FAA Airworthiness Directive involving its Boeing 767 aircraft and proposing a monetary settlement. The Company believes it has adequately reserved for those monetary penalties being proposed by the FAA, although it's possible that the FAA may propose additional penalties exceeding the amounts currently reserved.

Environmental Matters

The Ohio Environmental Protection Agency ("OEPA") was contemplating a proceeding against DHL, in its former capacity as the owner of Wilmington Air Park ("ILN"), and ABX, in its former capacity as the permit holder for the stormwater treatment system at ILN, arising from the unauthorized discharge of stormwater from ILN on or about May 7, 2008, and seeking a monetary penalty in the amount of $210,000. DHL, which had agreed to indemnify ABX for claims arising from this matter under the terms of the Mutual Termination Agreement and Release, dated March 29, 2010, among DPWN Holdings (USA), Inc., DHL Network Operations (USA), Inc., DHL Express (USA), Inc., Air Transport Services Group, Inc. and ABX Air, Inc., subsequently held discussions with the OEPA regarding this matter. Thereafter, on January 5, 2011, the OEPA issued the Director's Final Findings and Orders pursuant to which DHL Express (USA), Inc. agreed to pay $80,000 to the OEPA in full settlement of the contemplated proceeding and related matters against DHL and ABX.

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Other

In addition to the foregoing matters, we are also currently a party to legal proceedings in various federal and state jurisdictions arising out of the operation of our business. The amount of alleged liability, if any, from these proceedings cannot be determined with certainty; however, we believe that our ultimate liability, if any, arising from the pending legal proceedings, as well as from asserted legal claims and known potential legal claims which are probable of assertion, taking into account established accruals for estimated liabilities, should not be material to our financial condition or results of operations.

ITEM 4. RESERVED

PART II

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

Common Stock

Our common stock is publicly traded on the NASDAQ Global Select Market under the symbol ATSG. Prior to May 21, 2008, our symbol on the NASDAQ Global Select Market was ABXA. The following table shows the range of high and low prices per share of our common stock for the periods.

2010 Quarter Ended:	Low	High
December 31, 2010	$5.99	$8.10
September 30, 2010	$4.48	$6.50
June 30, 2010	$3.52	$6.03
March 31, 2010	$1.78	$3.49

2009 Quarter Ended:	Low	High
December 31, 2009	$2.11	$3.50
September 30, 2009	$2.13	$4.06
June 30, 2009	$0.44	$2.49
March 31, 2009	$0.17	$0.84

On March 8, 2011, there were 1,800 stockholders of record of the Company's common stock. The closing price of the Company's common stock was $8.25 on March 8, 2011.

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Performance Graph

The graph below compares the cumulative total stockholder return on a $100 investment in the Company's common stock with the cumulative total return of a $100 investment in the NASDAQ Global Select Market and the cumulative total return of a $100 investment in the NASDAQ Transportation Index for the period beginning on December 31, 2005 and ending on December 31, 2010.

	12/31/2005	12/31/2006	12/31/2007	12/31/2008	12/31/2009	12/31/2010
Air Transport Services Group, Inc.	100.00	88.28	53.25	2.29	33.63	100.64
NASDAQ Composite Index	100.00	111.74	124.67	73.77	107.12	125.93
NASDAQ Transportation Index	100.00	111.57	117.39	88.90	91.15	117.01

Dividends

The Company is restricted from paying dividends on its common stock in excess of $50.0 million during any calendar year under the provisions of its credit agreement. Under the provisions of its promissory note due to DHL, the Company is required to prepay the DHL note $0.20 for each dollar of dividend distributed to the stockholders of ATSG. The same prepayment stipulation applies to stock repurchases. No cash dividends have been paid or declared.

Securities authorized for issuance under equity compensation plans

For the response to this Item, see Item 12.

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ITEM 6. SELECTED CONSOLIDATED FINANCIAL DATA

The following selected consolidated financial data should be read in conjunction with the consolidated financial statements and the notes thereto and the information contained in Item 7 of Part II, “Management’s Discussion and Analysis of Financial Condition and Results of Operations.” The selected consolidated financial data and the consolidated operations data below are derived from the Company’s audited consolidated financial statements.

	As of and for the Years Ended December 31				
	2010	2009	2008	2007	2006
	(In thousands, except per share data)				
OPERATING RESULTS (1):					
Continuing revenues	$667,382	$823,483	$941,686	$573,256	$548,576
Operating expenses	585,706	751,693	963,638	538,025	514,014
Net interest expense	18,359	26,432	34,667	9,510	6,772
Earnings (loss) from continuing operations before income taxes (3)	63,317	45,358	(56,619)	25,721	27,790
Income tax benefit (expense) (2)	(23,413)	(17,156)	(6,229)	(10,898)	57,096
Earnings (loss) from continuing operations	39,904	28,202	(62,848)	14,823	84,886
Discontinued earnings, net of tax (4)	(70)	6,247	6,858	4,764	5,168
Net earnings (loss)	$39,834	$34,449	$(55,990)	$19,587	$90,054
EARNINGS (LOSS) PER SHARE FROM CONTINUING OPERATIONS (1):					
Basic	$0.64	$0.45	$(1.01)	$0.26	$1.46
Diluted	$0.62	$0.44	$(1.01)	$0.25	$1.45
WEIGHTED AVERAGE SHARES (1):					
Basic	62,807	62,674	62,484	58,296	58,270
Diluted	64,009	63,279	62,484	58,649	58,403
SELECTED CONSOLIDATED FINANCIAL DATA (1):					
Cash and cash equivalents	$46,543	$83,229	$116,114	$59,271	$63,219
Deferred income tax asset (2)	12,879	31,597	74,979	35,056	101,715
Property and equipment, net	658,756	636,089	671,552	690,813	458,638
Goodwill and intangible assets (3)	99,036	99,890	100,777	210,354	—
Total assets	900,654	1,002,773	1,101,349	1,162,967	679,798
Post-retirement liabilities	119,746	155,720	299,964	190,028	224,376
Capital lease obligations (5)	6,103	12,918	72,282	88,483	73,551
Long-term debt, other than leases (5)	296,425	364,509	440,204	502,319	125,126
Deferred income tax liability	39,746	50,044	—	—	—
Stockholders’ equity	302,077	245,982	80,392	200,003	120,210

(1) The consolidated financial data includes the Company’s acquisition of Cargo Holdings International, Inc. as of December 31, 2007.

(2) In the fourth quarter of 2006, an income tax benefit was recognized to completely reverse the valuation allowance on ABX’s deferred tax assets.

(3) In the fourth quarter of 2008, the Company recorded an impairment charge of $73.2 million on goodwill and $18.0 million on acquired intangibles.

(4) In the third quarter of 2009, ABX ceased providing hub services and fuel services for DHL. Accordingly, these business activities are reflected as discontinued operations for all years presented.

(5) Capital lease obligations reflects the assumption and extinguishment of aircraft lease obligations by DHL during 2009 totaling $45.7 million. Additionally, Long-term debt reflects the extinguishment of $46.3 million of the

DHL promissory note during 2009. (See Note H to the accompanying financial statements.)

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ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following Management's Discussion and Analysis has been prepared with reference to the historical financial condition and results of operations of Air Transport Services Group, Inc., and its subsidiaries and should be read in conjunction with the "Risk Factors" in Item 1A of this report, our historical financial statements, and the related notes contained in this report.

INTRODUCTION

Air Transport Services Group, Inc. (the "Company") is a holding company whose principal subsidiaries include three independently certificated airlines, ABX Air, Inc. ("ABX"), Capital Cargo International Airlines, Inc. ("CCIA") and Air Transport International, LLC ("ATI"), and an aircraft leasing company, Cargo Aircraft Management, Inc. ("CAM"). When the context requires, we may also use the terms "Company" and "ATSG" in this report to refer to the business of ATSG and its subsidiaries on a consolidated basis.

The Company, through ABX, has had long term contracts with DHL Network Operations (USA), Inc. and its affiliates, which are collectively referred to as "DHL," since August 16, 2003. DHL, an international, integrated delivery company, is the Company's largest customer. In March 2010, the Company and DHL executed new follow-on agreements, effective March 31, 2010. The new agreements separate CAM's lease of freighter aircraft to DHL from the maintenance and operation of those aircraft on behalf of DHL. DHL committed to lease 13 Boeing 767 freighter aircraft from CAM and DHL contracted with ABX to operate those aircraft under a separate crew, maintenance and insurance ("CMI") agreement. The CMI agreement is no longer based on a cost-plus pricing arrangement, but instead pricing is based on a pre-defined fee, scaled for the number of aircraft operated and the number of flight crews provided to DHL for its U.S. network. The initial term of the CMI agreement is five years, while the term of the aircraft leases are seven years, with early termination provisions. Until CAM completes the aircraft modification process for the 13 aircraft committed to DHL, ABX is operating its own Boeing 767 aircraft as bridging aircraft for DHL under short term, month-to-month arrangements under economic terms similar to those under the lease agreements for the 13 aircraft. Prior to the new follow-on agreements, ABX provided flight crews, maintenance and aircraft to DHL under an aircraft, crew, maintenance and insurance agreement ("DHL ACMI agreement") which compensated ABX on a cost-plus mark-up basis.

The new follow-on agreements with DHL commenced on March 31, 2010. Due to the similarities among the Company's airline operations, including the new CMI agreement with DHL, the airline operations have been aggregated into a single reportable segment. The segment information has been updated to retrospectively reflect the aggregation of the former DHL segment with the ACMI Services segment.

SEGMENT ANALYSIS

The Company has two reportable segments: ACMI Services and CAM. The Company's other business activities do not constitute reportable segments and have been aggregated in Other Activities.

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A summary of our revenues and pre-tax earnings from continuing operations is shown below (in thousands):

	Years Ended December 31		
	2010	2009	2008
Revenues from Continuing Operations:			
CAM	$101,375	$60,685	$47,480
ACMI Services			
Airline services	432,082	556,152	716,533
Other Reimbursable	143,330	91,306	155,905
S&R activites	4,000	121,366	29,109
Total ACMI Services	579,412	768,824	901,547
Other Activities	87,660	64,914	48,707
Total Revenues	768,447	894,423	997,734
Eliminate internal revenues	(101,065)	(70,940)	(56,048)
Customer Revenues	$667,382	$823,483	$941,686
Pre-Tax Earnings from Continuing Operations:			
CAM, inclusive of interest expense	41,586	22,775	18,102
ACMI Services			
Airline services	17,339	11,665	20,738
S&R activites	3,549	16,727	816
Impairments	—	—	(91,241)
Total ACMI Services	20,888	28,392	(69,687)
Other Activities	8,017	3,518	7,070
Net unallocated interest expense	(7,174)	(9,327)	(12,104)
Total Pre-Tax Earnings from Continuing Operations	$63,317	$45,358	$(56,619)

Under a severance and retention agreement ("S&R agreement"), DHL compensated and reimbursed ABX for its management and costs associated with DHL's network restructuring starting in May 2008 and continuing through March 2010. Other Reimbursable revenues include certain operating costs that are reimbursed to the airlines by their customers. Such costs include fuel used, landing fees and certain aircraft maintenance expenses. The type of costs that are reimbursed varies by customer operating agreement.

CAM

The Company offers aircraft leasing through its CAM subsidiary. Aircraft leases normally cover a term of five to seven years. In a typical leasing agreement, customers pay rent and a maintenance deposit on a monthly basis. Since December 31, 2009, CAM has completed the modification of six Boeing 767-200 aircraft into standard cargo configuration and acquired twelve other Boeing 767-200 freighter aircraft from ABX. As of December 31, 2010, CAM had 60 aircraft that were under lease, 44 of them to ABX, ATI and CCIA. CAM's revenues from ABX, ATI and CCIA were $58.1 million and $49.8 million for 2010 and 2009, respectively.

CAM's revenues for 2010 grew $40.7 million to $101.4 million compared to $60.7 million in 2009. Revenues from external customers, particularly DHL, accounted for $32.4 million of the increase. In April 2010, as part of the follow-on agreements with DHL, CAM placed seven Boeing 767-200 aircraft under lease with DHL. These seven aircraft were previously associated with the DHL network and were reflected in the ACMI Services segment revenues prior to April 1, 2010. By the end of 2010, CAM leased four additional Boeing 767-200 aircraft to DHL, bringing the total number of 767-200 aircraft leased to DHL to eleven. At this time, CAM does not expect to have all 13 Boeing 767 freighter aircraft available for lease to DHL until the second quarter of 2011. Accordingly, ABX is operating two of its aircraft for DHL under short term, month-to-month bridging arrangements with economic terms similar to the

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leases for the 13 aircraft until CAM completes the aircraft modification process in 2011 for the remaining two Boeing 767-200 aircraft committed to DHL. In addition to the eleven leases with DHL in 2010, CAM placed two Boeing 767-200 freighter aircraft under lease to a Florida based operator in February and July 2010, bringing the total number of external aircraft leases to 16.

Pre-tax segment earnings for CAM were $41.6 million for 2010 and $22.8 million in 2009. The increase in pre-tax earnings reflects 18 additional aircraft that CAM has placed in service since December 31, 2009, 12 of them to external customers. CAM's results reflected an allocation of overhead expenses and interest expense based on the Company's external interest rates and the carrying value of CAM's operating assets. Interest expense allocated to CAM was $9.3 million and $10.3 million in 2010 and 2009, respectively.

Outlook

We plan to continue to invest in the modification of Boeing 767 aircraft. The fuel efficiency, cubic capacity, payload and operating costs of the Boeing 767 make it a desirable freighter aircraft in medium-range international air cargo markets and in trans-U.S. routes. Interest in efficient, reliable Boeing 767 aircraft remains strong.

As of December 31, 2010, two of CAM's non-standard Boeing 767-200 freighter aircraft were undergoing modification to standard freighter configuration by Israel Aerospace Industries, Ltd. ("IAI"). Currently, we plan to modify all four of the remaining non-standard Boeing 767-200 freighter aircraft that we own into a standard freighter configuration. The aircraft are scheduled for the modification process through September of 2011 at IAI. We will consider a number of factors, including the fleet plans of customers, long-term demand for airlift, the quantity and quality of customer prospects, competitive alternatives and general economic conditions before deciding to place an aircraft into the modification process. If a non-standard Boeing 767-200 freighter aircraft is not placed into the modification process, we will consider other alternatives, including the sale of the aircraft or the salvaging and parting-out of the aircraft to support the Company's other Boeing 767 aircraft. .

In May 2010, CAM entered into a purchase agreement for three passenger-configured Boeing 767-300 extended range aircraft, each equipped with General Electric CF6-80C2-B6 engines. On August 6, 2010, CAM entered into an agreement with M&B Conversions Limited and IAI for the conversion by IAI of the three Boeing 767-300 series passenger aircraft to a full freighter configuration. The agreement includes an option to convert up to seven additional Boeing 767-300 series passenger aircraft during the 10-year term of the agreement. The Company plans to modify the aircraft into standard freighter configuration. As of December 31, 2010, one Boeing 767-300 aircraft was undergoing freighter modification.

In October 2010, CAM entered an agreement with Precision Conversions, LLC ("Precision") for the design, engineering and certification of a Boeing 757 "combi" aircraft variant. The Boeing 757 "combi" variant to be developed by Precision will incorporate 10 full cargo pallet positions along with passenger seating for up to 58 occupants. The Boeing 757 combi is intended to strategically position CAM to provide next-generation combi aircraft to complement and eventually replace, the DC-8 combi aircraft that ATI operates for the U.S. Military. If the military decides not to transition to the 757 combi in the near future, we have the option to convert Boeing 757 aircraft to standard freighter aircraft instead. CAM is committed to convert a minimum of two Boeing 757 aircraft with Precision.

Besides the passenger aircraft that were undergoing freighter modification at December 31, 2010, CAM owned one passenger aircraft, a Boeing 767-200 extended range aircraft, that is scheduled for operation in April 2011.

ACMI Services Segment

Through its three airline subsidiaries, the Company provides airlift to other airlines, freight forwarders and the U.S. Military. In addition to DHL, BAX Global, Inc. ("BAX/Schenker") and the U.S. Military are also significant customers. CCIA and ATI each have airline operating agreements with BAX/Schenker. DHL, BAX/Schenker and the U.S. Military account for 85% of ACMI services 2010 revenues.

At December 31, 2010, ACMI Services included 47 in-service aircraft which the Company owned or leased. Additionally, ACMI Services included the results from operations by ABX of eleven CAM-owned freighter aircraft for DHL under the CMI agreement by the end of 2010. In the fourth quarter of 2010, ABX began to lease and operate two DHL-owned Boeing 767-200 aircraft under the CMI agreement. Beginning in November 2010, ABX began to lease a Boeing 767-300 aircraft from an external lessor for a 45 month period. ABX is operating the Boeing 767-300

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under an ACMI agreement with DHL for a transatlantic flight. Also in November 2010, ABX began to operate one of its Boeing 767-200 aircraft in Asia under an agreement with Japan Airlines International Co., Ltd. and DHL. During 2010, ATI leased its third Boeing 767-200 cargo aircraft, while CCIA redeployed one of its leased Boeing 727 aircraft that had been temporarily unassigned and scrapped a Boeing 727 airframe, permanently removing it from service. During 2010, ABX returned one of its leased Boeing 767-200 aircraft to CAM, which then leased the aircraft to an external customer under a seven year agreement.

ACMI Services revenues were $579.4 million during 2010, declining $189.4 million compared to 2009. Revenues generated from DHL's U.S. network declined $250.3 million compared to 2009, when those revenues included the reimbursement of employee severance and retention benefits and aircraft depreciation expense, as well as compensation from DHL for a larger U.S. air network. Beginning April 1, 2010, certain aircraft that ABX had been operating for DHL under the former DHL ACMI agreement were instead leased to DHL through CAM as part of the new follow-on agreements and the lease revenues began being reflected in CAM's revenues. Under a severance and retention agreement (“S&R agreement”) which was terminated and settled on March 31, 2010, DHL was obligated to reimburse ABX for the cost of employee severance, retention, productivity bonuses and vacation benefits paid in accordance with the agreement. Revenues from the S&R agreement declined $117.4 million in 2010 compared to 2009. The reduction in revenues includes a reduction in the reimbursement of severance and retention benefits since 2009, when ABX experienced significant employee terminations. The decline in revenues from the S&R agreement was partially offset by increased block hours flown for customers in Europe, Asia Pacific and the Caribbean. Block hours increased 14% to 92,508 hours during 2010 compared to 2009.

The pre-tax earnings for ACMI Services were $20.9 million for 2010, compared to pre-tax earnings of $28.4 million during 2009. Pre-tax earnings included $3.5 million and $16.7 million for 2010 and 2009, respectively, for administering the wind-down of the DHL operations under the S&R agreement which was terminated on March 31, 2010. ACMI Services pre-tax earnings from airline services increased 49% to $17.3 million for 2010 compared to $11.7 million for 2009. Higher pre-tax earnings in 2010 from airline services reflect increased block hours and improved profits from European and transatlantic operations. In early 2010, we restructured ABX's scheduled service for TNT Airways SA as a conventional ACMI agreement, which contributed positively to the segment's earnings during 2010. Also, in November 2010, we added an additional transatlantic flight with DHL under a separate ACMI agreement. These improvements were partially offset by increased crew training costs, lower performance incentive revenues and higher aircraft maintenance expenses among the ATSG airlines during 2010. Maintenance expense not specifically reimbursed under contractual provisions increased by approximately $11.7 million during 2010 compared to 2009. Non-reimbursed maintenance expenses increased due to premature engine and component failures as well as extra planned maintenance tasks with the intent of improving aircraft performance for future periods. The costs of training flight crews increased in 2010 as the airlines added aircraft and made preparations to add additional aircraft in 2011.

Outlook

CCIA and ATI have the exclusive right to supply all main deck freighter airlift in BAX/Schenker's U.S. domestic network through December 31, 2011. The Company and BAX/Schenker have already begun discussions regarding the renewal or follow-on agreements for services.

ABX began to lease and operate a third and fourth DHL-owned Boeing 767-200 aircraft beginning in the first quarter of 2011. Each DHL-owned aircraft will generate a pre-negotiated monthly service fee. ACMI Services results included revenues of $12.1 million from bridging aircraft that ABX temporarily supplied to DHL during 2010. These bridging revenues are expected to decline as DHL deploys the remaining two aircraft that it is committed to lease from CAM.

Through CAM, we continue to make investments in Boeing 767 and 757 aircraft. As these aircraft are modified, we will place them into service under dry leasing arrangements to external customers or ACMI operations using our airlines, depending on which alternative provides the best long term return and considering other factors, including geographical placement and customer diversification. Future earnings from ACMI Services will also be impacted by utilization levels which are driven by customer demand and our ability to maintain the aircraft at reliability levels expected by our customers. Customer preferences for ACMI agreements with our airlines will depend on the cost competitiveness of the airlines. New customer agreements typically involve start-up expenses, including those for route authorities, overfly rights, travel and other activities, and may impact future operating results. Revenue-generating service may begin sometime later; however, depending on satisfaction of a number of conditions, including international

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regulations and laws, contract negotiations, flight crew availability, and arranging resources for aircraft handling. Additional external aircraft leases by CAM to other airlines may adversely impact the ACMI Services operating results by reducing utilization levels for our aircraft. Additionally, our earnings will fluctuate due to the timing of scheduled heavy maintenance which, under ABX's policy are expensed as maintenance is performed.

Fleet Summary

The Company's aircraft fleet is summarized below as of December 31, 2010 ($'s in thousands):

	ACMI Services	CAM	Total
In-service aircraft			
Aircraft owned or under capital lease			
Boeing 767-200	14	17	31
Boeing 757	2	—	2
Boeing 727	12	—	12
DC-8	15	—	15
Total	43	17	60
Carrying value			$552,919
Operating lease			
Boeing 767-200	2	—	2
Boeing 767-300	1	—	1
Boeing 727	1	—	1
Total	4	—	4
Carrying value			$1,932
Aircraft in freighter modification or awaiting modification			
Boeing 767-200	—	6	6
Boeing 767-300	—	3	3
Total	—	9	9
Carrying value			$54,385
Idle aircraft (not scheduled for revenue)			
Aircraft owned or under capital lease			
DC-8	3	—	3
Carrying value			$604
Operating lease	2	—	2

During 2010, we completed the modification of six Boeing 767-200 aircraft into standard freighter configuration; we acquired three Boeing 767-300 passenger aircraft that we plan to modify into standard freighter aircraft; we began to lease two Boeing 767-200 aircraft from DHL; we began to lease a Boeing 767-300 aircraft; we redeployed a Boeing 727 aircraft that had been unassigned at the beginning of the year and we scrapped a Boeing 727 airframe. During 2010, we transferred 20 Boeing 767-200 aircraft to CAM from ABX. Of these 20 aircraft, two are in modification, four are awaiting modification, seven were leased to external customers, and seven were leased internally as of December 31, 2010.

As of December 31, 2010, ACMI Services was leasing 41 of its 47 in-service aircraft internally from CAM. ACMI Services operated 11 of the 16 aircraft that CAM leases to external customers. ACMI Services had idle airframes with a carrying value of $0.6 million for which the engines and rotables were being used to support other aircraft in the Company's fleets. The spare airframes can be reactivated, as needed.

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Other Activities

Through separate subsidiaries, the Company sells aircraft parts and provides aircraft maintenance and modification services to other airlines. The Company also operates three U.S. Postal Service ("USPS") sorting facilities. The Company provides equipment leasing and facility maintenance, as well as specialized services for aircraft fuel management and freight logistics. Other activities also include the management of workers' compensation claims under an agreement with DHL and gains from the reduction to employee post-retirement obligations. Prior to April 1, 2010, other activities included an allocation of ABX's overhead expenses that could not be charged to DHL under the former cost-plus agreements. In September and October of 2010, the USPS renewed the Company's operating agreements for each of the three sorting facilities. The renewed agreements were extended through September and October 2012 at substantially the same terms.

External customer revenues from all other activities increased $1.6 million, to $45.9 million in 2010 compared to 2009. The pre-tax earnings from all other activities were $8.0 million and $3.5 million for 2010 and 2009, respectively. The increase in pre-tax earnings of $4.5 million for 2010 reflects $3.8 million from the reduction to employee post-retirement obligations, services fees for managing workers compensation claims for DHL, increased revenues from aircraft modification services and improved productivity at the USPS sort centers we manage. These increases to pre-tax earnings for 2010 were partially offset by lower gains from sales of spare aircraft and engines in 2010 compared to 2009.

Outlook

Under the follow-on agreements reached with DHL, our Airborne Maintenance and Engineering Services, Inc. ("AMES") subsidiary continues to provide maintenance services for the Boeing 767 aircraft that operate in the DHL network. Since the AMES subsidiary was formed in 2009 from ABX's maintenance and engineering organization, it continues to add to its customer base and invest in new capabilities. AMES has limited hangar facilities and significant fixed costs. As a result, our operating results in future quarters may be impacted by the amount and timing of the completion of aircraft maintenance and engineering projects for AMES's customers.

Discontinued Operations

Discontinued operations include the results of the hub services and the fuel management previously provided to DHL. In July 2009, sort operations in Wilmington ceased and the sorting and hub operations were transferred to the Cincinnati/Northern Kentucky International Airport ("CVG"). In conjunction with the transfer of the hub operations to CVG in July 2009, DHL assumed management of fueling services for its U.S. network previously provided by ABX. At that time, ABX ceased providing aircraft fuel and related services for its aircraft that remained in the DHL network. During 2010, ABX continued to provide certain transitional services to DHL on a short term arrangement. Revenues from the hub services were $0.2 million and $143.0 million in 2010 and 2009, respectively. Pre-tax losses from the hub services were $0.1 million for 2010 compared to pre-tax earnings of $9.2 million for 2009. Pre-tax earnings from hub services included $2.6 million in 2009 from the S&R agreement to manage the wind-down of DHL's U.S. domestic operations. The cost of discontinued operations for 2010 included pension expenses for former employees that supported the sort operations and medical costs in excess of initially estimated accruals for former employees under severance benefit plans and COBRA.

RESULTS OF OPERATIONS

2010 compared to 2009

Summary

Customer revenues from continued operations decreased $156.1 million in 2010 compared to 2009, due primarily to the completion of the S&R agreement. Revenues from the S&R agreement, which was terminated on March 31, 2010, declined $117.4 million in 2010 compared to 2009. Additionally, revenues declined compared to 2009 when ABX was compensated by DHL for a larger U.S. network capacity.

Consolidated net earnings from continuing operations increased $11.7 million to $39.9 million for 2010 compared to 2009. Improved earnings were driven by CAM. Pre-tax earnings from continuing operations increased $18.0 million to $63.3 million for 2010 compared to 2009, led by improved pre-tax earnings for CAM. CAM's pre-tax earnings,

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inclusive of interest expense, increased by $18.8 million during 2010 compared to 2009, reflecting the lease of thirteen additional Boeing 767 aircraft to external lessees since December 2009, including eleven aircraft leases initiated with DHL since March 2010. Pre-tax earnings related to the S&R agreement with DHL declined $13.2 million in 2010 compared to 2009, reflecting the completion of DHL's U.S. restructuring at ABX. ACMI Services' segment earnings from airline services increased $5.7 million in 2010 compared to 2009, led by new European and transatlantic contracts. In early 2010, we restructured the scheduled service for TNT Airways S.A. as a conventional ACMI agreement and, in November 2010, added another transatlantic flight for DHL. The increase in pre-tax earnings from continuing operations included $4.5 million from reductions in employee post-retirement obligations and the pre-tax earnings of our other business operations. Additionally, unallocated interest expense, net of interest income declined $2.2 million due to more capitalized interest for additional aircraft modifications, lower outstanding debt levels and lower interest rates.

Operating Expenses

Salaries, wages and benefits expense decreased $203.3 million, or 53% during 2010, compared to 2009. The decrease is due primarily to the DHL restructuring, which occurred throughout 2009. The Company's expense for severance and retention compensation declined $104.2 million in 2010 compared to 2009. Additionally, benefits expense declined $90.6 million from 2009 when it included $41.5 million for severance and retention benefits for terminated employees and $26.3 million of expense adjustments for pension benefits as a result of employee terminations and plan amendments. Headcount, excluding employees associated with the discontinued operations, declined 20% as of December 31, 2010 compared to March 31, 2009.

Fuel expense increased $24.5 million during 2010, compared to 2009. The increase reflects the higher cost of aviation fuel which increased significantly compared to 2009. The average price of a gallon of aviation fuel increased 29% in 2010 compared to 2009. The cost of fuel is generally reimbursed to our airlines under our operating agreements and reflected as revenues.

Maintenance, materials and repairs increased $12.5 million during 2010 compared to 2009. The increase in maintenance expense included $6.5 million for scheduled airframe heavy maintenance (referred to as a C-check) on DHL-owned aircraft which was reimbursed by DHL. The increase in maintenance expenses for 2010 also included additional C-check expense for aircraft operated by ABX, whose policy is to expense C-checks as incurred. Additionally, 2010 aircraft maintenance expense increased due to procedures by CCIA with the intent of improving the recent on-time reliability level of the Boeing 727 and Boeing 757 aircraft. The increase in maintenance expenses also reflects the increased cost to support the growth in block hours flown since 2009 and the higher maintenance cost for Boeing 727 aircraft operating in the BAX/Schenker network. CCIA's Boeing 727 aircraft scheduled in the BAX/Schenker network have been assigned to operate on a greater number of multi-stop routes compared to 2009, which negatively impacted reliability and increased the costs of operating those aircraft.

Depreciation and amortization expense increased $3.6 million during 2010, compared to 2009. Depreciation expense increased due to the deployment of six modified aircraft since the end of 2009.

Landing and ramp expense, which includes the cost of deicing chemicals, decreased $5.5 million in 2010, compared to 2009. The decrease is a result of DHL's removal of aircraft from service in conjunction with its U.S. restructuring plan during the first quarter of 2009.

Travel expense increased $0.9 million during 2010 compared to 2009. The increase is a result of additional crew training and increased international flying, particularly in the Europe and Asia-Pacific regions.

Rent expense increased $4.4 million during 2010 compared to 2009. The increase reflects a change in the allocation of expense for the Wilmington, Ohio facility due to the closure of the freight sorting operations there in July 2009, and an increase in the rental rates for the Wilmington facility in conjunction with a new lease agreement executed with a regional port authority in May 2010.

Insurance decreased $1.7 million during 2010 compared to 2009. The decline in insurance expense primarily reflects the transition to a Company-insured employee medical coverage plan from a third party insurance plan for certain employee groups. Company insured medical expenses are recorded in salaries, wages and benefits.

Other operating expenses include professional fees, navigational services, employee training, utilities, the cost of parts sold to customers and gains and losses from the disposition of aircraft. Other operating expenses decreased $1.5

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million during 2010 compared to 2009 due to a lower volume of parts sales and a lower level of external professional fees incurred since 2009 to support the wind-down of DHL's domestic operations. The declines in the cost of parts sold and professional fees incurred during 2010 were offset by declines in gains from the sale and disposal of spare equipment compared to 2009.

Interest expense decreased $8.2 million during 2010 compared to 2009. The decline in interest expense reflects the reduction in the Company’s debt since December 2009 and lower interest rates. Interest rates on the Company’s variable interest, unsubordinated term loan decreased from 2.9% in the fourth quarter of 2009 to 2.6% for the fourth quarter of 2010, while interest bearing debt decreased $74.9 million since December 31, 2009.

Interest income declined $0.1million during 2010, compared to 2009 due to lower short-term interest rates on our cash and cash equivalents and a decrease in the cash and cash equivalents balance.

The effective tax rate for continuing operations was 37% for 2010 and 38% for 2009. The Company recorded deferred tax benefits of $0.4 million and $0.7 million in 2010 and 2009, respectively, related to the recognition of previously unrecognized tax positions that either expired or were settled. The effective tax rate declined for 2010 due to the proportionately lower level of non-deductible tax expenses in 2010 compared to 2009.

As of December 31, 2010, the Company had operating loss carryforwards for U.S. federal income tax purposes of approximately $29.2 million, which will begin to expire in 2025. We expect to utilize the loss carryforwards to offset federal income tax liabilities in the future. As a result, we do not expect to pay federal income taxes until 2013 or later. The Company may, however, be required to pay alternative minimum taxes and certain state and local income taxes before then.

2009 compared to 2008

Summary

Customer revenues from continued operations decreased $118.2 million, or 13%, in 2009 compared to 2008, primarily due to the DHL restructuring in the U.S. and lower fuel prices. The decline reflects lower revenues from the DHL agreements by approximately $76.4 million for 2009. Additionally, the decline is a result of lower fuel prices for those ACMI, block space and charter agreements that include fuel in their contractual price. CAM's revenue from leases to external customers increased to $10.9 million in 2009 from $2.7 million in 2008, reflecting additional Boeing 767 aircraft that CAM placed in service during 2009 and 2008. Additionally, compared to 2008, the Company's revenues from other activities for outside customers grew 15%, primarily from aircraft and facility maintenance services. This reflects the Company's focus on diversifying and replacing revenues lost from the DHL ACMI agreement.

Pre-tax earnings from continuing operations were $45.4 million for 2009 compared to a pre-tax loss of $56.6 million in 2008. The changes in pre-tax earnings between 2009 and 2008 are summarized as follows.

- Pre-tax earnings in 2008 included impairment charges of $91.2 million on goodwill and intangibles associated with ATI and CCIA.
- Pre-tax earnings from the DHL ACMI agreement declined $2.5 million compared to 2008 as a result of DHL removing aircraft in conjunction with its restructuring plans.
- Pre-tax earnings for 2009 improved $15.9 million from the S&R agreement with DHL, primarily due to settlement of benefits with ABX crewmembers.
- ABX experienced losses from its transatlantic scheduled service, resulting in a combined reduction of pre-tax earnings of $6.6 million among our airline service contracts with customers other than DHL.
- CAM's pre-tax earnings, inclusive of interest expense allocations, improved $4.7 million due to the deployment of additional aircraft.
- Pre-tax gains from the sale of aircraft, including insurance settlements in 2008 stemming from an aircraft fire, were $4.9 million less in 2009 compared to 2008.

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- Corporate expenses were $3.1 million lower in 2009 compared to 2008, when the Company incurred professional expenses related to the arbitration of a dispute with DHL.
- Net non-reimbursed interest expense declined $2.8 million in 2009 compared to 2008 due to lower outstanding debt levels and interest rates.

The Company's aircraft fleet is summarized below as of December 31, 2009 ($ in thousands).

	ACMI Services	CAM	Total
In-service aircraft			
Aircraft owned or under capital lease			
Boeing 767-200	29	4	33
Boeing 757	2	—	2
Boeing 727	12	—	12
DC-8	15	—	15
Total	58	4	62
Carrying value			$538,251
Operating lease			
Boeing 767-200	4	—	4
Total	4	—	4
Aircraft in freighter modification			
Boeing 767-200	—	4	4
Carrying value			$50,472
Idle aircraft (not scheduled for revenue)			
Aircraft owned or under capital lease			
DC-8	3	—	3
Boeing 727	1	—	1
Carrying value			$1,631
Operating lease	1	—	1

As of December 31, 2009, ACMI Services was leasing 36 of its 58 in-service aircraft internally from CAM. As of December 31, 2009, CAM had four Boeing 767-200 aircraft having a book value of $50.5 million, which were in the process of being modified to standard freighter configuration and were temporarily removed from service. ACMI Services had idle airframes with a carrying value of $1.6 million whose engines and rotables were being used for other aircraft in the Company's fleets. The spare airframes can be reactivated, as needed. ACMI Services had one aircraft under an operating lease that was not scheduled for service through the end of its lease term in October 2010.

ACMI Services

Revenues from ACMI Services declined $132.7 million in 2009 compared to 2008. The results for ACMI Services in 2009 and 2008 were significantly impacted by DHL's restructuring plans. In 2008, DHL began to restructure its U.S. operations due to continued losses. Pursuant to its 2008 restructuring plans, DHL discontinued intra-U.S. domestic pickup and delivery services in January 2009. DHL now provides only international services to and from the U.S. During 2009, DHL discontinued the use of ABX's McDonnell Douglas DC-9 aircraft and five of ABX's Pratt & Whitney powered Boeing 767 aircraft.

Pre-tax earnings from the DHL ACMI agreement were $11.1 million for 2009 and decreased by $2.5 million compared to 2008 due to the reductions in service in conjunction with DHL's U.S. restructuring. Revenues from the

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DHL ACMI agreement reflected revenue amendments in 2009 and 2008 which effectively fixed ABX's pre-tax earnings from the DHL ACMI agreement for the fourth quarter of 2008 and each quarter of 2009. Prior to the revenue amendments, expenses incurred under the DHL ACMI agreement were generally marked-up by 1.75% and included in revenues. The DHL ACMI agreement also allowed ABX to earn incremental revenues calculated on mark-ups above the 1.75% base mark-up (up to an additional 1.60% under the DHL ACMI agreement) from the achievement of certain cost-related and service goals specified in the two agreements. Under the revenue amendments, annual goals were not set for 2009, nor were quarterly cost goals. Instead, the agreed revenue for 2009 included amounts to replace these incremental revenues.

In 2008, ABX and DHL executed the S&R agreement to facilitate the restructuring and wind-down of DHL's U.S. operations. The S&R agreement specified employee severance, retention and other benefits that DHL reimbursed to ABX for payment to its employees that were affected by DHL's U.S. restructuring plan. Through December 31, 2009, ABX terminated approximately 8,700 employee positions during the implementation by DHL of its U.S. restructuring plan beginning in mid-2008. Employees received severance, retention and other benefits under the S&R agreement. In accordance with the agreement, DHL was obligated to reimburse ABX for the cost of non-pilot employee severance, retention, productivity bonuses and vacation benefits paid. The S&R agreement also included a provision for DHL to fund up to $75.0 million, contingent upon ABX negotiating an agreement with its pilot union, in regards to severance, retention and/or other issues arising from DHL's U.S. restructuring plan.

Pre-tax earnings from continuing operations in 2009 included $16.7 million for administering the wind-down of DHL's operations under the S&R agreement in 2009. In December 2009, ABX and the pilots' union reached an agreement with regard to the distribution of the $75.0 million provided by the S&R agreement for pilot severance and benefits. To settle the S&R agreement funding, ABX amended its pilot pension plans in December 2009, to effectively increase the benefits of those crewmembers with higher seniority. The Company recorded a pension expense of $19.2 million for the benefit amendments. The Company also agreed to fund the pilot pension plan with $37.8 million in 2009 in addition to previously remitted contributions. The Company further agreed to pay $43.6 million to furloughed crewmembers for severance benefits. As a result, pre-tax earnings for 2009 included $12.2 million for settling the S&R agreement funding with the crewmembers. Including the additional pension contribution of $37.8 million made by the Company, the settlement of the S&R agreement funding resulted in a net cash outflow of approximately $6.4 million after all payments were completed. Our pre-tax earnings from the S&R agreement for 2009 also included $4.5 million for the reimbursement of employee vacation benefits that ABX paid to terminated employees. Our pre-tax earnings from continuing operations for 2008 included $0.8 million from the S&R agreement related to reimbursed employee vacation.

Our 2009 results for ACMI Services include losses from a Boeing 767 transatlantic scheduled service which commenced in January 2009. We experienced higher costs for ABX flight crews and lower cargo volumes than expected. The costs of ABX flight crews were detrimentally impacted due to scheduling changes caused when senior DC-9 flight crewmembers were retrained for the Boeing 767. High levels of sick occurrences among crewmembers in 2009 resulted in higher pay premiums for unscheduled crewmembers who flew open routes. In January 2010, ABX terminated the scheduled transatlantic service which generated the losses. The operation was replaced by a conventional ACMI agreement with TNT Airways S.A. Pre-tax earnings in 2009 were also negatively impacted by the timing of scheduled aircraft maintenance checks. ABX, which expenses aircraft maintenance as it is incurred, completed eight scheduled maintenance checks during 2009, compared to six maintenance checks during 2008. Aircraft block hours flown for the ACMI Services segment declined 43% to 80,955 hours in 2009 compared to 142,096 hours in 2008, due to the removal of aircraft from the DHL ACMI agreement starting in June 2008.

In 2008, the Company recognized an impairment charge of $73.2 million to reduce the combined ATI and CCIA goodwill to $55.4 million. Projected cash flows for the airlines were expected to decline beginning in 2009 due to the deep economic recession. The global economic recession affected U.S. customers, including BAX/Schenker. ATI and CCIA each reduced their planned flying for BAX/Schenker for 2009. ATI planned to operate seven aircraft in the BAX network in 2009 compared to nine DC-8 aircraft in 2008, and CCIA planned to operate eight aircraft in 2009, compared to twelve Boeing 727 aircraft for BAX/Schenker's U.S. network in 2008. As of December 31, 2008, we tested the recorded goodwill associated with ATI and CCIA for impairment. To test the goodwill, we determined the fair values of ATI and CCIA separately using industry market multiples and discounted cash flows, utilizing a market-derived rate of return. The impairment charge was precipitated by a large-scale drop in market values of transportation companies and higher costs of capital emerging from the credit crisis in the fourth quarter of 2008.

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In conjunction with the goodwill test, we recorded a charge of $18.0 million in 2008 to reduce ATI's and CCIA's customer relationship intangibles to their fair value at December 31, 2008. The carrying amount of the finite lived intangible assets was determined to not be recoverable because the carrying amount exceeded the sum of the undiscounted cash flows expected to result from its use and eventual disposition. The amount of the impairment charge was measured as the amount by which the carrying amount exceeded its fair value. The fair value of these assets was derived using projected revenues from existing customers and related attrition rates. The projected net cash flows attributed to existing customers were discounted using an estimated cost of capital based on market participant assumptions. The impairment charge reflected lower projected revenues and earnings in future years from existing customers. Deep recessionary conditions in the U.S. caused the demand for airlift from ATI and CCIA's major customer, BAX/Schenker, to decline. Additionally, ATI experienced reductions in flying for the U.S. Military.

CAM

Pre-tax segment earnings for CAM were $22.8 million and $18.1 million for 2009 and 2008, respectively. The increase in pre-tax earnings reflects eight additional aircraft that CAM has placed in service since December 31, 2008. CAM's results reflected an allocation of interest expense of $10.3 million and $12.4 million in 2009 and 2008, respectively, based on prevailing interest rates and the carrying value of its operating assets. CAM's revenues for 2009 and 2008 included $49.8 million and $44.8 million, respectively, for the leasing of aircraft to ATI, CCIA and ABX.

Other Activities

Revenues from all other activities increased $16.2 million during 2009 compared to 2008. Increased revenues were primarily a result of an increase in aircraft and facility maintenance services when compared to 2008. Pre-tax earnings from all other activities were $3.5 million during 2009 compared to $7.1 million in 2008. Lower pre-tax earnings for 2009 compared to 2008 were a result of 1) a net gain of $5.8 million recorded in 2008 stemming from the insurance proceeds for an aircraft which experienced a fire prior to engine start and 2) a charge of $2.5 million in 2008 for professional fees stemming from the arbitration of a dispute with DHL.

Discontinued Operations

Revenues from the hub services were $143.0 million and $336.1 million for 2009 and 2008, respectively. Pre-tax earnings from hub services were $9.2 million, or 17%, of consolidated pre-tax earnings for 2009 and $10.8 million of consolidated pre-tax earnings for 2008. Pre-tax earnings from hub services included $2.6 million and $2.4 million in 2009 and 2008, respectively, from the S&R agreement to manage the wind-down of DHL's U.S. domestic operations. In conjunction with the transfer of the hub operations to CVG in July 2009, DHL assumed management of fueling services for its U.S. network previously provided by ABX. ABX ceased providing aircraft fuel and related services for its aircraft that remain in the DHL network. Revenues from fuel were $28.5 million and $332.9 million for 2009 and 2008, respectively. ABX did not earn a mark-up on fuel used within the DHL network.

Operating Expenses

Salaries, wages and benefits expense decreased 5% during 2009, compared to 2008. Due primarily to the DHL restructuring, headcount declined approximately 58% as of December 31, 2009, compared to December 31, 2008. Benefits expense includes $41.5 million and $20.3 million in 2009 and 2008, respectively, for severance and retention benefits for terminated employees. Also, this line includes pension expense adjustments as a result of employee terminations and plan amendments of $26.3 million and $5.5 million in 2009 and 2008, respectively.

Fuel expense decreased $67.5 million during 2009, compared to 2008. The decrease reflects the reduction in the number of aircraft in service for DHL. In addition, the average price of aviation fuel decreased significantly compared to 2008. The average price of a gallon of aviation fuel decreased 42% in 2009 compared to 2008.

Maintenance, materials and repairs decreased $20.7 million during 2009 compared to 2008. The decrease is a result of DHL's removal of aircraft from service in conjunction with its U.S. restructuring plans.

Depreciation and amortization expense decreased $9.8 million during 2009, compared to 2008. Depreciation expense decreased due to the removal of the ABX DC-9 fleet and five Boeing 767 aircraft since DHL's restructuring announcement in May 2008. The depreciation expense for 2009 also reflects the addition of one Boeing 757 aircraft and seven Boeing 767-200 standard freighter aircraft that the Company has had in service since December 31, 2008.

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Landing and ramp expense, which includes the cost of deicing chemicals, decreased $5.3 million in 2009, compared to 2008. The decrease is a result of DHL's removal of aircraft from service in conjunction with its U.S. restructuring plans.

Travel expense decreased $7.6 million during 2009 compared to 2008. The decrease is a result of DHL's removal of aircraft from service, and the resulting decline in required flight crew travel, in conjunction with its U.S. restructuring plans.

Insurance increased $0.5 million during 2009 compared to 2008. The increase is a result of placing additional Boeing 767 freighter aircraft into service since mid 2008.

Other operating expenses include professional fees, navigational services, employee training, utilities, the cost of parts sold to customers and gains and losses from the disposition of aircraft. Other operating expenses increased $8.1 million during 2009 compared to 2008. During 2009, the Company incurred higher expenses for international navigation services, reflecting increased transatlantic and European aircraft operations. The increase in 2009 expenses also reflects expenses for expanded aircraft and facility maintenance revenues compared to 2008. The comparison of other operating expense between 2009 and 2008 is affected by 2008 expenses related to the arbitration of a dispute with DHL and the 2008 gain on an aircraft disposition due to a fire.

Interest expense decreased $10.1 million during 2009 compared to 2008. The decline in interest expense reflects the reduction in the Company's debt since December 2008 and lower interest rates. Interest rates on the Company's variable interest, unsubordinated term loan decreased from 4.5% in the fourth quarter of 2008 to 2.9% for the fourth quarter of 2009.

Interest income decreased $1.9 million during 2009, compared to 2008 due to lower short-term interest rates on our cash and cash equivalents and a decrease in the cash and cash equivalents balance.

The effective tax rate for continuing operations was 38% for 2009 and 11% for 2008. The Company's effective tax rate for continuing operations in 2008 was 38% of pre-tax earnings after adjusting for $73.2 million of impairment charges that were not deductible for income tax purposes. The Company recorded a deferred tax benefit in 2009 related to the recognition of a previously unrecognized tax position under FASB ASC Topic 740-10, Income Taxes. The effective settlement of this item resulted in a deferred tax benefit of $0.7 million.

FINANCIAL CONDITION, LIQUIDITY AND CAPITAL RESOURCES

During 2010, the Company’s debt obligations declined $74.9 million to $302.5 million as of December 31, 2010. The decline included principal payments of $70.2 million paid by the Company. Additionally, $4.7 million of principal balance for the DHL promissory note was extinguished, pursuant to the CMI Agreement with DHL. During 2010, the Company’s combined liability for the underfunded status of pension plans declined by $36.0 million. This improvement reflects cash contributions made by the Company into the pension master trusts and improved investment returns during 2010.

During 2009, the Company's debt obligations declined $135.1 million to $377.4 million as of December 31, 2009. The decline included principal payments of $43.1 million paid by the Company. Additionally, the Company negotiated an amendment with DHL regarding the unsecured DHL promissory note. DHL agreed to extinguish $46.3 million of principal balance and the Company agreed to pay DHL $15.0 million of the principal balance, which was paid in 2010. Further, DHL assumed all of ABX's financial obligations for five Boeing 767 aircraft under capital leases, retroactive to January 31, 2009, totaling $45.7 million. In return, ABX granted DHL a credit of $10.0 million as prepaid rent toward the lease payments of four Boeing 767-200 aircraft. Additionally, during 2009, the Company's combined liability for the underfunded status of the pension plans declined by $147.6 million due to cash contributions made by the Company into the pension master trusts, improved investment returns during 2009 and the curtailment of previously projected benefit liabilities due to the reduction in the number of employees and the freezing of employee pension plan benefits.

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Operating Cash Flows

Net cash generated from operating activities were $112.3 million, $103.0 million and $161.7 million for 2010, 2009 and 2008, respectively. Improved operating cash flows in 2010 compared to 2009 reflect improved profitability of the Company's operations and the collection of accounts receivable from DHL in excess of payments to employees for severance and retention benefits. Operating cash flows declined from 2008 when ABX's operations included the Hub Services agreement, aircraft fueling and a larger air network for DHL. Cash outlays included pension contributions of $36.6 million, $83.2 million and $39.6 million in 2010, 2009 and 2008, respectively. During 2009, we contributed $37.8 million to crewmember pension plans in conjunction with settling the S&R agreement.

All of the cash generated from the discontinued operations was classified as operating cash flows because there were no assets or debts related to discontinued operations that generated investing or financing cash flows. Net operating cash generated from discontinued operations was $7.7 million in 2010, reflecting the reimbursement payments received from DHL for severance and employee benefits which we had paid to employees. Net operating cash used in discontinued operations was $13.1 million in 2009 primarily due to payments of severance and employee benefits in advance of DHL's reimbursement of those costs to ABX. Net operating cash generated from discontinued operations was $18.7 million in 2008, primarily reflecting advances from DHL for aircraft fuel costs.

Capital Expenditures and Equipment Proceeds

Cash payments for capital expenditures were $110.7 million in 2010 compared to $101.2 million and $111.9 million in 2009 and 2008, respectively. Our capital spending is primarily for acquiring and modifying Boeing 767 aircraft into standard freighter configuration. Our capital expenditures included $74.8 million and $69.6 million for the acquisition and modification of aircraft in 2010 and 2009, respectively. During 2010, we purchased three Boeing 767-300 aircraft and in 2009 we purchased one Boeing 767-200 aircraft. During 2010, we completed six cargo modifications compared to five and six completed cargo modifications in 2009 and 2008, respectively. Our capital expenditures for 2010, 2009 and 2008 included the cargo modification costs for nine, ten and nine aircraft, respectively. Our capital expenditures for 2010 included $29.9 million for required heavy maintenance and $6.0 million for other equipment. Our capital expenditures for 2009 included $25.6 million for required heavy maintenance and $6.0 million for other equipment costs.

Proceeds from the disposal of equipment in 2010 included $29.7 million from DHL to complete the sale of the aircraft ABX previously put to DHL under provisions of the DHL ACMI agreement. Proceeds from the disposal of equipment in 2008 included $30.3 million from insurance proceeds for an aircraft that experienced a fire prior to engine start and was rendered a complete loss by the Company's insurer.

Financing Activities

Net cash used in financing activities were $70.2 million, $43.1 million and $79.8 million in 2010, 2009 and 2008, respectively. During 2010, debt payments included $18.5 million to pay down the outstanding revolving credit facility and $15.0 million to DHL toward the balance of the promissory note. During 2010 and 2009, the Company did not draw on the revolving credit facility. During 2008, the principal payments of $116.8 million included $47.5 million paid by a subsidiary of the Company to the lead banks of the Credit Agreement to invest in the Company's unsubordinated term loan. This intercompany loan is eliminated upon consolidation. During 2008, debt origination costs were $1.5 million.

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Outlook

The table below summarizes the Company’s contractual obligations and commercial commitments (in thousands) as of December 31, 2010.

Contractual Obligations	Payments Due By Period Total	Less Than 1 Year	2-3 Years	4-5 Years	After 5 Years
Long-term debt, including interest payments	$340,078	$44,665	$191,928	$29,094	$74,391
Capital lease obligations	6,323	6,323	—	—	—
Operating leases	84,486	18,809	35,315	19,713	10,649
Unconditional purchase obligations	25,793	25,793	—	—	—
Employee severance and retention benefits	506	506	—	—	—
Total contractual cash obligations	$457,186	$96,096	$227,243	$48,807	$85,040

The long-term debt bears interest at 2.87% to 7.36% per annum.

The Company provides defined benefit pension plans to certain employee groups. The table above does not include cash contributions for pension funding due to the absence of scheduled maturities. The timing of pension and post-retirement healthcare payments cannot be reasonably determined, except for $4.0 million scheduled to be paid in 2011. We are considering additional pension contributions which would result in total contributions of $15 million to $20 million for 2011. We will periodically evaluate whether to make the additional contributions.

Unconditional purchase obligations of $25.8 million as of December 31, 2010 reflect the estimated remaining cost to complete the modification of the two Boeing 767-200 aircraft and one Boeing 767-300 aircraft that were undergoing freighter conversion at year end 2010. If CAM were to cancel the conversion programs as of December 31, 2010, it would owe the vendor, IAI, in addition to payments for aircraft currently undergoing modification, approximately $10.3 million associated with additional conversion part kits which have been ordered.

We estimate that total capital expenditures for 2011 could total $170 million to $200 million and would include the completion of modifications for six Boeing 767-200 aircraft, three Boeing 767-300 aircraft and two or three Boeing 757 aircraft. Actual capital spending for any future period will be impacted by the number of aircraft we decide to modify and the progress in the aircraft modification process. We expect to finance the aircraft purchases and modifications from current cash balances, future operating cash flow and existing credit facilities.

Provisions of the Company’s Credit Agreement requires that cash proceeds from the sale of equipment and recoveries from insurance proceeds must be reinvested in like-kind assets within 180 days of receipt or remitted as a repayment against the term loan. Aggregate proceeds exceeding $75.0 million in a calendar year must be remitted as a repayment against the term loan, except that the Company is not required to remit proceeds from the put of aircraft to DHL toward the term loan. At this time, we do not anticipate a required repayment of the term loan with proceeds from the sale of equipment or insurance recoveries.

Through its Credit Agreement, the Company has a syndicated, unsubordinated term loan and a revolving credit facility that are collateralized by substantially all the aircraft, property and equipment owned by the Company that are not separately collateralized under aircraft loans or capital leases. The lenders currently consist of 15 U.S.-based financial institutions. Under the Credit Agreement, the Company is subject to expenses, covenants and warranties that are usual and customary. The Credit Agreement contains covenants including, among other things, limitations on certain additional indebtedness, guarantees of indebtedness, and the level of annual capital expenditures. The Credit Agreement stipulates events of default including unspecified events that may have a material adverse effect on the Company. If an event of default occurs, the Company may be forced to repay, renegotiate or replace the Credit Agreement. As of December 31, 2010, the Company had $3.6 million of capitalized loan origination costs and $4.6 million of unrealized losses from the hedging of interest payments that could adversely impact future operating results if the Credit Agreement is terminated early. The Company is in compliance with all financial covenants specified in the Credit Agreement.

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The Company's existing Credit Agreement expires on December 31, 2012. At that time a balloon payment of $139.1 million is due to the consortium of banks that finance the Company's term loan, plus any draws on the revolving credit facility that may be outstanding on December 31, 2012. We are exploring alternatives which may secure longer term debt financing before the balloon payment is due. Alternatives which we may consider include amending and extending the current Credit Agreement beyond 2012, terminating and replacing the current Credit Agreement with a new bank facility, as well as other alternatives. A new follow-on credit agreement, assuming one can be obtained before December 31, 2012, may contain more restrictive covenants, dividend limitations, tighter restrictions on capital spending and higher costs of interest than the existing Credit Agreement.

Liquidity

At December 31, 2010, the Company had approximately $46.5 million of cash balances. The Company had $59.8 million of unused credit facility, net of outstanding letters of credit of $15.2 million, through a syndicated Credit Agreement that expires in December 2012. As specified under terms of ABX's CMI agreement with DHL, the $26.4 million balance at December 31, 2010 of the unsecured note payable to DHL will be extinguished ratably without payment through March 31, 2015. We believe that the Company's current cash balances and forecasted cash flows provided from its operating agreements, combined with its credit facility, will be sufficient to fund operations, scheduled debt payments, required pension funding and planned capital expenditures for at least the next 12 months.

Off-Balance Sheet Arrangements

As part of our ongoing business, we do not participate in transactions that generate relationships with unconsolidated entities or financial partnerships, such as entities often referred to as structured finance or special purpose entities (“SPEs”), which would have been established for the purpose of facilitating off-balance sheet arrangements or other contractually narrow or limited purposes. As of December 31, 2010 and 2009, we were not involved in any material unconsolidated SPE transactions.

Certain of our operating leases and agreements contain indemnification obligations to the lessor or one or more other parties that are considered ordinary and customary (e.g. use, tax and environmental indemnifications), the terms of which range in duration and are often limited. Such indemnification obligations may continue after the expiration of the respective lease or agreement. No amounts have been recognized in our financial statements for the underlying fair value of guarantees and indemnifications.

CRITICAL ACCOUNTING POLICIES AND ESTIMATES

“Management’s Discussion and Analysis of Financial Condition and Results of Operations,” as well as certain disclosures included elsewhere in this report, are based upon our consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States of America. The preparation of these financial statements requires us to select appropriate accounting policies and make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses, and related disclosure of contingencies. In certain cases, there are alternative policies or estimation techniques which could be selected. On an ongoing basis, we evaluate our selection of policies and the estimation techniques we use, including those related to revenue recognition, post-retirement liabilities, bad debts, self-insurance reserves, valuation of spare parts inventory, useful lives, salvage values and impairment of property and equipment, income taxes, contingencies and litigation. We base our estimates on historical experience, current conditions and on various other assumptions that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources, as well as for identifying and assessing our accounting treatment with respect to commitments and contingencies. Actual results may differ from these estimates under different assumptions or conditions. We believe the following significant and critical accounting policies involve the more significant judgments and estimates used in preparing the consolidated financial statements.

Revenue Recognition

Revenues generated from airline service agreements are typically recognized based on hours flown or the amount of aircraft and crew resources provided during a reporting period. Certain agreements include provisions for incentive payments based upon on-time reliability. These incentives are typically measured on a monthly basis and recorded to

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revenue in the corresponding month earned. Revenues for operating expenses that are reimbursed through customer agreements, including consumption of aircraft fuel, are generally recognized as the costs are incurred. Revenues from charter service agreements are recognized on scheduled and non-scheduled flights when the specific flight has been completed. Revenue for the sale of aircraft parts are recognized when the parts are delivered. Revenues earned and expenses incurred in providing aircraft-related maintenance, repair or technical services are recognized in the period in which the services are completed and delivered to the customer. Revenues derived from transporting freight and sorting parcels are recognized upon delivery of shipments and completion of services. Aircraft lease revenues are recognized as operating lease revenue on a straight-line basis over the term of the applicable lease agreements.

The Company's revenues for 2009 and the first quarter of 2010 included reimbursement for expenses incurred under the former DHL ACMI agreement, the incremental mark-up revenues set by amendments to the DHL ACMI agreement, and reimbursement for employee severance, retention, vacation and other benefit costs incurred during the period. Revenues from the former DHL ACMI agreement were generally determined based on expenses incurred during a period plus mark-ups and were recognized when the related services were performed. ABX and DHL amended the DHL ACMI agreement to set mark-ups to specific quarterly amounts for 2009 and the first quarter of 2010. In 2008, ABX and DHL executed a severance and retention agreement (“S&R agreement”) which specified employee severance, retention and other benefits that DHL reimbursed to ABX for payment to its employees that were affected in conjunction with DHL's U.S. restructuring plan. DHL was obligated to reimburse ABX for the cost of employee severance, retention, productivity bonuses and vacation benefits paid in accordance with the agreement.

Goodwill and Intangible Assets

In accordance with the Financial Accounting Standards Board Accounting Standards Codification (“FASB ASC”) Topic 350-20 Intangibles—Goodwill and Other, we assess in the fourth quarter of each year whether the Company’s goodwill acquired in acquisitions is impaired. Additional assessments may be performed on an interim basis whenever events or changes in circumstances indicate an impairment may have occurred. Indefinite-lived intangible assets are not amortized but are assessed for impairment annually, or more frequently if impairment indicators occur. Finite-lived intangible assets are amortized over their estimated useful economic lives and are periodically reviewed for impairment.

Application of the goodwill impairment test requires significant judgment, including the determination of the fair value of each reporting unit that has goodwill. The Company has two reporting units, ATI and CAM, that have goodwill. We estimate the fair value of ATI and CAM separately using a market approach and an income approach utilizing discounted cash flows applied to a market-derived rate of return. The market approach utilizes market multiples from comparable publicly traded companies. The market multiples include revenues, EBIT (earnings before interest and taxes), EBITDA (earnings before interest, taxes, depreciation and amortization) and EBITDAR (earnings before interest, taxes, depreciation, amortization and rents). We derive cash flow assumptions from many factors including recent market trends, expected revenues, cost structure, aircraft maintenance schedules and long-term strategic plans for the deployment of aircraft. Key assumptions under the discounted cash flow models included projections for the number of aircraft in service, capital expenditures, long-term growth rates, operating cash flows and market-derived discount rates.

The first step of the goodwill impairment test requires a comparison of the fair value of the reporting unit to its respective carrying value. If the carrying value of a reporting unit is less than its fair value, no indication of impairment exists and a second step is not performed. If the carrying amount of a reporting unit is higher than its fair value, there is an indication that an impairment may exist and a second step is performed. In the second step, fair values are assigned to all of the assets and liabilities of a reporting unit, including any unrecognized intangible assets, and the implied fair value of goodwill is calculated. If the implied fair value of goodwill is less than the recorded goodwill, an impairment loss is recorded for the difference and charged to operations.

We have used the assistance of an independent business valuation firm in estimating our expected market rate of return, and in the development of our market approach from comparable publicly traded companies. Based on our analysis, as of December 31, 2010, CAM and ATI’s fair values each exceeded their carrying values by more than 25%. The Company’s key assumptions used for goodwill testing include uncertainties. Those uncertainties include the level of demand for cargo aircraft by shippers, the U.S. Military and freight forwarders and CAM’s ability to lease aircraft near their expected modification completion dates. We anticipate, as of December 31, 2010, that CAM will successfully modify eight more Boeing 767 aircraft into standard freighter configuration over the next year and deploy

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them under long-term lease agreements. We expect that ATI will continue to operate for BAX/Schenker and for the U.S. Military. The demand for customer airlift is projected based on inputs from customers, the volume of bids requested by the U.S. Military, management's interface with customer planning personnel and aircraft utilization trends. Certain events or changes in circumstances could negatively impact our key assumptions. Customer preferences for cargo aircraft may be impacted by changes in aviation fuel prices. DHL and other customers may decide that they do not need as many aircraft as projected, or they may find alternative airlift.

The Company's finite lived intangible assets are for customer relationships acquired with ATI. These assets are amortized over their estimated useful economic lives and reviewed for impairment whenever events or changes in circumstances indicate that carrying amounts may not be recoverable. The fair value of this asset was derived using projected revenues from existing customers and related attrition rates using the guidance under FASB ASC Topic 360-10 Property, Plant and Equipment separately from a discounted cash flow model used for goodwill impairment. The projected net cash flows attributed to existing customers were discounted using an estimated cost of capital, based on market participant assumptions.

Depreciation

Depreciation of property and equipment is provided on a straight-line basis over the lesser of the asset's useful life or lease term. We periodically evaluate the estimated service lives and residual values used to depreciate our property and equipment. The acceleration of depreciation expense or the recording of significant impairment losses could result from changes in the estimated useful lives of our assets. We may change the estimated useful lives due to a number of reasons, such as the existence of excess capacity in our air system or ground networks, or changes in regulations grounding or limiting the use of aircraft.

Self-Insurance

We self-insure certain claims relating to workers' compensation, aircraft, automobile, general liability and employee healthcare. We record a liability for reported claims and an estimate for incurred claims that have not yet been reported. Accruals for these claims are estimated utilizing historical paid claims data, recent claims trends and, in the case of employee healthcare and workers' compensation, an independent actuarial evaluation. Changes in claim severity and frequency could result in actual claims being materially different than the costs provided for in our results of operations. We maintain excess claim coverage with common insurance carriers to mitigate our exposure to large claim losses.

Contingencies

We are involved in legal matters that have a degree of uncertainty associated with them. We continually assess the likely outcomes of these matters and the adequacy of amounts, if any, provided for these matters. There can be no assurance that the ultimate outcome of these matters will not differ materially from our assessment of them. There also can be no assurance that we know all matters that may be brought against us at any point in time.

Income Taxes

We account for income taxes under the provisions of FASB ASC Topic 740-10 Income Taxes. The objectives of accounting for income taxes are to recognize the amount of taxes payable or refundable for the current year and deferred tax liabilities and assets for the future tax consequences of events that have been recognized in the Company's financial statements or tax returns. Judgment is required in assessing the future tax consequences of events that have been recognized in the Company's financial statements or tax returns. Fluctuations in the actual outcome of expected future tax consequences could materially impact the Company's financial position or its results of operations.

The Company has significant deferred tax assets including net operating loss carryforwards ("NOL CFs") for federal income tax purposes which begin to expire in 2025. Based upon projections of taxable income, we determined that it was more likely than not that the NOL CF's will be realized prior to their expiration. Accordingly, we do not have an allowance against these deferred tax assets at this time.

We recognize the impact of a tax position, if that position is more likely than not of being sustained on audit, based on the technical merits of the position.

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Post-retirement Obligations

The Company sponsors qualified defined benefit pension plans for ABX’s flight crewmembers and other eligible employees. The Company also sponsors non-qualified, unfunded excess plans that provide benefits to executive management and crewmembers that are in addition to amounts permitted to be paid through our qualified plans under provisions of the tax laws. In 2009, we amended each defined benefit plan to freeze the accrual of additional benefits and we provided notification to the affected employees. The Company also sponsors unfunded post-retirement healthcare plans for ABX’s flight crewmembers and non-flight crewmember employees.

The accounting and valuation for these post-retirement obligations are determined by prescribed accounting and actuarial methods that consider a number of assumptions and estimates. The selection of appropriate assumptions and estimates is significant due to the long time period over which benefits will be accrued and paid. The long-term nature of these benefit payouts increases the sensitivity of certain estimates on our post-retirement costs. In actuarially valuing our pension obligations and determining related expense amounts, assumptions we consider most sensitive are discount rates and expected long-term investment returns on plan assets. Other assumptions concerning retirement ages, mortality and employee turnover also affect the valuations. For our post-retirement healthcare plans, consideration of future medical cost trend rates is an important assumption in valuing these obligations. Actual results and future changes in these assumptions could result in future costs that are materially different than those recorded in our annual results of operations.

Our actuarial valuation includes an assumed long-term rate of return on pension plan assets of 6.75%. Our assumed rate of return is based on a targeted long-term investment allocation of 50% equity securities, 45% fixed income securities and 5% real estate. The actual asset allocation at December 31, 2010 was 48% equities, 49% fixed income, 2% real estate and 1% cash. The pension trust includes $37.7 million of investments (6% of the plans' assets) whose fair values have been estimated in the absence of readily determinable fair values. Such investments include private equity, multi-fund investments and real estate funds. Management’s estimates are based on information provided by the fund managers or general partners of those funds.

In evaluating our assumptions regarding expected long-term investment returns on plan assets, we consider a number of factors, including our historical plan returns in connection with our asset allocation policies, assistance from investment consultants hired to provide oversight over our actively managed investment portfolio and long-term inflation assumptions. The selection of the expected return rate materially affects our pension costs. We reduced our expected long-term rate of return from 7.0% to 6.75% after analyzing expected returns on investment vehicles and considering our long term asset allocation expectations. If we were to lower our long-term rate of return assumption by a hypothetical 100 basis points, expense in 2010 would be increased by approximately $5.8 million. We use a market value of assets as of the measurement date for determining pension expense.

In selecting the interest rate to discount estimated future benefit payments that have been earned to date to their net present value (defined as the projected benefit obligation), we match the plan’s benefit payment streams to high-quality bonds of similar maturities. The selection of the discount rate not only affects the reported funded status information as of December 31 (as shown in Note J to the accompanying financial statements), but also affects the succeeding year’s pension and post-retirement healthcare costs. The discount rates selected for December 31, 2010, based on the method described above, were 5.35% to 5.55%. If we were to lower our discount rates by a hypothetical 50 basis points, pension expense in 2010 would be increased by approximately $3.4 million.

The assumed future increase in salaries and wages is no longer a significant estimate in determining pension costs because each defined benefit pension plan was frozen during 2009 with respect to additional benefit accruals.

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The following table illustrates the sensitivity of the aforementioned assumptions on our pension expense (in thousands):

	Effect of change		
		December 31, 2010	
Change in assumption	2010 Pension expense	Funded status	Accumulated other comprehensive income (pre-tax)
100 basis point decrease in rate of return	$5,782	$—	$—
50 basis point decrease in discount rate	3,391	(52,148)	52,148
Aggregate effect of all the above changes	9,173	(52,148)	52,148

Discontinued Operations

In accordance with the guidance of FASB ASC Topic 205-20 Presentation of Financial Statements, a business component whose operations are discontinued is reported as discontinued operations if the cash flows of the component have been eliminated from the ongoing operations of the Company and the Company will no longer have any significant continuing involvement in the business component. The results of discontinued operations are aggregated and presented separately in the consolidated statement of operations. FASB ASC Topic 205-20 requires the reclassification of amounts presented for prior years to reflect their classification as discontinued operations.

Exit Activities

We account for the costs associated with exit activities in accordance with FASB ASC Topic 420-10 Exit or Disposal Cost Obligations. One-time, involuntary employee termination benefits are generally expensed when the Company communicates the benefit arrangement to the employee that it will no longer require the services of the employee beyond a minimum retention period. Liabilities for contract termination costs associated with exit activities are recognized in the period incurred and measured initially at fair value. Pension obligations are accounted for in accordance with FASB ASC Topic 715-30 Compensation—Retirement Benefits in the event that the expected working life of employees is significantly reduced due to terminations or a pension plan is suspended.

NEW ACCOUNTING PRONOUNCEMENTS

In July 2010, the FASB issued an Accounting Standards Update No. 2010-20, Receivables, Disclosure about the Credit Quality of Financing Receivables and Allowances for Credit Losses. The new guidance will require additional disclosures about the nature of credit risk in a company's portfolio of financing receivables, how risk is analyzed and assessed in arriving at the allowance for credit losses and the reasons for changes in the allowance for credit losses. The new guidance will be effective in fiscal years beginning on or after December 15, 2010 and is not expected to have a material impact on the Company's financial statements.

ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

The Company faces financial exposure to changes in interest rates. As of December 31, 2010, we have $124.5 million of fixed interest rate debt and $178.0 million of variable interest rate debt outstanding. Variable interest rate debt exposes us to differences in future cash flows resulting from changes in market interest rates. Variable interest rate risk can be quantified by estimating the change in annual cash flows resulting from a hypothetical 20% increase in interest rates. A hypothetical 20% increase or decrease in interest rates would have resulted in a change in interest expense of approximately $1.1 million for the year ended December 31, 2010.

The debt issued at fixed interest rates is exposed to fluctuations in fair value resulting from changes in market interest rates. Fixed interest rate risk can be quantified by estimating the increase in fair value of our long-term debt through a hypothetical 20% increase in interest rates. As of December 31, 2010, a 20% increase in interest rates would have decreased the fair value of our fixed interest rate debt by approximately $4.3 million.

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To reduce the effects of fluctuating LIBOR-based interest rates on interest payments that stem from its variable rate outstanding debt, the Company entered into interest rate swaps in January 2008. Under the interest rate swap agreements, the Company will pay a fixed rate of 3.105% and receive a floating rate that resets quarterly based on LIBOR. For the outstanding notional value, the Company expects that the amounts received from the floating leg of the interest rate swap will offset fluctuating payments for interest expense because interest rates for its outstanding debt and the interest rate swap are both based on LIBOR and reset quarterly. The notional values were $108.0 million as of December 31, 2010. See Note L in the accompanying financial statements for discussion of our accounting treatment for these hedging transactions.
We are exposed to concentration of credit risk primarily through cash deposits, cash equivalents, marketable securities and derivatives. As part of our risk management process, we monitor and evaluate the credit standing of the financial institutions with which we do business. The financial institutions with which we do business are generally highly rated. We are exposed to counterparty risk, which is the loss we could incur if a counterparty to a derivative contract defaulted.
At December 31, 2010, ABX's defined benefit pension plans had total investment assets of $588.5 million under investment management. See Note J in the accompanying financial statements for further discussion of these assets.
In the ordinary course of our business, we are exposed to market risk for changes in the price of jet and diesel fuel; however, this risk is largely mitigated by reimbursement through ABX's CMI agreement with DHL, ATI's and CCIA's operating agreements with BAX/Schenker and charter agreements with other customers.

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ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

Index to Consolidated Financial Statements

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Stockholders of Air Transport Services Group, Inc.
Wilmington, Ohio

We have audited the accompanying consolidated balance sheets of Air Transport Services Group, Inc. and subsidiaries (the "Company") as of December 31, 2010 and 2009, and the related consolidated statements of operations, stockholders' equity, and cash flows for each of the three years in the period ended December 31, 2010. Our audits also included the financial statement schedule listed in the Table of Contents at Item 15a(2). These financial statements and financial statement schedule are the responsibility of the Company's management. Our responsibility is to express an opinion on the financial statements and financial statement schedule 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 audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, such consolidated financial statements present fairly, in all material respects, the financial position of the Company as of December 31, 2010 and 2009, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2010, in conformity with accounting principles generally accepted in the United States of America. Also, in our opinion, such financial statement schedule, when considered in relation to the basic consolidated financial statements taken as a whole, presents fairly, in all material respects, the information set forth therein.

As discussed in Note B to the consolidated financial statements, the Company's three principal customers account for a substantial portion of the Company's revenue. The Company's financial security is dependent on its relationship with these customers.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the Company's internal control over financial reporting as of December 31, 2010, based on the criteria established in Internal Control-Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated March 8, 2011 expressed an unqualified opinion on the Company's internal control over financial reporting.

DELOITTE & TOUCHE LLP
Dayton, Ohio
March 8, 2011

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AIR TRANSPORT SERVICES GROUP, INC.
CONSOLIDATED BALANCE SHEETS
(In thousands, except share data)

	December 31 2010	2009
ASSETS		
CURRENT ASSETS:		
Cash and cash equivalents	$46,543	$83,229
Accounts receivable, net of allowance of $1,090 in 2010 and $1,288 in 2009	40,876	87,708
Inventory	7,205	5,226
Prepaid supplies and other	10,132	7,093
Deferred income taxes	12,879	31,597
Aircraft and engines held for sale	—	30,634
TOTAL CURRENT ASSETS	117,635	245,487
Property and equipment, net	658,756	636,089
Other assets	25,227	21,307
Intangibles	9,259	10,113
Goodwill	89,777	89,777
TOTAL ASSETS	$900,654	$1,002,773
LIABILITIES AND STOCKHOLDERS' EQUITY		
CURRENT LIABILITIES:		
Accounts payable	$40,558	$38,174
Accrued salaries, wages and benefits	23,639	44,077
Accrued severance and retention	506	18,959
Accrued expenses	12,144	16,429
Current portion of debt obligations	36,591	51,737
Unearned revenue	10,794	15,340
TOTAL CURRENT LIABILITIES	124,232	184,716
Long-term debt obligations	265,937	325,690
Post-retirement liabilities	116,614	152,297
Other liabilities	52,048	44,044
Deferred income taxes	39,746	50,044
Commitments and contingencies (Note I)		
STOCKHOLDERS' EQUITY:		
Preferred stock, 20,000,000 shares authorized, including 75,000 Series A Junior Participating Preferred Stock	—	—
Common stock, par value $0.01 per share; 75,000,000 shares authorized; 63,652,228 and 63,416,564 shares issued and outstanding in 2010 and 2009, respectively	637	634
Additional paid-in capital	518,925	502,822
Accumulated deficit	(171,251)	(211,085)
Accumulated other comprehensive loss	(46,234)	(46,389)
TOTAL STOCKHOLDERS' EQUITY	302,077	245,982
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	$900,654	$1,002,773

See notes to consolidated financial statements.

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AIR TRANSPORT SERVICES GROUP, INC.
CONSOLIDATED STATEMENTS OF OPERATIONS
(In thousands, except per share data)

	Years Ended December 31		
	2010	2009	2008
REVENUES	$667,382	$ 823,483	$ 941,686
OPERATING EXPENSES			
Salaries, wages and benefits	176,988	380,276	400,644
Fuel	133,776	109,242	176,722
Depreciation and amortization	87,594	83,964	93,752
Maintenance, materials and repairs	79,143	66,621	87,344
Landing and ramp	23,782	29,236	34,526
Travel	22,709	21,761	29,407
Rent	15,339	10,926	8,947
Insurance	9,171	10,918	10,454
Impairment of goodwill	—	—	73,178
Impairment of acquired intangibles	—	—	18,063
Other operating expenses	37,204	38,749	30,601
	585,706	751,693	963,638
INTEREST EXPENSE	(18,675)	(26,881)	(37,002)
INTEREST INCOME	316	449	2,335
EARNINGS (LOSS) FROM CONTINUING OPERATIONS BEFORE INCOME TAXES	63,317	45,358	(56,619)
INCOME TAXES	(23,413)	(17,156)	(6,229)
EARNINGS (LOSS) FROM CONTINUING OPERATIONS	39,904	28,202	(62,848)
EARNINGS (LOSS) FROM DISCONTINUED OPERATIONS, NET OF TAX	(70)	6,247	6,858
NET EARNINGS (LOSS)	$39,834	$ 34,449	$ (55,990)
BASIC EARNINGS (LOSS) PER SHARE			
Continuing operations	$0.64	$ 0.45	$ (1.01)
Discontinued operations	(0.01)	0.10	0.11
TOTAL NET EARNINGS (LOSS) PER SHARE - Basic	$0.63	$ 0.55	$ (0.90)
DILUTED EARNINGS (LOSS) PER SHARE			
Continuing operations	$0.62	$ 0.44	$ (1.01)
Discontinued operations	—	0.10	0.11
TOTAL NET EARNINGS (LOSS) PER SHARE - Diluted	$0.62	$ 0.54	$ (0.90)
WEIGHTED AVERAGE SHARES			
Basic	62,807	62,674	62,484
Diluted			

Total states and municipals		**103,097**	**6.22**	85,842	6.29	67,209	6.27
Total securities:[2]							
Maturing within 1 year		**12,683**	**4.94**	13,268	6.35	4,409	5.21
Maturing after 1 year, but within 5 years		**27,091**	**5.56**	22,723	6.02	22,215	5.93
Maturing after 5 years, but within 10 years		**47,411**	**6.26**	37,472	6.30	31,140	6.39
Maturing after 10 years		**28,312**	**6.26**	25,751	6.09	18,667	6.21
Total securities	**$**	**115,497**	**5.95%**	$ 99,214	6.18%	$ 76,431	6.14%

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

2 Total securities excludes preferred stock at amortized cost of $1.3 million at December 31, 2009, $1.6 million at December 31, 2008 and $4.0 million at December 31, 2007 (estimated fair value of $1.3 million at December 31, 2009, $1.6 million at December 31, 2008 and $3.9 million at December 31, 2007).

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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 principally provided by individuals and businesses located within the communities served.

Deposits totaled $606.6 million at December 31, 2009, compared to $550.7 million at December 31, 2008, with the increase primarily due to a $45.6 million increase in time deposits. The increase in noninterest-bearing demand and lower-costing transaction accounts occurred due to our deposit strategies that emphasize retention of multi-service customer relationships. Growth in time deposits occurred in the shorter-term time deposits of municipalities and retail depositors through-out our branch network. The increase in time deposits for our retail depositors was a result of overall growth at the branches and the fact that many customers are holding cash to maintain flexibility in their investing options due to the volatility in the stock market. The Corporation had no brokered certificates of deposit outstanding at December 31, 2009, compared to $10.0 million outstanding at December 31, 2008.

Table 12 presents the average deposit balances and average rates paid for the years 2009, 2008 and 2007.

TABLE 12: Average Deposits and Rates Paid

	Year Ended December 31,					
	2009		2008		2007	
(Dollars in thousands)	Average Balance	Average Rate	Average Balance	Average Rate	Average Balance	Average Rate
Noninterest-bearing demand deposits	**$ 85,811**		$ 83,533		$ 84,365	
Interest-bearing transaction accounts	**86,478**	**0.74%**	82,560	1.01%	82,109	1.11%
Money market deposit accounts	**66,562**	**1.54**	68,406	2.48	51,624	2.97
Savings accounts	**41,449**	**0.11**	42,445	0.25	45,452	0.66
Certificates of deposit, $100 thousand or more	**119,246**	**2.88**	99,726	4.10	99,653	4.73
Other certificates of deposit	**176,657**	**2.93**	167,849	3.94	169,431	4.41
Total interest-bearing deposits	**490,392**	**2.10%**	460,986	2.89%	448,269	3.33%
Total deposits	**$ 576,203**		$ 544,519		$ 532,634	

Table 13 details maturities of certificates of deposit with balances of $100,000 or more at December 31, 2009.

TABLE 13: Maturities of Certificates of Deposit with Balances of $100,000 or More

(Dollars in thousands)	December 31, 2009
3 months or less	**$ 15,795**
3-6 months	**24,784**
6-12 months	**49,514**
Over 12 months	**52,944**
Total	**$ 143,037**

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BORROWINGS

In addition to deposits, the Corporation utilizes short-term borrowings from the Federal Reserve Bank, and to a lesser extent 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, and overnight unsecured fed funds lines with correspondent banks. Long-term borrowings consist of advances from the FHLB, advances under a non-recourse revolving bank line of credit and securities sold under agreements to repurchase with a third-party broker. All FHLB advances are secured by a blanket floating lien on all of the Bank s qualifying closed-end and revolving, open-end loans secured by 1-4 family residential properties. All Federal Reserve Bank advances are secured by loan-specific liens on certain qualifying loans of C&F Bank that are not otherwise pledged. The bank line of credit is non-recourse and is secured by loans at C&F Finance. The repurchase agreement is secured by a portion of the Bank s securities portfolio.

In December, 2007, Trust II, a wholly-owned subsidiary of the Corporation, was formed for the purpose of issuing trust preferred capital securities for general corporate purposes including the refinancing of existing debt. On December 14, 2007, Trust II 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 Trust II is $10.3 million of the Corporation s trust preferred capital notes. In July 2005, 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. On July 21, 2005, Trust I 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 Trust I is $10.3 million of the Corporation s 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 8: 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 $74.0 million at December 31, 2009 and $75.0 million at December 31, 2008.

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 $8.9 million at December 31, 2009 and $7.8 million at December 31, 2008.

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At December 31, 2009, C&F Mortgage had rate lock commitments to originate mortgage loans aggregating $47.7 million and loans held for sale of $28.8 million. C&F Mortgage has entered into corresponding commitments with third party investors to sell loans of approximately $76.4 million. Under the contractual relationship with these investors, C&F Mortgage is obligated to sell the loans, and the investor is obligated to purchase 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 loss due to borrower misrepresentation, fraud or early default. 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 $554,000 in 2009, $600,000 in 2008 and $84,000 in 2007. 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 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 $67.7 million at December 31, 2009. The Corporation s funding sources consist of (1) federal funds lines with correspondent banks totaling $36.0 million that had no outstanding balance as of December 31, 2009, (2) a $93.5 million line with the FHLB that had $52.5 million outstanding as of December 31, 2009, (3) a $120.0 million revolving line of credit with a third-party bank that had $81.6 million outstanding as of December 31, 2009 and (4) a $65.2 million line with the Federal Reserve Bank that had $5.0 million outstanding as of December 31, 2009. 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 $90.1 million at December 31, 2009; certificates of deposit of $100,000 or more, maturing in more than one year, totaled $52.9 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, 2009:

CONTRACTUAL OBLIGATIONS

		Payments Due by Period			
(Dollars in thousands)	**Total**	**Less than 1 Year**	**1-3 Years**	**3-5 Years**	**More than 5 Years**
Bank lines of credit	$ 81,630	$	$ 81,630	$	$
FHLB advances[1]	52,500		17,500	12,500	22,500
Federal Reserve Bank borrowings	5,000	5,000			
Trust preferred capital notes	20,620				20,620
Securities sold under agreements to repurchase	11,082	6,082			5,000
Operating leases	2,432	1,091	1,210	131	
Total	$ 173,264	$ 12,173	$ 100,340	$ 12,631	$ 48,120

[1] FHLB advances include convertible advances of $17.5 million maturing in 2012, $12.5 million maturing in 2014, $17.5 million maturing in 2017 and $5.0 million maturing in 2018. These advances have fixed rates of interest unless the FHLB exercises its option to convert the interest on these advances from fixed-rate to variable-rate (i.e., the conversion date). We can elect to repay the advances in whole or in part on their respective conversion dates and on any interest payment dates thereafter without the payment of a fee if the FHLB elects to convert the advances. However, we would incur a fee if we repay the advances prior to their respective conversion dates, if the FHLB does not convert the advance on the conversion date, or, after notification of conversion, on any date other than the conversion date or any interest payment date thereafter. For further information concerning the Corporation s FHLB borrowings, refer to Item 8, Financial Statements and Supplementary Data, under the heading Note 8: Borrowings.

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.

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. However, in connection with the Corporation s participation in the Capital Purchase Program, as previously described, certain limitations on the Corporation s ability to repurchase its common stock have been imposed. For more information on these restrictions, see Item 8, Financial Statements and Supplementary Data, under the heading Note 9: Shareholders Equity, Other Comprehensive Income and Earnings Per Common Share.

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 1 capital, total risk-based capital, and leverage ratios, as previously described in the Regulation and Supervision section of Item 1. The Corporation s Tier 1 capital to risk-weighted assets ratio was 14.6 percent at December 31, 2009, compared with 10.8 percent at December 31, 2008. The total capital to risk-weighted assets ratio was 15.9 percent at December 31, 2009, compared with 12.3 percent at December 31, 2008. The Tier 1 leverage ratio was 11.5 percent at December 31, 2009, compared with 8.9 percent at December 31, 2008. These ratios are in excess of the mandated minimum requirements. These ratios include the trust preferred securities issued in December 2007 and July 2005, as well as the $20.0 million of Series A Preferred Stock sold to the Treasury under its Capital Purchase Program in January 2009, in Tier 1 capital for regulatory capital adequacy determination purposes.

Shareholders equity was $88.9 million at year-end 2009 compared with $64.9 million at year-end 2008. During 2009, the Corporation declared common stock dividends of $1.06 per share, compared to $1.24 per share declared in 2008 and in 2007. The dividend payout ratio, based on net income available to common shareholders, was 73.5 percent in 2009, 89.8 percent in 2008 and 44.5 percent in 2007.

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 Significant 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, 2008 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 from net income of significant impairment charges, net of tax benefit, recognized in 2008 permits a comparison of results for ongoing business operations, and it is on this basis that we internally assess the Corporation s performance 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 an alternative to 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, 2008
Net Income and Earnings Per Share			
Net income available to common shareholders (GAAP)	A	$	4,181
Other-than-temporary impairment on Fannie Mae and Freddie Mac preferred stock, net of income tax benefit (GAAP)			976
Net income, excluding other-than-temporary impairment on Fannie Mae and Freddie Mac preferred stock	B	$	5,157
Weighted average shares assuming dilution (GAAP)	C		3,058
Weighted average shares basic (GAAP)	D		3,028
Earnings per share assuming dilution			
GAAP	A/C	$	1.37
Excluding other-than-temporary impairment on Fannie Mae and Freddie Mac preferred stock	B/C	$	1.69
Earnings per share basic			
GAAP	A/D	$	1.38
Excluding other-than-temporary impairment on Fannie Mae and Freddie Mac preferred stock	B/D	$	1.70
Return on Average Assets			
Average assets (GAAP)	E	$	819,999
Return on average assets			
GAAP	A/E		0.51%
Excluding other-than-temporary impairment on Fannie Mae and Freddie Mac preferred stock	B/E		0.63%
Return on Average Common Equity			
Average common equity (GAAP)	F	$	65,402
Return on average common equity			
GAAP	A/F		6.39%
Excluding other-than-temporary impairment on Fannie Mae and Freddie Mac preferred stock	B/F		7.89%
Other and Eliminations Segment			
Net income (loss) (GAAP)		$	(1,694)
Other-than-temporary impairment on Fannie Mae and Freddie Mac preferred stock, net of income tax benefit (GAAP)			976
Net income (loss), excluding other-than-temporary impairment on Fannie Mae and Freddie Mac preferred stock		$	(718)

* 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.

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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 a significant portion 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, 2009.

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 most 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 and repricing dates of assets and liabilities to the extent believed necessary to balance minimizing interest rate risk and increasing net interest income in current market conditions. However, borrowers with fixed rate obligations are less likely to prepay in a rising rate environment and more likely to prepay in a falling rate environment. Conversely, depositors who are receiving fixed rates are more likely to withdraw funds before maturity in a rising rate environment and less likely to do so in a falling rate environment. Management monitors rates, maturities and repricing dates of assets and liabilities and attempts to manage interest rate risk by adjusting terms of new loans, deposits and borrowings and by investing in securities with terms that manage the Corporation s overall interest rate risk.

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.

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The simulation analysis results are presented in the table below. These results, based on a measurement date balance sheet as of December 31, 2009, indicate that the Corporation would expect net interest income to decrease over the next twelve months 2.59 percent assuming an immediate downward shift in market interest rates of 200 basis points (BP) and to increase 0.50 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, 2010	
Assumed Market Interest Rate Shift	**Dollars**	**Percentage**
-200 BP shock	$ (1,364)	(2.59)%
+200 BP shock	$ 262	0.50%

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.

The EVE analysis results are presented in the table below. These results as of December 31, 2009 indicate that the EVE would increase 5.81 percent assuming an immediate downward shift in market interest rates of 200 BP and would decrease 13.14 percent if rates shifted upward in the same manner.

Static EVE Change (dollars in thousands)

	Hypothetical Change in EVE	
Assumed Market Interest Rate Shift	**Dollars**	**Percentage**
-200 BP shock	$ 5,965	5.81%
+200 BP shock	$ (13,499)	(13.14)%

In the net interest income simulation above, net interest increases over the next twelve months in the event of an immediate upward shift in interest rates, but declines in the event of an immediate downward shift in interest rates. In a rising rate environment, the Corporation s assets would reprice quicker than what the Corporation pays on its borrowings and deposits primarily due to the shorter maturity or repricing dates of its cash equivalents and loan portfolios. However, in a falling rate environment the simulation assumes that adjustable-rate assets will continue to reprice downward, subject to floors on certain loans, and fixed-rate assets with prepayment or callable options will reprice at lower rates while certain deposits cannot reprice any lower.

The EVE analysis above indicates a decline in the EVE in an immediate upward shift in interest rates, but an increase in the EVE in an immediate downward shift in interest rates. Given the longer time horizon of the analysis, the Corporation s assets would take longer to reprice than what the Corporation pays on its borrowings and due to the longer maturity or repricing dates of its investment and loan portfolios as compared to time deposits and borrowings.

At C&F Mortgage, 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

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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, and the investor is obligated to purchase the loan, 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, 2009**	**2008**
Assets		
Cash and due from banks	**$ 8,434**	$ 9,727
Interest-bearing deposits in other banks	**29,627**	161
Total cash and cash equivalents	**38,061**	9,888
Securities available for sale at fair value, amortized cost of $116,774 and $100,778, respectively	**118,570**	100,603
Loans held for sale, net	**28,756**	37,042
Loans, net of allowance for loan losses of $24,027 and $19,806, respectively	**613,004**	633,017
Federal Home Loan Bank stock, at cost	**3,887**	5,284
Corporate premises and equipment, net	**29,490**	31,131
Other real estate owned, net of valuation allowance of $2,402 and $73, respectively	**12,800**	1,967
Accrued interest receivable	**5,408**	5,096
Goodwill	**10,724**	10,724
Other assets	**27,730**	20,905
Total assets	**$ 888,430**	$ 855,657
Liabilities		
Deposits		
Noninterest-bearing demand deposits	**$ 83,708**	$ 77,634
Savings and interest-bearing demand deposits	**208,388**	204,193
Time deposits	**314,534**	268,898
Total deposits	**606,630**	550,725
Short-term borrowings	**11,082**	56,024
Long-term borrowings	**139,130**	142,816
Trust preferred capital notes	**20,620**	20,620
Accrued interest payable	**1,569**	1,921
Other liabilities	**20,523**	18,694
Total liabilities	**799,554**	790,800
Commitments and contingent liabilities		
Shareholders Equity		
Preferred stock ($1.00 par value, 3,000,000 shares authorized, 20,000 and 0 shares issued and outstanding, respectively)	**20**	
Common stock ($1.00 par value, 8,000,000 shares authorized, 3,067,666 and 3,037,441 shares issued and outstanding, respectively)	**3,009**	2,992
Additional paid-in capital	**21,210**	551
Retained earnings	**63,669**	62,361
Accumulated other comprehensive income (loss), net	**968**	(1,047)
Total shareholders equity	**88,876**	64,857
Total liabilities and shareholders equity	**$ 888,430**	$ 855,657

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, 2009	2008	2007
Interest income			
Interest and fees on loans	**$ 60,116**	$ 59,853	$ 60,938
Interest on money market investments	**6**	28	443
Interest and dividends on securities			
U.S. government agencies and corporations	**418**	542	296
Tax-exempt obligations of states and political subdivisions	**4,208**	3,192	2,608
Corporate bonds and other	**223**	515	540
Total interest income	**64,971**	64,130	64,825
Interest expense			
Savings and interest-bearing deposits	**1,711**	2,638	2,747
Certificates of deposit, $100 thousand or more	**3,433**	4,088	4,714
Other time deposits	**5,174**	6,614	7,469
Borrowings	**4,071**	6,749	7,724
Trust preferred capital notes	**1,070**	1,306	724
Total interest expense	**15,459**	21,395	23,378
Net interest income	**49,512**	42,735	41,447
Provision for loan losses	**18,563**	13,766	7,130
Net interest income after provision for loan losses	**30,949**	28,969	34,317
Noninterest income			
Gains on sales of loans	**24,976**	16,693	15,833
Service charges on deposit accounts	**3,303**	3,907	3,684
Other service charges and fees	**5,018**	3,721	4,020
Net gains on calls and sales of available for sale securities	**22**	234	21
Other-than-temporary impairment of available for sale securities		(1,575)	
Other income	**3,370**	2,169	2,320
Total noninterest income	**36,689**	25,149	25,878
Noninterest expenses			
Salaries and employee benefits	**35,118**	27,724	30,787
Occupancy expenses	**5,714**	6,031	6,058
Other expenses	**19,335**	15,565	11,526
Total noninterest expenses	**60,167**	49,320	48,371
Income before income taxes	**7,471**	4,798	11,824
Income tax expense	**1,945**	617	3,344
Net income	**5,526**	4,181	8,480
Effective dividends on preferred stock	**1,130**		
Net income available to common shareholders	**$ 4,396**	$ 4,181	$ 8,480

Earnings per common share basic	**$**	**1.44**	$	1.38	$	2.77
Earnings per common share assuming dilution	**$**	**1.44**	$	1.37	$	2.67

See notes to consolidated financial statements.

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CONSOLIDATED STATEMENTS OF SHAREHOLDERS EQUITY

(Dollars in thousands, except per share amounts)	Preferred Stock	Common Stock	Additional Paid-In Capital	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total Shareholders Equity
Balance December 31, 2006	$	$ 3,159	$ 324	$ 64,402	$ 121	$ 68,006
Comprehensive income:						
Net income				8,480		8,480
Other comprehensive income (loss), net						
Changes in defined benefit plan assets and benefit obligations, net					301	
Unrealized holding losses on securities, net of reclassification adjustment					(225)	
Other comprehensive income, net					76	76
Comprehensive income						8,556
Purchase of common stock		(204)	(1,166)	(7,065)		(8,435)
Stock options exercised		24	543			567
Share-based compensation			299			299
Cash dividends paid ($1.24 per share)				(3,769)		(3,769)
Balance December 31, 2007		2,979		62,048	197	65,224
Comprehensive income:						
Net income				4,181		4,181
Other comprehensive loss, net						
Changes in defined benefit plan assets and benefit obligations, net					(591)	
Unrealized holding losses on securities, net of reclassification adjustment					(653)	
Other comprehensive loss, net					(1,244)	(1,244)
Comprehensive income						2,937
Purchase of common stock		(1)	(39)			(40)
Stock options exercised		14	298			312
Share-based compensation			292			292
Reduction due to change in pension measurement date				(114)		(114)
Cash dividends paid ($1.24 per share)				(3,754)		(3,754)
Balance December 31, 2008		**2,992**	**551**	**62,361**	**(1,047)**	**64,857**
Comprehensive income:						
Net income				**5,526**		**5,526**
Other comprehensive income, net						
Changes in defined benefit plan assets and benefit obligations, net					**734**	
Unrealized holding gains on securities, net of reclassification adjustment					**1,281**	
Other comprehensive income, net					**2,015**	**2,015**
Comprehensive income						**7,541**
Stock options exercised		**17**	**309**			**326**

Share-based compensation			318			318
Issuance of preferred stock and warrant	20		19,894			19,914
Accretion of preferred stock discount			138	(138)		
Cash dividends paid common stock ($1.06 per share)				(3,230)		(3,230)
Cash dividends paid preferred stock (5% per annum)				(850)		(850)
Balance December 31, 2009	$ 20	$ 3,009	$ 21,210	$ 63,669	$ 968	$ 88,876

See notes to consolidated financial statements.

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CONSOLIDATED STATEMENTS OF CASH FLOWS

(Dollars in thousands)	Year Ended December 31, 2009	2008	2007
Operating activities:			
Net income	**$ 5,526**	$ 4,181	$ 8,480
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation	**2,067**	2,381	2,563
Deferred income taxes	**(3,477)**	(2,672)	(1,112)
Provision for loan losses	**18,563**	13,766	7,130
Provision for other real estate owned losses	**2,614**	296	
Share-based compensation	**318**	292	299
Accretion of discounts and amortization of premiums on securities, net	**172**	55	50
Net realized gain on securities	**(22)**	(234)	(21)
Net realized loss on sale of other real estate owned	**93**	8	
Other-than-temporary impairment of securities		1,575	
Origination of loans held for sale	**(1,063,108)**	(749,177)	(828,379)
Sale of loans	**1,071,394**	746,218	847,800
Change in other assets and liabilities:			
Accrued interest receivable	**(312)**	(27)	(637)
Other assets	**(4,579)**	1,637	(1,106)
Accrued interest payable	**(352)**	(194)	200
Other liabilities	**2,944**	2,912	(1,554)
Net cash provided by operating activities	**31,841**	21,017	33,713
Investing activities:			
Proceeds from maturities, calls and sales of securities available for sale	**23,139**	18,516	6,189
Purchase of securities available for sale	**(39,286)**	(40,265)	(20,235)
Net redemptions (purchases) of FHLB stock	**1,397**	(897)	(2,294)
Investment in statutory trust			(310)
Net increase in customer loans	**(15,424)**	(64,163)	(75,168)
Proceeds from sales of other real estate owned	**3,495**	990	
Purchases of corporate premises and equipment, net	**(426)**	(658)	(2,228)
Net cash used in investing activities	**(27,105)**	(86,477)	(94,046)
Financing activities:			
Net increase (decrease) in demand, interest-bearing demand and savings deposits	**10,269**	17,205	(14,088)
Net increase in time deposits	**45,636**	5,949	8,824
Net (decrease) increase in borrowings	**(48,628)**	43,413	50,681
Issuance of trust preferred capital notes			10,310
Issuance of preferred stock	**19,914**		
Purchases of common stock		(40)	(8,435)
Proceeds from exercise of stock options	**326**	312	567
Cash dividends	**(4,080)**	(3,754)	(3,769)
Net cash provided by financing activities	**23,437**	63,085	44,090
Net increase (decrease) in cash and cash equivalents	**28,173**	(2,375)	(16,243)
Cash and cash equivalents at beginning of year	**9,888**	12,263	28,506
Cash and cash equivalents at end of year	**$ 38,061**	$ 9,888	$ 12,263

Supplemental disclosure			
Interest paid	**$ 15,811**	$ 21,589	$ 23,178
Income taxes paid	**4,231**	3,116	4,087
Supplemental disclosure of noncash investing and financing activities			
Unrealized gains (losses) on securities available for sale	**$ 1,970**	$ (1,005)	$ (347)
Loans transferred to other real estate owned	**(16,874)**	(3,261)	
Pension adjustment	**1,129**	(909)	463

See notes to consolidated financial statements.

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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 and C&F Financial Statutory Trust II, which are unconsolidated subsidiaries. The subordinated debt owed to these trusts is reported as a liability of the Corporation. 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 (U.S. GAAP) 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 and Certified Appraisals LLC, provides ancillary mortgage loan production services, such as loan settlements, title searches and residential appraisals. C&F Finance, acquired on September 1, 2002, is a regional finance company providing automobile loans. C&F Title Agency, Inc., organized in October 1992, primarily sells title insurance to the mortgage loan customers of the Bank and C&F Mortgage. C&F Investment Services, Inc., organized in April 1995, is a full-service brokerage firm offering a comprehensive range of investment services. C&F Insurance Services, Inc., organized in July 1999, owns an equity interest in an insurance agency that sells insurance products to customers of the Bank, C&F Mortgage and other financial institutions that have an equity interest in the agency. Business segment data is presented in Note 17.

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

Significant Group Concentrations of Credit Risk: Substantially all of the Corporation s lending activities are with customers located in Virginia, Maryland, Tennessee and North Carolina. At December 31, 2009, 38.6 percent of the Corporation s loan portfolio consisted of commercial, financial and agricultural loans, which include loans secured by real estate for builder lines, acquisition and development and commercial development, as well as commercial loans secured by personal property. In addition, 30% of the Corporation s loan portfolio consisted of non-prime consumer finance loans to individuals, secured by automobiles. The Corporation does not have any significant loan concentrations to any one customer. 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. The Corporation does not have any significant securities concentrations in any one industry or to any one issuer. Note 2 discusses the Corporation s investment activities.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

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. The Bank is required to maintain average balances on hand or with the Federal Reserve Bank. At December 31, 2009 and 2008, these reserve balances amounted to $147,000 and $315,000, respectively.

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. Purchase premiums and discounts are recognized in interest income using the interest method over the terms of the securities.

Impairment of securities occurs when the fair value of a security is less than its amortized cost. For debt securities, impairment is considered other-than-temporary and recognized in its entirety in net income if either (i) we intend to sell the security or (ii) it is more-likely-than-not that we will be required to sell the security before recovery of its amortized cost basis. If, however, we do not intend to sell the security and it is not more-likely-than-not that we will be required to sell the security before recovery, we must determine what portion of the impairment is attributable to a credit loss, which occurs when the amortized cost basis of the security exceeds the present value of the cash flows expected to be collected from the security. If there is no credit loss, there is no other-than-temporary impairment. If there is a credit loss, other-than-temporary impairment exists, and the credit loss must be recognized in net income and the remaining portion of impairment must be recognized in other comprehensive income. For equity securities, impairment is considered to be other-than-temporary based on our ability and intent to hold the investment until a recovery of fair value. Other-than-temporary impairment of an equity security results in a write-down that must be included in net income. We regularly review each investment security for other-than-temporary impairment based on criteria that 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, our best estimate of the present value of cash flows expected to be collected from debt securities, our intention with regard to holding the security to maturity and the likelihood that we would be required to sell the security before recovery.

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 discounts, 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. 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, construction and residential loans in excess of $500,000 by either the present value of expected future cash flows discounted at the loan s effective interest rate, the loan s obtainable market price, or the fair value of the collateral if the loan is collateral dependent. Large groups of smaller balance homogeneous loans are collectively evaluated for impairment. Accordingly, the Corporation does not separately identify individual consumer, residential and certain small commercial loans for impairment disclosures. Consistent with the Corporation s method for nonaccrual loans, payments on impaired loans are first applied to principal outstanding.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

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 level of the allowance is based on evaluations of the collectibility of loans while taking into consideration such factors as trends in delinquencies and charge-offs, changes in the nature and volume of the loan portfolio, current economic conditions which may affect a borrower s ability to repay and the value of collateral, overall portfolio quality and review of specific potential losses. This evaluation is inherently subjective, 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 impaired, and 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 those loans classified as doubtful, substandard or special mention, and is based on historical loss experience adjusted for qualitative factors, such as current economic conditions.

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, and the purchaser is obligated to buy the loan, 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.

Allowance for Indemnifications: The allowance for indemnifications is established through charges to earnings in the form of a provision for indemnifications, which is included in other noninterest expenses. A loss is charged against the allowance for indemnifications when a purchaser of a loan (investor) sold by C&F Mortgage incurs a loss due to demonstrated borrower misrepresentation, fraud or early default.

The allowance represents an amount that, in management s judgment, will be adequate to absorb any losses arising from indemnification requests. Management s judgment in determining the level of the allowance is based on the volume of loans sold, current economic conditions and information provided by investors. This evaluation is inherently subjective, as it requires estimates that are susceptible to significant revision as more information becomes available.

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 Financial Accounting Standards Board (FASB) Topic 320-10: *Investments Debt and Equity Securities*.

Other Real Estate Owned (OREO): Assets acquired through, or in lieu of, loan foreclosure are held for sale and are initially recorded at the lower of the loan balance or the fair value less costs to sell at the date of foreclosure. Subsequent to foreclosure, management periodically performs valuations of the foreclosed assets based on updated appraisals, general market conditions, recent sales of like properties, length of time the properties have been held,

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

and our ability and intention with regard to continued ownership of the properties. The Corporation may incur additional write-downs of foreclosed assets to fair value less costs to sell if valuations indicate a further other-than-temporary deterioration in market conditions. Revenue and expenses from operations and changes in the property valuations 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 included in income.

Goodwill: Goodwill is subject to at least an annual assessment for impairment by applying a fair value based test. Additionally, 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. The Corporation s goodwill was recognized in connection with the Bank s acquisition of C&F Finance in September 2002. The annual test for impairment was completed during the fourth quarter of 2009 and it was determined there was no impairment to be recognized in 2009.

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.

When tax returns are filed, it is highly certain that some positions taken would be sustained upon examination by the taxing authorities, while others are subject to uncertainty about the merits of the position taken or the amount of the position that would be ultimately sustained. The benefit of a tax position is recognized in the financial statements in the period during which, based on all available evidence, management believes it is more likely than not that the position will be sustained upon examination, including the resolution of appeals or litigation processes, if any. Tax positions taken are not offset or aggregated with other positions. Tax positions that meet the more-likely-than-not recognition threshold are measured as the largest amount of tax benefit that is more than 50 percent likely of being realized upon settlement with the applicable taxing authority. The portion of the benefits associated with tax positions taken that exceeds the amount measured as described above is reflected as a liability for unrecognized tax benefits in the accompanying balance sheet along with any associated interest and penalties that would be payable to the taxing authorities upon examination. Interest and penalties associated with unrecognized tax benefits are classified as additional income taxes in the statement of income.

Retirement Plan: The Corporation recognizes the overfunded or underfunded status of its defined benefit postretirement plan as an asset or liability in the balance sheet and recognizes changes in the plan s funded status in the year in which the changes occur through comprehensive income. The funded status of a benefit plan is measured as the difference between plan assets at fair value and the benefit obligation. For the Corporation s pension plan, the benefit obligation is the projected benefit obligation as of December 31. In addition, enhanced disclosures 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 are presented in the notes to financial statements. Valuations in 2009 and 2008 determined that the Corporation s pension plan was underfunded. As a result, the Corporation recognized pension liabilities of $431,000 at December 31, 2009 and $2.05 million at December 31, 2008, and recognized a net gain of $734,000 in 2009, a net loss of $591,000 in 2008 and a net gain of $301,000 in 2007 as components of other comprehensive income. In addition, the Corporation recognized a net adjustment to retained earnings of $114,000 in 2008 due to the change in the measurement date of the funded status of the plan. The Corporation s pension plan is described more fully in Note 11.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Share-Based Compensation: 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 years ended December 31, 2009, 2008 and 2007 included $318,000 ($197,000 after tax), $292,000 ($181,000 after tax) and $299,000 ($186,000 after tax), respectively, for options and restricted stock granted during 2006 through 2009. As of December 31, 2009, there was $931,000 of unrecognized compensation expense related to unvested restricted stock that will be recognized over the remaining vesting periods. The Corporation estimates forfeitures when recognizing compensation expense and this estimate of forfeitures is 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. The Corporation s share-based compensation plans are described more fully in Note 13.

Earnings Per Common Share: In June 2008, the FASB concluded that all outstanding unvested share-based payment awards that contain rights to nonforfeitable dividends participate in undistributed earnings with common shareholders. This conclusion affects entities that accrue cash dividends on share-based payment awards during the awards service period when the dividends do not need to be returned if the employees forfeit the awards. Because the awards are considered participating securities, the issuing entity is required to apply the two-class method of computing basic and diluted earnings per share (EPS). The transition guidance requires an entity to retroactively adjust all prior-period EPS computations. The Corporation adopted the two-class method of computing basic and diluted EPS effective January 1, 2009, and has applied it to its EPS calculations for the years ended December 31, 2009, 2008 and 2007 because the Corporation s unvested restricted shares outstanding contain rights to nonforfeitable dividends. Accordingly, the weighted average number of common shares used in the calculation of basic and diluted EPS includes both vested and unvested common shares outstanding. The retroactive adjustments made to the EPS computations resulted in a reduction of $0.02 in basic EPS and a reduction of $0.01 in diluted EPS for both 2008 and 2007. EPS calculations are presented in Note 9.

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 and changes in defined benefit plan assets and liabilities, 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. See also Note 9 for further information.

Recent Significant Accounting Pronouncements:

Adoption of New Accounting Standards:

In June 2009, the FASB issued new accounting guidance related to U.S. GAAP (FASB Accounting Standards Codification (FASB ASC) 105, *Generally Accepted Accounting Principles*). This guidance establishes FASB ASC as the source of authoritative U.S. GAAP recognized by FASB to be applied by nongovernmental entities. Rules and interpretive releases of the Securities and Exchange Commission (SEC) under authority of federal securities laws are also sources of authoritative U.S. GAAP for SEC registrants. FASB ASC supersedes all existing non-SEC accounting and reporting standards. All other nongrandfathered, non-SEC accounting literature not included in FASB ASC has become nonauthoritative. FASB will no longer issue new standards in the form of Statements, FASB Staff Positions or Emerging Issues Task Force Abstracts. Instead, it will issue Accounting Standards Updates (ASUs), which will serve to update FASB ASC, provide background information about the guidance and provide the basis for conclusions on the changes to FASB ASC. FASB ASC is not intended to change U.S. GAAP or any requirements of the SEC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The Corporation adopted new guidance impacting ASC Topic 805: *Business Combinations* (Topic 805) on January 1, 2009. This guidance requires the acquiring entity in a business combination to recognize the full fair value of assets acquired and liabilities assumed in the transaction (whether a full or partial acquisition); establishes the acquisition-date fair value as the measurement objective for all assets acquired and liabilities assumed; requires expensing of most transaction and restructuring costs; and requires the acquirer to disclose to investors and other users all of the information needed to evaluate and understand the nature and financial effect of the business combination. The adoption of the new guidance did not have a material effect on the Corporation s consolidated financial statements.

In April 2009, the FASB issued new guidance affecting Topic 805. This guidance addresses application issues raised by preparers, auditors and members of the legal profession on initial recognition and measurement, subsequent measurement and accounting, and disclosure of assets and liabilities arising from contingencies in a business combination. This guidance was effective for business combinations entered into on or after January 1, 2009. This guidance did not have a material effect on the Corporation s consolidated financial statements.

In December 2008, the FASB issued new guidance affecting ASC Topic 715-20: *Compensation Retirement Benefits Defined Benefit Plans General*. The objectives of this guidance are to provide users of the financial statements with more detailed information related to the major categories of plan assets, the inputs and valuation techniques used to measure the fair value of plan assets and the effect of fair value measurements using significant unobservable inputs (Level 3) on changes in plan assets for the period, as well as how investment allocation decisions are made, including the factors that are pertinent to an understanding of investment policies and strategies. The disclosures about plan assets required by this guidance are included in Note 11.

In April 2009, the FASB issued new guidance impacting ASC Topic 820: *Fair Value Measurements and Disclosures* (Topic 820). This interpretation provides additional guidance for estimating fair value when the volume and level of activity for the asset or liability have significantly decreased. This also includes guidance on identifying circumstances that indicate a transaction is not orderly and requires additional disclosures of valuation inputs and techniques in interim periods and defines the major security types that are required to be disclosed. This guidance was effective for interim and annual periods ending after June 15, 2009, and should be applied prospectively. The adoption of the standard did not have a material effect on the Corporation s consolidated financial statements.

In April 2009, the FASB issued new guidance impacting ASC Topic 320-10: *Investments Debt and Equity Securities*. This guidance amends U.S. GAAP for debt securities to make the guidance more operational and to improve the presentation and disclosure of other-than-temporary impairments on debt and equity securities in the financial statements. This guidance was effective for interim and annual periods ending after June 15, 2009, with earlier adoption permitted for periods ending after March 15, 2009. The Corporation did not have any cumulative effect adjustment related to the adoption of this guidance.

In May 2009, the FASB issued new guidance impacting ASC Topic 855: *Subsequent Events*. This update provides guidance on management s assessment of subsequent events that occur after the balance sheet date through the date that the financial statements are issued. This guidance is generally consistent with current accounting practice. This guidance was effective for periods ending after June 15, 2009 and had no effect on the Corporation s consolidated financial statements.

In August 2009, the FASB issued new guidance impacting Topic 820. This guidance is intended to reduce ambiguity in financial reporting when measuring the fair value of liabilities. This guidance was effective for the first reporting period (including interim periods) after issuance and had no effect on the Corporation s consolidated financial statements.

In September 2009, the FASB issued new guidance impacting Topic 820. This creates a practical expedient to measure the fair value of an alternative investment that does not have a readily determinable fair value. This guidance also requires certain additional disclosures. This guidance is effective for interim and annual periods ending after December 15, 2009. The adoption of this guidance did not have a material effect on its consolidated financial statements.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Accounting Standards Not Yet Effective:

In June 2009, the FASB issued new guidance relating to the accounting for transfers of financial assets. The new guidance, which was issued as Statement of Financial Accounting Standard (SFAS) No. 166, *Accounting for Transfers of Financial Assets, an amendment to SFAS No. 140,* was adopted into Codification in December 2009 through the issuance of ASU 2009-16. The new standard provides guidance to improve the relevance, representational faithfulness, and comparability of the information that an entity provides in its financial statements about a transfer of financial assets; the effects of a transfer on its financial position, financial performance, and cash flows; and a transferor s continuing involvement, if any, in transferred financial assets. The Corporation will adopt the new guidance in 2010 and is evaluating the effect it will have, if any, on its consolidated financial statements.

In June 2009, the FASB issued new guidance relating to the variable interest entities. The new guidance, which was issued as SFAS No. 167, *Amendments to FASB Interpretation No. 46(R),* was adopted into Codification in December 2009 through the issuance of ASU 2009-17 and updates ASC Topic 810: *Consolidation* (ASC Topic 810). The objective of the guidance is to improve financial reporting by enterprises involved with variable interest entities and to provide more relevant and reliable information to users of financial statements. ASC Topic 810 is effective as of January 1, 2010. The Corporation does not expect the adoption of the new guidance to have a material effect on its consolidated financial statements.

In January 2010, the FASB issued ASU No. 2010-06, *Fair Value Measurements and Disclosures (Topic 820): Improving Disclosures about Fair Value Measurements* (ASU 2010-06). ASU 2010-06 amends Subtopic 820-10 to clarify existing disclosures, require new disclosures, and includes conforming amendments to guidance on employers disclosures about postretirement benefit plan assets. ASU 2010-06 is effective for interim and annual periods beginning after December 15, 2009, except for disclosures about purchases, sales, issuances, and settlements in the roll forward of activity in Level 3 fair value measurements. Those disclosures are effective for fiscal years beginning after December 15, 2010 and for interim periods within those fiscal years. The Corporation does not expect the adoption of ASU 2010-06 to have a material effect on its consolidated financial statements.

NOTE 2: Securities

Debt and equity securities are summarized as follows:

	December 31, 2009			
(Dollars in thousands)	**Amortized Cost**	**Gross Unrealized Gains**	**Gross Unrealized Losses**	**Estimated Fair Value**
Available for Sale				
U.S. government agencies and corporations	**$ 9,772**	**$ 33**	**$ (62)**	**$ 9,743**
Mortgage-backed securities	**2,628**	**81**		**2,709**
Obligations of states and political subdivisions	**103,097**	**2,144**	**(374)**	**104,867**
Preferred stock	**1,277**	**59**	**(85)**	**1,251**
	$ 116,774	**$ 2,317**	**$ (521)**	**$ 118,570**

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

	December 31, 2008			
(Dollars in thousands)	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Available for Sale				
U.S. government agencies and corporations	$ 11,108	$ 59	$ (5)	$ 11,162
Mortgage-backed securities	2,264	54		2,318
Obligations of states and political subdivisions	85,842	858	(1,189)	85,511
Preferred stock	1,564	146	(98)	1,612
	$ 100,778	$ 1,117	$ (1,292)	$ 100,603

The amortized cost and estimated fair value of securities at December 31, 2009 and 2008, by the earlier of contractual maturity or expected maturity, are shown below. Expected maturities will differ from contractual maturities because borrowers may have the right to prepay obligations with or without call or prepayment penalties.

	December 31, 2009		December 31, 2008	
(Dollars in thousands)	Amortized Cost	Estimated Fair Value	Amortized Cost	Estimated Fair Value
Available for Sale				
Due in one year or less	**$ 12,683**	**$ 12,762**	$ 13,268	$ 13,281
Due after one year through five years	**27,091**	**27,356**	22,723	22,803
Due after five years through ten years	**47,411**	**48,236**	37,472	37,227
Due after ten years	**28,312**	**28,965**	25,751	25,680
Preferred stock	**1,277**	**1,251**	1,564	1,612
	$ 116,774	**$ 118,570**	$ 100,778	$ 100,603

Proceeds from the maturities, calls and sales of securities available for sale in 2009 were $23.14 million, resulting in gross realized gains of $48,000 and gross realized losses of $26,000, in 2008 were $18.52 million, resulting in gross realized gains of $253,000 and gross realized losses of $19,000, and in 2007 were $6.19 million, resulting in gross realized gains of $21,000.

The Corporation pledges securities to secure public deposits, Federal Reserve Bank treasury, tax and loan deposits and repurchase agreements. Securities with an aggregate amortized cost of $87.44 million and an aggregate fair value of $88.90 million were pledged at December 31, 2009. Securities with an aggregate amortized cost of $40.57 million and an aggregate fair value of $40.84 million were pledged at December 31, 2008.

Securities in an unrealized loss position at December 31, 2009, by duration of the period of the unrealized loss, are shown below.

	Less Than 12 Months		12 Months or More		Total	
(Dollars in thousands)	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss
U.S. government agencies and corporations	**$ 3,298**	**$ 62**	**$**	**$**	**$ 3,298**	**$ 62**
Obligations of states and political subdivisions	**18,872**	**255**	**2,853**	**119**	**21,725**	**374**
Subtotal-debt securities	**22,170**	**317**	**2,853**	**119**	**25,023**	**436**

Preferred stock	**401**	**13**	**408**	**72**	**809**	**85**
Total temporarily impaired securities	**$ 22,571**	**$ 330**	**$ 3,261**	**$ 191**	**$ 25,832**	**$ 521**

There are 80 debt securities totaling $25.02 million considered temporarily impaired at December 31, 2009. The primary cause of the temporary impairments in the Corporation s investments in debt securities was fluctuations in interest rates. Because the Corporation intends to hold these investments in debt securities to maturity and it is more likely than not that the Corporation will not be required to sell these investments before a recovery of

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

unrealized losses, the Corporation does not consider these investments to be other-than-temporarily impaired at December 31, 2009 and no impairment has been recognized. There are four equity securities totaling $809,000 considered temporarily impaired at December 31, 2009. The Corporation has the intent and ability to hold these equity securities until a recovery of unrealized losses and therefore does not consider these investments to be other-than-temporarily impaired at December 31, 2009.

The Corporation s investment in Federal Home Loan Bank (FHLB) stock totaled $3.9 million at December 31, 2009. FHLB stock is generally viewed as a long-term investment and as a restricted investment security, which is carried at cost, because there is no market for the stock, other than the FHLBs or member institutions. Therefore, when evaluating FHLB stock for impairment, its value is based on the ultimate recoverability of the par value rather than by recognizing temporary declines in value. Despite the FHLB s temporary suspension of repurchases of excess capital stock in 2009, the Corporation does not consider this investment to be other-than-temporarily impaired at December 31, 2009 and no impairment has been recognized. FHLB stock is shown as a separate line item on the balance sheet and is not a part of the available for sale securities portfolio.

Securities in an unrealized loss position at December 31, 2008, by duration of the period of the unrealized loss, are shown below.

	Less Than 12 Months		12 Months or More		Total	
(Dollars in thousands)	**Fair Value**	**Unrealized Loss**	**Fair Value**	**Unrealized Loss**	**Fair Value**	**Unrealized Loss**
U.S. government agencies and corporations	$ 495	$ 5	$	$	$ 495	$ 5
Obligations of states and political subdivisions	32,846	1,189			32,846	1,189
Subtotal-debt securities	33,341	1,194			33,341	1,194
Preferred stock	699	88	20	10	719	98
Total temporarily impaired securities	$ 34,040	$ 1,282	$ 20	$ 10	$ 34,060	$ 1,292

In 2008, the Corporation recognized a $1.58 million other-than-temporary impairment charge related to its investments in perpetual preferred stock of the Federal National Mortgage Association (Fannie Mae) and the Federal Home Loan Mortgage Corporation (Freddie Mac). The impairment in the holdings of these government-sponsored entities resulted from the decline in market value of these shares in connection with the federal government s takeover of Fannie Mae and Freddie Mac in September 2008, along with the elimination of dividends on these shares. At December 31, 2009, the fair value of the Corporation s investment in the preferred shares of Fannie Mae and Freddie Mac was $17,000 and $40,000, respectively.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

NOTE 3: Loans

Major classifications of loans are summarized as follows:

(Dollars in thousands)	December 31, 2009	2008
Real estate mortgage	**$ 147,850**	$ 141,271
Real estate construction	**14,053**	28,300
Commercial, financial and agricultural[1]	**245,759**	272,440
Equity lines	**32,220**	29,136
Consumer	**7,710**	9,515
Consumer finance	**189,439**	172,385
	637,031	653,047
Less unearned loan fees		(224)
	637,031	652,823
Less allowance for loan losses	**(24,027)**	(19,806)
	$ 613,004	$ 633,017

[1] Includes loans secured by real estate for builder lines, acquisition and development and commercial development, as well as commercial loans secured by personal property.

Consumer loans included $266,000 and $221,000 of demand deposit overdrafts at December 31, 2009 and 2008, respectively. Loans on nonaccrual status were $5.40 million and $19.48 million at December 31, 2009 and 2008, respectively. If interest income had been recognized on nonaccrual loans at their stated rates during years 2009, 2008 and 2007, interest income would have increased by approximately $668,000, $439,000 and $56,000, respectively. Accruing loans past due for 90 days or more were $451,000 and $3.52 million at December 31, 2009 and 2008, respectively. The balance of impaired loans was $5.01 million and $16.83 million at December 31, 2009 and 2008, respectively, for which there were specific valuation allowances of $1.12 million and $940,000 as of December 31, 2009 and 2008. The average balances of impaired loans for 2009, 2008 and 2007 were $12.43 million, $5.82 million and $557,000, respectively. The Corporation has no obligation to fund additional advances on its impaired loans.

NOTE 4: Allowance for Loan Losses

Changes in the allowance for loan losses were as follows:

(Dollars in thousands)	Year Ended December 31, 2009	2008	2007
Balance at the beginning of year	**$ 19,806**	$ 15,963	$ 14,216
Provision charged to operations	**18,563**	13,766	7,130
Loans charged off	**(16,177)**	(11,559)	(7,300)
Recoveries of loans previously charged off	**1,835**	1,636	1,917
Balance at the end of year	**$ 24,027**	$ 19,806	$ 15,963

NOTE 5: Other Real Estate Owned

At December 31, 2009 and 2008, OREO was $12.8 million and $2.0 million, respectively. During the years ended December 31, 2009 and 2008, the Corporation transferred $16.9 million and $3.3 million, respectively, from loans to OREO. OREO is primarily comprised of residential properties associated with commercial relationships and is located primarily in the state of Virginia. During 2009 and 2008, the Corporation had sales proceeds of $3.5 million and $990,000, respectively, and recognized a loss of $93,000 and $8,000, respectively.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

OREO is presented net of an allowance for losses. Changes in the allowance for OREO losses are as follows:

	Year Ended December 31,		
(Dollars in thousands)	**2009**	**2008**	**2007**
Balance at the beginning of year	**$ 73**	$	
Provision for losses	**2,614**	296	
Charge-offs	**(285)**	(223)	
Recoveries of OREO previously charged off			
Balance at the end of year	**$ 2,402**	$ 73	

Expenses applicable to OREO, other than the provision for losses, were $129,000, $82,000 and zero for the years ended December 31, 2009, 2008 and 2007, respectively.

NOTE 6: Corporate Premises and Equipment

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

	December 31,	
(Dollars in thousands)	**2009**	**2008**
Land	**$ 6,734**	$ 6,734
Buildings	**26,357**	26,347
Equipment, furniture and fixtures	**20,925**	20,726
	54,016	53,807
Less accumulated depreciation	**(24,526)**	(22,676)
	$ 29,490	$ 31,131

NOTE 7: Time Deposits

Time deposits are summarized as follows:

	December 31,	
(Dollars in thousands)	**2009**	**2008**
Certificates of deposit, $100 thousand or more	**$ 143,037**	$ 99,711
Other time deposits	**171,497**	169,187
	$ 314,534	$ 268,898

Remaining maturities on time deposits at December 31, 2009 are as follows:

(Dollars in thousands)

2010	**$ 196,344**
2011	**42,174**
2012	**62,203**
2013	**1,802**
2014	**11,593**
Thereafter	**418**
	$ 314,534

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

NOTE 8: **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 $6.08 million on December 31, 2009 and $7.22 million on December 31, 2008. Short-term borrowings also include borrowings from the Federal Reserve Bank under its discount window lending programs which are secured by a loan-specific lien on certain qualifying loans. There was $5.00 million outstanding under the Federal Reserve Bank discount window lending programs on December 31, 2009 and $15.00 million outstanding on December 31, 2008. Short-term borrowings also include advances from the FHLB, which are secured by a blanket floating lien on all qualifying closed-end and revolving, open-end loans secured by 1-4 family residential properties. There were no short-term FHLB advances outstanding on December 31, 2009, compared to $33.80 million outstanding on December 31, 2008. Short-term borrowings can also include advances against $36.00 million in federal funds lines with correspondent banks. There were no outstanding federal funds purchased on December 31, 2009 and 2008.

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

	December 31,	
(Dollars in thousands)	**2009**	**2008**
Balance outstanding at year end	**$ 11,082**	$ 56,024
Maximum balance at any month end during the year	**$ 61,655**	$ 59,382
Average balance for the year	**$ 31,328**	$ 35,071
Weighted average rate for the year	**0.60%**	2.12%
Weighted average rate on borrowings at year end	**0.84%**	0.67%
Estimated fair value at year end	**$ 11,082**	$ 56,024

Long-term borrowings at December 31, 2009 consist of a repurchase agreement with a third-party broker, which is secured by investment securities; advances under a non-recourse revolving bank line of credit secured by loans at C&F Finance; and advances from the FHLB, which are secured by a blanket floating lien on all qualifying closed-end and revolving, open-end loans secured by 1-4 family residential properties. The interest rate on the repurchase agreement, which matures in 2018, is 3.55% (7.00% minus three-month LIBOR with a maximum rate of 3.55%) and the outstanding balance as of December 31, 2009 was $5.00 million. The interest rate on the revolving bank line of credit, which matures in 2012, floats at the one-month LIBOR rate plus 175 basis points, and the outstanding balance as of December 31, 2009 was $81.63 million. 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 2009. Long-term advances from the FHLB at December 31, 2009 consist of $52.50 million of convertible advances. These advances have fixed rates of interest unless the FHLB exercises its option to convert the interest on these advances from fixed rate to variable rate.

The table below presents selected information on the FHLB advances:

(Dollars in thousands)

Balance Outstanding at December 31, 2009	Interest Rate	Maturity Date	Next Conversion Option Date
$5,000	**3.90%**	**08/30/12**	**02/26/10**
$5,000	**4.08**	**08/30/12**	**02/26/10**
$7,500	**4.15**	**10/19/12**	**10/19/10**
$5,000	**3.95**	**11/17/14**	**11/17/10**
$7,500	**3.69**	**11/28/14**	**11/29/10**
$7,500	**3.70**	**10/19/17**	**01/19/10**
$5,000	**4.06**	**10/25/17**	**10/25/11**
$5,000	**2.93**	**11/27/17**	**02/26/10**

$5,000	**3.59**	**06/06/18**	**06/06/12**

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The contractual maturities of long-term borrowings at December 31, 2009 are as follows:

(Dollars in thousands)	Fixed Rate	Floating Rate	Total
2012	$ 17,500	$ 81,630	$ 99,130
2013			
2014	12,500		12,500
Thereafter	22,500	5,000	27,500
	$ 52,500	$ 86,630	$ 139,130

The Corporation s unused lines of credit for future borrowings total approximately $175.56 million at December 31, 2009, which consists of $40.99 million available from the FHLB, $38.37 million on C&F Finance s revolving bank line of credit, $60.20 million available from the Federal Reserve Bank and $36.00 million under federal funds agreements with a third party financial institution. Additional loans are available that can be pledged as collateral for future borrowings from the Federal Reserve Bank above the current lendable collateral value.

In December 2007, C&F Financial Statutory Trust II (Trust II), a wholly-owned non-operating subsidiary of the Corporation, was formed for the purpose of issuing trust preferred capital securities for general corporate purposes including the refinancing of existing debt. On December 14, 2007, Trust II issued $10.00 million of trust preferred capital securities in a private placement to an institutional investor and $310,000 in common equity to the Corporation in exchange for cash. The securities mature in December 2037, are redeemable at the Corporation s option beginning after five years, and require quarterly distributions by Trust II to the holder of the securities at a fixed rate of 7.73% as to $5.00 million of the securities and at a rate equal to the three-month LIBOR rate plus 3.15% as to the remaining $5.00 million, which rate was 3.40% at December 31, 2009. The fixed rate portion of the securities converts to the three-month LIBOR rate plus 3.15% in December 2012. The principal asset of Trust II is $10.31 million of the Corporation s 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 Trust II to pay the quarterly distributions payable by Trust II to the holders of the trust preferred capital securities.

In July 2005, C&F Financial Statutory Trust I (Trust I), 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, Trust I issued $10.00 million of trust preferred capital securities in a private placement to an institutional investor and $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 Trust I 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 1.82% at December 31, 2009. The fixed rate portion of the securities converts to the three-month LIBOR rate plus 1.57% in September 2010. The principal asset of Trust I is $10.31 million of the Corporation s 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 Trust I to pay the quarterly distributions payable by Trust I 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 9: Shareholders Equity, Other Comprehensive Income and Earnings Per Common Share

Shareholders Equity

Preferred Shares. On January 9, 2009, as part of the Capital Purchase Program (Capital Purchase Program) established by the U.S. Department of the Treasury (Treasury) under the Emergency Economic Stabilization Act of 2008 (EESA), the Corporation issued and sold to Treasury for an aggregate purchase price of $20.00 million in cash (1) 20,000 shares of the Corporation s fixed rate cumulative perpetual preferred stock, Series A, par value $1.00 per share, having a liquidation preference of $1,000 per share (Series A Preferred Stock) and (2) a ten-year warrant to

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

purchase up to 167,504 shares of the Corporation s common stock, par value $1.00 per share (Common Stock), at an initial exercise price of $17.91 per share (Warrant). The Series A Preferred Stock may be treated as Tier 1 capital for regulatory capital adequacy determination purposes.

Cumulative dividends on the Series A Preferred Stock will accrue on the liquidation preference at a rate of 5% per annum for the first five years, and at a rate of 9% per annum thereafter. The Series A Preferred Stock has no maturity date and ranks senior to the Common Stock with respect to the payment of dividends. The Corporation may redeem the Series A Preferred Stock at 100% of their liquidation preference (plus any accrued and unpaid dividends), subject to the consent of the Federal Deposit Insurance Corporation.

The Warrant has a 10-year term and was immediately exercisable upon issuance, with an exercise price, subject to anti-dilution adjustments, equal to $17.91 per share of Common Stock. Of the aggregate amount of $20.00 million received, approximately $19.21 million was attributable to the Series A Preferred Stock and approximately $792,000 was attributable to the Warrant, based on the relative fair values of these instruments on the date of issuance. The Corporation used a discounted cash flow analysis to determine the fair value of the Series A Preferred Stock, which included the following key assumptions: (i) a discount rate of 10 percent, (ii) a dividend rate for the first five years of 5 percent and (iii) a dividend rate after five years of 9 percent. The Corporation used the Black-Scholes option-pricing model to determine the fair value of the Warrant, which included the following key assumptions: (i) volatility of 30 percent, (ii) an exercise price of $17.91, (iii) a dividend yield of 4.0 percent and (iv) the five-year risk-free rate of 2.4 percent. The resulting fair values of the Series A Preferred Stock and the Warrant were used to allocate the aggregate purchase price of $20.00 million on a relative fair value basis. As the Series A Preferred Stock was initially valued at $19.21 million, the difference between the initial value and the par value of the Series A Preferred Stock will be accreted over a period of five years through a reduction to retained earnings on an effective yield basis. While this accretion does not affect net income, it, along with the dividends, reduces the amount of net income available to common shareholders, and thus reduces both basic and diluted earnings per common share.

The purchase agreement pursuant to which the Series A Preferred Stock and the Warrant were sold contains limitations on the payment of dividends or distributions on the Common Stock (including the payment of the cash dividends in excess of the Corporation s quarterly cash dividend at the time of issuance of the Series A Preferred Stock of $0.31 per share) and on the Corporation s ability to repurchase, redeem or acquire its Common Stock or other securities, and subjects the Corporation to certain of the executive compensation limitations included in the EESA until such time as Treasury no longer owns any Series A Preferred Stock acquired through the Capital Purchase Program.

Common Shares. During 2008, the Corporation purchased 1,600 shares of its common stock in open-market transactions at prices ranging between $20.49 and $31.06 per share in accordance with board-approved stock purchase programs. The program in effect at December 31, 2008, expired in July 2009. Limitations on future share repurchases are described above.

During 2007, the Corporation purchased 54,800 shares of its common stock in negotiated and open-market transactions at prices ranging between $32.50 and $43.20 in accordance with a board-approved stock purchase program that expired in July 2008. Purchases of 149,720 shares at prices between $37.25 and $45.07 per share were made in accordance with a board-approved stock purchase program, which was terminated in July 2007.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Other Comprehensive Income

The following table presents the cumulative balances of the components of other comprehensive income, net of deferred tax assets (liabilities) of $521,000, $(565,000) and $105,000 as of December 31, 2009, 2008 and 2007, respectively.

	December 31,		
(Dollars in thousands)	**2009**	**2008**	**2007**
Net unrealized gains (losses) on securities	**$ 1,168**	$ (113)	$ 540
Net unrecognized gains (losses) on defined benefit plans	**(200)**	(934)	(343)
Total cumulative other comprehensive income (loss)	**$ 968**	$ (1,047)	$ 197

The Corporation reclassified net gains (losses) of $14,000, $(885,000) and $14,000 from other comprehensive income to earnings for the years ended December 31, 2009, 2008 and 2007, respectively.

Earnings Per Common Share

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

	December 31,		
(Dollars in thousands)	**2009**	**2008**	**2007**
Net income	**$ 5,526**	$ 4,181	$ 8,480
Accumulated dividends on Series A Preferred Stock	**(992)**		
Amortization of Series A Preferred Stock discount	**(138)**		
Net income available to common shareholders	**$ 4,396**	$ 4,181	$ 8,480
Weighted average number of common shares used in earnings per common share basic	**3,044,009**	3,027,700	3,062,932
Effect of dilutive securities:			
Stock option awards and warrant	**4,482**	30,574	118,513
Weighted average number of common shares used in earnings per common share assuming dilution	**3,048,491**	3,058,274	3,181,445

Potential common shares that may be issued by the Corporation for its stock option awards and Warrant are determined using the treasury stock method. Options, including the Warrant in 2009, on approximately 548,000, 372,000 and 98,000 shares were not included in computing diluted earnings per common share for the years ended December 31, 2009, 2008 and 2007, respectively, because they were anti-dilutive.

NOTE 10: 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)	

	2009	2008	2007
Current taxes	**$ 5,422**	$ 3,289	$ 4,456
Deferred taxes	**(3,477)**	(2,672)	(1,112)
	$ 1,945	$ 617	$ 3,344

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

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)	2009	Percent of Pre-tax Income	2008	Percent of Pre-tax Income	2007	Percent of Pre-tax Income
Income tax computed at federal statutory rates	**$ 2,540**	**34.0%**	$ 1,631	34.0%	$ 4,139	35.0%
Tax effect of exclusion of interest income on obligations of states and political subdivisions	**(1,431)**	**(19.2)**	(1,085)	(22.6)	(913)	(7.7)
Reduction of interest expense incurred to carry tax-exempt assets	**115**	**1.5**	122	2.6	115	1.0
State income taxes, net of federal tax benefit	**665**	**8.9**	157	3.3	248	2.1
Tax effect of dividends-received deduction on preferred stock	**(22)**	**(0.2)**	(45)	(0.9)	(72)	(0.6)
Compensation in excess of deductible limits	**219**	**2.9**				
Tax credits	**(118)**	**(1.6)**	(147)	(3.1)	(101)	(0.9)
Other	**(23)**	**(0.3)**	(16)	(0.4)	(72)	(0.6)
	$ 1,945	**26.0%**	$ 617	12.9%	$ 3,344	28.3%

The Corporation s net deferred income taxes totaled $12.37 million and $9.98 million at December 31, 2009 and 2008, respectively. The tax effects of each type of significant item that gave rise to deferred taxes are:

	December 31,	
(Dollars in thousands)	2009	2008
Deferred tax asset		
Allowance for loan losses	**$ 10,823**	$ 7,715
Deferred compensation	**1,655**	1,557
Other-than-temporary impairment of Fannie Mae and Freddie Mac preferred stock	**614**	614
Defined benefit plan	**151**	369
Share-based compensation	**367**	250
Interest on nonaccrual loans	**124**	88
Depreciation	**51**	
Net unrealized loss on securities available for sale		61
Other	**1,094**	899
Deferred tax asset	**14,879**	11,553
Deferred tax liability		
Goodwill and other intangible assets	**(1,877)**	(1,568)
Depreciation		(3)
Net unrealized gain on securities available for sale	**(628)**	
Deferred tax liability	**(2,505)**	(1,571)
Net deferred tax asset	**$ 12,374**	$ 9,982

The Corporation files income tax returns in the U.S. federal jurisdiction and several states. With few exceptions, the Corporation is no longer subject to U.S. federal, state and local income tax examinations by tax authorities for years prior to 2005. The Corporation adopted the provisions of FIN 48, *Accounting for Uncertainty in Income Taxes* (ASC Topic 740 *Income Taxes*), on January 1, 2007 with no effect on the financial statements.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

NOTE 11: Employee Benefit Plans

The Bank maintains a Defined Contribution Profit-Sharing Plan (the Profit-Sharing Plan) sponsored by the Virginia Bankers Association (VBA). 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 VBA. An employee is 20% vested in the Bank s contributions after two years of service, 40% after three years, 60% after four years, 80% after five years and fully vested after six years. The amounts charged to expense under this plan were $409,000, $437,000 and $420,000 in 2009, 2008 and 2007, 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% in the employer s contributions after two years of service, 50% after three years, 75% after four years, and fully vested after five years. The amounts charged to expense under this plan were $18,000, $75,000 and $182,000 for 2009, 2008 and 2007 respectively.

C&F Finance maintains a Defined Contribution Profit-Sharing Plan sponsored by the VBA with plan features similar to the Profit-Sharing Plan of the Bank. The amounts charged to expense under this plan were $89,000, $79,000 and $94,000 in 2009, 2008 and 2007, respectively.

Individual performance bonuses are awarded annually to certain members of management under a management incentive bonus policy. The Corporation s Compensation Committee recommends to the Corporation s Board of Directors the bonuses to be paid to the Chief Executive Officer and the Chief Financial 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 and C&F Finance. 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 of Directors 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 $418,000, $333,000 and $780,000 in 2009, 2008 and 2007, respectively. In accordance with employment agreements for certain senior officers of C&F Mortgage, performance bonuses of $1.8 million, $695,000 and $811,000 were expensed in 2009, 2008 and 2007, respectively. Performance used in determining the awards is directly related to the profitability of C&F Mortgage.

The Corporation has a nonqualified 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 Plan and a non-contributory cash balance pension plan (Cash Balance Plan) and to enhance retirement benefits by providing supplemental contributions from time to time. Expenses under this plan were $90,000, $92,000 and $115,000 in 2009, 2008 and 2007, 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.

The Bank has a non-contributory, defined benefit pension plan for all full-time employees over 21 years of age. Historically, benefits were generally based upon years of service and average compensation for the five highest-paid consecutive years of service. Effective December, 31, 2008, this plan was converted to a the Cash Balance Plan for all full-time employees over 21 years of age. Under the Cash Balance Plan, benefits earned by participants under the prior defined benefit pension plan through December 31, 2008 were converted to an opening account balance for each participant. This account balance for each participant will grow each year with annual pay credits based on age and years of service and monthly interest credits based on an amount established each year by the Compensation Committee. The Bank funds pension costs in accordance with the funding provisions of the Employee Retirement Income Security Act.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

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 December 31, 2009 and 2008 and October 1, 2007.

	Period Ended		
	December 31,		September 30,
(Dollars in thousands)	**2009**	**2008**	**2007**
Change in benefit obligation			
Projected benefit obligation, beginning	**$ 6,400**	$ 7,083	$ 6,438
Service cost	**504**	1,044	777
Interest cost	**373**	550	384
Actuarial (gain)	**(13)**	(426)	(190)
Benefits paid	**(448)**	(435)	(326)
Prior service cost due to amendment		(1,416)	
Projected benefit obligation, ending	**$ 6,816**	$ 6,400	$ 7,083
Change in plan assets			
Fair value of plan assets, beginning	**$ 4,346**	$ 6,814	$ 6,438
Actual return on plan assets	**1,487**	(2,033)	702
Employer contributions	**1,000**		
Benefits paid	**(448)**	(435)	(326)
Fair value of plan assets, ending	**$ 6,385**	$ 4,346	$ 6,814
Funded status	**$ (431)**	$ (2,054)	$ (269)
Amounts recognized as an other liability	**$ (431)**	$ (2,054)	$ (269)
Amounts recognized in accumulated other comprehensive income			
Net loss	**$ 1,595**	$ 2,798	$ 472
Net obligation at transition	**(9)**	(14)	(22)
Prior service cost	**(1,279)**	(1,347)	78
Deferred taxes	**(107)**	(503)	(185)
Total recognized in accumulated other comprehensive income	**$ 200**	$ 934	$ 343
Weighted-average assumptions for benefit obligation as valuation date			
Discount rate	**6.0%**	6.0%	6.3%
Expected return on plan assets	**8.0**	8.5	8.5
Rate of compensation increase	**4.0**	4.0	4.0

The accumulated benefit obligation was $6.81 million and $5.29 million as of the actuarial valuation dates in 2009 and 2008, respectively.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Dollars in thousands)	Year Ended December 31, 2009	2008	2007
Components of net periodic benefit cost			
Service cost	**$ 504**	$ 835	$ 777
Interest cost	**373**	440	384
Expected return on plan assets	**(413)**	(576)	(447)
Amortization of prior service cost	**(68)**	7	7
Amortization of net obligation at transition	**(5)**	(5)	(5)
Recognized net actuarial loss	**115**		16
Net periodic benefit cost	**506**	701	732
Other changes in plan assets and benefit obligations recognized in other comprehensive income			
Net (gain) loss	**(1,203)**	2,326	(461)
Net obligation at transition			
Amortization of net obligation at transition	**5**	8	5
Prior service cost		(1,416)	
Amortization of prior service costs	**68**	(9)	(7)
Deferred taxes	**396**	(318)	162
Total recognized in accumulated other comprehensive income	**(734)**	591	(301)
Total recognized in net periodic benefit cost and other comprehensive income	**$ (228)**	$ 1,292	$ 431

The estimated net loss, obligation at transition and prior service cost that will be (accreted to) amortized from accumulated other comprehensive income into net periodic benefit cost over the next year are $48,000, $(5,000) and $(68,000), respectively.

	January 1, [1] 2009	October 1, [1] 2007	2006
Weighted-average assumptions for net periodic benefit cost as of			
Discount rate	**6.0%**	6.3%	6.0%
Expected return on plan assets	**8.0**	8.5	8.5
Rate of compensation increase	**4.0**	4.0	4.0

(1) Net periodic benefit cost is based on assumptions determined at the valuation date of the prior year. The Corporation changed the valuation date during 2008 from a 10/1 to a 1/1 date. As such, the October 1, 2007 and 2006 valuation dates were applicable to the years ended December 31, 2008 and 2007, respectively.

The benefits expected to be paid by the plan in the next ten years are as follows:

(Dollars in thousands)	
2010	$ 413
2011	192
2012	519

2013	103
2014	603
2015 2019	3,285
	$ 5,115

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.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

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 Bank s defined benefit pension plan s weighted average asset allocations by asset category are as follows:

	December 31, 2009	2008
Mutual funds-fixed income	**38%**	31%
Mutual funds-equity	**61**	64
Cash and equivalents	**1**	5
	100%	100%

As of December 31, 2009, the fair value of plan assets is as follows:

(Dollars in thousands)	December 31, 2009 Fair Value Measurements Using Level 1	Level 2	Level 3	Assets at Fair Value
Mutual funds-fixed income (1)	**$ 2,441**			**$ 2,441**
Mutual funds-equity (2)	**3,879**			**3,879**
Cash and equivalents (3)	**65**			**65**
Total pension assets	**$ 6,385**			**$ 6,385**

(1) This category includes investments in mutual funds focused on fixed income securities with both short-term and long-term investments. The funds are valued using the net asset value method in which an average of the market prices for the underlying investments is used to value the funds.

(2) This category includes investments in mutual funds focused on equity securities with a diversified portfolio and includes investments in large cap and small cap funds, growth funds, international focused funds and value funds. The funds are valued using the net asset value method in which an average of the market prices for the underlying investments is used to value the funds.

(3) This category comprises cash and short-term cash equivalent funds. The funds are valued at cost which approximates fair value.

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.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

NOTE 12: Related Party Transactions

Loans outstanding to directors and executive officers totaled $683,000 and $734,000 at December 31, 2009 and 2008, respectively. New advances to directors and officers totaled $18,000 and repayments totaled $69,000 in the year ended December 31, 2009. 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.

NOTE 13: Share-Based Plans

On April 15, 2008, the Corporation s shareholders approved the Amended and Restated C&F Financial Corporation 2004 Incentive Stock Plan (the Amended 2004 Plan), which, among other things, expanded the group of eligible award recipients to include certain key employees of the Corporation, as well as non-employee directors (including non-employee regional or advisory directors). The Amended 2004 Plan authorizes an aggregate of 500,000 shares of Corporation common stock to be issued as equity awards in the form of stock options, stock appreciation rights, restricted stock and/or restricted stock units to key employees and non-employee directors. Since the Amended 2004 Plan s approval, equity awards have only been issued in the form of restricted stock, which are accounted for using the fair market value of the Corporation s common stock on the date the restricted shares are awarded.

Prior to the approval of the Amended 2004 Plan, the Corporation awarded options to purchase common stock and/or grants of restricted shares of common stock to certain key employees of the Corporation under the C&F Financial Corporation 2004 Incentive Stock Plan (the 2004 Plan), which was approved by the Corporation s shareholders on April 20, 2004. Options were issued to employees at a price equal to the fair market value of common stock at the date granted. Restricted shares were accounted for using the fair market value of the Corporation s common stock on the date the restricted shares were awarded. The maximum aggregate number of shares that could be issued pursuant to awards made under the 2004 Plan was 500,000. No options were granted under the 2004 Plan in 2008, 2007 and 2006. All options outstanding under the 2004 Plan are exercisable on December 31, 2009. 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. All options outstanding under the 1994 Plan are exercisable as of December 31, 2009. 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 were issued to non-employee directors at a price equal to the fair market value of common stock at the date granted. All options outstanding under the Director Plan are exercisable as of December 31, 2009. All options expire ten years from the grant date. In 2008, the Corporation ceased granting awards to non-employee directors under the Director Plan, which expired in 2008, and non-employee directors were added to the group of eligible award recipients under the Amended 2004 Plan.

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). Options were issued to regional directors of the Bank at a price equal to the fair market value of common stock at the date granted. All options outstanding under the Regional Director Plan are exercisable as of December 31, 2009. All options expire ten years from the grant date. Upon approval of the Amended 2004 Plan in 2008, the Corporation ceased granting awards to regional directors of the Bank under the Regional Director Plan, which was to expire in 2009, and regional directors of the Bank were added to the group of eligible award recipients under the Amended 2004 Plan.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

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

	2009			2008		2007	
(Dollars in thousands, except for per share amounts)	**Shares**	**Exercise Price***	**Intrinsic Value**	**Shares**	**Exercise Price***	**Shares**	**Exercise Price***
Outstanding at beginning of year	**455,017**	**$ 32.71**		510,217	$ 32.17	530,167	$ 31.54
Granted						13,500	37.17
Exercised	**(17,100)**	**16.91**		(13,950)	19.05	(24,000)	21.39
Cancelled	**(20,200)**	**25.35**		(41,250)	30.65	(9,450)	31.65
Outstanding at end of year	**417,717**	**$ 33.71**	**$ 108**	455,017	$ 32.71	510,217	$ 32.17

* *Weighted average*

	2009	2008	2007
Options exercisable at year-end	**417,717**	455,017	496,717
Weighted-average fair value of options granted during the year	**N/A**	N/A	$ 8.05

The total intrinsic value of in-the-money options exercised in 2009 was $46,000. Cash received from option exercises during 2009 was $289,000. The Corporation has a policy of issuing new shares to satisfy the exercise of stock options.

There were no option grants during 2009. The fair value of each option granted in 2007 was estimated on the date of grant using the Black-Scholes option-pricing model with the following weighted-average assumptions: dividend yield of 3.3 percent, dividend growth rate of 5.0 percent, expected life of eight years, expected volatility of 25.0 percent, and a risk-free interest rate of 4.7 percent. The dividend yield and growth rate assumptions were based on the Corporation s history and expectation of dividend payouts. The expected life was based on historical exercise experience. The expected volatility was based on historical volatility. The risk-free interest rates for periods within the contractual life of the awards were 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, 2009:

	Options Outstanding and Exercisable		
Range of Exercise Prices	**Number Outstanding at December 31, 2009**	**Remaining Contractual Life***	**Exercise Price***
$15.75 to $23.49	116,767	2.1	$ 19.77
$35.20 to $39.60	228,850	5.7	38.28
$40.50 to $46.20	72,100	4.3	41.78
Total	417,717	4.4	$ 33.71

* *Weighted average*

As permitted under the Amended 2004 Plan and previously the 2004 Plan, the Corporation awards shares of restricted stock to certain key employees and non-employee directors. Restricted shares awarded to employees are generally subject to a five-year vesting period and restricted shares awarded to non-employee directors are subject to a three-year vesting period. A summary of 2009 activity for restricted stock awards is presented below:

	Shares	Weighted-Average Grant Date Fair Value
Unvested, January 1, 2009	45,700	$ 32.07
Granted	14,425	$ 16.63
Vested	(100)	$ 31.50
Cancelled	(1,300)	$ 18.02
Unvested, December 31, 2009	58,725	$ 28.59

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Compensation is accounted for using the fair market value of the Corporation s common stock on the date the restricted shares are awarded. The weighted-average grant date fair value of restricted stock granted for the years 2009, 2008 and 2007 was $16.63, $19.66 and $31.87, respectively. Compensation expense is charged to income ratably over the vesting periods. As of December 31, 2009, there was $931,000 of total unrecognized compensation cost related to restricted stock granted under the Amended 2004 Plan and the 2004 Plan. The cost is expected to be recognized through 2014.

NOTE 14: Regulatory Requirements and Restrictions

The Corporation (on a consolidated basis) 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 1 capital to risk-weighted assets and of Tier 1 capital to average assets (all as defined in the regulations). For both the Corporation and the Bank, Tier 1 capital consists of shareholders equity excluding any net unrealized gain (loss) on securities available for sale, amounts resulting from changes in the funded status of the pension plan and goodwill net of any related deferred tax liability, and total capital consists of Tier 1 capital and a portion of the allowance for loan losses. For the Corporation only, Tier 1 and total capital also include trust preferred securities. Risk-weighted assets for the Corporation and the Bank were $678.12 million and $673.82 million, respectively, at December 31, 2009 and $681.25 million and $676.37 million, respectively, at December 31, 2008. Management believes that, as of December 31, 2009, the Corporation and the Bank met all capital adequacy requirements to which they are subject.

As of December 31, 2009, 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 1 risk-based and Tier 1 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.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

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

(Dollars in thousands)	Actual Amount	Actual Ratio	Minimum Capital Requirements Amount	Minimum Capital Requirements Ratio	Minimum To Be Well Capitalized Under Prompt Corrective Action Provisions Amount	Minimum To Be Well Capitalized Under Prompt Corrective Action Provisions Ratio
As of December 31, 2009:						
Total Capital (to Risk-Weighted Assets)						
Corporation	**$ 107,724**	**15.9%**	**$ 54,250**	**8.0%**	**N/A**	**N/A**
Bank	**103,693**	**15.4**	**53,906**	**8.0**	**$ 67,382**	**10.0%**
Tier 1 Capital (to Risk-Weighted Assets)						
Corporation	**99,056**	**14.6**	**27,125**	**4.0**	**N/A**	**N/A**
Bank	**95,078**	**14.1**	**26,953**	**4.0**	**40,429**	**6.0**
Tier 1 Capital (to Average Tangible Assets)						
Corporation	**99,056**	**11.5**	**34,450**	**4.0**	**N/A**	**N/A**
Bank	**95,078**	**11.1**	**34,258**	**4.0**	**42,822**	**5.0**
As of December 31, 2008:						
Total Capital (to Risk-Weighted Assets)						
Corporation	$ 83,836	12.3%	$ 54,500	8.0%	N/A	N/A
Bank	81,174	12.0	54,109	8.0	$ 67,637	10.0%
Tier 1 Capital (to Risk-Weighted Assets)						
Corporation	73,575	10.8	27,250	4.0	N/A	N/A
Bank	72,579	10.7	27,055	4.0	40,582	6.0
Tier 1 Capital (to Average Tangible Assets)						
Corporation	73,575	8.9	33,263	4.0	N/A	N/A
Bank	72,579	8.7	33,217	4.0	41,521	5.0

On January 9, 2009, as part of the Capital Purchase Program, the Corporation issued and sold to Treasury 20,000 shares of the Corporation s Series A Preferred Stock having a liquidation preference of $1,000 per share and a Warrant for the purchase of up to 167,504 shares of the Corporation s Common Stock, for a total price of $20.0 million. The Series A Preferred Stock and the Warrant has been treated as Tier 1 capital for regulatory capital adequacy determination purposes as of December 31, 2009.

On December 14, 2007, the Corporation issued $10.00 million of trust preferred securities through a statutory business trust for general corporate purposes including the refinancing of existing debt. On July 21, 2005, the Corporation issued $10.00 million of trust preferred securities through a statutory business trust to partially fund the purchase of 427,186 shares of the Corporation s common stock at $41 per share on July 27, 2005. These 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, $20.00 million and $18.39 million of the Corporation s trust preferred securities is included in Tier 1 capital in the Corporation s capital ratios presented above for 2009 and 2008, respectively. The remaining $1.61 million of the Corporation s total trust preferred securities outstanding on December 31, 2008 is included in the Corporation s total capital ratios presented above as a component of Tier 2 capital.

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.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

NOTE 15: 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 Corporation 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 $73.97 million and $75.03 million at December 31, 2009 and 2008, 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 $8.92 million and $7.82 million at December 31, 2009 and 2008, respectively.

At December 31, 2009, C&F Mortgage had rate lock commitments to originate mortgage loans amounting to approximately $47.68 million and loans held for sale of $28.76 million. C&F Mortgage has entered into corresponding commitments with third party investors to sell loans of approximately $76.44 million. Under the contractual relationship with these investors, C&F Mortgage is obligated to sell the loans, and the investors are obligated to purchase 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 loss due to borrower misrepresentation, fraud or early default. 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. C&F Mortgage maintains an indemnification reserve for potential claims made under these recourse provisions. 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 $1.23 million, $1.30 million and $1.19 million, for the years ended December 31, 2009, 2008 and 2007, respectively.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Future minimum lease payments due under these leases as of December 31, 2009 are as follows *(dollars in thousands)*:

2010	$ 1,091
2011	850
2012	360
2013	98
2014	33
Thereafter	
	$ 2,432

NOTE 16: Fair Value of Assets and Liabilities

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

Level 1 Valuation is based upon quoted prices for identical instruments traded in active markets. Level 1 assets and liabilities include debt and equity securities traded in an active exchange market, as well as U.S. Treasury securities.

Level 2 Valuation is based upon quoted prices for similar instruments in active markets, quoted prices for identical or similar instruments in markets that are not active, and model based valuation techniques for which all significant assumptions are observable in the market or can be corroborated by observable market data for substantially the full term of the assets or liabilities.

Level 3 Valuation is determined using model-based techniques with significant assumptions not observable in the market.

U.S. GAAP allows an entity the irrevocable option to elect fair value (the fair value option) for the initial and subsequent measurement for certain financial assets and liabilities on a contract-by-contract basis. The Corporation has not made any fair value option elections as of December 31, 2009.

Assets and Liabilities Measured at Fair Value on a Recurring Basis

The following table presents the balances of financial assets measured at fair value on a recurring basis. There were no liabilities measured at fair value on a recurring basis at December 31, 2009 or 2008.

	December 31, 2009			
	Fair Value Measurements Using			Assets at Fair
(Dollars in thousands)	Level 1	Level 2	Level 3	Value
Securities Available for Sale				
U.S. government agencies and corporations		**$ 9,743**		**$ 9,743**
Mortgage-backed securities		**2,709**		**2,709**

Obligations of states and political subdivisions	**104,867**	**104,867**
Preferred stock	**1,251**	**1,251**
Total Securities Available for Sale	**$ 118,570**	**$ 118,570**

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

	December 31, 2008			
	Fair Value Measurements Using			Assets at Fair
(Dollars in thousands)	Level 1	Level 2	Level 3	Value
Securities Available for Sale[(1)]		$ 100,603		$ 100,603

(1) Securities available for sale were not broken out by security type at December 31, 2008, as the fair value and disclosure requirements are applied prospectively.

Assets and Liabilities Measured at Fair Value on a Nonrecurring Basis

The Corporation is also required to measure and recognize certain other financial assets at fair value on a nonrecurring basis in the consolidated balance sheet. For assets measured at fair value on a nonrecurring basis and still held on the consolidated balance sheets, the following table provides the fair value measures by level of valuation assumptions used. Fair value adjustments for OREO are recorded in other non-interest expense, and fair value adjustments for loans held for investment are recorded in the provision for loan losses in the consolidated statements of income.

	December 31, 2009			
	Fair Value Measurements Using			Assets at Fair
(Dollars in thousands)	Level 1	Level 2	Level 3	Value
Loans, net		**$ 3,893**		**$ 3,893**
OREO		**12,800**		**12,800**
Total		**$ 16,693**		**$ 16,693**

	December 31, 2008			
	Fair Value Measurements Using			Assets at Fair
(Dollars in thousands)	Level 1	Level 2	Level 3	Value
Loans, net		$ 15,894		$ 15,894

Fair Value of Financial Instruments

The following reflects the fair value of financial instruments whether or not recognized on the consolidated balance sheet at fair value.

	December 31,			
	2009		2008	
	Carrying	Estimated Fair	Carrying	Estimated
(Dollars in thousands)	Amount	Value	Amount	Fair Value
Financial assets:				
Cash and short-term investments	**$ 38,061**	**$ 38,061**	$ 9,888	$ 9,888
Securities	**118,570**	**118,570**	100,603	100,603
Net loans	**613,004**	**611,420**	633,017	634,928
Loans held for sale, net	**28,756**	**29,032**	37,042	37,904
Accrued interest receivable	**5,408**	**5,408**	5,096	5,096
Financial liabilities:				

Demand deposits	**292,096**	**276,935**	281,827	272,164
Time deposits	**314,534**	**319,593**	268,898	272,340
Borrowings	**170,832**	**166,533**	219,460	210,640
Accrued interest payable	**1,569**	**1,569**	1,921	1,921

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The following describes the valuation techniques used by the Corporation to measure financial assets and financial liabilities at fair value as of December 31, 2009 and 2008.

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 Available for Sale. Securities available for sale are recorded at fair value on a recurring basis. Where quoted prices are available in an active market, securities are classified as Level 1 of the valuation hierarchy. Level 1 securities would include highly liquid government bonds, mortgage products and exchange-traded equities. If quoted market prices are not available, then fair values are estimated by using pricing models, quoted prices of securities with similar characteristics, or discounted cash flow and are classified within Level 2 of the valuation hierarchy. Level 2 securities would include U.S. agency securities, mortgage-backed agency securities, obligations of states and political subdivisions and certain corporate, asset-backed and other securities. In certain cases where there is limited activity or less transparency around inputs to the valuation, securities are classified within Level 3 of the valuation hierarchy.

Loans, net. The estimated fair value of the loan portfolio is based on present values using discount rates equal to the market rates currently charged on similar products.

Certain loans are accounted for under ASC Topic 310 - *Receivables*, including impaired loans measured at an observable market price (if available), or at the fair value of the loan s collateral (if the loan is collateral dependent). Collateral may be in the form of real estate or business assets including equipment, inventory and accounts receivable. A significant portion of the collateral securing the Corporation s impaired loans is real estate. The fair value of real estate collateral is determined utilizing an income or market valuation approach based on an appraisal conducted by an independent, licensed appraiser outside of the Corporation using observable market data (Level 2). However, if an appraisal of the real estate property is over two years old, then the fair value is considered Level 3. The value of business equipment is based upon an outside appraisal if deemed significant, or the net book value on the applicable business s financial statements if not considered significant using observable market data. Likewise, values for inventory and accounts receivable collateral are based on financial statement balances or aging reports (Level 3). At December 31, 2009 and 2008, the Corporation s impaired loans were valued at $3.89 million and $15.89 million, respectively.

Loans Held for Sale. Loans held for sale are required to be measured at the lower of cost or fair value. These loans currently consist of residential loans originated for sale in the secondary market. Fair value is based on the price secondary markets are currently offering for similar loans using observable market data, which is not generally materially different than cost due to the short duration between origination and sale (Level 2). As such, the Corporation records any fair value adjustments on a nonrecurring basis. No nonrecurring fair value adjustments were recorded on loans held for sale during the year ended December 31, 2009.

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

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

Borrowings. The fair value of borrowings is determined using the discounted cash flow method. The discount rate was equal to the rate currently offered on similar products.

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

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

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

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

The 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 balance minimizing interest rate risk and increasing net interest income in current market conditions. However, borrowers with fixed rate obligations are less likely to prepay in a rising rate environment and more likely to prepay in a falling rate environment. Conversely, depositors who are receiving fixed rates are more likely to withdraw funds before maturity in a rising rate environment and less likely to do so in a falling rate environment. Management monitors rates, maturities and repricing dates of assets and liabilities and attempts to manage interest rate risk by adjusting terms of new loans, deposits and borrowings and by investing in securities with terms that mitigate the Corporation s overall interest rate risk.

NOTE 17: 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 retail installment sales contracts.

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. Revenue and expenses of the Corporation are also included in Other, and consist primarily of dividends received on the Corporation s investment in equity securities and interest expense associated with the Corporation s trust preferred capital notes

	Year Ended December 31, 2009					
(Dollars in thousands)	**Retail Banking**	**Mortgage Banking**	**Consumer Finance**	**Other**	**Eliminations**	**Consolidated**
Revenues:						
Interest income	**$ 34,021**	**$ 2,471**	**$ 31,590**	**$ 259**	**$ (3,370)**	**$ 64,971**
Gains on sales of loans		**24,976**				**24,976**
Other noninterest income	**5,804**	**4,211**	**603**	**1,095**		**11,713**
Total operating income (loss)	**39,825**	**31,658**	**32,193**	**1,354**	**(3,370)**	**101,660**
Expenses:						
Provision for loan losses	**6,400**	**563**	**11,600**			**18,563**
Interest expense	**12,588**	**267**	**4,881**	**1,124**	**(3,401)**	**15,459**
Salaries and employee benefits	**13,881**	**15,381**	**5,183**	**673**		**35,118**
Other noninterest expenses	**12,472**	**9,374**	**2,713**	**490**		**25,049**
Total operating expenses	**45,341**	**25,585**	**24,377**	**2,287**	**(3,401)**	**94,189**
Income (loss) before income taxes	**(5,516)**	**6,073**	**7,816**	**(933)**	**31**	**7,471**
Income tax expense (benefit)	**(3,352)**	**2,643**	**3,022**	**(379)**	**11**	**1,945**
Net income (loss)	**$ (2,164)**	**$ 3,430**	**$ 4,794**	**$ (554)**	**$ 20**	**$ 5,526**

Total assets	**$ 739,390**	**$ 40,523**	**$ 193,817**	**$ 2,579**	**$ (87,879)**	**$ 888,430**
Goodwill	**$**	**$**	**$ 10,724**	**$**	**$**	**$ 10,724**
Capital expenditures	**$ 155**	**$ 252**	**$ 66**	**$ 1**	**$**	**$ 474**

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

	Year Ended December 31, 2008					
(Dollars in thousands)	Retail Banking	Mortgage Banking	Consumer Finance	Other	Eliminations	Consolidated
Revenues:						
Interest income	$ 36,376	$ 2,034	$ 28,955	$ 194	$ (3,429)	$ 64,130
Gains on sales of loans		16,714			(21)	16,693
Other noninterest income	6,033	2,168	588	(333)		8,456
Total operating income (loss)	42,409	20,916	29,543	(139)	(3,450)	89,279
Expenses:						
Provision for loan losses	2,300	796	10,670			13,766
Interest expense	15,873	370	7,178	1,459	(3,485)	21,395
Salaries and employee benefits	13,378	8,889	4,662	758	37	27,724
Other noninterest expenses	9,927	8,498	2,715	456		21,596
Total operating expenses	41,478	18,553	25,225	2,673	(3,448)	84,481
Income (loss) before income taxes	931	2,363	4,318	(2,812)	(2)	4,798
Income tax expense (benefit)	(764)	898	1,603	(1,119)	(1)	617
Net income (loss)	$ 1,695	$ 1,465	$ 2,715	$ (1,693)	$ (1)	$ 4,181
Total assets	$ 697,882	$ 45,132	$ 178,679	$ 2,521	$ (68,557)	$ 855,657
Goodwill	$	$	$ 10,724	$	$	$ 10,724
Capital expenditures	$ 395	$ 215	$ 114	$ 4	$	$ 728

	Year Ended December 31, 2007					
(Dollars in thousands)	Retail Banking	Mortgage Banking	Consumer Finance	Other	Eliminations	Consolidated
Revenues:						
Interest income	$ 39,908	$ 2,482	$ 26,060	$ 295	$ (3,920)	$ 64,825
Gains on sales of loans		15,854			(21)	15,833
Other noninterest income	5,316	2,790	590	1,349		10,045
Total operating income	45,224	21,126	26,650	1,644	(3,941)	90,703
Expenses:						
Provision for loan losses	280	120	6,730			7,130
Interest expense	16,616	992	8,708	1,055	(3,993)	23,378
Salaries and employee benefits	14,626	11,095	4,317	720	29	30,787
Other noninterest expenses	8,591	6,090	2,470	433		17,584
Total operating expenses	40,113	18,297	22,225	2,208	(3,964)	78,879
Income (loss) before income taxes	5,111	2,829	4,425	(564)	23	11,824
Income tax expense (benefit)	871	1,075	1,681	(292)	9	3,344

Net income (loss)	$ 4,240	$ 1,754	$ 2,744	$ (272)	$ 14	$ 8,480
Total assets	$ 634,722	$ 44,841	$ 167,400	$ 40	$ (61,407)	$ 785,596
Goodwill	$	$	$ 10,724	$	$	$ 10,724
Capital expenditures	$ 1,711	$ 273	$ 267	$	$	$ 2,251

The Retail Banking segment extends a warehouse line of credit to the Mortgage Banking segment, providing a portion of the funds needed to originate mortgage loans. The Retail Banking segment charges the Mortgage Banking segment interest at the daily FHLB advance rate plus 50 basis points. The Retail Banking segment also provides the Consumer Finance segment with a portion of the funds needed to originate loans by means of a variable rate line of credit that carries interest at one-month LIBOR plus 175 basis points and fixed rate loans that carry interest rates ranging from 5.4 percent to 8.0 percent. The Retail Banking segment acquires certain residential real estate loans from the Mortgage Banking segment at prices similar to those paid by third-party investors. These transactions are eliminated to reach consolidated totals. Certain corporate overhead costs incurred by the Retail Banking segment are not allocated to the Mortgage Banking, Consumer Finance and Other segments.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

NOTE 18: Parent Company Condensed Financial Information

Financial information for the parent company is as follows:

(Dollars in thousands)	December 31, 2009	2008
Balance Sheets		
Assets		
Cash	**$ 510**	$ 92
Securities available for sale	**1,251**	1,612
Other assets	**2,917**	3,266
Investments in subsidiary	**104,889**	80,607
Total assets	**$ 109,567**	$ 85,577
Liabilities and shareholders equity		
Trust preferred capital notes	**$ 20,620**	$ 20,620
Other liabilities	**71**	100
Shareholders equity	**88,876**	64,857
Total liabilities and shareholders equity	**$ 109,567**	$ 85,577

(Dollars in thousands)	Year Ended December 31, 2009	2008	2007
Statements of Income			
Interest income on securities	**$ 92**	$ 189	$ 292
Interest expense on borrowings	**(1,070)**	(1,306)	(874)
Dividends received from bank subsidiary	**4,220**	3,859	19,394
Equity in undistributed net income of subsidiary	**2,293**	2,258	(10,325)
Other income	**675**	1,358	584
Other expenses	**(684)**	(2,177)	(591)
Net income	**$ 5,526**	$ 4,181	$ 8,480

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Dollars in thousands)	Year Ended December 31, 2009	2008	2007
Statements of Cash Flows			
Operating activities:			
Net income	**$ 5,526**	$ 4,181	$ 8,480
Adjustments to reconcile net income to net cash provided by operating activities:			
Equity in undistributed earnings of subsidiary	**(2,293)**	(2,258)	10,325
Stock-based compensation	**318**	292	299
Net loss (gain) on securities	**22**	(6)	
Other-than-temporary impairment of securities		1,575	
Decrease (increase) in other assets	**349**	(1,222)	(391)
(Decrease) increase in other liabilities	**(2)**	5	4
Net cash provided by operating activities	**3,920**	2,567	18,717
Investing activities:			
Proceeds from maturities and calls of securities	**265**	860	500
Purchase of securities			(555)
Investment in bank subsidiary	**(19,927)**		(10,000)
Investment in statutory trust			(310)
Net cash (used in) provided by investing activities	**(19,662)**	860	(10,365)
Financing activities:			
Net decrease in borrowings			(7,000)
Issuance of trust preferred capital notes			10,310
Net proceeds from issuance of preferred stock	**19,914**		
Purchase of common stock		(40)	(8,435)
Cash dividends	**(4,080)**	(3,754)	(3,769)
Proceeds from exercise of stock options	**326**	312	567
Net cash provided by (used in) financing activities	**16,160**	(3,482)	(8,327)
Net increase (decrease) in cash and cash equivalents	**418**	(55)	25
Cash at beginning of year	**92**	147	122
Cash at end of year	**$ 510**	$ 92	$ 147

NOTE 19: Other Noninterest Expenses

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

(Dollars in thousands)	Year Ended December 31, 2009	2008	2007
FDIC expenses	**$ 1,341**	$ 369	$ 62
Provision for indemnification losses	**2,490**	1,091	97
Loan and OREO expenses	**3,267**	749	74
Telecommunication expenses	**1,057**	1,108	1,107
Marketing and advertising expenses	**614**	906	1,224
Tax service and investor fees	**1,018**	641	658

Data processing fees	**2,122**	1,895	1,531
All other noninterest expenses	**7,426**	8,806	6,773
Total Other Noninterest Expenses	**$ 19,335**	$ 15,565	$ 11,526

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

NOTE 20: Quarterly Condensed Statements of Income Unaudited

	2009 Quarter Ended			
Dollars in thousands (except per share amounts)	**March 31**	**June 30**	**September 30**	**December 31**
Total interest income	**$ 15,437**	**$ 16,125**	**$ 16,625**	**$ 16,784**
Net interest income after provision for loan losses	**7,152**	**7,737**	**8,535**	**7,525**
Other income	**9,241**	**9,958**	**8,560**	**8,930**
Other expenses	**14,486**	**15,305**	**14,721**	**15,655**
Income before income taxes	**1,907**	**2,390**	**2,374**	**800**
Net income	**1,508**	**1,750**	**1,658**	**610**
Net income available to common shareholders	**1,248**	**1,462**	**1,367**	**319**
Earnings per common share assuming dilution	**0.41**	**0.48**	**0.45**	**0.10**
Dividends per common share	**0.31**	**0.25**	**0.25**	**0.25**

	2008 Quarter Ended			
Dollars in thousands (except per share amounts)	**March 31**	**June 30**	**September 30**	**December 31**
Total interest income	$ 15,904	$ 15,908	$ 16,386	$ 15,932
Net interest income after provision for loan losses	7,808	7,371	7,922	5,868
Other income	6,068	7,182	5,823	6,076
Other expenses	12,053	12,723	12,812	11,732
Income before income taxes	1,823	1,830	933	212
Net income available to common shareholders	1,428	1,417	299	1,037
Earnings per common share assuming dilution	0.46	0.46	0.10	0.34
Dividends per common share	0.31	0.31	0.31	0.31

NOTE 21: Subsequent Event

The Corporation evaluates subsequent events that have occurred after the balance sheet date but before the financial statements are issued. There are two types of subsequent events: (1) recognized, or those that provide additional evidence about conditions that existed at the date of the balance sheet, including the estimates inherent in the process of preparing financial statements, and (2) nonrecognized, or those that provide evidence about conditions that did not exist at the date of the balance sheet but arose after that date.

Based on the evaluation, the Corporation did not identify any recognized or nonrecognized subsequent events that would have required adjustment to or disclosure in the consolidated financial statements.

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Shareholders

C&F Financial Corporation and Subsidiary

West Point, Virginia

We have audited the accompanying consolidated balance sheets of C&F Financial Corporation and Subsidiary as of December 31, 2009 and 2008, and the related consolidated statements of income, shareholders equity, and cash flows for the years ended December 31, 2009, 2008 and 2007. These financial statements are the responsibility of the Corporation s management. Our responsibility is to express an opinion on these financial statements 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 audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

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, 2009 and 2008, and the results of their operations and their cash flows for the years ended December 31, 2009, 2008 and 2007, in conformity with U.S. generally accepted accounting principles.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), C&F Financial Corporation and Subsidiary s internal control over financial reporting as of December 31, 2009, based on criteria established in *Internal Control Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission, and our report dated March 3, 2010 expressed an unqualified opinion on the effectiveness of C&F Financial Corporation and Subsidiary s internal control over financial reporting.

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

Winchester, Virginia

March 3, 2010

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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 s management, with the participation of the Corporation s Chief Executive Officer and the Chief Financial Officer, has evaluated the effectiveness of the Corporation s disclosure controls and procedures (as defined in Rule 13a-15(e) under the Securities Exchange Act of 1934, as amended (the Exchange Act)) as of the end of the period covered by this report. Based on that evaluation, the Chief Executive Officer and the Chief Financial Officer have concluded that the Corporation s disclosure controls and procedures were effective as of December 31, 2009 to ensure that information required to be disclosed by the Corporation in reports that it files or submits under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in SEC rules and forms and that such information is accumulated and communicated to the Corporation s management, including the Corporation s Chief Executive Officer and Chief Financial Officer, as appropriate to allow timely decisions regarding required disclosure. Because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that the Corporation s disclosure controls and procedures will detect or uncover every situation involving the failure of persons within the Corporation or its subsidiary to disclose material information required to be set forth in the Corporation s periodic reports.

Management s Report on Internal Control over Financial Reporting. Management of the Corporation is also responsible for establishing and maintaining adequate internal control over financial reporting (as defined in Rule 13a-15(f) under the Exchange Act). 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, 2009. 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, 2009, the Corporation s internal control over financial reporting was effective based on those criteria.

The effectiveness of the Corporation s internal control over financial reporting as of December 31, 2009 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 the Corporation s internal control over financial reporting appears on pages 99 and 100 hereof.

Changes in Internal Controls. There were no changes in the Corporation s internal control over financial reporting during the Corporation s quarter ended December 31, 2009 that have materially affected, or are reasonably likely to materially affect, the Corporation s internal control over financial reporting.

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Shareholders

C&F Financial Corporation and Subsidiary

West Point, Virginia

We have audited C&F Financial Corporation and Subsidiary s internal control over financial reporting as of December 31, 2009, based on criteria established in *Internal Control Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission. C&F Financial Corporation and Subsidiary s management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting included in the accompanying *Management s Report on Internal Control over Financial Reporting*. Our responsibility is to express an opinion on the Corporation s internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audit also included performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

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 *(a)* pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the corporation; *(b)* 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 *(c)* 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.

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In our opinion, C&F Financial Corporation and Subsidiary maintained, in all material respects, effective internal control over financial reporting as of December 31, 2009, based on criteria established in *Internal Control Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets and the related consolidated statements of income, shareholders equity and cash flows of C&F Financial Corporation and Subsidiary and our report dated March 3, 2010 expressed an unqualified opinion.

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

Winchester, Virginia
March 3, 2010

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ITEM 9B. OTHER INFORMATION

None

PART III

ITEM 10. DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE

The information with respect to the directors of the Corporation is contained on pages 4 through 7 of the 2010 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 40 of the 2010 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 (Code) that applies to its directors, executives and employees including the principal executive officer, principal financial officer, principal accounting officer and controller, or persons performing similar functions. This Code is posted on our Internet website at http://www.cffc.com under About C&F/C&F Financial Corporation/Corporate Governance. We will provide a copy of the Code to any person without charge upon written request to C&F Financial Corporation, c/o Secretary, P.O. Box 391, West Point, Virginia 23181. We intend to provide any required disclosure of any amendment to or waiver from the Code that applies to our principal executive officer, principal financial officer, principal accounting officer or controller, or persons performing similar functions, on http://www.cffc.com under About C&F/C&F Financial Corporation/Corporate Governance promptly following the amendment or waiver. We may elect to disclose any such amendment or waiver in a report on Form 8-K filed with the SEC either in addition to or in lieu of the website disclosure. The information contained on or connected to our Internet website is not incorporated by reference in this report and should not be considered part of this or any other report that we file or furnish to the SEC.

The board of directors of the Corporation has a standing Audit Committee, which is comprised of four 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, C. Elis Olsson 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.

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ITEM 11. EXECUTIVE COMPENSATION

The information contained on pages 13 through 31 of the 2010 Proxy Statement under the captions, Compensation Committee Interlocks and Insider Participation, Compensation Policies and Practices as They Relate to Risk Management, Executive Compensation and Compensation Committee Report, and the information on pages 31 through 36 of the 2010 Proxy Statement are incorporated herein by reference. The information regarding director compensation contained on pages 11 and 12 of the 2010 Proxy Statement under the caption, Director Compensation, is incorporated herein by reference.

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

The information contained on page 3 of the 2010 Proxy Statement under the caption, Security Ownership of Certain Beneficial Owners and Management, is incorporated herein by reference.

The information contained on page 40 of the 2010 Proxy Statement under the caption, Equity Compensation Plan Information, is incorporated herein by reference.

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

The information contained on pages 12 and 13 of the 2010 Proxy Statement under the caption, Interest of Management in Certain Transactions, is incorporated herein by reference. The information contained on page 8 of the 2010 Proxy Statement under the caption, Director Independence, is incorporated herein by reference.

ITEM 14. PRINCIPAL ACCOUNTANT FEES AND SERVICES

The information contained on page 39 of the 2010 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)
3.1.1	Amendment to Articles of Incorporation of C&F Financial Corporation (incorporated by reference to Exhibit 3.1.1 to Form 8-K filed January 14, 2009)
3.2	Amended and Restated Bylaws of C&F Financial Corporation, as adopted October 16, 2007 (incorporated by reference to Exhibit 3.2 to Form 8-K filed October 22, 2007)

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.

4.1	Certificate of Designations for 20,000 shares of Fixed Rate Cumulative Perpetual Preferred Stock, Series A (incorporated by reference to Exhibit 3.1.1 to Form 8-K filed January 14, 2009)
4.2	Warrant to Purchase up to 167,504 shares of Common Stock, dated January 9, 2009 (incorporated by reference to Exhibit 4.2 to Form 8-K filed January 14, 2009)
*10.1	Amended and Restated Change in Control Agreement dated December 30, 2008 between C&F Financial Corporation and Larry G. Dillon (incorporated by reference to Exhibit 10.1 to Form 10-K filed March 9, 2009)
*10.3	Amended and Restated Change in Control Agreement dated December 30, 2008 between C&F Financial Corporation and Thomas F. Cherry (incorporated by reference to Exhibit 10.3 to Form 10-K filed March 9, 2009)
*10.4	Restated VBA Executives Non-Qualified Deferred Compensation Plan for C&F Financial Corporation (incorporated by reference to Exhibit 10.4 to Form 10-K filed March 7, 2008)
*10.4.1	Adoption Agreement for the Restated VBA Executives Non-Qualified Deferred Compensation Plan for C&F Financial Corporation dated as of December 31, 2008 (incorporated by reference to Exhibit 10.4.1 to Form 10-K filed March 9, 2009)
*10.4.2	Attachment to the Adoption Agreement for the Restated VBA Executives Non-Qualified Deferred Compensation Plan for C&F Financial Corporation dated as of January 1, 2008 (incorporated by reference to Exhibit 10.4.2 to Form 10-K filed March 7, 2008)

*10.4.3	Amendment to Adoption Agreement for the Restated VBA Executives Non-Qualified Deferred Compensation Plan for C&F Financial Corporation effectively dated as of December 31, 2008 (incorporated by reference to Exhibit 10.4.3 to Form 10-K filed March 9, 2009)
*10.4.4	Amendment to Adoption Agreement for the Restated VBA Executives Non-Qualified Deferred Compensation Plan for C&F Financial Corporation effectively dated as of January 1, 2009
*10.5	Restated VBA Directors Deferred Compensation Plan for C&F Financial Corporation (incorporated by reference to Exhibit 10.5 to Form 10-K filed March 7, 2008)

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*10.5.1	Adoption Agreement for the Restated VBA Director s Deferred Compensation Plan for C&F Financial Corporation dated as of December 31, 2008 (incorporated by reference to Exhibit 10.5.1 to Form 10-K filed March 9, 2009)
*10.5.2	Amendment to Adoption Agreement for the Restated VBA Directors Deferred Compensation Plan for C&F Financial Corporation effectively dated as of December 31, 2008 (incorporated by reference to Exhibit 10.5.2 to Form 10-K filed March 9, 2009)
*10.6	Amended and Restated C&F Financial Corporation 1994 Incentive Stock Plan (incorporated by reference to Exhibit 10.6 to Form 10-K filed March 7, 2008)
*10.7	Amended and Restated C&F Financial Corporation 1998 Non-Employee Director Stock Compensation Plan (incorporated by reference to Exhibit 10.7 to Form 10-K filed March 7, 2008)
*10.8	Amended and Restated C&F Financial Corporation 1999 Regional Director Stock Compensation Plan (incorporated by reference to Exhibit 10.8 to Form 10-K filed March 7, 2008)
*10.9	C&F Financial Corporation Management Incentive Plan dated February 25, 2005, as amended March 6, 2006 (incorporated by reference to Exhibit 10.8 to Form 10-K filed March 9, 2006)
*10.10	Amended and Restated C&F Financial Corporation 2004 Incentive Stock Plan (incorporated by reference to Exhibit 10.10 to Form 10-K filed March 7, 2008)
*10.10.1	Form of C&F Financial Corporation Restricted Stock Agreement (incorporated by reference to Exhibit 10.10.1 to Form 10-Q filed August 8, 2008)
*10.10.2	Form of C&F Financial Corporation Restricted Stock Agreement (incorporated by reference to Exhibit 10.10.2 to Form 8-K filed December 8, 2009)
*10.10.3	Form of C&F Financial Corporation TARP-Compliant Restricted Stock Agreement (incorporated by reference to Exhibit 10.10.3 to Form 8-K filed December 8, 2009)
*10.11	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)
*10.12	Employment Agreement dated April 16, 2002 between C&F Mortgage Corporation and Bryan McKernon, as amended December 19, 2006 (incorporated by reference to Exhibit 10.11 to Form 10-K filed March 9, 2007)
*10.12.1	Amendment to Employment Agreement between C&F Mortgage Corporation and Bryan McKernon, dated December 30, 2008 (incorporated by reference to Exhibit 10.12.1 to Form 10-K filed March 9, 2009)

*10.14	Amended and Restated Change in Control Agreement dated December 30, 2008 between C&F Financial Corporation and Bryan McKernon (incorporated by reference to Exhibit 10.14 to Form 10-K filed March 9, 2009)
*10.15	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)
*10.16	Base Salaries for Named Executive Officers of C&F Financial Corporation

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*10.17	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	Amended and Restated Loan and Security Agreement by and between Wells Fargo Preferred Capital, Inc., various financial institutions and C&F Finance Company dated as of August 25, 2008 (incorporated by reference to Exhibit 10.19 to Form 8-K filed August 28, 2008)
10.24	Letter Agreement, dated January 9, 2009, including the Securities Purchase Agreement-Standard Terms incorporated by reference therein, between C&F Financial Corporation and the United States Depart of the Treasury (incorporated by reference to Exhibit 10.24 to Form 8-K filed January 14, 2009)
*10.25	Form of Waiver executed by each of Larry G. Dillon, Thomas F. Cherry and Bryan E. McKernon (incorporated by reference to Exhibit 10.25 to Form 8-K filed January 14, 2009)
*10.26	Omnibus Benefit Plan Amendment dated January 9, 2009, and Form of Consent executed by each of Larry G. Dillon, Thomas F. Cherry and Bryan E. McKernon (incorporated by reference to Exhibit 10.26 to Form 8-K filed January 14, 2009)
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
99.1	Certification of CEO pursuant to 31 C.F.R. Section 30.15
99.2	Certification of CFO pursuant to 31 C.F.R. Section 30.15

* 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 3, 2010

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 3, 2010
/s/ THOMAS F. CHERRY **Thomas F. Cherry, Executive Vice President, Chief Financial Officer and Secretary (Principal Financial and Accounting Officer)**	Date: March 3, 2010
/s/ J. P. CAUSEY JR. **J. P. Causey Jr., Director**	Date: March 3, 2010
/s/ BARRY R. CHERNACK **Barry R. Chernack, Director**	Date: March 3, 2010
/s/ AUDREY D. HOLMES **Audrey D. Holmes, Director**	Date: March 3, 2010
/s/ JAMES H. HUDSON III **James H. Hudson III, Director**	Date: March 3, 2010
/s/ JOSHUA H. LAWSON **Joshua H. Lawson, Director**	Date: March 3, 2010
/s/ WILLIAM E. O CONNELL JR. **William E. O Connell Jr., Director**	Date: March 3, 2010
/s/ C. ELIS OLSSON **C. Elis Olsson, Director**	Date: March 3, 2010
/s/ PAUL C. ROBINSON **Paul C. Robinson, Director**	Date: March 3, 2010