

PEOPLES FINANCIAL CORP /MS/

Form 10-Q

November 08, 2010

**Table of Contents**

**SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549  
FORM 10-Q**

**QUARTERLY REPORT PURSUANT TO SECTION 13 or 15 (D) OF THE SECURITIES EXCHANGE ACT OF 1934**

**For the quarterly period ended September 30, 2010**

**or**

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

**Commission File Number 001-12103  
PEOPLES FINANCIAL CORPORATION**

(Exact name of registrant as specified in its charter)

Mississippi

64-0709834

(State or other jurisdiction of incorporation or organization)

(I.R.S. Employer Identification No.)

Lameuse and Howard Avenues, Biloxi, Mississippi

39533

(Address of principal executive offices)

(Zip Code)

(228) 435-5511

(Registrant's telephone number, including area code)

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

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer 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  Accelerated filer  Non-accelerated filer  Smaller reporting company   
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 Exchange Act). Yes  No

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the last practicable date. Peoples Financial Corporation has only one class of common stock authorized. At October 29, 2010, there were 15,000,000 shares of \$1 par value common stock authorized, with 5,151,697 shares issued and outstanding.



**TABLE OF CONTENTS**

Part 1 Financial Information

Item 1: Financial Statements

Item 2: Management's Discussion and Analysis of Financial Condition and Results of Operations

Item 4: Controls and Procedures

**PART II OTHER INFORMATION**

Item 1: Legal Proceedings

Item 6 Exhibits and Reports on Form 8-K

**SIGNATURES**

EX-10.1

EX-31.1

EX-31.2

EX-32.1

EX-32.2

---

**Table of Contents****Part 1 Financial Information****Item 1: Financial Statements**

**Peoples Financial Corporation and Subsidiaries**  
**Consolidated Statements of Condition**

	<b>September 30, 2010 (Unaudited)</b>	<b>December 31, 2009 (Audited)</b>
<b>Assets</b>		
Cash and due from banks	\$ 34,523,516	\$ 29,155,294
Available for sale securities	302,832,580	311,434,437
Held to maturity securities, fair value of \$2,972,300 at September 30, 2010; \$3,340,974 at December 31, 2009	2,814,137	3,201,966
Other investments	4,020,754	4,036,304
Federal Home Loan Bank Stock, at cost	3,375,400	5,015,900
Loans	422,161,589	464,976,291
Less: Allowance for loan losses	8,995,828	7,827,806
Loans, net	413,165,761	457,148,485
Bank premises and equipment, net of accumulated depreciation	30,150,716	31,418,884
Other real estate	2,818,833	1,521,313
Accrued interest receivable	3,307,210	4,646,752
Cash surrender value of life insurance	15,786,368	15,329,394
Prepaid FDIC assessments	3,990,239	4,958,309
Other assets	2,651,824	1,139,861
<b>Total assets</b>	<b>\$ 819,437,338</b>	<b>\$ 869,006,899</b>

**Table of Contents**

**Peoples Financial Corporation and Subsidiaries**  
**Consolidated Statements of Condition (continued)**

	<b>September 30, 2010 (Unaudited)</b>	<b>December 31, 2009 (Audited)</b>
<b>Liabilities &amp; Shareholders Equity</b>		
<b>Liabilities:</b>		
Deposits:		
Demand, non-interest bearing	\$ 116,955,635	\$ 96,541,387
Savings and demand, interest bearing	221,140,824	206,167,484
Time, \$100,000 or more	144,589,941	117,347,663
Other time deposits	50,229,892	50,644,895
Total deposits	532,916,292	470,701,429
Federal funds purchased and securities sold under agreements to repurchase	142,380,679	174,430,877
Borrowings from Federal Home Loan Bank	18,978,441	104,270,452
Other liabilities	17,019,609	16,016,204
<b>Total liabilities</b>	<b>711,295,021</b>	<b>765,418,962</b>
<b>Shareholders Equity:</b>		
Common stock, \$1 par value, 15,000,000 shares authorized, 5,151,697 shares issued and outstanding at September 30, 2010 and December 31, 2009	5,151,697	5,151,697
Surplus	65,780,254	65,780,254
Undivided profits	34,968,596	32,853,346
Accumulated other comprehensive income (loss), net of tax	2,241,770	(197,360)
<b>Total shareholders equity</b>	<b>108,142,317</b>	<b>103,587,937</b>
<b>Total liabilities &amp; shareholders equity</b>	<b>\$ 819,437,338</b>	<b>\$ 869,006,899</b>

See selected notes to consolidated financial statements.

**Table of Contents**

**Peoples Financial Corporation and Subsidiaries**  
**Consolidated Statements of Income**  
**(Unaudited)**

	<b>Three Months Ended</b>		<b>Nine Months Ended</b>	
	<b>September 30,</b>		<b>September</b>	
	<b>2010</b>	<b>2009</b>	<b>2010</b>	<b>2009</b>
<b>Interest income:</b>				
Interest and fees on loans	\$4,814,583	\$5,028,179	\$14,695,051	\$15,232,634
Interest and dividends on securities:				
U.S. Treasury	77,382	243,566	402,860	1,019,885
U.S. Government agencies	1,620,180	2,704,828	6,232,606	7,474,592
Mortgage-backed securities		388,091	518,924	1,179,745
States and political subdivisions	332,366	291,065	1,005,963	903,488
Other investments	14,769	9,673	22,423	16,567
Interest on federal funds sold	4,496	5,194	9,832	6,631
<b>Total interest income</b>	<b>6,863,776</b>	<b>8,670,596</b>	<b>22,887,659</b>	<b>25,833,542</b>
<b>Interest expense:</b>				
Deposits	826,304	1,072,368	2,493,090	4,026,055
Long-term borrowings	57,894	141,723	304,098	413,500
Federal funds purchased and securities sold under agreements to repurchase	249,005	437,897	811,746	1,531,569
<b>Total interest expense</b>	<b>1,133,203</b>	<b>1,651,988</b>	<b>3,608,934</b>	<b>5,971,124</b>
<b>Net interest income</b>	<b>5,730,573</b>	<b>7,018,608</b>	<b>19,278,725</b>	<b>19,862,418</b>
<b>Provision for allowance for losses on loans</b>	<b>1,045,000</b>	<b>1,875,000</b>	<b>3,780,000</b>	<b>3,725,000</b>
<b>Net interest income after provision for allowance for losses on loans</b>	<b>\$4,685,573</b>	<b>\$5,143,608</b>	<b>\$15,498,725</b>	<b>\$16,137,418</b>

Table of Contents

**Peoples Financial Corporation and Subsidiaries**  
**Consolidated Statements of Income (continued)**  
**(Unaudited)**

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2010	2009	2010	2009
<b>Non-interest income:</b>				
Trust department income and fees	\$ 352,712	\$ 355,982	\$ 942,949	\$ 1,017,998
Service charges on deposit accounts	1,513,957	1,692,387	4,665,945	5,057,784
Gain on sales or calls of securities	92,023	265,247	1,659,509	402,046
Other income	254,446	281,810	762,394	906,395
<b>Total non-interest income</b>	<b>2,213,138</b>	<b>2,595,426</b>	<b>8,030,797</b>	<b>7,384,223</b>
<b>Non-interest expense:</b>				
Salaries and employee benefits	3,393,160	3,557,067	10,203,623	10,631,766
Net occupancy	604,669	564,631	1,673,567	1,757,734
Equipment rentals, depreciation and maintenance	911,225	939,523	2,797,990	2,844,079
FDIC assessments	400,307	251,508	1,141,211	875,947
Other expense	1,621,950	1,357,195	4,731,194	4,199,331
<b>Total non-interest expense</b>	<b>6,931,311</b>	<b>6,669,924</b>	<b>20,547,585</b>	<b>20,308,857</b>
<b>Income before income taxes</b>	<b>(32,600)</b>	<b>1,069,110</b>	<b>2,981,937</b>	<b>3,212,784</b>
Income taxes	(397,000)	95,000	300,000	335,000
<b>Net income</b>	<b>\$ 364,400</b>	<b>\$ 974,110</b>	<b>\$ 2,681,937</b>	<b>\$ 2,877,784</b>
<b>Basic and diluted earnings per share</b>	<b>\$ .07</b>	<b>\$ .19</b>	<b>\$ .52</b>	<b>\$ .56</b>

See selected notes to consolidated financial statements.



**Table of Contents**

**Peoples Financial Corporation and Subsidiaries**  
**Consolidated Statement of Shareholders Equity**

	Number of Common Shares	Common Stock	Surplus	Accumulated			Total
				Undivided Profits	Other Comprehensive Income (Loss)	Comprehensive Income	
Balance, January 1, 2010	5,151,697	\$ 5,151,697	\$ 65,780,254	\$ 32,853,346	\$ (197,360)		\$ 103,587,937
Comprehensive Income:							
Net income				2,681,937		\$ 2,681,937	2,681,937
Net unrealized gain on available for sale securities, net of tax					3,473,671	3,473,671	3,473,671
Reclassification adjustment for available for sale securities called or sold in current year, net of tax					(1,034,541)	(1,034,541)	(1,034,541)
Total comprehensive income						\$ 5,121,067	
Dividend declared, (\$.11 per share)				(566,687)			(566,687)
Balance, Sept. 30, 2010	5,151,697	\$ 5,151,697	\$ 65,780,254	\$ 34,968,596	\$ 2,241,770		\$ 108,142,317

Note: Balances as of January 1, 2010 were audited.  
See selected notes to consolidated financial statements.

**Table of Contents**

**Peoples Financial Corporation and Subsidiaries**  
**Consolidated Statements of Cash Flows (Unaudited)**

	<b>Nine Months Ended September</b>	
	<b>30,</b>	
	<b>2010</b>	<b>2009</b>
<b>Cash flows from operating activities:</b>		
Net income	\$ 2,681,937	\$ 2,877,784
Adjustment to reconcile net income to net cash provided by operating activities:		
Depreciation	1,807,000	1,798,500
Provision for allowance for loan losses	3,780,000	3,725,000
Loss on writedown of other real estate	77,350	
Loss on sales of other real estate	48,850	3,000
(Income) loss on other investments	15,550	(110,338)
Gain on sales and calls of securities	(1,659,509)	(402,046)
Loss on impairment of equity securities		149,517
Change in accrued interest receivable	1,339,542	461,749
Change in other assets	(893,521)	(801,830)
Change in other liabilities	385,503	2,540,113
<b>Net cash provided by operating activities</b>	<b>7,582,702</b>	<b>10,241,449</b>
<b>Cash flows from investing activities:</b>		
Proceeds from maturities, sales and calls of available for sale securities	337,327,553	218,568,260
Investment in available for sale securities	(323,142,857)	(215,425,390)
Proceeds from maturities of held to maturity securities	389,920	195,000
Investment in held to maturity securities	(2,091)	(2,012)
(Investment in) redemption of Federal Home Loan Bank Stock	1,640,500	(1,453,100)
Proceeds from sales of other real estate	1,092,500	326,076
Loans, net change	37,686,504	(8,054,574)
Acquisition of premises and equipment	(538,832)	(88,645)
Change in cash surrender value of life insurance	(458,474)	(453,808)
<b>Net cash provided by (used in) investing activities</b>	<b>\$ 53,994,723</b>	<b>\$ (6,388,193)</b>

**Table of Contents**

**Peoples Financial Corporation and Subsidiaries**  
**Consolidated Statements of Cash Flows (continued)**  
**(Unaudited)**

	<b>Nine Months Ended September</b>	
	<b>30,</b>	
	<b>2010</b>	<b>2009</b>
<b>Cash flows from financing activities:</b>		
Demand and savings deposits, net change	\$ 35,387,588	\$ (21,400,239)
Time deposits, net change	26,827,275	52,491,912
Cash dividends	(1,081,857)	(2,614,119)
Retirement of common stock		(2,366,559)
Borrowings from Federal Home Loan Bank	621,880,492	219,906,300
Repayments to Federal Home Loan Bank	(707,172,503)	(219,971,353)
Federal funds purchased and securities sold under agreements to repurchase, net change	(32,050,198)	(38,126,176)
<b>Net cash used in financing activities</b>	<b>(56,209,203)</b>	<b>(12,080,234)</b>
<b>Net increase (decrease) in cash and cash equivalents</b>	<b>5,368,222</b>	<b>(8,226,978)</b>
<b>Cash and cash equivalents, beginning of year</b>	<b>29,155,294</b>	<b>34,019,590</b>
<b>Cash and cash equivalents, end of year</b>	<b>\$ 34,523,516</b>	<b>\$ 25,792,612</b>

See selected notes to consolidated financial statements.

**Table of Contents**

PEOPLES FINANCIAL CORPORATION AND SUBSIDIARIES  
SELECTED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
For the Nine Months Ended September 30, 2010 and 2009

**1. Basis of Presentation:**

The accompanying unaudited consolidated financial statements and notes thereto contain all adjustments, consisting only of normal recurring adjustments, necessary to present fairly, in accordance with accounting principles generally accepted in the United States of America, the financial position of Peoples Financial Corporation and its subsidiaries (the Company ) as of September 30, 2010 and the results of their operations and their cash flows for the periods presented. The interim financial information should be read in conjunction with the annual consolidated financial statements and the notes thereto included in the Company s 2009 Annual Report and Form 10-K.

The results of operations for the nine months ended September 30, 2010, are not necessarily indicative of the results to be expected for the full year.

**Use of Estimates** The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the reported period. Actual results could differ from those estimates.

**Summary of Significant Accounting Policies** The accounting and reporting policies of the Company conform with accounting principles generally accepted in the United States of America and general practices within the banking industry. There have been no material changes or developments in the application of principles or in our evaluation of the accounting estimates and the underlying assumptions or methodologies that we believe to be Critical Accounting Policies as disclosed in our Form 10-K for the year ended December 31, 2009.

**2. Earnings Per Share:**

Per share data is based on the weighted average shares of common stock outstanding of 5,151,697 and 5,176,744 for the nine months ended September 30, 2010 and 2009, respectively, and 5,151,697 for the quarters ended September 30, 2010 and 2009, respectively.

**3. Statements of Cash Flows:**

The Company has defined cash and cash equivalents to include cash and due from banks and federal funds sold. The Company paid \$3,621,074 and \$6,094,012 for the nine months ended September 30, 2010 and 2009, respectively, for interest on deposits and borrowings. Income tax payments of \$2,332,000 and \$520,000 were made during the nine months ended September 30, 2010 and 2009, respectively. Loans in the amount of \$2,516,220 and \$520,000 were transferred to other real estate during the nine months ended September 30, 2010 and 2009, respectively.

**Table of Contents**

## 4. Investments:

The amortized cost and estimated fair value of securities at September 30, 2010 and December 31, 2009, respectively, were as follows:

September 30, 2010	Amortized cost	Gross unrealized gains	Gross unrealized losses	Estimated fair value
Available for sale securities:				
Debt securities:				
U.S. Treasury	\$ 48,006,860	\$ 77,594	\$ (81)	\$ 48,084,373
U.S. Government agencies	209,984,401	2,569,662	(47,470)	212,506,593
States and political subdivisions	39,495,091	2,237,940	(141,400)	41,591,631
Total debt securities	297,486,352	4,885,196	(188,951)	302,182,597
Equity securities	649,983			649,983
Total available for sale securities	\$298,136,335	\$4,885,196	\$(188,951)	\$302,832,580
Held to maturity securities:				
States and political subdivisions	\$ 2,814,137	\$ 158,163	\$	\$ 2,972,300
Total held to maturity securities	\$ 2,814,137	\$ 158,163	\$	\$ 2,972,300

**Table of Contents**

December 31, 2009	Amortized cost	Gross unrealized gains	Gross unrealized losses	Estimated fair value
Available for sale securities:				
Debt securities:				
U.S. Treasury	\$ 23,987,222	\$ 752,918	\$	\$ 24,740,140
U.S. Government agencies	216,473,270	695,213	(2,590,287)	214,578,196
Mortgage-backed securities	30,035,546	1,278,310	(51,186)	31,262,670
States and political subdivisions	39,290,502	1,179,412	(266,466)	40,203,448
Total debt securities	309,786,540	3,905,853	(2,907,939)	310,784,454
Equity securities	649,983			649,983
Total available for sale securities	\$310,436,523	\$3,905,853	\$(2,907,939)	\$311,434,437
Held to maturity securities:				
States and political subdivisions	\$ 3,201,966	\$ 139,008	\$	\$ 3,340,974
Total held to maturity securities	\$ 3,201,966	\$ 139,008	\$	\$ 3,340,974

The Company's available for sale securities are reported at their estimated fair value, which is determined utilizing several sources. The primary source is Interactive Data Corporation, which utilizes pricing models that vary based on asset class and include available trade, bid and other market information and whose methodology includes broker quotes, proprietary models and vast descriptive databases. The other source for determining fair value is matrix pricing, which is a mathematical technique used widely in the industry to value debt securities without relying exclusively on quoted prices for the specific securities but rather by relying on the securities' relationship to other benchmark quoted securities.

The balances of available for sale securities, which are the only assets measured at fair value on a recurring basis, by level within the hierarchy, as of September 30, 2010 and December 31, 2009 were as follows:

**Table of Contents**

September 30, 2010:	Total	Fair Value Measurement Using		
		Level 1	Level 2	Level 3
U.S. Treasury	\$ 48,084,373	\$	\$ 48,084,373	\$
U.S. Government agencies	212,506,593		212,506,593	
States and political subdivisions	41,591,631		41,591,631	
Equity securities	649,983		649,983	
Totals	\$302,832,580	\$	\$302,832,580	\$

December 31, 2009:	Total	Fair Value Measurement Using		
		Level 1	Level 2	Level 3
U.S. Treasury	\$ 24,740,140	\$	\$ 24,740,140	\$
U.S. Government agencies	214,578,196		214,578,196	
Mortgage-backed securities	31,262,670		31,262,670	
States and political subdivisions	40,203,448		40,203,448	
Equity securities	649,983		649,983	
Totals	\$311,434,437	\$	\$311,434,437	\$

At September 30, 2010, available for sale securities with an amortized cost of \$298,136,335 were reported at a fair value, net of unrealized gains and losses, of \$302,832,580. The net change in unrealized loss of \$2,439,130 was included in comprehensive income during the first nine months of 2010. At December 31, 2009, available for sale securities with an amortized cost of \$310,436,523 were reported at a fair value, net of unrealized gains and losses, of \$311,434,437. The net change in unrealized gain of \$2,867,464 was included in comprehensive income during the year ended December 31, 2009.

The amortized cost and estimated fair value of debt securities at September 30, 2010, by contractual maturity, are shown below. Expected maturities will differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

	Amortized cost	Estimated fair value
Available for sale securities:		
Due in one year or less	\$ 39,019,639	\$ 39,045,296
Due after one year through five years	91,047,253	92,346,530
Due after five years through ten years	90,858,610	93,147,617
Due after ten years	76,560,850	77,643,154
Totals	\$297,486,352	\$302,182,597
Held to maturity securities:		
Due in one year or less	\$ 210,000	\$ 213,437

Edgar Filing: PEOPLES FINANCIAL CORP /MS/ - Form 10-Q

Due after one year through five years	1,606,671	1,717,626
Due after five years through ten years	997,466	1,041,237
Totals	\$ 2,814,137	\$ 2,972,300



**Table of Contents**

Securities with gross unrealized losses at September 30, 2010 and December 31, 2009, respectively, aggregated by investment category and length of time that individual securities have been in a continuous loss position are as follows:

September 30, 2010	Less Than Twelve Months		Over Twelve Months		Total	
	Fair Value	Gross Unrealized Loss	Fair Value	Gross Unrealized Loss	Fair Value	Gross Unrealized Loss
U.S. Treasury	\$ 7,049,389	\$ 81	\$	\$	\$ 7,049,389	\$ 81
U.S. Government agencies	18,452,530	47,470			18,452,530	47,470
States and political subdivisions	2,117,991	109,424	630,489	31,976	2,748,480	141,400
<b>TOTAL</b>	<b>\$27,619,910</b>	<b>\$156,975</b>	<b>\$630,489</b>	<b>\$31,976</b>	<b>\$28,250,399</b>	<b>\$188,951</b>

December 31, 2009:	Less Than Twelve Months		Over Twelve Months		Total	
	Fair Value	Gross Unrealized Loss	Fair Value	Gross Unrealized Loss	Fair Value	Gross Unrealized Loss
U.S. Government agencies	\$138,913,530	\$2,590,287	\$	\$	\$138,913,530	\$2,590,287
Mortgage-backed Securities	4,856,429	51,186			4,856,429	51,186
States and political subdivisions	9,501,227	148,396	2,520,564	118,070	12,021,791	266,466
<b>TOTAL</b>	<b>\$153,271,186</b>	<b>\$2,789,869</b>	<b>\$2,520,564</b>	<b>\$118,070</b>	<b>\$155,791,750</b>	<b>\$2,907,939</b>

Management evaluates securities for other-than-temporary impairment on a monthly basis. In performing this evaluation, the length of time and the extent to which the fair value has been less than cost, the fact that the Company's securities are primarily issued by U.S. Treasury and U.S. Government Agencies and the cause of the decline in value are considered. In addition, the Company does not intend to sell and it is not more likely than not that we will be required to sell these securities before maturity. While some available for sale securities have been sold for liquidity purposes, the Company has traditionally held its securities, including those classified as available for sale, until maturity. As a result of this evaluation, the Company has determined that the declines summarized in the tables above are not deemed to be other-than-temporary.

**Table of Contents****5. Loans:**

Loans past due ninety days or more and still accruing were \$3,158,755 and \$6,733,659 at September 30, 2010 and December 31, 2009, respectively.

On September 1, 2010, the Company modified two loans by granting interest rate concessions to the borrowers. These loans are in compliance with these modified terms and the Company has classified them as troubled debt restructurings.

Impaired loans include the restructured loans totaling \$708,149 at September 30, 2010 and nonaccrual loans which amounted to \$22,126,831 and \$22,005,748 at September 30, 2010 and December 31, 2009, respectively. The average recorded investment in impaired loans amounted to approximately \$18,052,178 and \$25,551,787 at September 30, 2010 and December 31, 2009, respectively. Impaired loans amounting to \$10,797,373 and \$6,852,271 had a specific allowance of \$2,964,350 and \$1,739,250 at September 30, 2010 and December 31, 2009, respectively. Impaired loans amounting to \$12,037,607 and \$15,153,477 did not have a specific allowance at September 30, 2010 and December 31, 2009, respectively. At September 30, 2010, impaired loans with a carrying amount of \$12,037,607 were written down to their fair value of \$11,917,278 through a \$120,329 charge to the provision for loan losses. At December 31, 2009, impaired loans with a carrying amount of \$22,005,748 were written down to their fair value of \$20,110,334 through a \$1,895,414 charge to the provision for loan losses. No material interest income was recognized on impaired loans for the nine months ended September 30, 2010 or the year ended December 31, 2009.

At each reporting period, the Company determines which loans are impaired. Accordingly, the Company's impaired loans are reported at their estimated fair value on a non-recurring basis. An allowance for each impaired loan is calculated based on the present value of expected future cash flows discounted at the loan's effective interest rate, the loan's observable market price or the fair value of its collateral. Most of the Company's impaired loans are collateral-dependent. The fair value of the collateral for these loans is based on appraisals performed by third-party valuation specialists, comparable sales and other estimates of fair value obtained principally from independent sources such as the Multiple Listing Service or county tax assessors' listings, adjusted for estimated selling costs. The Company has a Real Estate Appraisal Policy (the "Policy") which is in compliance with the guidelines set forth in the Interagency Appraisal and Evaluation Guidelines which implement Title XI of the Financial Institutions Reform, Recovery and Enforcement Act of 1989 ( "FIRREA"). The Policy further requires that appraisals be in writing and conform to the Uniform Standards of Professional Appraisal Practice ( "USPAP"). An appraisal prepared by a state-licensed or state-certified appraiser is required on all new loans secured by real estate in excess of \$250,000. Loans secured by real estate in an amount of \$250,000 or less, or that qualify for an exemption under FIRREA, must have a summary appraisal report or in-house evaluation, depending on the facts and circumstances. Factors, including the assumptions and techniques utilized by the appraiser, which could result in a downward adjustment to the collateral value estimates indicated in the appraisal, are considered by the Company.

Changes in the general economy, or economy or real estate market in a particular geographic area or industry are reflected in the general reserve component of the allowance for loan losses.

**Table of Contents**

Appraisals are generally considered to be valid for a period of at least twelve months. However, appraisals that are less than 12 months old may need to be adjusted. The criteria for determining whether an existing appraisal remains valid will vary depending upon the condition of the property, time, volatility of the local market and loan to value issues. Through the loan review process, suspected deterioration or downgrade of a loan might indicate that a new appraisal is needed. A decline in the credit quality or ability to repay of a borrower is the primary indicator for the need of an updated appraisal on the related collateral.

Management has determined that appraisals on impaired loans should be discounted to record the fair value of collateral. The discounts applied to those appraisals are the same as the loan to value percentages specified in the Company's Loan Policy for new loans, supported by Management's experience. Loan to value percentages are from 65% on unimproved real estate (a 35% discount), 70% - 75% on improved residential and commercial real estate (a 25% - 30% discount) and 80% on improved owner occupied residential real estate (a 20% discount). Every appraisal is discounted, as the Company does not make loans where the loan to value is 100%.

If the recorded investment in the impaired loan exceeds the measure of fair value of the collateral, a valuation allowance is recorded as a component of the allowance for loan losses.

The balances of impaired loans, which are measured at fair value on a non-recurring basis, by level within the hierarchy as of September 30, 2010 and December 31, 2009 were as follows:

	Total	Fair Value Measurement Using		
		Level 1	Level 2	Level 3
September 30, 2010	\$ 19,750,301	\$	\$ 11,917,278	\$ 7,833,023
December 31, 2009	20,110,334		20,110,334	

The following table sets forth a summary of changes in the fair value of impaired loans, the Company's only Level 3 assets:

	For the nine months ended september 30, 2010
Fair value, beginning of period	\$
Net gains	7,833,023
Fair value, end of period	\$ 7,833,023

When Management determines that it has sustained a loss on a loan, it may be necessary to foreclose on the related collateral. Other real estate acquired through foreclosure is carried at fair value, less estimated costs to sell. The fair value of the collateral is based on appraisals performed by third-party valuation specialists. Factors including the assumptions and techniques utilized by the appraiser are considered by Management. If the current appraisal is more than one year old and/or the loan balance is more than \$200,000, a new appraisal is obtained. Otherwise, the Bank's in-house property evaluator and management will determine the fair value of the collateral, based on

**Table of Contents**

comparable sales, market conditions, Management's plans for disposition and other estimates of fair value obtained from principally independent sources, adjusted for estimated selling costs. Accordingly, the Company's other real estate is reported at its estimated fair value on a non-recurring basis.

The balances of other real estate, which are measured at fair value on a non-recurring basis, by level within the hierarchy as of September 30, 2010 and December 31, 2009 were as follows:

	Total	Fair Value Measurement Using		
		Level 1	Level 2	Level 3
September 30, 2010	\$ 2,818,833	\$	\$ 2,818,833	\$
December 31, 2009	1,521,313		1,521,313	

## 6. Allowance for Loan Losses:

Transactions in the allowance for loan losses were as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2010	2009	2010	2009
Balance, beginning of period	\$ 9,167,927	\$ 9,797,881	\$ 7,827,806	\$ 11,113,575
Recoveries	90,591	5,140	164,792	334,774
Loans charged off	(1,307,690)	(3,571,433)	(2,776,770)	(7,066,761)
Provision for allowance for loan losses	1,045,000	1,875,000	3,780,000	3,725,000
Balance, end of period	\$ 8,995,828	\$ 8,106,588	\$ 8,995,828	\$ 8,106,588

## 7. Deposits:

At September 30, 2010, time deposits of \$100,000 or more include brokered deposits of \$29,399,000, of which \$19,399,000 matures in 2011 and \$10,000,000 matures in 2012.

## 8. Other Comprehensive Income:

The income tax effect from the unrealized gain on available for sale securities on accumulated other comprehensive income was \$1,256,521 at September 30, 2010.

## 9. Shareholders' Equity:

On June 23, 2010, the Board approved a semi-annual dividend of \$.11 per share with a record date of July 9, 2010 and distribution date of July 16, 2010.

**Table of Contents****10. Fair Value of Financial Instruments:**

The carrying amounts and estimated fair value for financial assets and financial liabilities at September 30, 2010 and December 31, 2009, respectively, were as follows:

	September 30, 2010		December 31, 2009	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
<b>Financial Assets:</b>				
Cash and due from banks	\$ 34,523,516	\$ 34,523,516	\$ 29,155,294	\$ 29,155,294
Available for sale securities	302,832,580	302,832,580	311,434,437	311,434,437
Held to maturity securities	2,814,137	2,972,300	3,201,966	3,340,974
Other investments	4,020,754	4,020,754	4,036,304	4,036,304
Federal Home Loan Bank stock	3,375,400	3,375,400	5,015,900	5,015,900
Loans, net	413,165,761	416,311,962	457,148,485	460,587,836
Cash surrender value	15,786,368	15,786,368	15,329,394	15,329,394
<b>Financial Liabilities:</b>				
<b>Deposits:</b>				
Non-interest bearing	116,955,635	116,955,635	96,541,387	96,541,387
Interest bearing	415,960,657	416,784,975	374,160,042	375,051,835
Total deposits	532,916,292	533,740,610	470,701,429	471,593,222
Federal funds purchased and securities sold under agreements to repurchase	142,380,679	142,380,679	174,430,877	174,430,877
Borrowings from Federal Home Loan Bank	18,978,441	20,586,523	104,270,452	105,815,000

**11. New Accounting Pronouncements:**

In February 2010, the FASB issued Accounting Standards Update No. 2010-09, Subsequent Events: Amendments to Certain Recognition and Disclosure Requirements ( ASU No. 2010-09 ). ASU No. 2010-09 removes some contradictions between the requirements of U.S. GAAP and the filing rules of the Securities and Exchange Commission ( SEC ). SEC filers are required to evaluate subsequent events through the date the financial statements are issued, and they are no longer required to disclose the date through which subsequent events have been evaluated.

This guidance was effective upon issuance except for the use of the issued date for conduit debt obligors, and it is not expected to have a material impact on Company's results of operations, financial position or disclosures.

In February 2010, the FASB issued Accounting Standards Update No. 2010-10, Consolidation: Amendments for Certain Investment Funds ( ASU No. 2010-10 ). ASU No. 2010-10 indefinitely defers the effective date for certain investment funds, the amendments made to FASB ASC 810-10 related to variable interest entities by Statement of Financial Accounting Standard ( SFAS ) No. 167, however this deferral does not apply to the disclosure requirements of SFAS No. 167. ASU No. 2010-10 also clarifies that (1) interests of related parties must be considered in determining whether fees paid to decision makers or service providers constitute a variable interest, and (2) a quantitative calculation should not be the only basis on which such determination is made. This guidance is effective as of the beginning of the first annual period beginning after November 15, 2009, and for interim periods within that first annual reporting period. It is not expected to have a material impact on Company's results of operations, financial position or disclosures.

**Table of Contents**

In March 2010, the FASB issued Accounting Standards Update No. 2010-11, Derivatives and Hedging: Scope Exception Related to Embedded Credit Derivatives ( ASU No. 2010-11 ). ASU No. 2010-11 clarifies the type of embedded credit derivative that is exempt from embedded derivative bifurcation requirements, by resolving a potential ambiguity about the breadth of the embedded credit derivative scope exception with regard to some types of contracts, such as collateralized debt obligations ( CDO s ) and synthetic CDO s. The scope exception will no longer apply to some contracts that contain an embedded credit derivative feature that transfers credit risk. The ASU is effective for fiscal quarters beginning after June 15, 2010, and is not expected to have a material impact on Company s results of operations, financial position or disclosures.

In April 2010, the FASB issued Accounting Standards Update No. 2010-18, Effect of a Loan Modification When the Loan is Part of a Pool That Is Accounted for as a Single Asset ( ASU No. 2010-18 ). ASU No. 2010-18 allows for the one-time election to terminate accounting for loans as a pool under ASU Subtopic 310-30. This election may be applied on a pool-by-pool basis and does not preclude an entity from applying pool accounting to subsequent acquisitions of loans with credit deterioration. ASU No. 2010-18 is effective for modifications of loans accounted for within pools under Subtopic 310-30 occurring in the first interim or annual period ending on or after July 15, 2010. It is not expected to have a material impact on Company s results of operations, financial position or disclosures.

In July 2010, the FASB issued Accounting Standards Update No. 2010-20, Disclosures about the Credit Quality of Financing Receivables and the Allowance for Credit Losses ( ASU No. 2010-20 ). ASU No. 2010-20 requires enhanced disclosures, including a greater level of disaggregated information, about the credit quality of financial receivables and the allowance for credit losses. Additionally, this standards update also requires an entity to disclose credit quality indicators, past due information, modifications to financing receivables and significant purchases and sales of financing receivables. The disclosures as of the end of a reporting period under ASU No. 2010-20 are effective for the Company for interim and annual reporting periods ending on or after December 15, 2010. The disclosures about activity that occurs during a reporting period are effective for the Company for interim and annual reporting periods beginning on or after December 15, 2010. It is not expected to have a material impact on Company s results of operations or financial position, but will require additional disclosures.

12. Reclassifications:

Certain reclassifications, which had no effect on prior year net income, have been made to prior period statements to conform to current year presentation.

**Table of Contents**

**Item 2: Management's Discussion and Analysis of Financial Condition and Results of Operations**

**GENERAL**

The Company is a one-bank holding company headquartered in Biloxi, Mississippi. It has two operating subsidiaries, PFC Service Corp. and The Peoples Bank, Biloxi, Mississippi (the Bank). The Bank provides a full range of banking, financial and trust services to state, county and local government entities and individuals and small and commercial businesses in Harrison, Hancock, Stone and Jackson counties in Mississippi.

The following presents Management's discussion and analysis of the consolidated financial condition and results of operations of Peoples Financial Corporation and Subsidiaries. These comments should be considered in combination with the Consolidated Financial Statements and Notes to Consolidated Financial Statements included in this report on Form 10-Q and the Consolidated Financial Statements, Notes to Consolidated Financial Statements and Management's Discussion and Analysis included in the Company's Form 10-K for the year ended December 31, 2009.

**Forward-Looking Information**

Congress passed the Private Securities Litigation Act of 1995 in an effort to encourage corporations to provide information about a company's anticipated future financial performance. This act provides a safe harbor for such disclosure which protects the companies from unwarranted litigation if actual results are different from management expectations. This report contains forward-looking statements and reflects industry conditions, company performance and financial results. These forward-looking statements are subject to a number of factors and uncertainties which could cause the Company's actual results and experience to differ from the anticipated results and expectations expressed in such forward-looking statements. Such factors and uncertainties include, but are not limited to: changes in interest rates and market prices, changes in local economic and business conditions, increased competition for deposits and loans, a deviation in actual experience from the underlying assumptions used to determine and establish the allowance for loan losses, changes in the availability of funds resulting from reduced liquidity, changes in government regulations and acts of terrorism, weather or other events beyond the Company's control.

**New Accounting Pronouncements**

The FASB has issued a number of Accounting Standards Updates, which have been disclosed in Note 11. The Company does not expect that any of these updates will have a material impact on its results of operations, financial position or disclosures.

**Critical Accounting Policies**

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires Management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. The Company evaluates these estimates and assumptions on an on-going basis

**Table of Contents**

using historical experience and other factors, including the current economic environment. We adjust such estimates and assumptions when facts and circumstances dictate. Certain critical accounting policies affect the more significant estimates and assumptions used in the preparation of the consolidated financial statements.

**Allowance for loan losses:**

The Company's most critical accounting policy relates to its allowance for loan losses ( ALL ), which reflects the estimated losses resulting from the inability of its borrowers to make loan payments. The ALL is established and maintained at an amount sufficient to cover the estimated loss associated with the loan portfolio of the Company as of the date of determination. Credit losses arise not only from credit risk, but also from other risks inherent in the lending process including, but not limited to, collateral risk, operation risk, concentration risk and economic risk. As such, all related risks of lending are considered when assessing the adequacy of the ALL. On a quarterly basis, Management estimates the probable level of losses to determine if the allowance is adequate to absorb reasonably foreseeable, anticipated losses in the existing portfolio based on our past loan loss experience, known and inherent risk in the portfolio, adverse situations that may affect the borrowers' ability to repay and the estimated value of any underlying collateral and current economic conditions. If there was a deterioration of any of the factors considered by Management in evaluating the allowance for loan losses, the estimate of loss would be updated, and additional provisions for loan losses may be required. The analysis divides the portfolio into two segments: a pool analysis of loans based upon loss history by loan type and a specific reserve analysis for those loans considered impaired under generally accepted accounting principles. All credit relationships with an outstanding balance of \$100,000 or greater are individually reviewed for impairment. All losses are charged to the ALL when the loss actually occurs or when a determination is made that a loss is likely to occur; recoveries are credited to the ALL at the time of receipt.

**Employee Benefit Plans:**

Employee benefit plan liabilities and pension costs are determined utilizing actuarially determined present value calculations. The valuation of the benefit obligation and net periodic expense is considered critical, as it requires Management and its actuaries to make estimates regarding the amount and timing of expected cash outflows including assumptions about mortality, expected service periods and the rate of compensation increases.

**OVERVIEW**

The Company's subsidiary is a community bank serving the financial and trust needs of its customers in Harrison, Hancock, Jackson and Stone Counties in Mississippi. Maintaining a strong core deposit base and providing commercial and real estate lending services in its trade area is the traditional focus of the Bank. Growth has largely been achieved through de novo branching activity, and it is expected that this strategy will continue to be utilized in the future.

With the focus of our core business being on the Mississippi Gulf Coast, any significant local events have the potential to impact the Company's business. Although the recent oil spill in the Gulf of Mexico



**Table of Contents**

has not had a significant direct impact on the Company, its effects on the seafood and tourism industries in our trade area and the local economy in general may not be known for years to come. Additionally, the current interest rate environment, the decline in the value of real estate and the general economic downturn on a local and national level has affected the Company's results. Managing the net interest margin in the Company's highly competitive market and in the context of larger national economic conditions has been very challenging and will continue to be so for the foreseeable future.

Net income for the third quarter of 2010 was \$364,400 compared with \$974,110 for the third quarter of 2009 and for the first three quarters of 2010 was \$2,681,937 compared with \$2,877,784 for the first three quarters of 2009. These decreases were almost entirely due to the decrease in net interest income of \$1,288,035 and \$583,693 for the third quarter of 2010 as compared with the third quarter of 2009 and the nine months ended September 30, 2010 as compared with the nine months ended September 30, 2009, respectively. More than \$230 million of the Company's investment in U.S. Agency securities have been called during the current year, with most of the proceeds being invested in similar securities but at a significantly lower rate. Management plans to modify its investment strategy beginning in the fourth quarter of 2010 in order to seek opportunities to improve the yield on its investment portfolio. Monitoring asset quality and addressing potential losses in our loan portfolio continues to be emphasized during these difficult economic times. During the third quarter of 2009, non-performing loans, particularly non-accrual loans, increased significantly and remained at those levels at September 30, 2010. Approximately 35% of our total nonaccrual loans as of September 30, 2010 relates to one performing credit relationship which has been classified as nonaccrual by the banking regulators in their shared national credit review.

Total assets at September 30, 2010 decreased \$49,569,561 as compared with December 31, 2009. Available for sale securities decreased \$8,601,857 while loans decreased \$42,814,702 as principal payments and maturities outpaced new loan volume. Deposits increased by \$62,214,863 at September 30, 2010, providing the liquidity for borrowings from the Federal Home Loan Bank to decrease \$85,292,011 as compared with December 31, 2009.

**RESULTS OF OPERATIONS**

**Net Interest Income**

Net interest income, the amount by which interest income on loans, investments and other interest earning assets exceeds interest expense on deposits and other borrowed funds, is the single largest component of the Company's income. Management's objective is to provide the largest possible amount of income while balancing interest rate, credit, liquidity and capital risk. Changes in the volume and mix of interest earning assets and interest-bearing liabilities combined with changes in market rates of interest directly affect net interest income.

**Table of Contents**

Quarter Ended September 30, 2010 as Compared with Quarter Ended September 30, 2009 The Company's average interest earning assets decreased approximately \$66,194,000, or 8%, from approximately \$823,075,000 for the third quarter of 2009 to approximately \$756,881,000 for the third quarter of 2010. The Company's average balance sheet has shrunk as principal payments and maturities of loans have outpaced new loans and investments have been called or sold.

The average yield on earning assets decreased 57 basis points from 4.29% for the third quarter of 2009 to 3.72% for the third quarter of 2010, with the biggest impact being to the yield on taxable available for sale securities. The Company's investment and liquidity strategy has been to invest most of the proceeds from sales and calls of securities in similar securities with a maturity of two years, the interest rates on which have decreased dramatically. As a result, the yield on taxable available for sale securities decreased from 4.36% for the third quarter of 2009 to 2.51% for the third quarter of 2010. Beginning in the fourth quarter of 2010, Management has begun acquiring such securities with a maturity of five years in order to improve the yield.

Average interest bearing liabilities decreased approximately \$81,450,000, or 12%, from approximately \$693,250,000 for the third quarter of 2009 to approximately \$611,800,000 for the third quarter of 2010. The average rate paid on interest bearing liabilities decreased 21 basis points, from .95% for the third quarter of 2009 to .74% for the third quarter of 2010. This dramatic decrease is the result of utilizing lower cost funding sources including brokered deposits and Federal Home Loan Bank advances in 2010 as compared with 2009. The Company believes that it is unlikely that its cost of funds can be materially reduced further.

The Company's net interest margin on a tax-equivalent basis, which is net interest income as a percentage of average earning assets, was 3.12% at September 30, 2010, down 36 basis points from 3.48% at September 30, 2009. In addition to adjusting the duration of investment purchases, the Company is also establishing floors on new and renewing loans in order to improve the net interest margin.

Nine Months Ended September 30, 2010 as Compared with Nine Months Ended September 30, 2009 The Company's average interest earning assets decreased approximately \$61,078,000, or 8%, from approximately \$827,475,000 for the first nine months of 2009 to approximately \$766,397,000 for the first nine months of 2010. The Company's average balance sheet has shrunk as principal payments and maturities of loans have outpaced new loans and investments have been called and sold.

The average yield on earning assets decreased 17 basis points, from 4.24% for the first nine months of 2009 to 4.07% for the first nine months of 2010. The yield on taxable available for sale securities decreased from 4.11% for the first nine months of 2009 to 3.55% for the first nine months of 2010, as a result of the investment strategy employed by the Company. As discussed in the quarter comparison above, investment maturities will be extended for future purchases. Average interest bearing liabilities decreased approximately \$61,336,000, or 9%, from approximately \$690,195,000 for the first nine months of 2009 to approximately \$628,859,000 for the first nine months of 2010. The average rate paid on interest bearing liabilities decreased 38 basis

**Table of Contents**

points, from 1.15% for the first nine months of 2009 to .77% for the first nine months of 2010. This decrease is the result of utilizing lower cost funding sources including brokered deposits and Federal Home Loan Bank advances in 2010 as compared with 2009. The Company believes that it is unlikely that its cost of funds can be materially reduced further.

The Company's net interest margin on a tax-equivalent basis, which is net interest income as a percentage of average earning assets, was 3.44% at September 30, 2010, up 16 basis points from 3.28% at September 30, 2009. The net interest margin increase for the first nine months of 2010 reflects only one quarter of the dramatic decrease in yield on taxable available for sale securities.

The tables on the following pages analyze the changes in tax-equivalent net interest income for the quarters ended September 30, 2010 and 2009 and the nine months ended September 30, 2010 and 2009.

**Table of Contents**Analysis of Average Balances, Interest Earned/Paid and Yield  
(In Thousands)

	Three Months Ended September 30, 2010			Three Months Ended September 30, 2009		
	Average Balance	Interest Earned/Paid	Rate	Average Balance	Interest Earned/Paid	Rate
Loans (2)(3)	\$428,664	\$ 4,815	4.49%	\$466,954	\$ 5,028	4.30%
Federal Funds Sold	10,202	5	0.20%	7,631	5	0.26%
HTM:						
Non taxable (1)	2,814	40	5.69%	3,201	39	4.87%
AFS:						
Taxable	270,549	1,698	2.51%	306,267	3,336	4.36%
Non taxable (1)	40,627	462	4.55%	34,848	402	4.61%
Other	4,025	15	1.49%	4,174	10	0.96%
<b>Total</b>	<b>\$756,881</b>	<b>\$ 7,035</b>	<b>3.72%</b>	<b>\$823,075</b>	<b>\$ 8,820</b>	<b>4.29%</b>
Savings & interest-bearing DDA	\$217,807	\$ 251	0.46%	\$225,233	\$ 303	0.54%
CD s	194,379	575	1.18%	203,479	769	1.51%
Federal funds purchased	151,615	249	0.66%	209,578	437	0.83%
FHLB advances	47,999	58	0.48%	54,960	142	1.03%
<b>Total</b>	<b>\$611,800</b>	<b>\$ 1,133</b>	<b>0.74%</b>	<b>\$693,250</b>	<b>\$ 1,651</b>	<b>0.95%</b>
Net tax-equivalent yield on earning assets			3.12%			3.48%

(1) All interest earned is reported on a taxable equivalent basis using a tax rate of 34% in 2010 and 2009.

(2) Loan fees of \$60,510 and \$107,898 for 2010 and 2009, respectively, are included in these figures.

(3) Includes nonaccrual

loans.

**Table of Contents**Analysis of Average Balances, Interest Earned/Paid and Yield  
(In Thousands)

	Nine Months Ended September 30, 2010			Nine Months Ended September 30, 2009		
	Average Balance	Interest Earned/Paid	Rate	Average Balance	Interest Earned/Paid	Rate
Loans (2)(3)	\$443,282	\$ 14,695	4.42%	\$470,290	\$ 15,233	4.32%
Federal Funds Sold	6,315	10	0.21%	3,409	7	0.27%
HTM:						
Non taxable (1)	3,012	116	5.14%	3,286	129	5.23%
AFS:						
Taxable	268,584	7,154	3.55%	313,690	9,674	4.11%
Non taxable (1)	40,446	1,408	4.64%	33,645	1,239	4.91%
Other	4,758	22	0.62%	3,155	17	0.72%
Total	\$766,397	\$23,405	4.07%	\$827,475	\$26,299	4.24%
Savings & interest-bearing DDA	\$221,561	\$ 829	0.50%	\$235,388	\$ 1,540	0.87%
CD s	189,707	1,664	1.17%	198,821	2,486	1.67%
Federal funds purchased	159,281	812	0.68%	222,447	1,532	0.92%
FHLB advances	58,310	304	0.70%	33,539	413	1.64%
Total	\$628,859	\$ 3,609	0.77%	\$690,195	\$ 5,971	1.15%
Net tax-equivalent yield on earning assets			3.44%			3.28%

(1) All interest earned is reported on a taxable equivalent basis using a tax rate of 34% in 2010 and 2009.

(2) Loan fees of \$376,112 and \$395,114 for 2010 and 2009, respectively, are included in these figures.

(3)

Includes  
nonaccrual  
loans.

25

---

**Table of Contents****Provision for Loan Losses**

In the normal course of business, the Company assumes risk in extending credit to its customers. This credit risk is managed through compliance with the loan policy, which is approved by Board of Directors. The policy establishes guidelines relating to underwriting standards, including but not limited to financial analysis, collateral valuation, lending limits, pricing considerations and loan grading. A loan review process further assists with evaluating credit quality and assessing potential performance issues. Loan delinquencies and deposit overdrafts are closely monitored in order to identify developing problems as early as possible. In addition, the Company continuously monitors its relationships with its loan customers in concentrated industries such as gaming and hotel/motel, as well as the exposure for out of area, land, development, construction and commercial real estate loans, and their direct and indirect impact on its operations. A watch list of credits which pose a potential loss to the Company is prepared based on the loan grading system. This list forms the foundation of the Company's allowance for loan loss computation. Management relies on its guidelines and existing methodology to monitor the performance of its loan portfolio and to identify and estimate potential losses based on the best available information. The potential effect of the economic downturn on a national and local level, the decline in real estate values and actual losses incurred by the Company were key factors in our analysis. The potential direct and/or indirect impact of the oil spill in the Gulf of Mexico on the Company and its customers was also considered and will continue to be monitored as there is sufficient uncertainty as to the ultimate impact. However, no potential losses as a result of the spill were identified at September 30, 2010.

The Company's on-going, systematic evaluation resulted in the Company recording a provision for loan losses of \$1,045,000 and \$1,875,000 for the third quarter of 2010 and 2009, respectively, and \$3,780,000 and \$3,725,000 for the nine months ended September 30, 2010 and 2009, respectively. The allowance for loan losses as a percentage of loans was 2.13% at September 30, 2010 as compared with 1.68% at December 31, 2009, in part due to the decrease in loans of \$42,814,702 during this time frame. Net charge-offs were \$2,611,978 for the first nine months of 2010 as compared with \$6,731,987 for the first nine months of 2009 as more potential losses on loans were identified during the prior year. Most of the Company's charge-offs were partial charge-offs, which represent that portion of a loan which is deemed to be uncollectible.

The allowance for loan losses is an estimate, and as such, events may occur in the future which may affect its accuracy. The Company anticipates that it is possible that additional information will be gathered in future quarters which may require an adjustment to the allowance for loan losses. Management will continue to closely monitor its portfolio and take such action as it deems appropriate to accurately report its financial condition and results of operations.

**Non-interest income**

Total non-interest income decreased \$382,288 for the third quarter of 2010 as compared with the third quarter of 2009. This decrease was primarily the result of a gain on sales or calls or securities of \$92,023 in 2010 as compared with \$265,247 in 2009 as the Company executed sales when it could maximize proceeds. Service charges on deposit accounts were impacted by the local economy and



**Table of Contents**

customers opting out of overdraft protection for debit card transactions which resulted in the decrease in NSF fee income of \$174,276.

Total non-interest income increased \$646,574 for the first nine months of 2010 as compared with the first nine months of 2009. This increase was primarily the result of gains on sales or calls or securities of \$1,257,463 in 2010 as compared with \$402,046 in 2009 as the Company liquidated its entire mortgage-backed securities portfolio and some of its short-term U.S. Treasuries during the second quarter of 2010. Trust department income and fees decreased \$75,079 for the first nine months of 2010 as compared with the first nine months of 2009 as a result of the decrease in market value, on which fees are based, of personal trust accounts. Service charges on deposit accounts were impacted by the local economy and customers opting out of overdraft protection for debit card transactions which resulted in the decrease in NSF fee income of \$349,617 for the first nine months of 2010 as compared with the first nine months of 2009. Other income decreased \$144,001 for the first nine months of 2010 as compared with the first nine months of 2009. Other income for 2010 included a decrease in rental income of \$73,891 as the Company lost one tenant who had occupied a large rental space in its Downtown Gulfport branch. Other income for 2009 included gains of \$94,423 from the sale of bank assets.

**Non-interest expense**

Total non-interest expense increased \$261,387 for the third quarter of 2010 as compared with the third quarter of 2009. Salaries and employee benefits decreased \$163,907 in 2010 as compared with 2009 as a result of the decrease in the number of employees as a result of attrition during 2009 and 2010. FDIC regular assessments have increased for 2010 as banks fund the replenishment of the bank insurance fund which was depleted in recent years by bank closures. Other expense increased \$264,755 in 2010 as compared with 2009 as a result of increased data processing charges, franchise tax expense and legal fees. For the third quarter of 2010, data processing charges increased \$53,838 over the third quarter of 2009 as a result of the outsourcing of some of the bank's I/T functions. Franchise tax expense increased \$85,238 for the third quarter of 2010 as compared with the third quarter of 2009 as prior years' refunds were received in 2009. Legal fees increased \$111,633 for the third quarter of 2010 as compared with the third quarter of 2009 as the Company engaged counsel to assist with several non-performing loan issues.

Total non-interest expense increased \$238,728 for the first nine months of 2010 as compared with the first nine months of 2009. Salaries and employee benefits decreased \$428,143 in 2010 as compared with 2009 as a result of the decrease in the number of employees as a result of attrition during 2009 and 2010. Included in the first nine months of 2010 was decreased occupancy expense of \$84,167 relating primarily to reduced property and casualty insurance costs. FDIC regular assessments have increased as banks fund the replenishment of the bank insurance fund which was depleted in recent years by bank closures resulting in an increase of \$265,264 for the first nine months of 2010 as compared with the first nine months of 2009. Other expense increased \$531,863 for the first nine months of 2010 as compared with the first nine months of 2009 as a result of increased data processing charges, franchise tax expense, legal fees, expenses relating to other real estate and trust expense. For the first nine months of 2010, data processing charges increased \$162,293 as compared with the first nine months of 2009 as a result of the outsourcing of the some

**Table of Contents**

of the bank's I/T functions. Franchise tax expense increased \$178,723 for the first nine months of 2010 as compared with the first nine months of 2009 as prior years' refunds were received in 2009. Legal fees increased \$120,585 for the first nine months of 2010 as compared with the first nine months of 2009 as the Company engaged counsel to assist with several non-performing loan issues. Expenses relating to other real estate increased \$158,822 during the first nine months of 2010 as compared with the first nine months of 2009 due to an increased number of foreclosures. Trust expense decreased \$45,907 for the first nine months of 2010 as compared with the first nine months of 2009 as the Company was able to reduce its monthly servicing fees for several months in 2010 using soft dollar credits from its processing vendor.

**Income Taxes**

Income taxes have been impacted by non-taxable income and federal tax credits during the quarters and nine months ended September 30, 2010 and 2009, respectively, as presented in the following tables:

	Quarter Ended September 30,			
	2010		2009	
	Tax	Rate	Tax	Rate
Taxes at statutory rate	\$ (11,084)	(34.00)	\$ 363,497	34.00
Increase (decrease) resulting from:				
Tax-exempt interest income	(113,016)	(346.68)	(98,962)	(9.26)
Income from BOLI	(42,991)	(131.87)	7,477	0.70
Federal tax credits	(208,289)	(638.92)	(65,000)	(6.08)
Other	(21,620)	(66.32)	(112,012)	(10.48)
Total income taxes	\$ (397,000)	(1,217.79)	\$ 95,000	8.88

	Nine Months Ended September 30,			
	2010		2009	
	Tax	Rate	Tax	Rate
Taxes at statutory rate	\$ 1,013,859	34.00	\$ 1,092,347	34.00
Increase (decrease) resulting from:				
Tax-exempt interest income	(342,027)	(11.47)	(307,186)	(9.56)
Income from BOLI	(130,012)	(4.36)	(126,562)	(3.94)
Federal tax credits	(223,289)	(7.49)	(195,000)	(6.07)
Other	(18,531)	(0.62)	(128,599)	(4.00)
Total income taxes	\$ 300,000	10.06	\$ 335,000	10.43

**FINANCIAL CONDITION**

Available for sale securities decreased \$8,601,857 at September 30, 2010, compared with December 31, 2009, as the bank subsidiary's liquidity position allowed. The Company sold its entire mortgage-backed securities portfolio in 2010 and increased its investment in short-term U.S. Treasury securities. The following schedule reflects the mix of available for sale securities at September 30, 2010 and December 31, 2009:

**Table of Contents**

	September 30, 2010	December 31, 2009
Available for sale securities:		
U.S. Treasury	\$ 48,084,373	\$ 24,740,140
U.S. Government agencies	212,506,593	214,578,196
Mortgage-backed securities		31,262,670
States and political subdivisions	41,591,631	40,203,448
Equity securities	649,983	649,983
 Total available for sale securities	 \$302,832,580	 \$311,434,437

The Company decreased its investment in Federal Home Loan Bank ( FHLB ) stock to \$3,375,400 as a result of its decreased borrowing from the FHLB.

Loans decreased \$42,814,702 as a result of principal payments and maturities and the slower volume of new loans, particularly in our real estate and commercial and industrial portfolio. The Company anticipates that its loan portfolio will decline further in the remaining quarter of 2010. The composition of the loan portfolio as of September 30, 2010 and December 31, 2009 was as follows:

	September 30, 2010	December 31, 2009
Real estate, construction	\$ 97,289,179	\$ 94,460,479
Real estate, mortgage	267,158,803	299,402,982
Loans to finance agricultural production	1,098,584	1,754,796
Commercial and industrial loans	44,160,077	52,250,231
Loans to individuals for household, family and other consumer expenditures	8,697,520	9,049,394
Obligations of states and political subdivisions	3,086,131	7,890,584
All other loans	671,295	167,825
 Total	 \$422,161,589	 \$464,976,291

Other real estate ( ORE ) increased \$1,297,520 at September 30, 2010, as compared with December 31, 2009 as foreclosures exceeded sales of ORE in 2010.

The decrease in volume and yield of interest-earning assets has directly impacted accrued interest receivable, which decreased \$1,339,542 during the first nine months of 2010.

Prepaid FDIC assessments decreased by \$968,070 at September 30, 2010 as compared with December 31, 2009 as a result of the amortization of these costs.

Other assets increased \$1,511,963 at September 30, 2010, as compared with December 31, 2009. This increase is primarily attributable to the increase in income taxes receivable of \$1,281,715 at September 30, 2010.

**Table of Contents**

Total deposits increased \$62,214,863 at September 30, 2010, as compared with December 31, 2009. Typically, significant increases or decreases in total deposits and/or significant fluctuations among the different types of deposits from quarter to quarter are anticipated by Management as customers in the casino industry and county and municipal entities reallocate their resources periodically. During the first nine months of 2010, time deposits with a balance of \$100,000 or more increased \$27,242,278 and include an increase in public fund time deposits of \$46,120,934. Federal funds purchased and securities sold under agreements to repurchase, which includes a non-deposit account, decreased \$32,050,198 at September 30, 2010 as compared with December 31, 2009 as customers periodically reallocate their funds.

Borrowings from the Federal Home Loan Bank decreased \$85,292,011 at September 30, 2010 as compared with December 31, 2009 based on the liquidity needs of the bank subsidiary.

**SHAREHOLDERS EQUITY AND CAPITAL ADEQUACY**

Strength, security and stability have been the hallmark of the Company since its founding in 1985 and of its bank subsidiary since its founding in 1896. A strong capital foundation is fundamental to the continuing prosperity of the Company and the security of its customers and shareholders. One measure of capital adequacy is the primary capital ratio which was 13.74% at September 30, 2010, which is well above the regulatory minimum of 6.00%. Management continues to emphasize the importance of maintaining the appropriate capital levels of the Company and has established the goal of maintaining its primary capital ratio at 8.00%, which is the minimum requirement for classification as being well-capitalized by the banking regulatory authorities.

**LIQUIDITY**

Liquidity represents the Company's ability to adequately provide funds to satisfy demands from depositors, borrowers and other commitments by either converting assets to cash or accessing new or existing sources of funds. Management monitors these funds requirements in such a manner as to satisfy these demands and provide the maximum earnings on its earning assets. The Company utilizes various tools to project its liquidity needs and performs analyses to determine the accuracy of those projections as well as to anticipate and plan for liquidity risk scenarios.

Deposits, payments of principal and interest on loans, proceeds from maturities, sales and calls of investment securities and earnings on investment securities are the principal sources of funds for the Company.

Borrowings from the Federal Home Loan Bank, federal funds sold and federal funds purchased are also utilized by the Company to manage its daily liquidity position. The Company may also utilize the Federal Reserve Bank Discount Window Primary Credit Program as a source of liquidity, if necessary.

**Table of Contents**

**REGULATORY MATTERS**

During 2009, Management identified opportunities for improving risk management, addressing asset quality concerns, managing concentrations of credit risk and ensuring sufficient liquidity at the Bank as a result of its own investigation as well as examinations performed by certain bank regulatory agencies. In concert with the regulators, the Company identified specific corrective steps and actions to enhance its risk management, asset quality and liquidity policies, controls and procedures. The Company and the Bank may not declare or pay any cash dividends without the prior written approval of their regulators.

The Company has been an accelerated filer since December 31, 2005. Based on the decrease of its market capitalization to \$43,604,128 at June 30, 2010, the Company will become a non-accelerated filer on December 31, 2010.

In July 2010, the Dodd-Frank Wall Street Reform and Consumer Protection Act ( the Act ) was passed by the Congress. The Act increases the supervisory authority of the Federal Reserve Board, creates a new Financial Services Oversight Council, creates a new process to liquidate failed financial firms, creates an independent Bureau of Consumer Financial Protection, implements comprehensive regulation of over-the-counter derivatives, establishes a Federal Insurance Office and increases the transparency and accountability for credit rating agencies. The Act requires more than 60 studies to be conducted and more than 200 regulations to be written over the next one to two years. The true impact of the legislation on the Company will be unknown until these are complete.

**Item 4: Controls and Procedures**

As of September 30, 2010, an evaluation was performed under the supervision and with the participation of the Chief Executive Officer and Chief Financial Officer of the effectiveness of the Company's disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e)). Based on that evaluation, the Chief Executive Officer and the Chief Financial Officer have concluded that the Company's disclosure controls and procedures are effective to ensure that the information required to be disclosed by the Company in the reports it files or submits under the Securities Exchange Act of 1934 is recorded, processed, summarized and reported, within the time periods specified in the Securities and Exchange Commission's rules and forms.

There were no changes in the Company's internal control over financial reporting that occurred during the period ended September 30, 2010 that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

**Table of Contents**

**PART II OTHER INFORMATION**

**Item 1: Legal Proceedings**

The bank is involved in various legal matters and claims which are being defended and handled in the ordinary course of business. None of these matters is expected, in the opinion of Management, to have a material adverse effect upon the financial position or results of operations of the Company.

**Item 6 Exhibits and Reports on Form 8-K**

(a) Exhibits

Exhibit 10.1: Description of Bonus Plan

Exhibit 31.1: Certification of Chief Executive Officer Pursuant to Section 302 of the Sarbanes Oxley Act of 2002

Exhibit 31.2: Certification of Chief Financial Officer Pursuant to Section 302 of the Sarbanes Oxley Act of 2002

Exhibit 32.1: Certification of Chief Executive Officer Pursuant to 18 U.S.C. ss. 1350

Exhibit 32.2: Certification of Chief Financial Officer Pursuant to 18 U.S.C. ss. 1350

(b) Reports on Form 8-K

A Form 8-K was filed on July 28, 2010 and October 27, 2010.

**Table of Contents**

SIGNATURES

Pursuant to the requirement of Section 13 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.

PEOPLES FINANCIAL CORPORATION  
(Registrant)

Date: November 8, 2010

By: /s/ Chevis C. Swetman  
Chevis C. Swetman  
Chairman, President and Chief  
Executive Officer  
(principal executive officer)

Date: November 8, 2010

By: /s/ Lauri A. Wood  
Lauri A. Wood  
Chief Financial Officer and Controller  
(principal financial and accounting  
officer)