

PEOPLES FINANCIAL CORP /MS/

Form 10-Q

November 14, 2011

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**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, 2011**

**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 November 1, 2011, there were 15,000,000 shares of \$1 par value common stock authorized, with 5,136,918 shares issued and outstanding.



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

	<b>September 30, 2011 (Unaudited)</b>	<b>December 31, 2010 (Audited)</b>
<b>Assets</b>		
Cash and due from banks	\$ 31,932,887	\$ 24,146,939
Available for sale securities	304,260,526	287,078,463
Held to maturity securities, fair value of \$2,003,692 at September 30, 2011; \$2,010,430 at December 31, 2010	1,917,039	1,914,879
Other investments	3,843,455	3,926,371
Federal Home Loan Bank Stock, at cost	1,714,600	2,281,200
Loans	422,157,215	409,898,757
Less: Allowance for loan losses	7,024,517	6,650,258
Loans, net	415,132,698	403,248,499
Bank premises and equipment, net of accumulated depreciation	28,532,026	29,756,239
Other real estate	6,962,738	5,744,150
Accrued interest receivable	2,702,923	3,292,430
Cash surrender value of life insurance	16,066,420	15,951,117
Prepaid FDIC assessments	2,500,123	3,652,972
Other assets	1,701,195	5,552,225
<b>Total assets</b>	<b>\$ 817,266,630</b>	<b>\$ 786,545,484</b>

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

	<b>September 30, 2011 (Unaudited)</b>	<b>December 31, 2010 (Audited)</b>
<b>Liabilities &amp; Shareholders Equity</b>		
<b>Liabilities:</b>		
Deposits:		
Demand, non-interest bearing	\$ 111,213,054	\$ 108,277,985
Savings and demand, interest bearing	218,669,274	193,631,209
Time, \$100,000 or more	110,327,037	134,667,660
Other time deposits	47,644,726	47,562,661
Total deposits	487,854,091	484,139,515
Federal funds purchased and securities sold under agreements to repurchase	172,940,667	140,102,019
Borrowings from Federal Home Loan Bank	30,101,572	42,957,016
Other liabilities	18,759,640	17,990,072
<b>Total liabilities</b>	<b>709,655,970</b>	<b>685,188,622</b>
<b>Shareholders Equity:</b>		
Common stock, \$1 par value, 15,000,000 shares authorized, 5,136,918 and 5,151,139 shares issued and outstanding at September 30, 2011 and December 31, 2010	5,136,918	5,151,139
Surplus	65,780,254	65,780,254
Undivided profits	34,486,812	33,302,381
Accumulated other comprehensive income (loss), net of tax	2,206,676	(2,876,912)
<b>Total shareholders equity</b>	<b>107,610,660</b>	<b>101,356,862</b>
<b>Total liabilities &amp; shareholders equity</b>	<b>\$ 817,266,630</b>	<b>\$ 786,545,484</b>

See accompanying notes to consolidated financial statements.

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**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>2011</b>	<b>2010</b>	<b>2011</b>	<b>2010</b>
<b>Interest income:</b>				
Interest and fees on loans	\$ 4,456,517	\$ 4,814,583	\$ 13,744,465	\$ 14,695,051
Interest and dividends on securities:				
U.S. Treasuries	54,069	77,382	181,198	402,860
U.S. Government agencies	1,254,858	1,620,180	4,405,916	6,232,606
Mortgage-backed securities	37,773		68,730	518,924
States and political subdivisions	339,376	332,366	1,068,833	1,005,963
Other investments	12,351	14,769	20,990	22,423
Interest on federal funds sold	1,686	4,496	6,425	9,832
<b>Total interest income</b>	<b>6,156,630</b>	<b>6,863,776</b>	<b>19,496,557</b>	<b>22,887,659</b>
<b>Interest expense:</b>				
Deposits	510,585	826,304	1,864,702	2,493,090
Long-term borrowings	39,967	57,894	135,434	304,098
Federal funds purchased and securities sold under agreements to repurchase	173,859	249,005	515,427	811,746
<b>Total interest expense</b>	<b>724,411</b>	<b>1,133,203</b>	<b>2,515,563</b>	<b>3,608,934</b>
<b>Net interest income</b>	<b>5,432,219</b>	<b>5,730,573</b>	<b>16,980,994</b>	<b>19,278,725</b>
<b>Provision for allowance for losses on loans</b>	<b>544,000</b>	<b>1,045,000</b>	<b>1,731,000</b>	<b>3,780,000</b>
<b>Net interest income after provision for allowance for losses on loans</b>	<b>\$ 4,888,219</b>	<b>\$ 4,685,573</b>	<b>\$ 15,249,994</b>	<b>\$ 15,498,725</b>





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

	<b>Three Months Ended</b>		<b>Nine Months Ended</b>	
	<b>September 30,</b>		<b>September</b>	
	<b>2011</b>	<b>2010</b>	<b>2011</b>	<b>2010</b>
<b>Non-interest income:</b>				
Trust department income and fees	\$ 361,346	\$ 352,712	\$ 1,031,269	\$ 942,949
Service charges on deposit accounts	1,493,674	1,513,957	4,367,848	4,665,945
Gain on sales or calls of securities	786,353	92,023	793,527	1,659,509
Increase in cash surrender value	123,798	126,444	381,478	382,388
Gain on death benefits from life insurance	80,621		469,740	
Other income	114,438	128,002	390,600	380,006
<b>Total non-interest income</b>	<b>2,960,230</b>	<b>2,213,138</b>	<b>7,434,462</b>	<b>8,030,797</b>
<b>Non-interest expense:</b>				
Salaries and employee benefits	3,393,984	3,393,160	10,165,371	10,203,623
Net occupancy	573,274	604,669	1,842,444	1,673,567
Equipment rentals, depreciation and maintenance	739,997	911,225	2,562,209	2,797,990
FDIC assessments	430,204	400,307	1,273,116	1,141,211
Other expense	2,281,314	1,621,950	5,506,223	4,731,194
<b>Total non-interest expense</b>	<b>7,418,773</b>	<b>6,931,311</b>	<b>21,349,363</b>	<b>20,547,585</b>
<b>Income (loss) before income taxes</b>	<b>429,676</b>	<b>(32,600)</b>	<b>1,335,093</b>	<b>2,981,937</b>
Income tax expense (benefit)	(148,000)	(397,000)	(490,000)	300,000
<b>Net income</b>	<b>\$ 577,676</b>	<b>\$ 364,400</b>	<b>\$ 1,825,093</b>	<b>\$ 2,681,937</b>
<b>Basic and diluted earnings per share</b>	<b>\$ .12</b>	<b>\$ .07</b>	<b>\$ .36</b>	<b>\$ .52</b>

<b>Dividends declared per share</b>	\$	\$	\$	.09	\$	.11
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See accompanying notes to consolidated financial statements.

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**Peoples Financial Corporation and Subsidiaries**  
**Consolidated Statement of Changes in Shareholders Equity and Comprehensive Income**

	Number of Common Shares	Common Stock	Surplus	Accumulated			Total
				Undivided Profits	Other Comprehensive Income (Loss)	Comprehensive Income	
Balance, January 1, 2011	5,151,139	\$ 5,151,139	\$ 65,780,254	\$ 33,302,381	\$ (2,876,912)		\$ 101,356,862
Comprehensive income:							
Net income				1,825,093		\$ 1,825,093	1,825,093
Net unrealized gain on available for sale securities, net of tax					5,607,316	5,607,316	5,607,316
Reclassification adjustment for available for sale securities called or sold in current year, net of tax					(523,728)	(523,728)	(523,728)
Total comprehensive income						\$ 6,908,681	
Dividend declared (\$ .09 per share)				(462,323)			(462,323)
Retirement of stock	(14,221)	(14,221)		(178,339)			(192,560)
Balance, September 30, 2011	5,136,918	\$ 5,136,918	\$ 65,780,254	\$ 34,486,812	\$ 2,206,676		\$ 107,610,660

Note: Balances as of January 1, 2011 were audited.  
See accompanying notes to consolidated financial statements.

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

	<b>Nine Months Ended September 30,</b>	
	<b>2011</b>	<b>2010</b>
<b>Cash flows from operating activities:</b>		
Net income	\$ 1,825,093	\$ 2,681,937
Adjustment to reconcile net income to net cash provided by operating activities:		
Depreciation	1,670,000	1,807,000
Provision for allowance for losses on loans	1,731,000	3,780,000
Loss on writedown of other real estate	666,006	77,350
Loss on sales of other real estate	57,891	48,850
Loss on other investments	82,916	15,550
Gain on sales and calls of securities	(793,526)	(1,659,509)
Accretion of held to maturity securities	(2,160)	(2,091)
Change in accrued interest receivable	589,507	1,339,542
Change in other assets	3,512,853	(893,521)
Change in other liabilities	107,536	385,503
<b>Net cash provided by operating activities</b>	<b>\$ 9,447,116</b>	<b>\$ 7,580,611</b>

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

	<b>Nine Months Ended September</b>	
	<b>30,</b>	
	<b>2011</b>	<b>2010</b>
<b>Cash flows from investing activities:</b>		
Proceeds from maturities, sales and calls of available for sale securities	\$ 257,158,575	\$ 337,327,553
Investment in available for sale securities	(265,848,144)	(323,142,857)
Proceeds from maturities of held to maturity securities		389,920
Redemption of Federal Home Loan Bank Stock	566,600	1,640,500
Proceeds from sales of other real estate	1,201,025	1,092,500
Loans, net change	(16,758,709)	37,686,504
Acquisition of premises and equipment	(445,787)	(538,832)
Investment in other assets	(115,302)	(458,474)
<b>Net cash provided by (used in) investing activities</b>	<b>(24,241,742)</b>	<b>53,996,814</b>
<b>Cash flows from financing activities:</b>		
Demand and savings deposits, net change	27,973,134	35,387,588
Time deposits made, net change	(24,258,558)	26,827,275
Cash dividends	(924,646)	(1,081,857)
Retirement of common stock	(192,560)	
Borrowings from Federal Home Loan Bank	460,700,115	621,880,492
Repayments to Federal Home Loan Bank	(473,555,559)	(707,172,503)
Federal funds purchased and securities sold under agreements to repurchase, net change	32,838,648	(32,050,198)
<b>Net cash provided by (used in) financing activities</b>	<b>22,580,574</b>	<b>(56,209,203)</b>
<b>Net increase in cash and cash equivalents</b>	<b>7,785,948</b>	<b>5,368,222</b>

<b>Cash and cash equivalents, beginning of period</b>	24,146,939	29,155,294
<b>Cash and cash equivalents, end of period</b>	\$ 31,932,887	\$ 34,523,516

See accompanying notes to consolidated financial statements.

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PEOPLES FINANCIAL CORPORATION AND SUBSIDIARIES  
NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS  
For the Nine Months Ended September 30, 2011 and 2010

**1. Basis of Presentation:**

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

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 (GAAP), the financial position of the Company and its subsidiaries as of September 30, 2011 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 2010 Annual Report and Form 10-K.

The results of operations for the nine months ended September 30, 2011, 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 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 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 GAAP 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, 2010.

**2. Earnings Per Share:**

Per share data is based on the weighted average shares of common stock outstanding of 5,136,918 and 5,151,697 for the nine months ended September 30, 2011 and 2010, respectively, and 5,136,918 and 5,151,697 for the quarters ended September 30, 2011 and 2010, respectively.

**3. Statements of Cash Flows:**

The Company has defined cash and cash equivalents as cash and due from banks. The Company paid \$2,551,707 and \$3,621,074 for the nine months ended September 30, 2011 and 2010, respectively, for interest on deposits and borrowings. Income tax payments of \$235,000 and

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\$2,332,000 were made during the nine months ended September 30, 2011 and 2010, respectively. Loans transferred to other real estate amounted to \$3,143,510 and \$2,516,220 during the nine months ended September 30, 2011 and 2010, respectively. Dividends payable of \$462,323 as of December 31, 2010 were paid during the nine months ended September 30, 2011.

## 4. Investments:

The amortized cost and fair value of securities at September 30, 2011 and December 31, 2010, are as follows:

September 30, 2011	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Available for sale securities:				
Debt securities:				
U.S. Treasuries	\$ 98,975,014	\$ 313,330	\$ (16,973)	\$ 99,271,371
U.S. Government agencies	158,317,839	2,298,114	(16,885)	160,599,068
Mortgage-backed securities	4,810,771	248,224		5,058,995
States and political subdivisions	36,555,109	2,126,000		38,681,109
Total debt securities	298,658,733	4,985,668	(33,858)	303,610,543
Equity securities	649,983			649,983
Total available for sale securities	\$ 299,308,716	\$ 4,985,668	\$ (33,858)	\$ 304,260,526
Held to maturity securities:				
States and political subdivisions	\$ 1,917,039	\$ 86,653	\$	\$ 2,003,692
Total held to maturity securities	\$ 1,917,039	\$ 86,653	\$	\$ 2,003,692

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December 31, 2010	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Available for sale securities:				
Debt securities:				
U.S. Treasuries	\$ 26,957,061	\$ 51,729	\$ (499,819)	\$ 26,508,971
U.S. Government agencies	221,639,699	1,055,500	(4,099,256)	218,595,943
States and political subdivisions	40,578,877	1,114,322	(369,633)	41,323,566
Total debt securities	289,175,637	2,221,551	(4,968,708)	286,428,480
Equity securities	649,983			649,983
Total available for sale securities	\$ 289,825,620	\$ 2,221,551	\$ (4,968,708)	\$ 287,078,463
Held to maturity securities:				
States and political subdivisions	\$ 1,914,879	\$ 95,551	\$	\$ 2,010,430
Total held to maturity securities	\$ 1,914,879	\$ 95,551	\$	\$ 2,010,430

The amortized cost and fair value of debt securities at September 30, 2011, 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	Fair Value
Available for sale securities:		
Due in one year or less	\$ 86,928,621	\$ 86,958,763
Due after one year through five years	75,380,778	76,255,402
Due after five years through ten years	85,655,717	88,317,101
Due after ten years	45,882,846	47,020,282
Mortgage-backed securities	4,810,771	5,058,995
Totals	\$ 298,658,733	\$ 303,610,543

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Held to maturity securities:

Due after one year through five years	\$ 1,452,596	\$ 1,520,497
Due after five years through ten years	464,443	483,195

Totals	\$ 1,917,039	\$ 2,003,692
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Securities with gross unrealized losses at September 30, 2011 and December 31, 2010, aggregated by investment category and length of time that individual securities have been in a continuous loss position are as follows:

	Less Than Twelve Months		Over Twelve Months		Total	
	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses
September 30, 2011:						
U.S. Treasuries	\$ 41,975,940	\$ 16,973	\$	\$	\$ 41,975,940	\$ 16,973
U.S. Government agencies	9,995,500	16,885			9,995,500	16,885
<b>TOTAL</b>	<b>\$ 51,971,440</b>	<b>\$ 33,858</b>	<b>\$</b>	<b>\$</b>	<b>\$ 51,971,440</b>	<b>\$ 33,858</b>
December 31, 2010:						
U.S. Treasuries	\$ 15,457,980	\$ 499,819	\$	\$	\$ 15,457,980	\$ 499,819
U.S. Government agencies	138,075,993	4,099,256			138,075,993	4,099,256
States and political subdivisions	5,295,359	172,435	2,028,616	197,198	7,323,975	369,633
<b>TOTAL</b>	<b>\$ 158,829,332</b>	<b>\$ 4,771,510</b>	<b>\$ 2,028,616</b>	<b>\$ 197,198</b>	<b>\$ 160,857,948</b>	<b>\$ 4,968,708</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 it will be required to sell these securities before maturity. While some available for sale securities have been sold for liquidity purposes or for gains, the Company has traditionally held its securities, including those classified as available for sale, until maturity. As a result of the evaluation of these securities, the Company has determined that the unrealized losses summarized in the tables above are not deemed to be other-than-temporary.

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## 5. Loans:

The composition of the loan portfolio at September 30, 2011 and December 31, 2010, is as follows:

	September 30, 2011	December 31, 2010
Gaming	\$ 37,592,200	\$ 44,342,798
Residential and land development	29,065,957	30,063,593
Real estate, construction	64,349,749	60,982,989
Real estate, mortgage	241,275,815	222,578,080
Commercial and industrial	36,935,888	36,463,500
Other	12,937,606	15,467,797
Total	\$ 422,157,215	\$ 409,898,757

The age analysis of the loan portfolio, segregated by class of loans, as of September 30, 2011 and December 31, 2010, is as follows:

	Number of Days Past Due					Total Loans	Loans Past Due Greater Than 90 Days & Still Accruing
	30 - 59	60 - 89	Greater Than 90	Total Past Due	Current		
September 30, 2011:							
Gaming	\$	\$	\$	\$	\$ 37,592,200	\$ 37,592,200	\$
Residential and land development	5,578,335	344,747	18,178,652	24,101,734	4,964,223	29,065,957	
Real estate, construction	3,936,458	865,012	1,925,317	6,726,787	57,622,962	64,349,749	4,308,259
Real estate, mortgage	11,493,401	7,733,635	2,610,259	21,837,295	219,438,520	241,275,815	1,848,052
Commercial and industrial	1,783,497	55,116	219,047	2,057,660	34,878,228	36,935,888	219,047
Other	173,386	32,417	66,019	271,822	12,665,784	12,937,606	5,124
Total	\$ 22,965,077	\$ 9,030,927	\$ 22,999,294	\$ 54,995,298	\$ 367,161,917	\$ 422,157,215	\$ 6,380,482

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December 31, 2010:								
Gaming	\$	\$	\$ 2,808,409	\$ 2,808,409	\$ 41,534,389	\$ 44,342,798	\$	
Residential and land development			2,317,327	4,599,002	25,464,591	30,063,593		
Real estate, construction	2,281,675	4,433,125	4,373,103	16,848,128	44,134,861	60,982,989	1,990,772	
Real estate, mortgage	8,041,900	4,639,802	5,139,974	28,259,277	194,318,803	222,578,080	955,715	
Commercial and industrial	18,479,501	98,328	41,181	1,697,865	34,765,635	36,463,500	14,099	
Other	1,558,356	33,544	969	308,453	15,159,344	15,467,797	969	
	273,940							
Total	\$ 30,635,372	\$ 9,204,799	\$ 14,680,963	\$ 54,521,134	\$ 355,377,623	\$ 409,898,757	\$ 2,961,555	

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The Company monitors the credit quality of its loan portfolio through the use of a loan grading system. A score of 1 to 5 is assigned to the loan based on factors including repayment ability, trends in net worth and/or financial condition of the borrower and guarantors, employment stability, management ability, loan to value fluctuations, the type and structure of the loan, conformity of the loan to bank policy and payment performance. Based on the total score, a loan grade of A to F is applied. A grade of A will generally be applied to loans for customers that are well known to the Company and that have excellent sources of repayment. A grade of B will generally be applied to loans for customers that have excellent sources of repayment which have no identifiable risk of collection. A grade of C will generally be applied to loans for customers that have adequate sources of repayment which have little identifiable risk of collection. Loans with a grade of C may be placed on the watch list if weaknesses are not resolved which could result in potential loss. A grade of D will generally be applied to loans for customers that are inadequately protected by current sound net worth, paying capacity of the borrower, or pledged collateral. Loans with a grade of D have unsatisfactory characteristics such as cash flow deficiencies, bankruptcy filing by the borrower or dependence on the sale of collateral for the primary source of repayment, causing more than acceptable levels of risk. Loans 60 to 89 days past due receive a grade of D. A grade of E will generally be applied to loans for customers with weaknesses inherent in the D classification and in which collection or liquidation in full is questionable. All loans 90 days or more past due are rated E. A grade of F is applied to loans which are considered uncollectible and of such little value that their continuance in an active bank is not warranted. Loans with this grade are charged off, even though partial or full recovery may be possible in the future. All loans 180 days or more past due are rated F and charged off unless the Bank is in the process of collection.

An analysis of the loan portfolio by loan grade, segregated by class of loans, as of September 30, 2011 and December 31, 2010, is as follows:



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	Loans With A Grade Of:				
	A or B	C	D	E	Total
September 30, 2011:					
Gaming	\$ 15,428,623	\$ 6,299,367	\$ 275,100	\$ 15,589,110	\$ 37,592,200
Residential and land development	4,964,222		8,281,915	15,819,820	29,065,957
Real estate, construction	54,506,091	348,807	9,343,856	150,995	64,349,749
Real estate, mortgage	202,039,876	2,829,951	35,696,164	709,824	241,275,815
Commercial and industrial	33,513,806	297,570	2,925,304	199,208	36,935,888
Other	12,448,480	47,239	376,096	65,791	12,937,606
Total	\$ 322,901,098	\$ 9,822,934	\$ 56,898,435	\$ 32,534,748	\$ 422,157,215
December 31, 2010:					
Gaming	\$ 27,397,218	\$	\$ 6,413,068	\$ 10,532,512	\$ 44,342,798
Residential and land development	25,664,590	864,342	3,102,340	432,321	30,063,593
Real estate, construction	52,417,942	314,806	7,715,653	534,588	60,982,989
Real estate, mortgage	184,963,841	8,247,627	25,669,185	3,697,427	222,578,080
Commercial and industrial	33,702,021	289,222	2,323,291	148,966	36,463,500
Other	15,232,311	39,865	195,621		15,467,797
Total	\$ 339,377,923	\$ 9,755,862	\$ 45,419,158	\$ 15,345,814	\$ 409,898,757

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Total loans on nonaccrual as of September 30, 2011 and December 31, 2010, are as follows:

	September 30, 2011	December 31, 2010
Gaming	\$ 15,589,110	\$ 10,221,662
Residential and land development	15,819,820	632,321
Real estate, construction		386,557
Real estate, mortgage	774,756	3,268,778
Commercial and industrial		27,081
Other	60,895	698
<b>Total</b>	<b>\$ 32,244,581</b>	<b>\$ 14,537,097</b>

The Company has modified certain loans by granting interest rate concessions to these customers. These loans are classified as troubled debt restructurings. These loans are all in compliance with their modified terms and are currently accruing. Troubled debt restructurings as of September 30, 2011 and December 31, 2010 are as follows:

	Number of Contracts	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment	Related Allowance
September 30, 2011:				
Real estate, construction	6	\$ 2,956,526	\$ 2,956,526	\$ 112,000
Real estate, mortgage	6	10,349,797	10,349,797	830,000
Commercial and industrial	1	707,410	707,410	
	13	\$ 14,013,733	\$ 14,013,733	\$ 942,000
December 31, 2010:				
Real estate, construction	1	\$ 186,831	\$ 186,831	\$ 116,000
Real estate, mortgage	1	515,663	515,663	110,000
	2	\$ 702,494	\$ 702,494	\$ 226,000



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Impaired loans, segregated by class of loans, as of September 30, 2011 and December 31, 2010, are as follows:

	Unpaid Principal Balance	Recorded Investment	Related Allowance	Average Recorded Investment
September 30, 2011:				
Gaming	\$ 15,589,110	\$ 15,589,110	\$	\$ 11,516,919
Residential and land development	19,014,568	15,819,820		7,382,320
Real estate, construction	3,032,631	2,956,526	112,000	184,818
Real estate, mortgage	12,114,942	11,124,553	1,216,114	4,850,146
Commercial and industrial	707,410	707,410		314,718
Other	60,895	60,895	6,800	20,165
<b>Total</b>	<b>\$ 50,519,556</b>	<b>\$ 46,258,314</b>	<b>\$ 1,334,914</b>	<b>\$ 24,269,086</b>
December 31, 2010:				
Gaming	\$ 10,532,512	\$ 10,221,662	\$ 107,328	\$ 9,363,015
Residential and land development	4,313,098	632,321	8,220	2,692,751
Real estate, construction	573,388	573,388	179,000	199,531
Real estate, mortgage	4,762,356	3,784,441	649,392	2,366,888
Commercial and industrial	27,081	27,081	195	8,065
Other	698	698	698	590
<b>Total</b>	<b>\$ 20,209,133</b>	<b>\$ 15,239,591</b>	<b>\$ 944,833</b>	<b>\$ 14,630,840</b>

No material interest income was recognized on impaired loans for the nine months ended September 30, 2011 and the year ended December 31, 2010.

6. Allowance for Loan Losses:

Transactions in the allowance for loan losses for the quarters and nine months ended September 30, 2011 and 2010, and the balances of loans, individually and collectively evaluated for impairment as of September 30, 2011 and 2010, are as follows (in thousands):

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	<b>Residential and Land</b>		<b>Real Estate, Construction</b>	<b>Real Estate, Mortgage</b>	<b>Commercial and Industrial</b>		<b>Other</b>	<b>Total</b>
For the nine months ended September 30, 2011:								
Allowance for Loan Losses:								
Beginning Balance	\$ 466	\$ 1,069	\$ 1,020	\$ 3,413	\$ 480	\$ 202	\$ 6,650	
Charge-offs			(275)	(1,098)	(46)	(144)	(1,563)	
Recoveries	35		32	46	17	76	206	
Provision	(118)	(514)	280	1,705	234	144	1,731	
Ending Balance	\$ 383	\$ 555	\$ 1,057	\$ 4,066	\$ 685	\$ 278	\$ 7,024	
For the quarter ended September 30, 2011:								
Allowance for Loan Losses:								
Beginning Balance	\$ 252	\$ 530	\$ 1,034	\$ 4,141	\$ 491	\$ 266	\$ 6,714	
Charge-offs			(64)	(142)		(41)	(247)	
Recoveries						13	13	
Provision	131	25	87	67	194	40	544	
Ending Balance	\$ 383	\$ 555	\$ 1,057	\$ 4,066	\$ 685	\$ 278	\$ 7,024	
Allowance for Loan Losses, September 30, 2011:								
Ending balance: individually evaluated for impairment	\$	\$	\$ 249	\$ 1,876	\$ 402	\$ 60	\$ 2,587	
Ending balance: collectively evaluated for impairment	\$ 383	\$ 555	\$ 808	\$ 2,190	\$ 283	\$ 218	\$ 4,437	
Total Loans, September 30, 2011:								
Ending balance: individually evaluated for impairment	\$ 15,589	\$ 23,712	\$ 24,248	\$ 38,295	\$ 8,185	\$ 3,626	\$ 113,655	
Ending balance: collectively evaluated for impairment	\$ 22,003	\$ 5,354	\$ 40,102	\$ 202,981	\$ 28,751	\$ 9,311	\$ 308,502	

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	<b>Gaming</b>	<b>Residential and Land Development</b>	<b>Real Estate, Construction</b>	<b>Real Estate, Mortgage</b>	<b>Commercial and Industrial</b>	<b>Other</b>	<b>Total</b>
For the nine months ended September 30, 2010:							
Allowance for Loan Losses: Beginning							
Balance	\$ 699	\$ 1,198	\$ 1,019	\$ 3,549	\$ 1,293	\$ 70	\$ 7,828
Charge-offs	(481)		(568)	(1,202)	(350)	(176)	(2,777)
Recoveries			61		12	92	165
Provision	271	1,833	145	1,659	(355)	227	3,780
Ending Balance	\$ 489	\$ 3,031	\$ 657	\$ 4,006	\$ 600	\$ 213	\$ 8,996
For the quarter ended September 30, 2010:							
Allowance for Loan Losses: Beginning							
Balance	\$ 996	\$ 2,640	\$ 532	\$ 4,203	\$ 698	\$ 99	\$ 9,168
Charge-offs	(481)		(6)	(417)	(350)	(54)	(1,308)
Recoveries			61		2	28	91
Provision	(26)	391	70	220	250	140	1,045
Ending Balance	\$ 489	\$ 3,031	\$ 657	\$ 4,006	\$ 600	\$ 213	\$ 8,996
Allowance for Loan Losses, September 30, 2010:							
Ending balance: individually evaluated for impairment	\$	\$ 1,809	\$ 475	\$ 1,521	\$ 314	\$ 19	\$ 4,138
Ending balance: collectively evaluated for impairment	\$ 489	\$ 1,222	\$ 182	\$ 2,485	\$ 286	\$ 194	\$ 4,858
Total Loans, September 30, 2010:							
Ending balance: individually evaluated for	\$	\$ 5,428	\$ 1,646	\$ 8,232	\$ 734	\$ 12	\$ 16,052

impairment

Ending balance:

collectively  
evaluated for

impairment	\$ 46,603	\$	29,690	\$	60,525	\$	212,619	\$	43,131	\$	13,542	\$	406,110
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7. Deposits:

At September 30, 2011, time deposits of \$100,000 or more include brokered deposits of \$24,262,000 which mature in 2012.

8. Shareholders Equity:

On June 29, 2011, the Board of Directors declared a semi-annual dividend of \$ .09 per share with a record date of July 13, 2011 and a payment date of July 20, 2011. During 2011, the Company repurchased and retired 14,221 shares of its common stock for a total purchase price of \$192,560.

9. Accumulated Other Comprehensive Income (Loss):

At September 30, 2011, accumulated other comprehensive income (loss) included the unrealized gain on available for sale securities of \$3,279,121, net of tax of \$1,672,690, and the loss from the unfunded post-retirement benefit obligation of \$1,072,445, net of tax of \$552,471.

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

The Company reports certain assets and liabilities at their estimated fair value. These assets and liabilities are classified and disclosed in one of three categories based on the inputs used to develop the measurements. The categories, which establish a hierarchy for ranking the quality and reliability of the information used to determine fair value, are: Level 1 Quoted market prices in active markets for identical assets or liabilities, Level 2 Observable market based inputs or unobservable inputs that are corroborated by market data, or Level 3 Unobservable inputs that are not corroborated by market data.

The Company is required to disclose the fair value of financial instruments, both assets and liabilities recognized and not recognized in the statement of condition, for which it is practical to estimate its fair value. Certain financial instruments and all nonfinancial instruments are excluded from these disclosure requirements. Significant assets and liabilities that are not considered financial instruments include deferred income taxes and bank premises and equipment. Accordingly, the aggregate fair value amounts presented do not represent the underlying value of the Company. In preparing these disclosures, Management made highly sensitive estimates and assumptions in developing the methodology to be utilized in the computation of fair value. These estimates and assumptions were formulated based on judgments regarding economic conditions and risk characteristics of the financial instruments that were present at the time the computations were made. Events may occur that alter these conditions and may change the assumptions as well. A change in the assumptions might affect the fair value of the financial instruments disclosed in this footnote. These estimates do not reflect any premium or discount that could result from offering for sale at one time the Company's entire holdings of a particular financial instrument. Fair value estimates are based on existing on and off-balance sheet financial instruments without attempting to estimate the value of anticipated future business and the value of assets and liabilities that are not considered financial instruments. In addition, the tax consequences related to the realization of the unrealized gains and losses have not been computed or disclosed herein. These methods and assumptions are set forth below.

**Cash and Due from Banks**

The carrying amount shown as cash and due from banks approximates fair value.

**Federal Funds Sold**

The carrying amount shown as federal funds sold approximates fair value.

**Available for Sale Securities**

The fair value of available for sale securities is based on quoted market prices. 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



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specific securities but rather by relying on the securities' relationship to other benchmark securities. All of the Company's available for sale securities are Level 2 assets.

**Held to Maturity Securities**

The fair value of held to maturity securities is based on quoted market prices.

**Other Investments**

The carrying amount shown as other investments approximates fair value.

**Federal Home Loan Bank Stock**

The carrying amount shown as Federal Home Loan Bank Stock approximates fair value.

**Loans**

The fair value of fixed rate loans is estimated by discounting the future cash flows using the current rates at which similar loans would be made to borrowers with similar credit ratings for the remaining maturities. The cash flows considered in computing the fair value of such loans are segmented into categories relating to the nature of the contract and collateral based on contractual principal maturities. Appropriate adjustments are made to reflect probable credit losses. Cash flows have not been adjusted for such factors as prepayment risk or the effect of the maturity of balloon notes. The fair value of floating rate loans is estimated to be its carrying value. 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, which are generally collateral-dependent, is calculated based on the fair value of its collateral. 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 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. When the fair value of the collateral is based on an observable market price or a current appraised value, the Company records the impaired loan as a non-recurring Level 2 asset. When an appraised value is not available or Management determines the fair value of the collateral is further impaired below the appraised value and there is no observable market price, the Company records the impaired loan as a non-recurring Level 3 asset.

**Other Real Estate**

In the course of lending operations, Management may determine that it is 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 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. When the fair value of the collateral is based on an observable market price or a current appraised value, the

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Company records the other real estate as a non-recurring Level 2 asset. When an appraised value is not available or Management determines the fair value of the collateral is further impaired below the appraised value and there is no observable market price, the Company records the other real estate as a non-recurring Level 3 asset.

**Cash Surrender Value of Life Insurance**

The carrying amount of cash surrender value of bank-owned life insurance approximates fair value.

**Deposits**

The fair value of non-interest bearing demand and interest bearing savings and demand deposits is the amount reported in the financial statements. The fair value of time deposits is estimated by discounting the cash flows using current rates of time deposits with similar remaining maturities. The cash flows considered in computing the fair value of such deposits are based on contractual maturities, since approximately 98% of time deposits provide for automatic renewal at current interest rates.

**Federal Funds Purchased and Securities Sold under Agreements to Repurchase**

The carrying amount shown as federal funds purchased and securities sold under agreements to repurchase approximates fair value.

**Borrowings from Federal Home Loan Bank**

The fair value of FHLB fixed rate borrowings is estimated using discounted cash flows based on current incremental borrowing rates for similar types of borrowing arrangements. The Company has no FHLB variable rate borrowings.

**Commitments to Extend Credit and Standby Letters of Credit**

Because commitments to extend credit and standby letters of credit are generally short-term and at variable rates, the contract value and estimated value associated with these instruments are immaterial.

The balances of available for sale securities, which are the only assets measured at fair value on a recurring basis, by level within the fair value hierarchy and by investment type, as of September 30, 2011 and December 31, 2010 are as follows:

September 30, 2011:	Total	Fair Value Measurement Using		
		Level 1	Level 2	Level 3
U.S. Treasuries	\$ 99,271,371	\$	\$ 99,271,371	\$
U.S. Government agencies	160,599,068		160,599,068	
Mortgage-backed securities	5,058,995		5,058,995	
States and political subdivisions	38,681,109		38,681,109	
Equity securities	649,983		649,983	
Total	\$ 304,260,526	\$	\$ 304,260,526	\$

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December 31, 2010:	Total	Fair Value Measurement Using		
		Level 1	Level 2	Level 3
U.S. Treasuries	\$ 26,508,971	\$	\$ 26,508,971	\$
U.S. Government agencies	218,595,943		218,595,943	
States and political subdivisions	41,323,566		41,323,566	
Equity securities	649,983		649,983	
Total	\$ 287,078,463	\$	\$ 287,078,463	\$

Impaired loans, which are measured at fair value on a non-recurring basis, by level within the fair value hierarchy as of September 30, 2011 and December 31, 2010 are as follows:

	Total	Fair Value Measurement Using		
		Level 1	Level 2	Level 3
September 30, 2011	\$ 44,923,400	\$	\$	\$ 44,923,400
December 31, 2010	14,294,758			14,294,758

The following table presents a summary of changes in the fair value of impaired loans which are measured using level 3 inputs:

	For the Nine Months Ended September 30, 2011	For the Year Ended December 31, 2010
Balance, beginning of period	\$ 14,294,758	\$ 20,110,330
Additions to impaired loans and troubled debt restructurings	38,015,735	5,519,905
Principal payments, charge-offs and transfers to other real estate	(6,997,012)	(12,286,059)
Change in allowance for loan losses on impaired loans	(390,081)	950,583
Balance, end of period	\$ 44,923,400	\$ 14,294,758

Other real estate, which is measured at fair value on a non-recurring basis, by level within the fair value hierarchy as of September 30, 2011 and December 31, 2010 are as follows:

	Total	Fair Value Measurement Using		
		Level 1	Level 2	Level 3
September 30, 2011	\$ 6,962,738	\$	\$ 3,803,000	\$ 3,159,738

December 31, 2010

5,744,150

1,248,816

4,495,334

The following table presents a summary of changes in the fair value of other real estate which is measured using level 3 inputs:

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	For the Nine Months Ended September 30, 2011	For the Year Ended December 31, 2010
Balance, beginning of period	\$ 4,495,334	\$ 1,521,313
Loans transferred to ORE	3,029,510	4,466,221
Sales and transfers to Level 2	(3,774,100)	(1,414,850)
Writedowns	(591,006)	(77,350)
Balance, end of period	\$ 3,159,738	\$ 4,495,334

The carrying value and estimated fair value of financial assets and financial liabilities at September 30, 2011 and December 31, 2010, are as follows:

	September 30, 2011		December 31, 2010	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
<b>Financial Assets:</b>				
Cash and due from banks	\$ 31,932,887	\$ 31,932,887	\$ 24,146,939	\$ 24,146,939
Available for sale securities	304,260,526	304,260,526	287,078,463	287,078,463
Held to maturity securities	1,917,039	2,003,692	1,914,879	2,010,430
Other investments	3,843,455	3,843,455	3,926,371	3,926,371
Federal Home Loan Bank stock	1,714,600	1,714,600	2,281,200	2,281,200
Loans, net	415,132,698	420,081,198	403,248,499	407,363,159
Cash surrender value of life insurance	16,066,420	16,066,420	15,951,117	15,951,117
<b>Financial Liabilities:</b>				
<b>Deposits:</b>				
Non-interest bearing	111,213,054	111,213,054	108,277,985	108,277,985
Interest bearing	376,641,037	377,719,904	375,861,530	376,715,446
Total deposits	487,854,091	488,932,958	484,139,515	484,993,431
Federal funds purchased and securities sold under agreements to repurchase	172,940,667	172,940,667	140,102,019	140,102,019
Borrowings from Federal Home Loan Bank	30,101,572	32,032,055	42,957,016	43,990,270

**11. New Accounting Pronouncements:**

In January 2011, the Financial Accounting Standards Board ( FASB ) issued Accounting Standards Update No. 2011-01, Receivables (Topic 310): Deferral of the Effective Date of Disclosures about Troubled Debt Restructurings in Update No. 2010-20 ( ASU No. 2011-01 ). ASU No. 2011-01 temporarily delays the effective date of the disclosures about troubled debt restructurings required in Accounting Standards Update No. 2010-20. It is not

expected to have a material impact on the Company's results of operations or financial position.

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In April 2011, the FASB issued Accounting Standards Update No. 2011-02, Receivables: A Creditor's Determination of Whether a Restructuring is a Troubled Debt Restructuring ( ASU No. 2011-02 ). ASU No. 2011-02 establishes the effective date for the disclosures about troubled debt restructurings required in ASU No. 2010-20. The standard is effective for the Company for fiscal quarters beginning after June 15, 2010 and is not expected to have a material impact on the Company's results of operations, financial position or disclosures.

In May 2011, the FASB issued ASU No. 2011-04, Fair Value Measurement ( ASU No. 2011-04 ). ASU No. 2011-04 amends the fair value measurement and disclosure requirements in order to gain consistency between the generally accepted accounting principles in the United States and the International Financial Reporting Standards. The effective date for ASU No. 2011-04 is for the first interim or annual period beginning on or after December 15, 2011. The adoption of ASU No. 2011-04 is not expected to have a material impact on the Company's results of operations, financial position or disclosures.

In June 2011, the FASB issued ASU No. 2011-05, Comprehensive Income ( ASU No. 2011-05 ). ASU No. 2011-05 requires entities to present the total of comprehensive income, the components of net income and the components of other comprehensive income in a single statement of comprehensive income or in two separate consecutive statements. The effective date for ASU 2011-05 is for the first interim or annual period beginning on or after December 15, 2011. The adoption of ASU No. 2011-05 is not expected to have a material impact on the Company's results of operations or financial position. As the Company currently presents changes in comprehensive income in the Consolidated Statement of Changes in Shareholders' Equity and Comprehensive Income, the adoption of ASU No. 2011-05 will result in a change in how comprehensive income is disclosed.

**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.

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**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., an inactive company, 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 operating 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, 2010.

**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 new accounting standards updates, which are disclosed in Note 11 to the accompanying consolidated financial statements. The Company does not expect that these updates will have a material impact on its results of operations or financial position. As the Company currently presents changes in comprehensive income in the Consolidated Statement of Changes in Shareholders' Equity and Comprehensive Income, the adoption of ASU No. 2011-05 will result in a change in how comprehensive income is disclosed.

**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



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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 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 whether 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. Management believes that the ALL is adequate and appropriate for all periods presented in these financial statements. If there was a deterioration of any of the factors considered by Management in evaluating the ALL, 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 which may be adjusted by qualitative factors 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 that are included in Management's loan watch list 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 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 in our trade area are the traditional focuses of the

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Company. Growth has largely been achieved through de novo branching activity, and it is expected that these strategies will continue to be emphasized 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 oil spill in the Gulf of Mexico, which occurred in the second quarter of 2010, 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 local and national levels have affected the Company's results. Managing the net interest margin in the Company's highly competitive market and in 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 2011 was \$577,676 compared with \$364,400 for the third quarter of 2010 and for the first three quarters of 2011 was \$1,825,093 as compared with \$2,681,937 for the first three quarters of 2010. Net interest income decreased \$298,354 for the third quarter of 2011 as compared with the third quarter of 2010 and \$2,297,731 for the first three quarters of 2011 as compared with the first three quarters of 2010 primarily from a decrease in interest rates earned on U.S. Agency securities. In the third quarter of 2011, interest income of \$160,000 was charged-off as a result of placing a loan on nonaccrual. There were no such charge-offs in 2010. Results for the third quarter and first three quarters of 2011 included a decrease in the provision for loan losses of \$501,000 and \$2,049,000, write downs of other real estate ( ORE ) of \$466,400 and \$666,000, an increase (decrease) in gains on sales or calls of securities of \$694,330 and \$(865,982) and as compared with 2010. Results for the first three quarters of 2011 also includes a decrease in service charges on deposits of \$298,097 and gains on death benefits from life insurance policies of \$469,740.

Monitoring asset quality and addressing potential losses in our loan portfolio continue to be emphasized during these difficult economic times. Nonaccrual loans and loans past due 90 days and still accruing were \$32,244,581 and \$6,380,482 at September 30, 2011 as compared with \$22,127,000 and \$3,158,755 at September 30, 2010, respectively. Nonaccrual loans at September 30, 2011, includes one gaming credit totaling \$15,589,110, which has been classified as nonaccrual by the regulatory authorities for two years even though the loan is performing, and one residential development loan totaling \$15,187,500, which has no specific reserve. Net charge-offs decreased to \$1,356,742 for the first three quarters of 2011 from \$2,611,978 for the first three quarters of 2010.

Total assets at September 30, 2011 increased \$30,721,146 as compared with December 31, 2010. Federal funds purchased and securities sold under agreements to repurchase increased \$32,838,648 at September 30, 2011 as compared with December 31, 2010, which funded the increase of \$17,182,063 in available for sale securities and the decrease in borrowings from the Federal Home Loan Bank ( FHLB ) of \$12,855,444 for the same period.

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**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.

**Quarter Ended September 30, 2011 as Compared with Quarter Ended September 30, 2010**

The Company's average interest earning assets decreased approximately \$35,764,000, or 5%, from approximately \$756,881,000 for the third quarter of 2010 to approximately \$721,117,000 for the third quarter of 2011. The Company's average balance sheet shrunk as principal payments, maturities, charge-offs and foreclosures relating to existing loans have outpaced new loans and investments.

The average yield on earning assets decreased by 21 basis points, from 3.72% for the third quarter of 2010 to 3.51% for the third quarter of 2011, with the biggest impact 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, calls and maturities 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 2.51% for the third quarter of 2010 to 1.95% for the third quarter of 2011. Beginning in the fourth quarter of 2010, maturities have been extended to five years and longer in order to improve yield. The charge off of interest income on loans of \$160,000 during the third quarter of 2011 reduced the average yield on earning assets by 9 basis points.

Average interest bearing liabilities decreased approximately \$25,211,000, or 4%, from approximately \$611,800,000 for the third quarter of 2010 to approximately \$586,589,000 for the third quarter of 2011.

The average rate paid on interest bearing liabilities decreased 25 basis points, from .74% for the third quarter of 2010 to .49% for the third quarter of 2011. This decrease is the result of utilizing lower cost funding sources including brokered deposits and FHLB advances in 2011 as compared with 2010. 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 income as a percentage of average earning assets, was 3.11% and 3.12% for the quarters ended September 30, 2011 and 2010, respectively. The charge off of interest income on loans of \$160,000 during the third quarter of 2011 reduced the net interest margin by 9 basis points.

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**Nine Months Ended September 30, 2011 as Compared with Nine Months Ended September 30, 2010**

The Company's average interest earning assets decreased approximately \$44,072,000, or 6%, from approximately \$766,397,000 for the first three quarters of 2010 to approximately \$722,325,000 for the first three quarters of 2011.

The Company's average balance sheet shrunk as principal payments, maturities, charge-offs and foreclosures relating to existing loans have outpaced new loans and investments.

The average yield on earning assets decreased by 37 basis points, from 4.07% for the first three quarters of 2010 to 3.70% for the first three quarters of 2011, with the biggest impact 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, calls and maturities 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 3.55% for the first three quarters of 2010 to 2.27% for the first three quarters of 2011. Beginning in the fourth quarter of 2010, maturities have been extended to five years and longer in order to improve yield. The charge off of interest income on loans of \$535,469 during the first three quarters of 2011 reduced the average yield on earning assets by 9 basis points.

Average interest bearing liabilities decreased approximately \$40,422,000, or 6%, from approximately \$628,859,000 for the first three quarters of 2010 to approximately \$588,437,000 for the first three quarters of 2011.

The average rate paid on interest bearing liabilities decreased 20 basis points, from .77% for the first three quarters of 2010 to .57% for the first three quarters of 2011. This decrease is the result of utilizing lower cost funding sources including brokered deposits and FHLB advances in 2011 as compared with 2010. 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 income as a percentage of average earning assets, was 3.24% for the nine months ended September 30, 2011, down 20 basis points from 3.44% for the nine months ended September 30, 2010. The charge off of interest income on loans of \$535,469 during the first three quarters of 2011 reduced the average yield on earning assets by 9 basis points.

The tables on the following pages analyze the changes in tax-equivalent net interest income for the quarters ended September 30, 2011 and 2010 and the nine months ended September 30, 2011 and 2010.

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

	Quarter Ended September 30, 2011			Quarter Ended September 30, 2010		
	Average Balance	Interest Earned/Paid	Rate	Average Balance	Interest Earned/Paid	Rate
Loans (2)(3)	\$ 399,409	\$ 4,456	4.46%	\$ 428,664	\$ 4,815	4.49%
Federal Funds Sold	2,851	2	0.28%	10,202	5	0.20%
HTM:						
Non taxable (1)	1,917	25	5.22%	2,814	40	5.69%
AFS:						
Taxable	276,372	1,347	1.95%	270,549	1,698	2.51%
Non taxable (1)	38,127	486	5.10%	40,627	462	4.55%
Other	2,441	12	1.97%	4,025	15	1.49%
Total	\$ 721,117	\$ 6,328	3.51%	\$ 756,881	\$ 7,035	3.72%
Savings & interest-bearing DDA	\$ 223,237	\$ 159	0.28%	\$ 217,807	\$ 251	0.46%
CD s	163,790	351	0.86%	194,379	575	1.18%
Federal funds purchased	173,348	174	0.40%	151,615	249	0.66%
FHLB advances	26,214	40	0.61%	47,999	58	0.48%
Total	\$ 586,589	\$ 724	0.49%	\$ 611,800	\$ 1,133	0.74%
Net tax-equivalent margin on earning assets			3.11%			3.12%

(1) All interest earned is reported on a taxable equivalent basis using a tax rate of 34% in 2011 and 2010.

(2) Loan fees of \$154 and \$61 for 2011 and 2010, 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, 2011			Nine Months Ended September 30, 2010		
	Average Balance	Interest Earned/Paid	Rate	Average Balance	Interest Earned/Paid	Rate
Loans (2)(3)	\$ 399,465	\$ 13,744	4.59%	\$ 443,282	\$ 14,695	4.42%
Federal Funds Sold	4,858	6	0.16%	6,315	10	0.21%
HTM:						
Non taxable (1)	1,916	80	5.57%	3,012	116	5.14%
AFS:						
Taxable	273,062	4,656	2.27%	268,584	7,154	3.55%
Non taxable (1)	40,208	1,539	5.10%	40,446	1,408	4.64%
Other	2,816	21	0.99%	4,758	22	0.62%
Total	\$ 722,325	\$ 20,046	3.70%	\$ 766,397	\$ 23,405	4.07%
Savings & interest-bearing DDA	\$ 230,217	\$ 684	0.40%	\$ 221,561	\$ 829	0.50%
CD s	171,424	1,181	0.92%	189,707	1,664	1.17%
Federal funds purchased	152,444	515	0.45%	159,281	812	0.68%
FHLB advances	34,352	135	0.52%	58,310	304	0.70%
Total	\$ 588,437	\$ 2,515	0.57%	\$ 628,859	\$ 3,609	0.77%
Net tax-equivalent margin on earning assets			3.24%			3.44%

(1) All interest earned is reported on a taxable equivalent basis using a tax rate of 34% in 2011 and 2010.

(2) Loan fees of \$517 and \$376 for 2011 and 2010, respectively, are included in these figures.

(3) Includes nonaccrual loans.

**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 the Board of Directors. The policy establishes guidelines relating to underwriting standards, including but not



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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 identify and estimate potential losses based on the best available information. The potential effect resulting from 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 Company's on-going, systematic evaluation resulted in the Company recording a provision for loan losses of \$544,000 and \$1,045,000 for the third quarters of 2011 and 2010, respectively, and \$1,731,000 and \$3,780,000 for the first three quarters of 2011 and 2010, respectively.

The decline in the value of real estate has negatively impacted the collateral relating to the Company's residential and land development portfolio. In 2010, the Company's evaluation of this portfolio and related collateral resulted in a significant increase in provisions for this portfolio. Specifically, approximately 37% and 49% of the provisions for the third quarter and first three quarters of 2010, respectively, related to the residential and land development portfolio. Additional provisions were charged to expense and, where appropriate, charge-offs against the allowance for loan losses were recorded during the last quarter of 2010. As a result of actions taken by Management in 2010, the allowance for loan losses on residential and land development portfolio decreased from \$3,031,000 at September 30, 2010 to \$555,000 at September 30, 2011. One loan included in this portfolio with a balance of \$15,187,500 at September 30, 2011 has no specific reserve as Management's specific analysis has determined that the underlying collateral is sufficient to cover the outstanding loan balance.

The allowance for loan losses as a percentage of loans was 1.66% and 1.62% at September 30, 2011 and December 31, 2010, respectively. The Company believes that its allowance for loan losses is appropriate as of September 30, 2011.

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.



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Non-interest income for the third quarter of 2011 increased \$747,092 as compared with the third quarter of 2010 as a result of changes in gains on sales or calls of securities and a gain on death benefits from life insurance policies. Gains on sales or calls of securities were \$786,353 for the third quarter of 2011 as compared with \$92,023 for the third quarter of 2010. As a result of the death of a participant in the Company's deferred compensation plans, bank owned life insurance was redeemed during the third quarter of 2011, resulting in a gain of \$80,621.

Non-interest income for the first three quarters of 2011 decreased \$596,335 as compared with the first three quarters of 2010 as a result of changes in service charges on deposit accounts, gains on sales or calls of securities and a gain on death benefits from life insurance policies. Service charges on deposit accounts decreased \$298,097 in 2011 as compared with 2010, primarily due to the decrease in NSF fee income of \$239,650. NSF fee income has decreased as a result of the local and national economy impacting customers' overdraft activity as well as customers opting out of overdraft protection service for debit card transactions. Gains on sales or calls of securities were \$793,527 for the first three quarters of 2011 as compared with \$1,659,509 for the first three quarters of 2010. During 2010, the Company liquidated its entire mortgage-backed securities portfolio and some of its short-term U.S. Treasuries. As a result of the death of participants in the Company's deferred compensation plans, bank owned life insurance was redeemed during the first three quarters of 2011, resulting in a gain of \$469,740.

**Non-interest expense**

Total non-interest expense increased \$487,462 for the third quarter of 2011 as compared with the third quarter of 2010 as a result of equipment rentals, depreciation and maintenance expense and other expense. Rental expense decreased \$54,384 in 2011 as the Company discontinued use of leased equipment. Depreciation on furniture and equipment decreased \$95,000 as equipment replaced after Hurricane Katrina is now fully depreciated. Other expenses increased \$659,364 for the third quarter of 2011 as compared with the third quarter of 2010 as costs associated with the larger volume of foreclosures increased \$675,221 in 2011 as compared with 2010.

Total non-interest expense increased \$801,778 for the first three quarters of 2011 as compared with the first three quarters half of 2010 as a result of net occupancy, equipment rentals, depreciation and maintenance expense, FDIC assessments and other expense. Net occupancy costs increased \$168,877 primarily due to insurance expense being \$103,159 higher in 2011 as compared with 2010 as a result of increased insurance rates on our properties. Rental expense decreased \$57,133 in 2011 as the Company discontinued use of leased equipment. Depreciation on furniture and equipment decreased \$137,000 as equipment replaced after Hurricane Katrina is now fully depreciated. FDIC and state insurance assessments increased \$131,905 for the first three quarters of 2011 as compared with the first three quarters of 2010 as banks fund the replenishment of the bank insurance fund which was depleted by the recent swell of bank closures and more frequent state assessments have been levied in the current year. Other expenses increased \$775,029 for the first three quarters of 2011 as compared with the first three quarters of 2010 as costs associated with the larger volume of

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foreclosures increased \$805,452 in 2011 as compared with 2010.

**Income Tax Expense (Benefit)**

Income taxes have been impacted by non-taxable income and federal tax credits during the quarters and nine months ended September 30, 2011 and 2010, as follows:

	Quarters Ended September 30,			
	2011		2010	
	Tax	Rate	Tax	Rate
Taxes at statutory rate	\$ 146,090	34.00	\$ (11,084)	(34.00)
Increase (decrease) resulting from:				
Tax-exempt interest income	(122,539)	(28.52)	(113,016)	(346.68)
Income from BOLI	(69,502)	(16.18)	(42,991)	(131.87)
Federal tax credits	(91,410)	(21.27)	(208,289)	(638.92)
Other	(10,639)	(2.48)	(21,620)	(66.32)
Total income taxes (benefit)	\$ (148,000)	(34.45)	\$ (397,000)	(1,217.79)

	Nine Months Ended September 30,			
	2011		2010	
	Tax	Rate	Tax	Rate
Taxes at statutory rate	\$ 453,932	34.00	\$ 1,013,859	34.00
Increase (decrease) resulting from:				
Tax-exempt interest income	(385,968)	(28.91)	(342,027)	(11.47)
Income from BOLI	(289,414)	(21.68)	(130,012)	(4.36)
Federal tax credits	(274,230)	(20.54)	(223,289)	(7.49)
Other	5,680	0.43	(18,531)	(0.62)
Total income taxes (benefit)	\$ (490,000)	(36.70)	\$ 300,000	10.06

**FINANCIAL CONDITION**

Available for sale securities increased \$17,182,063 at September 30, 2011, compared with December 31, 2010, as funds available from the increase in deposits and federal funds purchased and securities sold under agreements to repurchase are invested in these securities.

Loans increased \$12,258,458 at September 30, 2011 as compared with December 31, 2010. For the first two quarters of 2011, loan payments, maturities, foreclosures, charge-offs and a slower volume of new loans reduced the loan portfolio to \$393,389,744 at June 30, 2011. During the third quarter of 2011, new loans outpaced payments, maturities, foreclosures and charge-offs. The Company anticipates that its loan portfolio will have moderate growth in the fourth quarter of 2011.

Other real estate ( ORE ) increased \$1,218,588 at September 30, 2011 as compared with December 31, 2010. Loans totaling \$3,143,510 were transferred into ORE, one property included in ORE was written down by \$666,006 and ORE totaling \$1,258,916 was sold during the first nine months of 2011. The Company is working diligently and prudently to reduce its ORE portfolio.

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Prepaid FDIC assessments decreased by \$1,152,849 at September 30, 2011 as compared with December 31, 2010 as a result of the amortization of these costs.

Other assets decreased \$3,851,030 at September 30, 2011 as compared with December 31, 2010 primarily as a result of the refund of income taxes of \$2,130,362 and a decrease in deferred tax assets of \$1,491,026. The increase in the fair value of available for securities changed from an unrealized loss to an unrealized gain which reduced a net deferred tax asset.

Total deposits increased \$3,714,576 at September 30, 2011, as compared with December 31, 2010. 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.

Federal funds purchased and securities sold under agreements to repurchase increased \$32,838,640 at September 30, 2011, as compared with December 31, 2010. This primarily includes non-deposit accounts which fluctuate as customers periodically reallocate their funds.

Borrowings from the Federal Home Loan Bank decreased \$12,855,444 at September 30, 2011 as compared with December 31, 2010 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.

The Company and the Bank are subject to regulatory capital adequacy requirements imposed by the federal banking agencies. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, specific capital guidelines that involve quantitative measures of the bank subsidiary's assets and certain off-balance sheet items, adjusted for credit risk, as calculated under regulatory accounting practices must be met. The risk-based capital standards currently in effect are designed to make regulatory capital requirements more sensitive to differences in risk profiles among bank holding companies and banks and to account for off-balance sheet exposure. Quantitative measures established by regulation to ensure capital adequacy require the Company and Bank to maintain minimum amounts and ratios of Total and Tier 1 capital to risk-weighted assets, and Tier 1 capital to average assets.

As of September 30, 2011, the most recent notification from the Federal Deposit Insurance Corporation categorized the bank subsidiary as well capitalized under the regulatory framework for prompt corrective action. To be categorized as well capitalized, the bank subsidiary must have a Total risk-based capital ratio of 10.00% or greater, a Tier 1 risk-based capital ratio of 6.00% or greater and a Leverage capital ratio of 5.00% or greater. There are no conditions or events since that notification that Management believes have changed the bank subsidiary's category. The actual capital amounts and ratios and required minimum capital amounts and ratios for the

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Company as of September 30, 2011 and December 31, 2010, are as follows (in thousands):

	Actual		For Capital Adequacy Purposes	
	Amount	Ratio	Amount	Ratio
September 30, 2011:				
Total Capital (to Risk Weighted Assets)	\$ 111,796	21.33%	\$ 41,931	8.00%
Tier 1 Capital (to Risk Weighted Assets)	105,249	20.08%	20,966	4.00%
Tier 1 Capital (to Average Assets)	105,249	12.85%	32,763	4.00%
December 31, 2010:				
Total Capital (to Risk Weighted Assets)	\$ 110,435	22.26%	\$ 39,691	8.00%
Tier 1 Capital (to Risk Weighted Assets)	104,233	21.01%	19,846	4.00%
Tier 1 Capital (to Average Assets)	104,233	12.40%	33,616	4.00%

The actual capital amounts and ratios and required minimum capital amounts and ratios for the Bank as of September 30, 2011 and December 31, 2010, are as follows (in thousands):

	Actual		For Capital Adequacy Purposes	
	Amount	Ratio	Amount	Ratio
September 30, 2011:				
Total Capital (to Risk Weighted Assets)	\$ 105,849	20.23%	\$ 41,864	8.00%
Tier 1 Capital (to Risk Weighted Assets)	99,302	18.98%	20,932	4.00%
Tier 1 Capital (to Average Assets)	99,302	12.34%	32,200	4.00%
December 31, 2010:				
Total Capital (to Risk Weighted Assets)	\$ 105,255	21.41%	\$ 39,320	8.00%
Tier 1 Capital (to Risk Weighted Assets)	99,111	20.16%	19,660	4.00%
Tier 1 Capital (to Average Assets)	99,111	11.86%	33,431	4.00%

In addition to monitoring its risk-based capital ratios, the Company also determines the primary capital ratio on a quarterly basis. This ratio was 14.17% at September 30, 2011, 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 manages and monitors its liquidity position through a number of methods, including through the computation of liquidity risk targets and the preparation of various analyses of its funding sources and utilization of those sources on a monthly basis. The Company also uses proforma liquidity projections which are updated on a continuous basis in the management of its liquidity needs and

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also conducts contingency testing on its liquidity plan.

Deposits, payments of principal and interest on loans, proceeds from maturities of investment securities and earnings on investment securities are the principal sources of funds for the Company. Borrowings from the FHLB, federal funds sold and federal funds purchased are utilized by the Company to manage its daily liquidity position. The Company has also been approved to participate in the Federal Reserve Bank's Discount Window Primary Credit Program, which it intends to use only as a contingency.

**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 and the Bank 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. All dividends declared and paid by the Company and the Bank have been approved by the regulatory authorities.

**Item 4: Controls and Procedures**

As of September 30, 2011, 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, 2011 that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

**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.

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**Item 5: Other Information**

Lyle M. Page, a director of the Company, passed away on July 22, 2011, after many years of service to the Company and its bank subsidiary. The Company appointed Jeffrey H. O'Keefe, a long time director of the bank subsidiary, to complete Mr. Page's one year term on the Company's board on August 24, 2011. The Company elected A. Wynn Alexander and A. Wes Fulmer to the board of directors of its bank subsidiary.

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

(a) Exhibits

- 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
- Exhibit 101 The following materials from the Company's quarterly report on Form 10-Q for the quarter ended September 30, 2011, formatted in XBRL (Extensible Business Reporting Language): (i) Consolidated Statements of Condition at September 30, 2011 and December 31, 2010, (ii) Consolidated Statements of Income for the quarters ended September 30, 2011 and 2010 and for the nine months ended September 30, 2011 and 2010, (iii) Consolidated Statement of Changes in Shareholders' Equity and Comprehensive Income for the nine months ended September 30, 2011, (iv) Consolidated Statements of Cash Flows for the nine months ended September 30, 2011 and 2010 and (v) Notes to the Unaudited Consolidated Financial Statements for the nine months ended September 30, 2011 and 2010 tagged as blocks of text.

In accordance with Rule 406T of Regulation S-T, the XBRL related information in Exhibit 101 to this Quarterly Report on Form 10-Q shall not be deemed to be filed for purposes of Section 18 of the Securities Exchange Act of 1934 (the Exchange Act), or otherwise subject to the liability of that section, and shall not be part of any registration statement or other document filed under the Securities Act of 1933 or the Exchange Act, except as shall be expressly set forth by specific reference in such filing.

(b) Reports on Form 8-K

A Form 8-K was filed on July 27, 2011, August 25, 2011, September 28, 2011 and October 26, 2011.

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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 14, 2011

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

Date: November 14, 2011

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

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