

PEOPLES FINANCIAL CORP /MS/  
Form 10-Q  
May 11, 2016

**SECURITIES AND EXCHANGE COMMISSION**

**Washington, D.C. 20549**

**FORM 10-Q**

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

**For the quarterly period ended March 31, 2016**

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

**(State or other jurisdiction of incorporation or organization)**

**Lameuse and Howard Avenues, Biloxi, Mississippi**  
**(Address of principal executive offices)**

**39533**  
**(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  (Do not check if a smaller reporting company)

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 April 30, 2016, there were 15,000,000 shares of \$1 par value common stock authorized, with 5,123,186 shares issued and outstanding.

**Part 1 Financial Information****Item 1: Financial Statements****Peoples Financial Corporation and Subsidiaries****Consolidated Statements of Condition****(in thousands except share data)**

	<b>March 31, 2016</b> <b>(unaudited)</b>	<b>December 31, 2015</b> <b>(audited)</b>
<b>Assets</b>		
Cash and due from banks	\$ 71,609	\$ 31,396
Available for sale securities	217,884	202,807
Held to maturity securities, fair value of \$22,046 at March 31, 2016; \$19,220 at December 31, 2015	21,743	19,025
Other investments	2,713	2,744
Federal Home Loan Bank Stock, at cost	1,642	1,637
Loans	337,911	337,557
Less: Allowance for loan losses	7,564	8,070
Loans, net	330,347	329,487
Bank premises and equipment, net of accumulated depreciation	22,513	22,446
Other real estate	9,840	9,916
Accrued interest receivable	1,932	1,832
Cash surrender value of life insurance	18,884	18,735
Other assets	1,130	979
<b>Total assets</b>	<b>\$ 700,237</b>	<b>\$ 641,004</b>

## Peoples Financial Corporation and Subsidiaries

## Consolidated Statements of Condition (continued)

(in thousands except share data)

	March 31, 2016 (unaudited)	December 31, 2015 (audited)
<b>Liabilities and Shareholders Equity</b>		
<b>Liabilities:</b>		
Deposits:		
Demand, non-interest bearing	\$ 130,617	\$ 122,743
Savings and demand, interest bearing	375,041	315,141
Time, \$100,000 or more	36,364	35,389
Other time deposits	39,213	39,434
Total deposits	581,235	512,707
Borrowings from Federal Home Loan Bank	8,333	18,409
Employee and director benefit plans liabilities	16,374	16,283
Other liabilities	1,139	1,766
<b>Total liabilities</b>	607,081	549,165
<b>Shareholders Equity:</b>		
Common stock, \$1 par value, 15,000,000 shares authorized, 5,123,186 shares issued and outstanding at March 31, 2016 and December 31, 2015	5,123	5,123
Surplus	65,780	65,780
Undivided profits	19,227	19,151
Accumulated other comprehensive income, net of tax	3,026	1,785
<b>Total shareholders equity</b>	93,156	91,839
<b>Total liabilities and shareholders equity</b>	\$ 700,237	\$ 641,004

See Notes to Consolidated Financial Statements.

**Peoples Financial Corporation and Subsidiaries**

**Consolidated Statements of Operations**

(in thousands except per share data)(unaudited)

	<b>Three Months Ended March 31,</b>	
	<b>2016</b>	<b>2015</b>
<b>Interest income:</b>		
Interest and fees on loans	\$ 3,697	\$ 3,753
Interest and dividends on securities:		
U.S. Treasuries	207	111
U.S. Government agencies	349	559
Mortgage-backed securities	143	154
States and political subdivisions	305	371
Corporate bonds	8	
Other investments	8	4
Interest on balances due from depository institutions	63	13
<b>Total interest income</b>	<b>4,780</b>	<b>4,965</b>
<b>Interest expense:</b>		
Deposits	200	164
Borrowings from Federal Home Loan Bank	42	46
<b>Total interest expense</b>	<b>242</b>	<b>210</b>
<b>Net interest income</b>	<b>4,538</b>	<b>4,755</b>
<b>Provision for allowance for loan losses</b>	<b>113</b>	<b>986</b>
<b>Net interest income after provision for allowance for loan losses</b>	<b>\$ 4,425</b>	<b>\$ 3,769</b>

**Peoples Financial Corporation and Subsidiaries**

**Consolidated Statements of Operations (continued)**

**(in thousands except per share data)(unaudited)**

	<b>Three Months Ended March 31,</b>	
	<b>2016</b>	<b>2015</b>
<b>Non-interest income:</b>		
Trust department income and fees	\$ 396	\$ 406
Service charges on deposit accounts	932	1,224
Gain on liquidation, sales and calls of securities	80	
Loss from other investments	(31)	(58)
Increase in cash surrender value of life insurance	102	122
Other income	164	247
<b>Total non-interest income</b>	<b>1,643</b>	<b>1,941</b>
<b>Non-interest expense:</b>		
Salaries and employee benefits	2,774	3,039
Net occupancy	647	667
Equipment rentals, depreciation and maintenance	714	717
FDIC and state banking assessments	226	246
Data processing	340	359
ATM expense	108	343
Other real estate expense	351	451
Other expense	832	1,039
<b>Total non-interest expense</b>	<b>5,992</b>	<b>6,861</b>
<b>Net income (loss)</b>	<b>\$ 76</b>	<b>\$ (1,151)</b>
<b>Basic and diluted earnings (loss) per share</b>	<b>\$ .01</b>	<b>\$ (.22)</b>
<b>Dividends declared per share</b>	<b>\$</b>	<b>\$</b>

See Notes to Consolidated Financial Statements.

**Peoples Financial Corporation and Subsidiaries**  
**Consolidated Statements of Comprehensive Income**  
(in thousands)(unaudited)

	<b>Three Months Ended March 31,</b>	
	<b>2016</b>	<b>2015</b>
<b>Net income (loss)</b>	\$ 76	\$ (1,151)
<b>Other comprehensive income:</b>		
Net unrealized gain on available for sale securities	1,313	2,602
Reclassification adjustment for realized gains on available for sale securities called or sold	(72)	
<b>Total other comprehensive income</b>	1,241	2,602
<b>Total comprehensive income</b>	\$ 1,317	\$ 1,451

See Notes to Consolidated Financial Statements.

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

(in thousands except share data)

	Number of Common Shares	Common Stock	Surplus	Undivided Profits	Accumulated Other Comprehensive Income	Total
<b>Balance, January 1, 2016</b>	5,123,186	\$ 5,123	\$ 65,780	\$ 19,151	\$ 1,785	\$ 91,839
Net income				76		76
Other comprehensive income					1,241	1,241
<b>Balance, March 31, 2016</b>	5,123,186	\$ 5,123	\$ 65,780	\$ 19,227	\$ 3,026	\$ 93,156

Note: Balances as of January 1, 2016 were audited.

See Notes to Consolidated Financial Statements.



**Peoples Financial Corporation and Subsidiaries**

**Consolidated Statements of Cash Flows**

(in thousands)(unaudited)

	<b>Three Months Ended March 31,</b>	
	<b>2016</b>	<b>2015</b>
<b>Cash flows from operating activities:</b>		
<b>Net income (loss)</b>	\$ 76	\$ (1,151)
Adjustments to reconcile net income (loss) to net cash provided by operating activities:		
Depreciation	447	445
Provision for allowance for loan losses	113	986
Writedown of other real estate	355	411
Gain on sales of other real estate	(57)	(24)
Loss from other investments	31	58
Amortization of available for sale securities	18	61
Amortization of held to maturity securities	30	17
Gain on liquidation, sales and calls of securities	(80)	
Change in accrued interest receivable	(100)	(56)
Increase in cash surrender value of life insurance	(102)	(122)
Change in other assets	(151)	190
Change in other liabilities	(536)	(73)
<b>Net cash provided by operating activities</b>	<b>\$ 44</b>	<b>\$ 742</b>

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

	<b>Three Months Ended March 31,</b>	
	<b>2016</b>	<b>2015</b>
<b>Cash flows from investing activities:</b>		
Proceeds from maturities, sales and calls of available for sale securities	\$ 56,126	\$ 26,327
Purchases of available for sale securities	(69,900)	(35,047)
Proceeds from maturities and calls of held to maturity securities	280	
Purchases of held to maturity securities	(3,028)	
Purchases of Federal Home Loan Bank stock	(5)	(406)
Proceeds from sales of other real estate	592	513
Loans, net change	(1,787)	(14,942)
Acquisition of bank premises and equipment	(514)	(58)
Investment in cash surrender value of life insurance	(47)	(35)
<b>Net cash used in investing activities</b>	<b>(18,283)</b>	<b>(23,648)</b>
<b>Cash flows from financing activities:</b>		
Demand and savings deposits, net change	67,774	45,747
Time deposits, net change	754	(975)
Borrowings from Federal Home Loan Bank	98,900	319,000
Repayments to Federal Home Loan Bank	(108,976)	(309,074)
<b>Net cash provided by financing activities</b>	<b>58,452</b>	<b>54,698</b>
<b>Net increase in cash and cash equivalents</b>	<b>40,213</b>	<b>31,792</b>
<b>Cash and cash equivalents, beginning of period</b>	<b>31,396</b>	<b>23,556</b>
<b>Cash and cash equivalents, end of period</b>	<b>\$ 71,609</b>	<b>\$ 55,348</b>

See Notes to Consolidated Financial Statements.

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PEOPLES FINANCIAL CORPORATION AND SUBSIDIARIES

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

For the three Months Ended March 31, 2016 and 2015

1. Basis of Presentation:

Peoples Financial Corporation (the Company) is a one-bank holding company headquartered in Biloxi, Mississippi. The Company 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 those portions of Mississippi, Louisiana and Alabama which are within a fifty mile radius of the Waveland, Wiggins and Gautier branches, the Bank's three most outlying locations (the trade area).

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 March 31, 2016 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 2015 Annual Report and Form 10-K.

The results of operations for the quarter ended March 31, 2016, 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. Material estimates common to the banking industry that are particularly susceptible to significant change in the near term include, but are not limited to, the determination of the allowance for loan losses, the valuation of other real estate acquired in connection with foreclosure or in satisfaction of loans and valuation allowances associated with the realization of deferred tax assets, which are based on future taxable income.

**Summary of Significant Accounting Policies** The accounting and reporting policies of the Company conform to 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, 2015.

**New Accounting Pronouncements** In February 2016, the Financial Accounting Standards Board (the FASB) issued Accounting Standards Update (ASU) No. 2016-02, *Leases (Topic 82)*. ASU 2016-02 provides certain targeted improvements to align lessor accounting with the lessee accounting model. This update will be effective for fiscal years, and interim periods within those fiscal years, beginning after January 1, 2019. The adoption of this ASU is not expected to have a material effect on the Company's financial position, results of operations or cash flows.

In March 2016, FASB issued ASU 2016-03, *Intangibles – Goodwill and Other (Topic 350); Business Combinations (Topic 805); Consolidation (Topic 810); Derivatives and Hedging (Topic 815): Effective Date and Transition Guidance*. ASU 2016-03 amends the guidance in ASUs 2014-02, 2014-03, 2014-7 and 2014-18 to remove their effective dates and render them effective immediately. The adoption of this ASU is not expected to have a material effect on the Company's financial position, results of operations or cash flows.

In March 2016, FASB issued ASU 2016-07, *Investments – Equity Method and Joint Ventures (Topic 323): Simplifying the Transition to the Equity Method of Accounting*. ASU 2016-07 eliminates the requirement that when an investment qualifies for use of the equity method as a result of an increase in the level of ownership interest or degree of influence, an investor must adjust the investment, results of operations and retained earnings retroactively on a step by step basis. This update will be effective for fiscal years, and interim periods within those fiscal years, beginning after January 1, 2016. The adoption of this ASU is not expected to have a material effect on the Company's financial position, results of operations or cash flows.

## 2. Earnings (Loss) Per Share:

Per share data is based on the weighted average shares of common stock outstanding of 5,123,186 for the three months ended March 31, 2016 and 2015.

## 3. Statements of Cash Flows:

The Company has defined cash and cash equivalents as cash and due from banks. The Company paid \$235,325 and \$204,656 for the three months ended March 31, 2016 and 2015, respectively, for interest on deposits and borrowings. No income tax payments were made during the three months ended March 31, 2016 and 2015. Loans transferred to other real estate amounted to \$813,589 and \$5,551,393 during the three months ended March 31, 2016 and 2015, respectively.

## 4. Investments:

The amortized cost and fair value of securities at March 31, 2016 and December 31, 2015, are as follows (in thousands):

March 31, 2016	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Available for sale securities:				
Debt securities:				
U.S. Treasuries	\$ 112,771	\$ 434	\$ (3)	\$ 113,202
U.S. Government agencies	52,887	319	(259)	52,947
Mortgage-backed securities	28,981	412		29,393
States and political subdivisions	20,872	862		21,734
<b>Total debt securities</b>	<b>215,511</b>	<b>2,027</b>	<b>(262)</b>	<b>217,276</b>
Equity securities	608			608
<b>Total available for sale securities</b>	<b>\$ 216,119</b>	<b>\$ 2,027</b>	<b>\$ (262)</b>	<b>\$ 217,884</b>
Held to maturity securities:				
States and political subdivisions	\$ 20,238	\$ 323	\$ (8)	\$ 20,553
Corporate bonds	1,505		(12)	1,493
<b>Total held to maturity securities</b>	<b>\$ 21,743</b>	<b>\$ 323</b>	<b>\$ (20)</b>	<b>\$ 22,046</b>

December 31, 2015	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
<b>Available for sale securities:</b>				
<b>Debt securities:</b>				
U.S. Treasuries	\$ 63,845	\$ 20	\$ (111)	\$ 63,754
U.S. Government agencies	84,849	176	(479)	84,546
Mortgage-backed securities	30,106	155	(131)	30,130
States and political subdivisions	22,833	894		23,727
<b>Total debt securities</b>	<b>201,633</b>	<b>1,245</b>	<b>(721)</b>	<b>202,157</b>
Equity securities	650			650
<b>Total available for sale securities</b>	<b>\$ 202,283</b>	<b>\$ 1,245</b>	<b>\$ (721)</b>	<b>\$ 202,807</b>
<b>Held to maturity securities:</b>				
States and political subdivisions	\$ 17,507	\$ 222	\$ (16)	\$ 17,713
Corporate bonds	1,518		(11)	1,507
<b>Total held to maturity securities</b>	<b>\$ 19,025</b>	<b>\$ 222</b>	<b>\$ (27)</b>	<b>\$ 19,220</b>

The amortized cost and fair value of debt securities at March 31, 2016 (in thousands), 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.

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	Amortized Cost	Fair Value
Available for sale securities:		
Due in one year or less	\$ 67,807	\$ 67,867
Due after one year through five years	81,725	82,627
Due after five years through ten years	25,980	26,295
Due after ten years	11,018	11,094
Mortgage-backed securities	28,981	29,393
Totals	\$ 215,511	\$ 217,276
Held to maturity securities:		
Due in one year or less	\$ 621	\$ 622
Due after one year through five years	8,505	8,570
Due after five years through ten years	7,985	8,140
Due after ten years	4,632	4,714
Totals	\$ 21,743	\$ 22,046

Available for sale and held to maturity securities with gross unrealized losses at March 31, 2016 and December 31, 2015, aggregated by investment category and length of time that individual securities have been in a continuous loss position, are as follows (in thousands):

	Less Than Twelve Months		Over Twelve Months		Total	
	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses
<b>March 31, 2016:</b>						
U.S. Treasuries	\$ 24,996	\$ 3	\$	\$	\$ 24,996	\$ 3
U.S. Government agencies	12,825	159	4,887	100	17,712	259
States and political subdivisions	1,254	7	596	1	1,850	8
Corporate bonds	1,493	12			1,493	12
<b>TOTAL</b>	<b>\$ 40,568</b>	<b>\$ 181</b>	<b>\$ 5,483</b>	<b>\$ 101</b>	<b>\$ 46,051</b>	<b>\$ 282</b>
<b>December 31, 2015:</b>						
U.S. Treasuries	\$ 39,889	\$ 111	\$	\$	\$ 39,889	\$ 111
U.S. Government agencies	14,894	87	12,581	392	27,475	479
Mortgage-backed securities	16,557	131			16,557	131
States and political subdivisions	2,225	8	1,362	8	3,587	16
Corporate bonds	1,507	11			1,507	11
<b>TOTAL</b>	<b>\$ 75,072</b>	<b>\$ 348</b>	<b>\$ 13,943</b>	<b>\$ 400</b>	<b>\$ 89,015</b>	<b>\$ 748</b>

At March 31, 2016, 5 of the 24 securities issued by the U.S. Treasury, 3 of the 10 securities issued by U.S. Government agencies, 8 of the 146 securities issued by states and political subdivisions and the corporate bonds contained unrealized losses.

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.

Proceeds from sales and calls of available for sale debt securities were \$19,590,781 during the three months ended March 31, 2016. Available for sale debt securities were sold or called for a realized gain of \$72,333 for the three months ended March 31, 2016. There were no sales or calls of available for sale debt securities for the three months ended March 31, 2015.



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Securities with a fair value of \$205,888,934 and \$168,724,920 at March 31, 2016 and December 31, 2015, respectively, were pledged to secure public deposits, federal funds purchased and other balances required by law.

#### 5. Loans:

The composition of the loan portfolio at March 31, 2016 and December 31, 2015, is as follows (in thousands):

	March 31, 2016	December 31, 2015
Gaming	\$ 31,492	\$ 31,655
Residential and land development	919	933
Real estate, construction	35,449	35,414
Real estate, mortgage	220,878	219,925
Commercial and industrial	41,934	42,480
Other	7,239	7,150
Total	\$ 337,911	\$ 337,557

The age analysis of the loan portfolio, segregated by class of loans, as of March 31, 2016 and December 31, 2015, is as follows (in thousands):

	Number of Days Past Due			Total Past Due	Current	Total Loans	Loans Past Due Greater Than 90 Days & Still Accruing
	30 - 59	60 - 89	Greater Than 90				
<b>March 31, 2016:</b>							
Gaming	\$	\$	\$	\$	\$ 31,492	\$ 31,492	\$
Residential and land development			309	309	610	919	
Real estate, construction	1,113		995	2,108	33,341	35,449	
Real estate, mortgage	8,564	2,599	1,962	13,125	207,753	220,878	103
Commercial and industrial	1,555		743	2,298	39,636	41,934	
Other	66	3	76	145	7,094	7,239	76
<b>Total</b>	<b>\$ 11,298</b>	<b>\$ 2,602</b>	<b>\$ 4,085</b>	<b>\$ 17,985</b>	<b>\$ 319,926</b>	<b>\$ 337,911</b>	<b>\$ 179</b>
<b>December 31, 2015:</b>							
Gaming	\$	\$	\$	\$	\$ 31,655	\$ 31,655	\$
Residential and land development			323	323	610	933	
Real estate, construction	851	448	1,346	2,645	32,769	35,414	
Real estate, mortgage	7,094	3,673	1,352	12,119	207,806	219,925	146
Commercial and industrial	1,206	31	237	1,474	41,006	42,480	
Other	67			67	7,083	7,150	
<b>Total</b>	<b>\$ 9,218</b>	<b>\$ 4,152</b>	<b>\$ 3,258</b>	<b>\$ 16,628</b>	<b>\$ 320,929</b>	<b>\$ 337,557</b>	<b>\$ 146</b>

The Company monitors the credit quality of its loan portfolio through the use of a loan grading system. A score of 1 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, B, C, S, D, E or 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. A grade of S will generally be applied to loans for customers who meet the criteria for a grade of C but who also warrant additional monitoring by placement on the watch list. 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. In addition, on a monthly basis the Company determines which loans are 90 days or more past due and assigns a grade of E to them. 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.

An analysis of the loan portfolio by loan grade, segregated by class of loans, as of March 31, 2016 and December 31, 2015, is as follows (in thousands):

	Loans With A Grade Of:					Total
	A, B or C	S	D	E	F	
<b>March 31, 2016:</b>						
Gaming	\$ 31,492	\$	\$	\$	\$	\$ 31,492
Residential and land development	610			309		919
Real estate, construction	32,514		725	2,210		35,449
Real estate, mortgage	168,381	16,541	23,019	12,937		220,878
Commercial and industrial	24,469	15,007	1,326	1,132		41,934
Other	7,121	1	117			7,239
<b>Total</b>	<b>\$ 264,587</b>	<b>\$ 31,549</b>	<b>\$ 25,187</b>	<b>\$ 16,588</b>	<b>\$</b>	<b>\$ 337,911</b>
<b>December 31, 2015:</b>						
Gaming	\$ 31,655	\$	\$	\$	\$	\$ 31,655
Residential and land development	610			323		933
Real estate, construction	31,935		883	2,596		35,414
Real estate, mortgage	167,286	16,678	23,686	12,275		219,925
Commercial and industrial	24,466	15,007	2,368	639		42,480
Other	7,114	1	35			7,150
<b>Total</b>	<b>\$ 263,066</b>	<b>\$ 31,686</b>	<b>\$ 26,972</b>	<b>\$ 15,833</b>	<b>\$</b>	<b>\$ 337,557</b>

A loan may be impaired but not on nonaccrual status when the loan is well secured and in the process of collection. Total loans on nonaccrual as of March 31, 2016 and December 31, 2015, are as follows (in thousands):

	March 31, 2016	December 31, 2015
Residential and land development	\$ 309	\$ 323
Real estate, construction	2,137	2,523
Real estate, mortgage	11,924	11,759
Commercial and industrial	1,078	581
<b>Total</b>	<b>\$ 15,448</b>	<b>\$ 15,186</b>

The Company has modified certain loans by granting interest rate concessions to these customers. These loans are in compliance with their modified terms, are currently accruing and the Company has classified them as troubled debt restructurings. Troubled debt restructurings as of March 31, 2016 and December 31, 2015 were as follows (in thousands except for number of contracts):

	Number of Contracts	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment	Related Allowance
<b>March 31, 2016:</b>				
Real estate, mortgage	3	\$ 1,216	\$ 1,216	\$ 107
<b>Total</b>	<b>3</b>	<b>\$ 1,216</b>	<b>\$ 1,216</b>	<b>\$ 107</b>
<b>December 31, 2015:</b>				
Real estate, mortgage	3	\$ 1,232	\$ 1,232	\$ 107
<b>Total</b>	<b>3</b>	<b>\$ 1,232</b>	<b>\$ 1,232</b>	<b>\$ 107</b>

Impaired loans, which include loans classified as nonaccrual and troubled debt restructurings, segregated by class of loans, as of March 31, 2016 and December 31, 2015, are as follows (in thousands):

	Unpaid Principal Balance	Recorded Investment	Related Allowance	Average Recorded Investment	Interest Income Recognized
<b>March 31, 2016:</b>					
With no related allowance recorded:					
Real estate, construction	\$ 1,933	\$ 1,458	\$	\$ 1,510	\$
Real estate, mortgage	9,693	8,937		8,734	8
Commercial and industrial	1,116	1,078		742	
<b>Total</b>	<b>12,742</b>	<b>11,473</b>		<b>10,986</b>	<b>8</b>
With a related allowance recorded:					
Residential and land development	309	309	109	318	
Real estate, construction	812	679	250	680	
Real estate, mortgage	4,203	4,203	1,539	4,215	7
<b>Total</b>	<b>5,324</b>	<b>5,191</b>	<b>1,898</b>	<b>5,213</b>	<b>7</b>
Total by class of loans:					
Residential and land development	309	309	109	318	
Real estate, construction	2,745	2,137	250	2,190	
Real estate, mortgage	13,896	13,140	1,539	12,949	15
Commercial and industrial	1,116	1,078		742	
<b>Total</b>	<b>\$ 18,066</b>	<b>\$ 16,664</b>	<b>\$ 1,898</b>	<b>\$ 16,199</b>	<b>\$ 15</b>

	Unpaid Principal Balance	Recorded Investment	Related Allowance	Average Recorded Investment	Interest Income Recognized
December 31, 2015:					
With no related allowance recorded:					
Real estate, construction	\$ 2,228	\$ 1,842	\$	\$ 1,878	\$
Real estate, mortgage	9,771	9,014		9,175	21
Commercial and industrial	619	581		653	
Total	12,618	11,437		11,706	21
With a related allowance recorded:					
Residential and land development	323	323	109	343	
Real estate, construction	814	681	252	780	
Real estate, mortgage	3,977	3,977	1,443	3,920	18
Total	5,114	4,981	1,804	5,043	18
Total by class of loans:					
Residential and land development	323	323	109	343	
Real estate, construction	3,042	2,523	252	2,658	
Real estate, mortgage	13,748	12,991	1,443	13,095	39
Commercial and industrial	619	581		653	
Total	\$ 17,732	\$ 16,418	\$ 1,804	\$ 16,749	\$ 39

## 6. Allowance for Loan Losses:

Transactions in the allowance for loan losses for the three months ended March 31, 2016 and 2015, and the balances of loans, individually and collectively evaluated for impairment, as of March 31, 2016 and 2015, are as follows (in thousands):

	Gaming	Residential and Land Development	Real Estate, Construction	Real Estate, Mortgage	Commercial and Industrial	Other	Total
<b>For the Quarter Ended</b>							
<b>March 31, 2016:</b>							
<b>Allowance for Loan Losses:</b>							
Beginning Balance	\$ 582	\$ 189	\$ 589	\$ 5,382	\$ 1,075	\$ 253	\$ 8,070
Charge-offs			(89)	(15)	(509)	(50)	(663)
Recoveries			1	7	15	21	44
Provision	(15)	6	(49)	40	105	26	113
<b>Ending Balance</b>	<b>\$ 567</b>	<b>\$ 195</b>	<b>\$ 452</b>	<b>\$ 5,414</b>	<b>\$ 686</b>	<b>\$ 250</b>	<b>\$ 7,564</b>
<b>Allowance for loan losses,</b>							
<b>March 31, 2016:</b>							
Ending balance: individually evaluated for impairment	\$	\$ 109	\$ 391	\$ 1,829	\$ 130	\$ 3	\$ 2,462
Ending balance: collectively evaluated for impairment	\$ 567	\$ 86	\$ 61	\$ 3,585	\$ 556	\$ 247	\$ 5,102
<b>Total Loans, March 31, 2016:</b>							
Ending balance: individually evaluated for impairment	\$	\$ 309	\$ 2,935	\$ 35,956	\$ 2,458	\$ 117	\$ 41,775
Ending balance: collectively evaluated for impairment	\$ 31,492	\$ 610	\$ 32,514	\$ 184,922	\$ 39,476	\$ 7,122	\$ 296,136



	Gaming	Residential and Land Development	Real Estate, Construction	Real Estate, Mortgage	Commercial and Industrial	Other	Total
For the Quarter Ended							
March 31, 2015:							
Allowance for Loan Losses:							
Beginning Balance	\$ 573	\$ 251	\$ 860	\$ 6,609	\$ 587	\$ 326	\$ 9,206
Charge-offs			(97)	(83)	(24)	(60)	(264)
Recoveries				7	10	40	57
Provision	(36)	817	(17)	134	68	20	986
Ending Balance	\$ 537	\$ 1,068	\$ 746	\$ 6,667	\$ 641	\$ 326	\$ 9,985

Allowance for loan losses,  
March 31, 2015:

Ending balance: individually evaluated for impairment	\$	\$ 894	\$ 687	\$ 2,922	\$ 264	\$ 12	\$ 4,779
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Ending balance: collectively evaluated for impairment	\$ 537	\$ 174	\$ 59	\$ 3,745	\$ 377	\$ 314	\$ 5,206
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Total Loans, March 31,  
2015:

Ending balance: individually evaluated for impairment	\$	\$ 5,436	\$ 5,546	\$ 38,574	\$ 1,852	\$ 31	\$ 51,439
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Ending balance: collectively evaluated for impairment	\$ 29,760	\$ 650	\$ 32,130	\$ 200,921	\$ 43,251	\$ 13,440	\$ 320,152
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#### 7. Deposits:

Time deposits of \$100,000 or more at March 31, 2016 and December 31, 2015 include brokered deposits of \$5,000,000, which mature in 2017.

Time deposits of \$250,000 or more totaled approximately \$24,938,000 and \$24,090,000 at March 31, 2016 and December 31, 2015, respectively.

#### 8. Fair Value Measurements and Disclosures:

The Company utilizes fair value measurements to record fair value adjustments to certain assets and liabilities and to determine fair value disclosures. Available for sale securities are recorded at fair value on a recurring basis.

Additionally, from time to time, the Company may be required to record other assets at fair value on a non-recurring basis, such as impaired loans and ORE. These non-recurring fair value adjustments typically involve application of lower of cost or market accounting or write-downs of individual assets. Additionally, the Company is required to disclose, but not record, the fair value of other financial instruments.

#### Fair Value Hierarchy

The Company groups assets and liabilities at fair value in three levels, based on the markets in which the assets and liabilities are traded and the reliability of the assumptions used to determine fair value. These levels are:

Level 1 Valuation is based upon quoted prices for identical instruments traded in active markets.

Level 2 Valuation is based upon quoted market prices for similar instruments in active markets, quoted prices for identical or similar instruments in markets that are not active and model-based valuation techniques for which all significant assumptions are observable in the market.

Level 3 Valuation is generated from model-based techniques that use at least one significant assumption not observable in the market. These unobservable assumptions reflect estimates of assumptions that market participants would use in pricing the asset or liability. Valuation techniques include the use of option pricing models, discounted cash flow models and similar techniques.

Following is a description of valuation methodologies used to determine the fair value of financial assets and liabilities.

### **Cash and Due from Banks**

The carrying amount shown as cash and due from banks 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. Another 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 securities. The Company's available for sale securities for which fair value is determined through the use of such pricing models and matrix pricing are classified as Level 2 assets. If the fair value of available for sale securities is generated through model-based techniques, including the discounting of estimated cash flows, such securities are classified as Level 3 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. Impaired loans are non-recurring Level 3 assets.

### **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. Other real estate is 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.

### **Borrowings from Federal Home Loan Bank**

The fair value of Federal Home Loan Bank ( FHLB ) fixed rate borrowings is estimated using discounted cash flows based on current incremental borrowing rates for similar types of borrowing arrangements. The fair value of FHLB variable rate borrowings is estimated to be its carrying value.

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 March 31, 2016 and December 31, 2015 are as follows (in thousands):

	Total	Fair Value Measurements Using		
		Level 1	Level 2	Level 3
<b>March 31, 2016:</b>				
U.S. Treasuries	\$ 113,202	\$	\$ 113,202	\$
U.S. Government agencies	52,947		52,947	
Mortgage-backed securities	29,393		29,393	
States and political subdivisions	21,734		21,554	180
Equity securities	608		608	
<b>Total</b>	<b>\$ 217,884</b>	<b>\$</b>	<b>\$ 217,704</b>	<b>\$ 180</b>
<b>December 31, 2015:</b>				
U.S. Treasuries	\$ 63,754	\$	\$ 63,754	\$
U.S. Government agencies	84,546		84,546	
Mortgage-backed securities	30,130		30,130	
States and political subdivisions	23,727		23,547	180
Equity securities	650		650	
<b>Total</b>	<b>\$ 202,807</b>	<b>\$</b>	<b>\$ 202,627</b>	<b>\$ 180</b>

Impaired loans, which are measured at fair value on a non-recurring basis, by level within the fair value hierarchy as of March 31, 2016 and December 31, 2015 are as follows (in thousands):

	Total	Fair Value Measurements Using		
		Level 1	Level 2	Level 3
March 31, 2016	\$ 7,752	\$	\$	\$ 7,752
December 31, 2015	7,811			7,811

Other real estate, which is measured at fair value on a non-recurring basis, by level within the fair value hierarchy as of March 31, 2016 and December 31, 2015 are as follows (in thousands):

	Total	Fair Value Measurements Using		
		Level 1	Level 2	Level 3
March 31, 2016	\$ 9,840	\$	\$	\$ 9,840
December 31, 2015	9,916			9,916

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

	For the Three Months Ended March 31, 2016	For the Year Ended December 31, 2015
Balance, beginning of period	\$ 9,916	\$ 7,646
Loans transferred to ORE	814	7,502
Sales	(535)	(4,295)
Writedowns	(355)	(937)
Balance, end of period	\$ 9,840	\$ 9,916

The carrying value and estimated fair value of financial instruments, by level within the fair value hierarchy, at March 31, 2016 and December 31, 2015, are as follows (in thousands):

	Carrying Amount	Fair Value Measurements Using			Total
		Level 1	Level 2	Level 3	
March 31, 2016:					
Financial Assets:					
Cash and due from banks	\$ 71,609	\$ 71,609	\$	\$	\$ 71,609
Available for sale securities	217,884		217,704	180	217,884
Held to maturity securities	21,743		22,046		22,046
Other investments	2,713	2,713			2,713
Federal Home Loan Bank stock	1,642		1,642		1,642
Loans, net	330,347			333,880	333,880
Other real estate	9,840			9,840	9,840
Cash surrender value of life insurance	18,884		18,884		18,884
Financial Liabilities:					
Deposits:					
Non-interest bearing	130,617	130,617			130,617
Interest bearing	450,618			450,891	450,891
Borrowings from Federal Home Loan					
Bank	8,333		9,857		9,857

December 31, 2015:

## Financial Assets:

Cash and due from banks	\$ 31,396	\$ 31,396	\$	\$	\$ 31,396
Available for sale securities	202,807		202,627	180	202,807
Held to maturity securities	19,025		19,220		19,220
Other investments	2,744	2,744			2,744
Federal Home Loan Bank stock	1,637		1,637		1,637
Loans, net	329,487			331,026	331,026
Other real estate	9,916			9,916	9,916
Cash surrender value of life insurance	18,735		18,735		18,735

## Financial Liabilities:

## Deposits:

Non-interest bearing	122,743	122,743			122,743
Interest bearing	389,964			390,205	390,205

## Borrowings from Federal Home Loan

Bank	18,409		19,731		19,731
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## 9. 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.



## **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. The Company 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 those portions of Mississippi, Louisiana and Alabama which are within a fifty mile radius of the Waveland, Wiggins and Gautier branches, the Bank's three most outlying locations (the trade area).

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, 2015.

### **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 Financial Accounting Standards Board (FASB) issued several new accounting standards updates during the first quarter of 2016, which have been disclosed in the Notes to Unaudited Consolidated Financial Statements. The Company does not expect that these updates will have a material effect on its financial position, or results of operations.

## **Critical Accounting Policies**

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America ( GAAP ) requires Management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. 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.

## **Investments**

Investments which are classified as available for sale are stated at fair value. A decline in the market value of an investment below cost that is deemed to be other-than-temporary is charged to earnings for the decline in value deemed to be credit related and a new cost basis in the security is established. The decline in value attributed to non-credit related factors is recognized in other comprehensive income. The determination of the fair value of securities may require Management to develop estimates and assumptions regarding the amount and timing of cash flows.

## **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 the financial statements. 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 a five year average loss history which is updated on a quarterly basis and which may be adjusted by qualitative factors by loan type and a specific reserve analysis for those loans considered impaired under GAAP. 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.

## **Other Real Estate**

Other real estate ( ORE ) includes real estate acquired through foreclosure. Each other real estate property is carried at fair value, less estimated costs to sell. Fair value is principally based on appraisals performed by third-party valuation specialists. If Management determines that the fair value of a property has decreased subsequent to foreclosure, the Company records a write down which is included in non-interest expense.



## **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.

## **Income Taxes**

GAAP requires the asset and liability approach for financial accounting and reporting for deferred income taxes. We use the asset and liability method of accounting for deferred income taxes and provide deferred income taxes for all significant income tax temporary differences. As part of the process of preparing our consolidated financial statements, the Company is required to estimate our income taxes in each of the jurisdictions in which we operate. This process involves estimating our actual current tax exposure together with assessing temporary differences resulting from differing treatment of items, such as the provision for loan losses, for tax and financial reporting purposes. These differences result in deferred tax assets and liabilities that are included in our consolidated statement of condition. We must also assess the likelihood that our deferred tax assets will be recovered from future taxable income, and to the extent we believe that recovery is not likely, we must establish a valuation allowance. Significant management judgment is required in determining our provision for income taxes, our deferred tax assets and liabilities and any valuation allowance recorded against our net deferred tax assets. To the extent the Company establishes a valuation allowance or adjusts this allowance in a period, we must include an expense or a benefit within the tax provisions in the consolidated statement of income.

## **OVERVIEW**

The Company is a community bank serving the financial and trust needs of its customers in our trade area, which is defined as those portions of Mississippi, Louisiana and Alabama which are within a fifty mile radius of the Waveland, Wiggins and Gautier branches, the bank subsidiary's three most outlying locations. Maintaining a strong core deposit base and providing commercial and real estate lending in our trade area are the traditional focuses of the 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.

The Company reported net income of \$76,000 for the first quarter of 2016 compared with a net loss of \$1,151,000 for the first quarter of 2015. Results in 2016 included decreases in the provision for the allowance for loan losses and non-interest expense which was partially offset by a decrease in net interest income and non-interest income as compared with 2015.

Managing the net interest margin in the Company's highly competitive market and in context of larger economic conditions has been very challenging and will continue to be so, for the foreseeable future. Net interest income was impacted primarily by the decrease in interest income on loans of \$56,000. This decrease was the result of the decrease in average loans and the yield on average loans. The decrease in average loans was a result of principal payments, maturities, charge-offs and foreclosures on existing loans exceeding new loans.

Monitoring asset quality, estimating potential losses in our loan portfolio and addressing non-performing loans continue to be emphasized during these difficult economic times, as the local economy continues to negatively impact collateral values and borrowers' ability to repay their loans. A provision for the allowance for loan losses of \$113,000 was recorded in 2016 as compared with \$986,000 in 2015. The Company is working diligently to address and reduce its non-performing assets. The Company's nonaccrual loans totaled \$15,448,000 and \$15,186,000 at March 31, 2016 and December 31, 2015, respectively. Most of these loans are collateral-dependent, and the Company has rigorously evaluated the value of its collateral to determine potential losses.

Non-interest income decreased \$298,000 for the three months ended March 31, 2016 as compared with 2015 results. Service charges on deposit accounts decreased \$292,000 for 2016 as compared with 2015 primarily as a result of decreased ATM fee income.

Non-interest expense decreased \$869,000 for the three months ended March 31, 2016 as compared with 2015 results. This decrease for the three months ended March 31, 2016 was the result of decreases in salaries and employee benefits of \$265,000, ATM expense of \$235,000 and other expense of \$207,000 as compared with 2015. Other expenses includes legal fees which decreased \$159,000 for the three months ended March 31, 2016 as compared with the same period for 2015.

Total assets at March 31, 2016 increased \$59,233,000 as compared with December 31, 2015. Cash and due from banks increased \$40,213,000 in the management of the Company's liquidity position. Available for sale securities increased \$15,077,000 primarily as a result of increased purchases of these investments at March 31, 2016.

## **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.

The Company's average interest earning assets decreased approximately \$16,133,000 or 3%, from approximately \$618,670,000 for the first quarter of 2015 to approximately \$602,537,000 for the first quarter of 2016. The Company's average balance sheet decreased primarily as average loans decreased approximately \$24,493,000 and average nontaxable available for sale securities decreased approximately \$12,839,000 and balances due from financial institutions increased approximately \$16,059,000 and taxable available for sale securities increased approximately \$3,223,000 for the

first quarter of 2016 as compared with the first quarter of 2015. Average loans decreased as principal payments, maturities, charge-offs and foreclosures relating to existing loans outpaced new loans. Average nontaxable available for sale securities decreased as some of the proceeds of the maturities of these securities were reinvested in taxable available for sale securities. Balances due from financial institutions increased from the proceeds of maturities of nontaxable available for sale securities and the management of the Company's liquidity position.

The average yield on interest-earning assets decreased from 3.33% for the first quarter of 2015 to 3.28% for the first quarter of 2016. This decrease is primarily the result of the yield on taxable available for sale securities decreasing from 1.78% for 2015 to 1.48% for 2016 as recent purchases have shorter durations, and therefore lower yields, in anticipation of rising rates.

Average interest bearing liabilities decreased approximately \$28,189,000, or 6%, from approximately \$478,294,000 for the first quarter of 2015 to approximately \$450,105,000 for the first quarter of 2016. Average savings and interest bearing DDA decreased \$18,186,000 primarily as several large customers reallocated their funds in the current year. Average borrowings from the Federal Home Loan Bank decreased \$10,075,000 due to the liquidity needs of the bank subsidiary.

The average rate paid on interest bearing liabilities for the first quarter of 2015 was .18% as compared with .22% for the first quarter of 2016. This increase is primarily due to the increased rates in the current year.

The Company's net interest margin on a tax-equivalent basis, which is net interest income as a percentage of average earning assets, was 3.20% for the quarter ended March 31, 2015 and 3.12% for the quarter ended March 31, 2016.

The tables on the following pages analyze the changes in tax-equivalent net interest income for the quarters ended March 31, 2016 and 2015.

## Analysis of Average Balances, Interest Earned/Paid and Yield

(In Thousands)

	Three Months Ended March 31, 2016			Three Months Ended March 31, 2015		
	Average Balance	Interest Earned/Paid	Rate	Average Balance	Interest Earned/Paid	Rate
Loans (2)(3)	\$ 337,950	\$ 3,697	4.38%	\$ 362,443	\$ 3,753	4.14%
Balances due from financial institutions	31,247	63	0.81%	15,188	13	0.34%
HTM:						
Taxable	1,513	8	2.12%			
Non taxable (1)	18,257	162	3.55%	17,777	151	3.40%
AFS:						
Taxable	188,735	699	1.48%	185,512	824	1.78%
Non taxable (1)	22,589	300	5.31%	35,428	411	4.64%
Other	2,246	8	1.42%	2,322	4	0.69%
Total	\$ 602,537	\$ 4,937	3.28%	\$ 618,670	\$ 5,156	3.33%
Savings & interest-bearing DDA	\$ 363,656	\$ 99	0.11%	\$ 381,842	\$ 70	0.07%
Time deposits	74,923	101	0.54%	74,851	94	0.50%
Borrowings from FHLB	11,526	42	1.46%	21,601	46	0.85%
Total	\$ 450,105	\$ 242	0.22%	\$ 478,294	\$ 210	0.18%
Net tax-equivalent spread			3.06%			3.15%
Net tax-equivalent margin on earning assets			3.12%			3.20%

(1) All interest earned is reported on a taxable equivalent basis using a tax rate of 34% in 2016 and 2015.

(2) Loan fees of \$112 and \$90 for 2016 and 2015, respectively, are included in these figures.

(3) Includes nonaccrual loans.

## Analysis of Changes in Interest Income and Interest Expense

(In Thousands)

	For the Three Months Ended March 31, 2016 compared with March 31, 2015			
	Volume	Rate	Rate/Volume	Total
<b>Interest earned on:</b>				
Loans	\$ (254)	\$ 212	\$ (14)	\$ (56)
Balances due from financial institutions	14	17	19	50
<b>Held to maturity securities:</b>				
Taxable	8			8
Non taxable	4	7		11
<b>Available for sale securities:</b>				
Taxable	14	(137)	(2)	(125)
Non taxable	(149)	60	(22)	(111)
Other	(1)	5		4
<b>Total</b>	<b>\$ (364)</b>	<b>\$ 164</b>	<b>\$ (19)</b>	<b>\$ (219)</b>
<b>Interest paid on:</b>				
Savings & interest-bearing DDA	\$ (3)	\$ 34	\$ (2)	\$ 29
Time deposits	1	6		7
Borrowings from FHLB	(21)	33	(16)	(4)
<b>Total</b>	<b>\$ (23)</b>	<b>\$ 73</b>	<b>\$ (18)</b>	<b>\$ 32</b>

**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 limited to financial analysis, collateral valuation, lending limits, pricing considerations and loan grading. The Company's Loan Review and Special Assets Departments play key roles in monitoring the loan portfolio and managing problem loans. New loans and, on a periodic basis, existing loans are reviewed to evaluate compliance with the loan policy. Loan customers in concentrated industries such as gaming and hotel/motel, as well as the exposure for out of area; residential and land development; construction and commercial real estate loans, and their direct and indirect impact on its operations are evaluated on a monthly basis. Loan delinquencies and deposit overdrafts are closely monitored in order to identify developing problems as early as possible. Lenders experienced in workout scenarios consult with loan officers and customers to address non-performing loans. 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 of the continuing decline in real estate values and actual losses incurred by the Company were key factors in our analysis. Much of the Company's loan portfolio is collateral-dependent, requiring careful consideration of changes in the value of the collateral.

The Company's analysis includes evaluating the current values of collateral securing all nonaccrual loans. Even though nonaccrual loans were \$15,448,000 and \$15,186,000 at March 31, 2016 and December 31, 2015, respectively, specific reserves of only \$1,791,000 and \$1,697,000, respectively, have been allocated to these loans as collateral values appear sufficient to cover loan losses or the loan balances have been charged down to their realizable value.

The Company's on-going, systematic evaluation resulted in the Company recording a provision for loan losses of \$113,000 and \$986,000 for the first quarters of 2016 and 2015, respectively. The allowance for loan losses as a percentage of loans was 2.24% and 2.69% at March 31, 2016 and December 31, 2015, respectively. The Company believes that its allowance for loan losses is appropriate as of March 31, 2016.

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**

Non-interest income decreased \$298,000 for the first quarter of 2016 as compared with the first quarter of 2015 as service charges on deposit accounts decreased by \$292,000 during the first quarter of 2016 as compared with the first quarter of 2015. ATM fee income decreased \$271,000 as the Company's off-site ATMs at a casino transferred to another vendor during 2015.

#### **Non-interest expense**

Total non-interest expense decreased \$869,000 for the first quarter of 2016 as compared with the first quarter of 2015. Salaries and employee benefits decreased \$265,000, ATM expense decreased \$235,000 and other expenses decreased \$207,000 for the first quarter of 2016 as compared with the first quarter of 2015.

Salaries and employee benefits decreased in 2016 as the Company updated the estimates of costs associated with its deferred compensation plans in 2015.

ATM expenses decreased in 2016 as a result of decreased ATM activity in the current year as a result of off-site ATMs at a casino transferring to another vendor.

Other expense decreased in 2016 primarily as 2015's results included increased legal fees associated with non-performing loans of \$159,000.

## **Income Taxes**

At December 31, 2014, the Company established a full valuation allowance on its deferred tax assets. Until such time as the Company returns to sustained earnings, and it is determined that it is more likely than not that the deferred tax asset will be realized, no income tax benefit or expense will be recorded.

## **FINANCIAL CONDITION**

Cash and due from banks increased \$40,213,000 at March 31, 2016, compared with December 31, 2015 in the management of the bank subsidiary's liquidity position.

Available for sale securities increased \$15,077,000 at March 31, 2016, compared with December 31, 2015 as the Company invested excess funds from increased deposits.

Other real estate ( ORE ) decreased \$76,000 at March 31, 2016 as compared with December 31, 2015. Loans totaling \$814,000 were transferred into ORE while \$592,000 was sold for a gain of \$57,000 and writedowns of ORE to fair value were \$355,000 during the first three months of 2016.

Total deposits increased \$68,528,000 at March 31, 2016, as compared with December 31, 2015. 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. Deposits from county and municipal entities increase significantly during the first quarter of each year based on property tax collections.

Borrowings from the Federal Home Loan Bank decreased \$10,076,000 at March 31, 2016 as compared with December 31, 2015 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.

New rules relating to risk-based capital requirements and the method for calculating components of capital and of computing risk-weighted assets to make them consistent with agreements that were reached by the Basel Committee on Banking Supervision and certain provisions of the Dodd-Frank Act became effective for the Company January 1, 2015. The rules establish a new common equity Tier 1 minimum capital requirement, increase the minimum capital ratios and assign a higher risk weight to certain assets based on the risk associated with these assets.

As of March 31, 2016, 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 Common Equity Tier 1 Capital ratio of 6.50% or greater, a Tier 1 risk-based capital ratio of 8.00% 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 Company's actual capital amounts and ratios and required minimum capital amounts and ratios as of March 31, 2016 and December 31, 2015, are as follows (in thousands):

	Actual		For Capital Adequacy Purposes	
	Amount	Ratio	Amount	Ratio
March 31, 2016:				
Total Capital (to Risk Weighted Assets)	\$ 95,480	21.79%	\$ 35,055	8.00%
Common Equity Tier 1 Capital (to Risk Weighted Assets)	89,977	20.53%	19,718	4.50%
Tier 1 Capital (to Risk Weighted Assets)	89,977	20.53%	26,291	6.00%
Tier 1 Capital (to Average Assets)	89,977	12.70%	27,291	4.00%
December 31, 2015:				
Total Capital (to Risk Weighted Assets)	\$ 95,395	21.83%	\$ 34,954	8.00%
Common Equity Tier 1 Capital (to Risk Weighted Assets)	89,901	20.58%	19,662	4.50%
Tier 1 Capital (to Risk Weighted Assets)	89,901	20.58%	26,215	6.00%
Tier 1 Capital (to Average Assets)	89,901	13.18%	27,291	4.00%

The actual capital amounts and ratios and required minimum capital amounts and ratios for the Bank as of March 31, 2016 and December 31, 2015, are as follows (in thousands):

	Actual		For Capital Adequacy Purposes		To Be Well Capitalized	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
March 31, 2016:						
Total Capital (to Risk Weighted Assets)	\$ 92,090	21.20%	\$ 34,746	8.00%	\$ 43,432	10.00%
Common Equity Tier 1 Capital (to Risk Weighted Assets)	86,635	19.95%	19,544	4.50%	28,231	6.50%
Tier 1 Capital (to Risk Weighted Assets)	86,635	19.95%	26,059	6.00%	34,746	8.00%
Tier 1 Capital (to Average Assets)	86,635	12.73%	27,232	4.00%	34,041	5.00%
December 31, 2015:						
Total Capital (to Risk Weighted Assets)	\$ 91,963	21.09%	\$ 34,889	8.00%	\$ 43,611	10.00%
Common Equity Tier 1 Capital (to Risk Weighted Assets)	86,479	19.83%	19,625	4.50%	28,347	6.50%
Tier 1 Capital (to Risk Weighted Assets)	86,479	19.83%	26,166	6.00%	34,889	8.00%
Tier 1 Capital (to Average Assets)	86,479	13.47%	25,680	4.00%	32,100	5.00%

Management continues to emphasize the importance of maintaining the appropriate capital levels of the Company and has established the goal of 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 monthly basis in the management of its liquidity needs and also conducts periodic 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 2014, Management identified opportunities for improving risk management and earnings, addressing asset quality concerns, analyzing and assessing the Bank's management and staffing needs, and managing concentrations of credit risk as a result of its own investigation as well as examinations performed by certain bank regulatory agencies. In concert with the regulators, the Company had identified specific corrective steps and actions to enhance its risk management, earnings, asset quality and staffing. The Company and the Bank may not declare or pay any cash dividends without the prior written approval of their regulators.

### **Item 4: Controls and Procedures**

As of March 31, 2016, 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 March 31, 2016 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.

**Item 5: Other Information**

None.

**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 March 31, 2016, formatted in XBRL (Extensible Business Reporting Language): (i) Consolidated Statements of Condition at March 31, 2016 and December 31, 2015, (ii) Consolidated Statements of Operations for the quarters ended March 31, 2016 and 2015, (iii) Consolidated Statements of Comprehensive Income (Loss) for the quarters ended March 31, 2016 and 2015, (iv) Consolidated Statement of Changes in Shareholders' Equity for the quarter ended March 31, 2016, (v) Consolidated Statements of Cash Flows for the quarters ended March 31, 2016 and 2015 and (vi) Notes to the Unaudited Consolidated Financial Statements for the quarters ended March 31, 2016 and 2015.

(b) Reports on Form 8-K

A Form 8-K was filed on January 27, 2016, April 27, 2016 and April 28, 2016.

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: May 11, 2016

By: /s/ Chevis C. Swetman  
Chevis C. Swetman  
Chairman, President and Chief Executive  
Officer

(principal executive officer)

Date: May 11, 2016

By: /s/ Lauri A. Wood  
Lauri A. Wood  
Chief Financial Officer and Controller

(principal financial and accounting officer)