

PEOPLES FINANCIAL CORP /MS/  
Form 10-Q  
November 13, 2018

**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, 2018**

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

**64-0709834**  
**(I.R.S. Employer**  
**Identification No.)**

**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 every Interactive Data File required to be submitted 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 such files.) Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, smaller reporting company or an emerging growth company. See the definitions of large accelerated filer, accelerated filer, smaller reporting company and emerging growth company in Rule 12b-2 of the Exchange Act.

Large accelerated filer

Accelerated filer

Non-accelerated filer

Smaller reporting company

Emerging growth company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes No

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the last practicable date. Peoples Financial Corporation has only one class of common stock authorized. At October 31, 2018, there were 15,000,000 shares of \$1 par value common stock authorized, with 4,999,058 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>September 30, 2018</b> <b>(unaudited)</b>	<b>December 31, 2017</b> <b>(audited)</b>
<b>Assets</b>		
Cash and due from banks	\$ 21,453	\$ 25,281
Available for sale securities	220,954	245,206
Held to maturity securities, fair value of \$50,620 at September 30, 2018; \$50,538 at December 31, 2017	52,366	51,163
Other investments	2,979	3,193
Federal Home Loan Bank Stock, at cost	1,446	1,370
Loans	273,947	280,449
Less: Allowance for loan losses	5,391	6,153
Loans, net	268,556	274,296
Bank premises and equipment, net of accumulated depreciation	19,331	20,153
Other real estate	9,892	8,232
Accrued interest receivable	2,252	1,904
Cash surrender value of life insurance	18,716	18,301
Other assets	1,450	1,325
<b>Total assets</b>	<b>\$ 619,395</b>	<b>\$ 650,424</b>

**Peoples Financial Corporation and Subsidiaries**

**Consolidated Statements of Condition (continued)**

(in thousands except share data)

	September 30, 2018 (unaudited)	December 31, 2017 (audited)
<b>Liabilities and Shareholders Equity</b>		
<b>Liabilities:</b>		
Deposits:		
Demand, non-interest bearing	\$ 130,746	\$ 127,274
Savings and demand, interest bearing	292,371	318,278
Time, \$100,000 or more	54,068	43,991
Other time deposits	27,608	40,027
Total deposits	504,793	529,570
Borrowings from Federal Home Loan Bank	9,156	11,198
Employee and director benefit plans liabilities	18,767	18,370
Other liabilities	1,711	1,787
<b>Total liabilities</b>	<b>534,427</b>	<b>560,925</b>
<b>Shareholders Equity:</b>		
Common stock, \$1 par value, 15,000,000 shares authorized, 5,013,186 and 5,083,186 shares issued and outstanding at September 30, 2018 and December 31, 2017	5,013	5,083
Surplus	65,780	65,780
Undivided profits	21,085	21,563
Accumulated other comprehensive loss, net of tax	(6,910)	(2,927)
<b>Total shareholders equity</b>	<b>84,968</b>	<b>89,499</b>
<b>Total liabilities and shareholders equity</b>	<b>\$ 619,395</b>	<b>\$ 650,424</b>

See notes to consolidated financial statements.

## Peoples Financial Corporation and Subsidiaries

## Consolidated Statements of Income

(in thousands except per share data)(unaudited)

	Three Months Ended September 30, 2018		Three Months Ended September 30, 2017	
	2018	2017	2018	2017
<b>Interest income:</b>				
Interest and fees on loans	\$ 3,335	\$ 3,165	\$ 9,798	\$ 9,734
Interest and dividends on securities:				
U.S. Treasuries	343	413	1,090	1,203
U.S. Government agencies	114	126	350	404
Mortgage-backed securities	662	343	1,835	876
States and political subdivisions	438	420	1,317	1,199
Corporate bonds				8
Other investments	10	8	20	14
Interest on balances due from depository institutions	80	148	179	384
<b>Total interest income</b>	<b>4,982</b>	<b>4,623</b>	<b>14,589</b>	<b>13,822</b>
<b>Interest expense:</b>				
Deposits	682	381	1,689	981
Federal funds purchased	1		8	1
Borrowings from Federal Home Loan Bank	26	8	131	31
<b>Total interest expense</b>	<b>709</b>	<b>389</b>	<b>1,828</b>	<b>1,013</b>
<b>Net interest income</b>	<b>4,273</b>	<b>4,234</b>	<b>12,761</b>	<b>12,809</b>
<b>Provision for allowance for loan losses</b>	<b>28</b>	<b>29</b>	<b>91</b>	<b>85</b>
<b>Net interest income after provision for allowance for loan losses</b>	<b>\$ 4,245</b>	<b>\$ 4,205</b>	<b>\$ 12,670</b>	<b>\$ 12,724</b>

## Peoples Financial Corporation and Subsidiaries

## Consolidated Statements of Income (continued)

(in thousands except per share data)(unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
<b>Non-interest income:</b>				
Trust department income and fees	\$ 475	\$ 430	\$ 1,360	\$ 1,224
Service charges on deposit accounts	941	947	2,771	2,799
Gain on liquidation, sales and calls of securities				137
Income (loss) from other investments	(115)	7	(214)	36
Increase in cash surrender value of life insurance	109	98	349	326
Gain from death benefits from life insurance				429
Other income	123	128	364	376
<b>Total non-interest income</b>	<b>1,533</b>	<b>1,610</b>	<b>4,630</b>	<b>5,327</b>
<b>Non-interest expense:</b>				
Salaries and employee benefits	2,706	2,746	8,260	8,344
Net occupancy	559	493	1,449	1,548
Equipment rentals, depreciation and maintenance	753	722	2,352	2,251
FDIC and state banking assessments	111	130	322	327
Data processing	359	322	1,016	972
ATM expense	167	141	439	399
Other real estate expense	174	305	658	635
Other expense	777	720	2,277	2,450
<b>Total non-interest expense</b>	<b>5,606</b>	<b>5,579</b>	<b>16,773</b>	<b>16,926</b>
<b>Income before income taxes</b>	<b>172</b>	<b>236</b>	<b>527</b>	<b>1,125</b>
Income tax benefit				(338)
<b>Net income</b>	<b>\$ 172</b>	<b>\$ 236</b>	<b>\$ 527</b>	<b>\$ 1,463</b>
<b>Basic and diluted earnings per share</b>	<b>\$ .03</b>	<b>\$ .05</b>	<b>\$ .10</b>	<b>\$ .29</b>
<b>Dividends declared per share</b>	<b>\$ .01</b>	<b>\$ .01</b>	<b>\$ .02</b>	<b>\$ .01</b>

See notes to consolidated financial statements.

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

	<b>Three Months Ended September 30,</b>		<b>Three Months Ended September 30,</b>	
	<b>2018</b>	<b>2017</b>	<b>2018</b>	<b>2017</b>
<b>Net income</b>	\$ 172	\$ 236	\$ 527	\$ 1,463
<b>Other comprehensive income (loss):</b>				
Net unrealized gain (loss) on available for sale securities	(898)	(319)	(3,983)	2,063
Reclassification adjustment for realized gain on available for sale securities called or sold				(137)
<b>Total other comprehensive income (loss)</b>	(898)	(319)	(3,983)	1,926
<b>Total comprehensive income (loss)</b>	\$ (726)	\$ (83)	\$ (3,456)	\$ 3,389

See notes to consolidated financial statements.

**Peoples Financial Corporation and Subsidiaries**

**Consolidated Statement of Changes in Shareholders' Equity**

(in thousands except share data)

	Number of Common Shares	Common Stock	Surplus	Accumulated		Total
				Undivided Profits	Other Comprehensive Loss	
<b>Balance, January 1, 2018</b>	5,083,186	\$ 5,083	\$ 65,780	\$ 21,563	\$ (2,927)	\$ 89,499
Net income				527		527
Other comprehensive loss					(3,983)	(3,983)
Dividends (\$ .01 per share)				(51)		(51)
Dividend declared (\$ .01 per share)				(50)		(50)
Retirement of stock	(70,000)	(70)		(904)		(974)
<b>Balance, September 30, 2018</b>	5,013,186	\$ 5,013	\$ 65,780	\$ 21,085	\$ (6,910)	\$ 84,968

Note: Balances as of January 1, 2018 were audited.

See notes to consolidated financial statements.



**Peoples Financial Corporation and Subsidiaries**

**Consolidated Statements of Cash Flows**

(in thousands)(unaudited)

	<b>Nine Months Ended September 30,</b>	
	<b>2018</b>	<b>2017</b>
<b>Cash flows from operating activities:</b>		
<b>Net income</b>	\$ 527	\$ 1,463
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation	1,462	1,426
Provision for allowance for loan losses	91	85
Writedown of other real estate	320	397
Losses on sales of other real estate		95
(Income) loss from other investments	214	(36)
Gain from death benefits from life insurance		(429)
Amortization of held to maturity securities	192	190
Amortization of available for sale securities	249	130
Gain on sales and calls of securities		(137)
Change in accrued interest receivable	(348)	(136)
Increase in cash surrender value of life insurance	(349)	(326)
Change in other assets	(126)	(18)
Change in employee and director benefit plan liabilities and other liabilities	271	574
<b>Net cash provided by operating activities</b>	<b>\$ 2,503</b>	<b>\$ 3,278</b>

## Peoples Financial Corporation and Subsidiaries

## Consolidated Statements of Cash Flows (continued)

(in thousands) (unaudited)

	Nine Months Ended September 30,	
	2018	2017
<b>Cash flows from investing activities:</b>		
Proceeds from maturities, sales and calls of available for sale securities	\$ 46,506	\$ 58,201
Proceeds from maturities of held to maturity securities	760	7,725
Purchases of available for sale securities	(26,486)	(68,478)
Purchases of held to maturity securities	(2,155)	(9,170)
Purchases of Federal Home Loan Bank stock	(76)	(5)
Proceeds from sales of other real estate	1,972	1,296
Loans, net change	1,697	41,777
Acquisition of bank premises and equipment	(640)	(323)
Investment in cash surrender value of life insurance	(65)	(78)
Proceeds from death benefits from life insurance		1,929
<b>Net cash provided by investing activities</b>	<b>21,513</b>	<b>32,874</b>
<b>Cash flows from financing activities:</b>		
Demand and savings deposits, net change	(22,435)	(38,656)
Time deposits, net change	(2,342)	8,707
Borrowings from Federal Home Loan Bank	851,800	
Repayments to Federal Home Loan Bank	(853,842)	(5,041)
Cash dividends paid	(51)	
Stock repurchase	(974)	
<b>Net cash used in financing activities</b>	<b>(27,844)</b>	<b>(34,990)</b>
<b>Net increase (decrease) in cash and cash equivalents</b>	<b>(3,828)</b>	<b>1,162</b>
<b>Cash and cash equivalents, beginning of period</b>	<b>25,281</b>	<b>41,116</b>
<b>Cash and cash equivalents, end of period</b>	<b>\$ 21,453</b>	<b>\$ 42,278</b>

See 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, 2018 and 2017

1. Basis of Presentation:

Peoples Financial Corporation (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 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 September 30, 2018 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 2017 Annual Report and Form 10-K.

The results of operations for the quarter or nine months ended September 30, 2018, 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 reporting 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, 2017.

Revenue Recognition - As of January 1, 2018, the Company adopted Accounting Standards Update (ASU) 2014-09, *Revenue from Contracts with Customers (Topic 606)*, using the modified retrospective method. Disclosures of revenue from contracts with customers for periods beginning after January 1, 2018 are presented under ASC Topic 606 and have not materially changed from the prior year amounts. This update prescribes the process related to the recognition of revenue to

depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. ASU 2014-09 excludes revenue streams relating to loans and investment securities, which are the major source of revenue for the Company, from its scope. As a result, the adoption of the guidance had no material impact on the measurement or recognition of revenue. Consistent with this guidance, the Company recognizes noninterest income within the scope of this guidance as services are transferred to its customers in an amount that reflects the consideration it expects to be entitled to in exchange for those services. Other types of revenue contracts, the income from which is included in non-interest income, that are within the scope of ASU 2014-09 are:

*Trust department income and fees:* A contract for fiduciary and/or investment administration services on personal trust accounts and corporate trust services. Personal trust fee income is determined as a percentage of assets under management and is recognized over the period the underlying trust is serviced. Corporate trust fee income is recognized over the period the Company provides service to the entity.

*Service charges on deposit accounts:* The deposit contract obligates the Company to serve as a custodian of the customer's deposited funds and is generally terminable at will by either party. The contract permits the customer to access the funds on deposit and request additional services for which the Company earns a fee, including NSF and analysis charges, related to the deposit account. Income for deposit accounts is recognized over the statement cycle period (typically on a monthly basis) or at the time the service is provided, if additional services are requested.

*ATM fee income:* A contract between the Company, as a card-issuing bank, and its customers whereby the Company receives a transaction fee from the merchant's bank whenever a customer uses a debit or credit card to make a purchase. These fees are earned as the service is provided (i.e., when the customer uses a debit or ATM card).

*Other noninterest income:* Other noninterest income includes several items, such as wire transfer income, check cashing fees, the increase in cash surrender value of life insurance, rental income from bank properties and safe deposit box rental fees. This income is generally recognized at the time the service is provided and/or the income is earned.

**New Accounting Pronouncements** In February 2018, the Financial Accounting Standards Board (the FASB) issued ASU 2018-03, *Technical Corrections and Improvements to Financial Instruments - Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities, that Clarifies the Guidance in ASU No. 2016-01, Financial Instruments - Overall (Subtopic 825-10)*. ASU 2018-03 clarifies guidance in ASU No. 2016-01 relating to equity securities without a readily determinable fair value, forward contracts and purchased options and fair value option liabilities. This update is effective for fiscal years, and interim periods within those fiscal years, beginning after June 15, 2018. The Company adopted the amendments in this ASU effective January 1, 2018. The adoption of this ASU did not have a material effect on the Company's financial position, result of operations or cash flows.

In March 2018, the FASB issued ASU 2018-05, *Income Taxes (Topic 740): Amendments to SEC Paragraphs Pursuant to SEC Staff Accounting Bulletin No. 118*. ASU 2018-05 adds SEC guidance to the accounting standards codification regarding the Tax Cuts and Jobs Act. This update became effective upon addition to the FASB Codification. The adoption of this ASU is not expected to have a material effect on the Company's financial position, result of operations or cash flows.

In May 2018, the FASB issued ASU 2018-06, *Codification Improvements to Topic 942, Financial Services Depository and Lending*. ASU 2018-06 removes outdated guidance related to Circular 202 because that guidance has been rescinded by the Office of the Comptroller of the Currency. The amendments in this update are effective upon issuance. The adoption of this ASU did not have a material effect on the Company's financial position, result of operations or cash flows.

In July 2018, the FASB issued ASU 2018-09, *Codification Improvements*. ASU 2018-09 amends topics that clarify, correct errors in or make minor improvements to the Codification. Topics affected include reporting comprehensive income, debt modifications and extinguishments, distinguishing liabilities from equity, income taxes on stock compensation, income taxes relating to business combinations, derivatives and hedging, fair value measurement, financial services and defined contribution plan accounting. The transition and effective date guidance is based on the facts and circumstances of each amendment. The adoption of this ASU did not have a material effect on the Company's financial position, result of operations or cash flows.

In August 2018, the FASB issued ASU 2018-13, *Fair Value Measurement (Topic 820): Disclosure Framework Changes to the Disclosure Requirements for Fair Value Measurement*. ASU 2018-13 changes the fair value measurement disclosure requirements. This update is effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2019. The adoption of this ASU is not expected to have a material effect on the Company's financial position, result of operations or cash flows.

## 2. Earnings Per Share:

Per share data is based on the weighted average shares of common stock outstanding of 5,051,306 and 5,123,186 for the nine months ended September 30, 2018 and 2017, respectively. Per share data is based on the weighted average shares of common stock outstanding of 5,020,021 and 5,123,186 for the quarters ended September 30, 2018 and 2017, respectively.

## 3. Statements of Cash Flows:

The Company has defined cash and cash equivalents as cash and due from banks. The Company paid \$1,816,998 and \$1,006,350 for the nine months ended September 30, 2018 and 2017, respectively, for interest on deposits and borrowings. No income tax payments were made during the nine months ended September 30, 2018 and 2017. Loans transferred to other real estate amounted to \$3,952,191 and \$1,355,642 during the nine months ended September 30, 2018 and 2017, respectively.

## 4. Investments:

The amortized cost and fair value of securities at September 30, 2018 and December 31, 2017, are as follows (in thousands):

September 30, 2018	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
<b>Available for sale securities:</b>				
<b>Debt securities:</b>				
U.S. Treasuries	\$ 95,853	\$	\$ (3,183)	\$ 92,670
U.S. Government agencies	14,991		(362)	14,629
Mortgage-backed securities	105,188	26	(3,570)	101,644
States and political subdivisions	11,892	119		12,011
<b>Total available for sale securities</b>	<b>\$ 227,924</b>	<b>\$ 145</b>	<b>\$ (7,115)</b>	<b>\$ 220,954</b>
<b>Held to maturity securities:</b>				
U.S. Government agencies	\$ 8,185	\$	\$ (496)	\$ 7,689
States and political subdivisions	44,181	28	(1,278)	42,931
<b>Total held to maturity securities</b>	<b>\$ 52,366</b>	<b>\$ 28</b>	<b>\$ (1,774)</b>	<b>\$ 50,620</b>

December 31, 2017	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
<b>Available for sale securities:</b>				
<b>Debt securities:</b>				
U.S. Treasuries	\$ 124,820	\$	\$ (2,176)	\$ 122,644
U.S. Government agencies	19,989		(158)	19,831
Mortgage-backed securities	89,207	96	(1,042)	88,261
States and political subdivisions	14,178	292		14,470
<b>Total available for sale securities</b>	<b>\$ 248,194</b>	<b>\$ 388</b>	<b>\$ (3,376)</b>	<b>\$ 245,206</b>
<b>Held to maturity securities:</b>				
U.S. Government agencies	\$ 8,185	\$	\$ (302)	\$ 7,883
States and political subdivisions	42,978	227	(550)	42,655
<b>Total held to maturity securities</b>	<b>\$ 51,163</b>	<b>\$ 227</b>	<b>\$ (852)</b>	<b>\$ 50,538</b>

The amortized cost and fair value of debt securities at September 30, 2018 (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.

	Amortized Cost	Fair Value
Available for sale securities:		
Due in one year or less	\$ 33,108	\$ 32,901
Due after one year through five years	73,364	71,173
Due after five years through ten years	15,930	14,890
Due after ten years	334	346
Mortgage-backed securities	105,188	101,644
<b>Totals</b>	<b>\$ 227,924</b>	<b>\$ 220,954</b>
Held to maturity securities:		
Due in one year or less	\$ 1,742	\$ 1,744
Due after one year through five years	13,718	13,510
Due after five years through ten years	22,815	22,022
Due after ten years	14,091	13,344
<b>Totals</b>	<b>\$ 52,366</b>	<b>\$ 50,620</b>



Available for sale and held to maturity securities with gross unrealized losses at September 30, 2018 and December 31, 2017, 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>September 30, 2018:</b>						
U.S. Treasuries	\$ 10,778	\$ 209	\$ 81,892	\$ 2,974	\$ 92,670	\$ 3,183
U.S. Government agencies	9,909	91	12,409	767	22,318	858
Mortgage-backed securities	72,034	2,153	22,278	1,417	94,312	3,570
States and political subdivisions	26,714	679	6,805	599	33,519	1,278
<b>TOTAL</b>	<b>\$ 119,435</b>	<b>\$ 3,132</b>	<b>\$ 123,384</b>	<b>\$ 5,757</b>	<b>\$ 242,819</b>	<b>\$ 8,889</b>
<b>December 31, 2017:</b>						
U.S. Treasuries	\$ 49,586	\$ 364	\$ 73,058	\$ 1,812	\$ 122,644	\$ 2,176
U.S. Government agencies	8,145	37	14,567	423	22,712	460
Mortgage-backed securities	60,230	415	13,492	627	73,722	1,042
States and political subdivisions	11,552	168	7,010	382	18,562	550
<b>TOTAL</b>	<b>\$ 129,513</b>	<b>\$ 984</b>	<b>\$ 108,127</b>	<b>\$ 3,244</b>	<b>\$ 237,640</b>	<b>\$ 4,228</b>

At September 30, 2018, 20 of 20 securities issued by the U.S. Treasury, 5 of the 5 securities issued by U.S. Government agencies, 70 of the 148 securities issued by states and political subdivisions and 37 of the 42 mortgage-backed securities 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 securities were \$23,703,484 during the nine months ended September 30, 2017. Available for sale debt securities were sold or called for a realized gain of \$136,781 for the nine months ended September 30, 2017. There were no sales or calls of securities in 2018.

Securities with a fair value of \$202,977,752 and \$196,702,218 at September 30, 2018 and December 31, 2017, 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 September 30, 2018 and December 31, 2017, is as follows (in thousands):

	September 30, 2018	December 31, 2017
Gaming	\$ 25,160	\$ 26,142
Residential and land development	239	263
Real estate, construction	32,097	31,947
Real estate, mortgage	185,906	189,201
Commercial and industrial	22,939	26,360
Other	7,606	6,536
<b>Total</b>	<b>\$ 273,947</b>	<b>\$ 280,449</b>

The age analysis of the loan portfolio, segregated by class of loans, as of September 30, 2018 and December 31, 2017, is as follows (in thousands):

	Number of Days Past Due			Total Past Due	Current	Total Loans	Loans Past Due Greater Than 90
	30 - 59	60 - 89	Greater Than 90				Days & Still Accruing
<b>September 30, 2018:</b>							
Gaming	\$	\$	\$	\$	\$ 25,160	\$ 25,160	\$
Residential and land development					239	239	
Real estate, construction	1,150	26	841	2,017	30,080	32,097	
Real estate, mortgage	8,223	1,601	1,527	11,351	174,555	185,906	
Commercial and industrial	87	49	1,805	1,941	20,998	22,939	
Other	76	2		78	7,528	7,606	
<b>Total</b>	<b>\$ 9,536</b>	<b>\$ 1,678</b>	<b>\$ 4,173</b>	<b>\$ 15,387</b>	<b>\$ 258,560</b>	<b>\$ 273,947</b>	<b>\$</b>
<b>December 31, 2017:</b>							
Gaming	\$	\$	\$	\$	\$ 26,142	\$ 26,142	\$
Residential and land development					263	263	
Real estate, construction	747	121	522	1,390	30,557	31,947	
Real estate, mortgage	5,321	790	4,884	10,995	178,206	189,201	
Commercial and industrial	375	2	2,344	2,721	23,639	26,360	
Other	26	3		29	6,507	6,536	
<b>Total</b>	<b>\$ 6,469</b>	<b>\$ 916</b>	<b>\$ 7,750</b>	<b>\$ 15,135</b>	<b>\$ 265,314</b>	<b>\$ 280,449</b>	<b>\$</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 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 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 September 30, 2018 and December 31, 2017, is as follows (in thousands):

	Loans With A Grade Of:					Total
	A, B or C	S	D	E	F	
<b>September 30, 2018:</b>						
Gaming	\$ 20,271	\$	\$ 4,889	\$	\$	\$ 25,160
Residential and land development	6			233		239
Real estate, construction	30,649		251	1,197		32,097
Real estate, mortgage	155,658	10,744	14,202	5,302		185,906
Commercial and industrial	20,657		171	2,111		22,939
Other	7,596		4	6		7,606
<b>Total</b>	<b>\$ 234,837</b>	<b>\$ 10,744</b>	<b>\$ 19,517</b>	<b>\$ 8,849</b>	<b>\$</b>	<b>\$ 273,947</b>
<b>December 31, 2017:</b>						
Gaming	\$ 26,142	\$	\$	\$	\$	\$ 26,142
Residential and land development				263		263
Real estate, construction	30,412		358	1,177		31,947
Real estate, mortgage	148,284	11,550	19,606	9,761		189,201
Commercial and industrial	23,133		265	2,962		26,360
Other	6,516		16	4		6,536
<b>Total</b>	<b>\$ 234,487</b>	<b>\$ 11,550</b>	<b>\$ 20,245</b>	<b>\$ 14,167</b>	<b>\$</b>	<b>\$ 280,449</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 September 30, 2018 and December 31, 2017, are as follows (in thousands):

	September 30, 2018	December 31, 2017
Residential and land development	\$ 233	\$ 263
Real estate, construction	1,197	1,177
Real estate, mortgage	5,120	9,548
Commercial and industrial	2,008	2,818
Other	2	4
Total	\$ 8,560	\$ 13,810

Prior to 2017, certain loans were modified by granting interest rate concessions to these customers with such loans being classified as troubled debt restructurings. During 2017 and 2018, the Company did not restructure any additional loans. Specific reserves of \$73,000 and \$86,000 were allocated to troubled debt restructurings as of September 30, 2018 and December 31, 2017, respectively. The Bank had no commitments to lend additional amounts to customers with outstanding loans classified as troubled debt restructurings as of September 30, 2018 and December 31, 2017.

Impaired loans, which include loans classified as nonaccrual and troubled debt restructurings, segregated by class of loans, as of September 30, 2018 and December 31, 2017, are as follows (in thousands):

	Unpaid Principal Balance	Recorded Investment	Related Allowance	Average Recorded Investment	Interest Income Recognized
<b>September 30, 2018:</b>					
With no related allowance recorded:					
Real estate, construction	\$ 1,478	\$ 1,003	\$	\$ 959	\$
Real estate, mortgage	6,539	5,645		5,737	21
Commercial and industrial	2,236	2,008		2,307	
Other	2	2		3	
<b>Total</b>	<b>10,255</b>	<b>8,658</b>		<b>9,006</b>	<b>21</b>
With a related allowance recorded:					
Residential and land development	233	233	20	250	
Real estate, construction	194	194	98	203	
Real estate, mortgage	582	582	88	593	19
<b>Total</b>	<b>1,009</b>	<b>1,009</b>	<b>206</b>	<b>1,046</b>	<b>19</b>
Total by class of loans:					
Residential and land development	233	233	20	250	
Real estate, construction	1,672	1,197	98	1,162	
Real estate, mortgage	7,121	6,227	88	6,330	40
Commercial and industrial	2,236	2,008		2,307	
Other	2	2		3	
<b>Total</b>	<b>\$ 11,264</b>	<b>\$ 9,667</b>	<b>\$ 206</b>	<b>\$ 10,052</b>	<b>\$ 40</b>

	Unpaid Principal Balance	Recorded Investment	Related Allowance	Average Recorded Investment	Interest Income Recognized
December 31, 2017:					
With no related allowance recorded:					
Real estate, construction	\$ 1,441	\$ 967	\$	\$ 1,024	\$
Real estate, mortgage	8,920	8,025		8,654	31
Commercial and industrial	922	884		916	
Other	4	4		4	
<b>Total</b>	<b>11,287</b>	<b>9,880</b>		<b>10,598</b>	<b>31</b>
With a related allowance recorded:					
Residential and land development	263	263	40	275	
Real estate, construction	210	210	105	226	
Real estate, mortgage	3,556	2,672	725	2,676	28
Commercial and industrial	1,934	1,934	342	1,923	
<b>Total</b>	<b>5,963</b>	<b>5,079</b>	<b>1,212</b>	<b>5,100</b>	<b>28</b>
Total by class of loans:					
Residential and land development	263	263	40	275	
Real estate, construction	1,651	1,177	105	1,250	
Real estate, mortgage	12,476	10,697	725	11,330	59
Commercial and industrial	2,856	2,818	342	2,839	
Other	4	4		4	
<b>Total</b>	<b>\$ 17,250</b>	<b>\$ 14,959</b>	<b>\$ 1,212</b>	<b>\$ 15,698</b>	<b>\$ 59</b>



## 6. Allowance for Loan Losses:

Transactions in the allowance for loan losses for the quarters and nine months ended September 30, 2018 and 2017, and the balances of loans, individually and collectively evaluated for impairment, as of September 30, 2018 and 2017, are as follows (in thousands):

	Gaming	Residential and Land Development	Real Estate, Construction	Real Estate, Mortgage	Commercial and Industrial	Other	Total
<b>For the Nine Months Ended September 30, 2018:</b>							
Allowance for Loan Losses:							
Beginning balance	\$ 536	\$ 40	\$ 202	\$ 4,305	\$ 892	\$ 178	\$ 6,153
Charge-offs				(681)	(372)	(251)	(1,304)
Recoveries			16	188	112	135	451
Provision	(129)	(17)	3	360	(218)	92	91
Ending Balance	\$ 407	\$ 23	\$ 221	\$ 4,172	\$ 414	\$ 154	\$ 5,391
<b>For the Quarter Ended September 30, 2018:</b>							
Allowance for Loan Losses:							
Beginning Balance	\$ 453	\$ 20	\$ 179	\$ 4,195	\$ 503	\$ 158	\$ 5,508
Charge-offs				(252)	(3)	(95)	(350)
Recoveries			15	70	67	53	205
Provision	(46)	3	27	159	(153)	38	28
Ending Balance	\$ 407	\$ 23	\$ 221	\$ 4,172	\$ 414	\$ 154	\$ 5,391
<b>Allowance for Loan Losses, September 30, 2018:</b>							
Ending balance: individually evaluated for impairment	\$	\$ 20	\$ 98	\$ 426	\$ 124	\$ 1	\$ 669
Ending balance: collectively evaluated for impairment	\$ 407	\$ 3	\$ 123	\$ 3,746	\$ 290	\$ 153	\$ 4,722
<b>Total Loans, September 30, 2018:</b>							
Ending balance: individually evaluated for impairment	\$ 4,889	\$ 233	\$ 1,448	\$ 19,504	\$ 2,282	\$ 10	\$ 28,366
Ending balance: collectively evaluated for impairment	\$ 20,271	\$ 6	\$ 30,649	\$ 166,402	\$ 20,657	\$ 7,596	\$ 245,581

	Gaming	Residential and Land Development	Real Estate, Construction	Real Estate, Mortgage	Commercial and Industrial	Other	Total
For the Nine Months Ended September 30, 2017:							
Allowance for Loan Losses:							
Beginning balance	\$ 545	\$ 66	\$ 199	\$ 3,800	\$ 651	\$ 205	\$ 5,466
Charge-offs				(8)	(32)	(158)	(198)
Recoveries		685	31	12	11	60	799
Provision	(119)	(701)	43	854	(99)	107	85
Ending Balance	\$ 426	\$ 50	\$ 273	\$ 4,658	\$ 531	\$ 214	\$ 6,152
For the Quarter Ended September 30, 2017:							
Allowance for Loan Losses:							
Beginning Balance	\$ 396	\$ 58	\$ 232	\$ 3,916	\$ 672	\$ 207	\$ 5,481
Charge-offs					(32)	(63)	(95)
Recoveries		685	19	4		29	737
Provision	30	(693)	22	738	(109)	41	29
Ending Balance	\$ 426	\$ 50	\$ 273	\$ 4,658	\$ 531	\$ 214	\$ 6,152
Allowance for Loan Losses, September 30, 2017:							
Ending balance:							
individually evaluated for impairment	\$	\$ 50	\$ 112	\$ 999	\$ 211	\$ 14	\$ 1,386
Ending balance: collectively evaluated for impairment	\$ 426	\$	\$ 161	\$ 3,659	\$ 320	\$ 200	\$ 4,766
Total Loans, September 30, 2017:							
Ending balance:							
individually evaluated for impairment	\$	\$ 273	\$ 1,675	\$ 31,365	\$ 3,157	\$ 28	\$ 36,498
Ending balance: collectively evaluated for impairment	\$ 18,824	\$	\$ 29,323	\$ 158,638	\$ 22,852	\$ 6,688	\$ 236,325

#### 7. Deposits:

Time deposits of \$250,000 or more totaled approximately \$31,968,000 and \$30,457,000 at September 30, 2018 and December 31, 2017, respectively.

#### 8. Shareholders' Equity:

On December 8, 2017, the Board of Directors approved the repurchase of up to 110,000 of the outstanding shares of the Company's common stock. As of August 1, 2018, the Company had repurchased and retired 110,000 shares for approximately \$1,477,000.

On September 26, 2018, the Board of Directors approved the repurchase of up to 70,000 of the outstanding shares of the Company's common stock. As of October 31, 2018, the Company had repurchased and retired 14,128 shares for approximately \$187,761.

On September 26, 2018, the Board of Directors approved a semi-annual dividend of \$ .01 per share, payable on October 15, 2018, to shareholders of record as of October 9, 2018.

## 9. 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 September 30, 2018 and December 31, 2017 are as follows (in thousands):

	Fair Value Measurements			
	Total	Level 1	Level 2	Level 3
September 30, 2018:				
U.S. Treasuries	\$ 92,670	\$	\$ 92,670	\$
U.S. Government agencies	14,629		14,629	
Mortgage-backed securities	101,644		101,644	
States and political subdivisions	12,011		12,011	
Total	\$ 220,954	\$	\$ 220,954	\$
December 31, 2017:				
U.S. Treasuries	\$ 122,644	\$	\$ 122,644	\$
U.S. Government agencies	19,831		19,831	
Mortgage-backed securities	88,261		88,261	
States and political subdivisions	14,470		14,470	
Total	\$ 245,206	\$	\$ 245,206	\$

Impaired loans, which are measured at fair value on a non-recurring basis, by level within the fair value hierarchy as of September 30, 2018 and December 31, 2017 are as follows (in thousands):

	Fair Value Measurements Using			
	Total	Level 1	Level 2	Level 3
September 30, 2018	\$ 3,585	\$	\$	\$ 3,585
December 31, 2017	6,511			6,511

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, 2018 and December 31, 2017 are as follows (in thousands):

	Total	Fair Value Measurements Using		
		Level 1	Level 2	Level 3
September 30, 2018	\$ 9,892	\$	\$	\$ 9,892
December 31, 2017	8,232			8,232

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 Nine	For the Year
	Months Ended	Ended
	September 30, 2018	December 31, 2017
Balance, beginning of period	\$ 8,232	\$ 8,513
Loans transferred to ORE	3,952	1,946
Sales	(1,972)	(1,767)
Writedowns	(320)	(460)
Balance, end of period	\$ 9,892	\$ 8,232



The carrying value and estimated fair value of financial instruments, by level within the fair value hierarchy, at September 30, 2018 and December 31, 2017, are as follows (in thousands):

	Carrying Amount	Fair Value Measurements Using			Total
		Level 1	Level 2	Level 3	
<b>September 30, 2018:</b>					
<b>Financial Assets:</b>					
Cash and due from banks	\$ 21,453	\$ 21,453	\$	\$	\$ 21,453
Available for sale securities	220,954		220,954		220,954
Held to maturity securities	52,366		50,620		50,620
Other investments	2,979	2,979			2,979
Federal Home Loan Bank stock	1,446		1,446		1,446
Loans, net	268,556			262,654	262,654
Other real estate	9,892			9,892	9,892
Cash surrender value of life insurance	18,716		18,716		18,716
<b>Financial Liabilities:</b>					
<b>Deposits:</b>					
Non-interest bearing	130,746	130,746			130,746
Interest bearing	374,047			374,430	374,430
<b>Borrowings from Federal Home Loan Bank</b>					
Bank	9,156		9,282		9,282
<b>December 31, 2017:</b>					
<b>Financial Assets:</b>					
Cash and due from banks	\$ 25,281	\$ 25,281	\$	\$	\$ 25,281
Available for sale securities	245,206		245,206		245,206
Held to maturity securities	51,163		50,538		50,538
Other investments	3,193	3,193			3,193
Federal Home Loan Bank stock	1,370		1,370		1,370
Loans, net	274,296			270,924	270,924
Other real estate	8,232			8,232	8,232
Cash surrender value of life insurance	18,301		18,301		18,301
<b>Financial Liabilities:</b>					
<b>Deposits:</b>					
Non-interest bearing	127,274	127,274			127,274
Interest bearing	402,296			402,610	402,610
<b>Borrowings from Federal Home Loan Bank</b>					
Bank	11,198		11,389		11,389

#### 10. Reclassifications:

Certain reclassifications have been made to prior year statements to conform to current year presentations. The reclassifications had no effect on prior year net income.



## **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, 2017.

### **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 and several accounting standards became effective during the first three quarters of 2018, which have been disclosed in the Notes to Unaudited Consolidated Financial Statements. The Company adopted ASU 2014-09 and ASU 2018-03 effective January 1, 2018, neither of which had a material effect on its financial position, results of operations or cash flows. The Company does not expect that the other updates discussed in the Notes will have a material effect on its financial position, results of operations or cash flows. The Company is in the process of determining the effect of ASU 2016-03, which will be effective for the Company on January 1, 2020, on its financial position, results of operations or cash flows.

## **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 allowance for loan losses ( ALL ) 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 ORE 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 the allowance 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 benefit within the tax provision in the consolidated statement of income.

### **GAAP Reconciliation and Explanation**

This Form 10-Q contains non-GAAP financial measures determined by methods other than in accordance with GAAP. Such non-GAAP financial measures include taxable equivalent interest income and taxable equivalent net interest income. Management uses these non-GAAP financial measures because it believes they are useful for evaluating our operations and performance over periods of time, as well as in managing and evaluating our business and in discussions about our operations and performance. Management believes these non-GAAP financial measures provide users of our financial information with a meaningful measure for assessing our financial results, as well as comparison to financial results for prior periods. These non-GAAP financial measures should not be considered as a substitute for operating results determined in accordance with GAAP and may not be comparable to other similarly titled financial measures used by other companies. A reconciliation of these operating performance measures to GAAP performance measures for the three months and nine months ended September 30, 2018 and 2017 is included in the table on the following page.

## RECONCILIATION OF NON-GAAP PERFORMANCE MEASURES (In thousands)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
<b>Interest income reconciliation:</b>				
Interest income - taxable equivalent	\$ 5,044	\$ 4,751	\$ 14,780	\$ 14,232
Taxable equivalent adjustment	(62)	(128)	(191)	(410)
<b>Interest income (GAAP)</b>	<b>\$ 4,982</b>	<b>\$ 4,623</b>	<b>\$ 14,589</b>	<b>\$ 13,822</b>
<b>Net interest income reconciliation:</b>				
Net interest income - taxable equivalent	\$ 4,335	\$ 4,362	\$ 12,952	\$ 13,219
Taxable equivalent adjustment	(62)	(128)	(191)	(410)
<b>Net interest income (GAAP)</b>	<b>\$ 4,273</b>	<b>\$ 4,234</b>	<b>\$ 12,761</b>	<b>\$ 12,809</b>

**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 earned net income of \$172,000 for the third quarter of 2018 compared with net income of \$236,000 for the third quarter of 2017 and earned net income of \$527,000 for the first three quarters of 2018 compared with net income of \$1,463,000 for the first three quarters of 2017. Results for the third quarter of 2017 included income from other investments of \$7,000 compared with a loss of \$115,000 in 2018. Results for the first three quarters of 2017 were significantly impacted by a non-recurring gain of \$429,000 from the redemption of death benefits on bank owned life insurance and a tax benefit of \$338,000, which reflects a correction to expected refunds for prior years as compared with 2018.

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 for the third quarter of 2018 as compared with the third quarter of 2017 increased \$39,000 and net interest income for the three quarters ended September 30, 2018 as compared with the three quarters ended September 30, 2017, decreased \$48,000. The increase for the third quarter of 2018 as compared with the third quarter of 2017 is attributed to the increase in interest and fees on loans. The decrease for the three quarters ended September 30, 2018 is attributed to the increase in total interest expense exceeding total interest income as compared with 2017.

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. The provision for the allowance for loan losses was \$28,000 and \$91,000 for the third quarter and first three quarters of 2018, respectively, compared with \$29,000 and \$85,000, respectively, for the third quarter and first three quarters of 2017. The Company is working diligently to address and reduce its non-performing assets. The Company's nonaccrual loans totaled \$8,560,000 and \$13,810,000 at September 30, 2018 and December 31, 2017, 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 \$77,000 and \$697,000 for the third quarter and first three quarters of 2018, respectively, as compared with 2017 results primarily as a result of the decrease in earnings from other investments and the non-recurring gain of \$429,000 discussed above.

Non-interest expense increased \$27,000 and decreased \$153,000 for the third quarter and first three quarters of 2018, respectively, as compared with 2017 results. This increase for the third quarter of 2018 was the result of an increase in net occupancy costs of \$66,000, equipment rentals, depreciation and maintenance of \$31,000 and an increase in data processing expense of \$37,000 which were partially offset by the decrease in other real estate expenses of \$131,000 as compared with 2017. This decrease for the first three quarters of 2018 was the result of decreases in net occupancy expenses of \$99,000 and other expense of \$173,000, which were partially offset by an increase in equipment rentals, depreciation and maintenance expense of \$101,000 as compared with 2017.

Total assets at September 30, 2018 decreased \$31,029,000 as compared with December 31, 2017. Available for sale securities decreased \$24,252,000 as maturities and unrealized losses on these securities exceeded investments. Total loans decreased \$6,502,000 as principal payments, maturities, charge-offs and foreclosures relating to existing loans outpaced new loans. Total deposits decreased \$24,777,000 at September 30, 2018 as compared with December 31, 2017 as customers in the casino industry and county and municipal entities reallocate their resources periodically.

## **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.

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Quarter Ended September 30, 2018 as Compared with Quarter Ended September 30, 2017

The Company's average interest-earning assets decreased approximately \$24,120,000, or 4%, from approximately \$591,132,000 for the third quarter of 2017 to approximately \$567,012,000 for the third quarter of 2018. The Company's average balance sheet decreased primarily as average loans decreased approximately \$9,025,000 and average balances due from financial institutions decreased approximately \$10,586,000 while average held to maturity taxable securities increased approximately \$4,404,000 and average taxable available for sale securities decreased approximately \$7,030,000. The Company's average loans decreased as principal payments, maturities, charge-offs and foreclosures relating to existing loans outpaced new loans. Average balances due from financial institutions decreased and average taxable held to maturity securities increased as excess funds were invested to increase interest income.

The average yield on earning assets increased by 35 basis points, from 3.21% for the third quarter of 2017 to 3.56% for the third quarter of 2018. The yield on average loans increased from 4.53% for the third quarter of 2017 to 4.93% for the third quarter of 2018 primarily as a result of the effect of the increase in prime rate during 2017 and 2018 on the Company's floating rate loans. The yield on average taxable available for sale securities increased from 1.52% for the third quarter of 2017 to 2.02% for the third quarter of 2018 as the Company changed its investment strategy to improve yield while not compromising duration and credit risk.

Average interest-bearing liabilities decreased approximately \$30,126,000, or 7%, from approximately \$432,952,000 for the third quarter of 2017 to approximately \$402,826,000 for the third quarter of 2018. Average savings and interest bearing DDA deposits decreased approximately \$37,904,000 primarily as several large customers reallocated their funds to other institutions in the current year. Average time deposits increased approximately \$4,714,000 as some customers transferred funds from their savings and interest bearing DDA accounts to improve their yield.

The average rate paid on interest-bearing liabilities for the third quarter of 2017 was .36% as compared with .70% for the third quarter of 2018. This increase is primarily due to increased rates in 2017 and 2018.

The Company's net interest margin on a tax-equivalent basis, which is net interest income as a percentage of average earning assets, was 2.95% for the third quarter of 2017 as compared with 3.06% for the third quarter of 2018.

Nine Months Ended September 30, 2018 as Compared with Nine Months Ended September 30, 2017

The Company's average interest-earning assets decreased approximately \$27,435,000, or 5%, from approximately \$605,721,000 for the first three quarters of 2017 to approximately \$578,286,000 for the first three quarters of 2018. The Company's average balance sheet decreased primarily as average loans decreased approximately \$20,458,000 and average balances due from financial institutions decreased approximately \$19,308,000 while average held to maturity taxable securities increased approximately \$5,098,000 and average taxable available for sale securities increased approximately \$9,767,000. The Company's average loans decreased as principal



payments, maturities, charge-offs and foreclosures relating to existing loans outpaced new loans. Average balances due from financial institutions decreased and average taxable held to maturity and average taxable available for sale securities increased as excess funds were invested to increase interest income.

The average yield on earning assets increased from 3.13% for the first three quarters of 2017 to 3.41% for the first three quarters of 2018. The yield on average loans increased from 4.41% for the first three quarters of 2017 to 4.77% for the first three quarters of 2018 primarily as a result of the effect of the increase in prime rate during 2017 and 2018 on the Company's floating rate loans. The yield on average taxable available for sale securities increased from 1.49% for the first three quarters of 2017 to 1.89% for the first three quarters of 2018 as the Company changed its investment strategy to improve yield while not compromising duration and credit risk.

Average interest-bearing liabilities decreased approximately \$27,202,000, or 6%, from approximately \$447,113,000 for the first three quarters of 2017 to approximately \$419,911,000 for the first three quarters of 2018. Average savings and interest bearing DDA balances decreased approximately \$38,963,000 primarily as several large commercial customers reallocated their funds to other institutions in the current year. Average time deposits increased approximately \$4,495,000 as some customers transferred funds from their savings and interest bearing DDA accounts to improve their yield. Average borrowings from the Federal Home Loan Bank increased approximately \$6,868,000 due to the liquidity needs of the bank subsidiary.

The average rate paid on interest-bearing liabilities for the first three quarters of 2017 was .30% compared with .58% for the first three quarters of 2018. This increase is primarily due to the increased rates in 2017 and 2018.

The Company's net interest margin on a tax-equivalent basis, which is net interest income as a percentage of average earning assets, was 2.91% for the first three quarters of 2017 as compared with 2.99% for the first three quarters of 2018.

The tables on the following pages analyze the changes in tax-equivalent net interest income for the quarters and nine months ended September 30, 2018 and 2017.

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

(In Thousands)

	Quarter Ended September 30, 2018			Quarter Ended September 30, 2017		
	Average Balance	Interest Earned/Paid	Rate	Average Balance	Interest Earned/Paid	Rate
Loans (2)(3)	\$ 270,746	\$ 3,335	4.93%	\$ 279,771	\$ 3,165	4.53%
Balances due from depository institutions	14,823	80	2.16%	25,409	148	2.33%
HTM:						
Taxable	34,535	249	2.88%	30,131	207	2.75%
Non taxable (1)	18,104	145	3.20%	18,802	177	3.77%
AFS:						
Taxable	214,166	1,079	2.02%	221,196	842	1.52%
Non taxable (1)	12,741	146	4.58%	14,821	204	5.51%
Other	1,897	10	2.11%	1,002	8	3.19%
Total	\$ 567,012	\$ 5,044	3.56%	\$ 591,132	\$ 4,751	3.21%
Savings & interest-bearing DDA	\$ 312,196	\$ 443	0.57%	\$ 350,100	\$ 218	0.25%
Time deposits	86,346	239	1.11%	81,632	163	0.80%
Federal funds purchased	92	1	4.35%			
Borrowings from FHLB	4,192	26	2.48%	1,220	8	2.62%
Total	\$ 402,826	\$ 709	0.70%	\$ 432,952	\$ 389	0.36%
Net tax-equivalent spread			2.86%			2.85%
Net tax-equivalent margin on earning assets			3.06%			2.95%

(1) All interest earned is reported on a taxable equivalent basis using a tax rate of 21% in 2018 and 34% in 2017. See disclosure of Non-GAAP financial measures on pages 32 and 33.

(2) Loan fees of \$75 and \$59 for 2018 and 2017, respectively, are included in these figures.

(3) Average balance includes nonaccrual loans.

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

(In Thousands)

	Nine Months Ended September 30, 2018			Nine Months Ended September 30, 2017		
	Average Balance	Interest Earned/Paid	Rate	Average Balance	Interest Earned/Paid	Rate
Loans (2)(3)	\$ 274,034	\$ 9,798	4.77%	\$ 294,492	\$ 9,734	4.41%
Balances due from depository institutions	14,742	179	1.62%	34,050	384	1.50%
HTM:						
Taxable	33,547	722	2.87%	28,449	524	2.46%
Non taxable (1)	18,326	437	3.18%	19,239	541	3.75%
AFS:						
Taxable	222,202	3,152	1.89%	212,435	2,370	1.49%
Non taxable (1)	13,554	472	4.64%	16,055	665	5.52%
Other	1,881	20	1.42%	1,001	14	1.86%
Total	\$ 578,286	\$ 14,780	3.41%	\$ 605,721	\$ 14,232	3.13%
Savings & interest-bearing DDA	\$ 325,769	\$ 1,045	0.43%	\$ 364,732	\$ 535	0.20%
Time deposits	85,423	644	1.01%	80,928	446	0.73%
Federal funds purchased	398	8	2.68%	36	1	0.35%
Borrowings from FHLB	8,321	131	2.10%	1,417	31	2.92%
Total	\$ 419,911	\$ 1,828	0.58%	\$ 447,113	\$ 1,013	0.30%
Net tax-equivalent spread			2.83%			2.83%
Net tax-equivalent margin on earning assets			2.99%			2.91%

(1) All interest earned is reported on a taxable equivalent basis using a tax rate of 21% in 2018 and 34% in 2017. See disclosure of Non-GAAP financial measures on pages 32 and 33.

(2) Loan fees of \$232 and \$238 for 2018 and 2017, respectively, are included in these figures.

(3) Average balance includes nonaccrual loans.

## Analysis of Changes in Interest Income and Interest Expense

(In Thousands)

	For the Quarter Ended			
	September 30, 2018 compared with September 30, 2017			
	Volume	Rate	Rate/Volume	Total
<b>Interest earned on:</b>				
Loans	\$ (102)	\$ 281	\$ (9)	\$ 170
Balances due from financial institutions	(62)	(11)	5	(68)
<b>Held to maturity securities:</b>				
Taxable	30	11	1	42
Non taxable	(7)	(26)	1	(32)
<b>Available for sale securities:</b>				
Taxable	(27)	272	(8)	237
Non taxable	(29)	(34)	5	(58)
Other	7	(3)	(2)	2
<b>Total</b>	<b>\$ (190)</b>	<b>\$ 490</b>	<b>\$ (7)</b>	<b>\$ 293</b>
<b>Interest paid on:</b>				
Savings & interest-bearing DDA	\$ (24)	\$ 279	\$ (30)	\$ 225
Time deposits	9	63	4	76
Federal funds purchased	1			1
Borrowings from FHLB	19		(1)	18
<b>Total</b>	<b>\$ 5</b>	<b>\$ 342</b>	<b>\$ (27)</b>	<b>\$ 320</b>

## Analysis of Changes in Interest Income and Interest Expense

(In Thousands)

	For the Nine Months Ended			
	September 30, 2018 compared with September 30, 2017			
	Volume	Rate	Rate/Volume	Total
<b>Interest earned on:</b>				
Loans	\$ (676)	\$ 795	\$ (55)	\$ 64
Balances due from financial institutions	(218)	29	(16)	(205)
<b>Held to maturity securities:</b>				
Taxable	94	88	16	198
Non taxable	(26)	(82)	4	(104)
<b>Available for sale securities:</b>				
Taxable	109	643	30	782
Non taxable	(104)	(105)	16	(193)
Other	12	(3)	(3)	6
<b>Total</b>	<b>\$ (809)</b>	<b>\$ 1,365</b>	<b>\$ (8)</b>	<b>\$ 548</b>
<b>Interest paid on:</b>				
Savings & interest-bearing DDA	\$ (57)	\$ 635	\$ (68)	\$ 510
Time deposits	25	164	9	198
Federal funds purchased	1	1	5	7
Borrowings from FHLB	147	(9)	(38)	100
<b>Total</b>	<b>\$ 116</b>	<b>\$ 791</b>	<b>\$ (92)</b>	<b>\$ 815</b>

**Provision for the Allowance 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 \$8,560,000 and \$13,810,000 at September 30, 2018 and December 31, 2017, respectively, specific reserves of only \$133,000 and \$1,126,000, 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 the allowance for loan losses of \$28,000 and \$29,000 for the third quarters of 2018 and 2017, respectively, and \$91,000 and \$85,000 for the first three quarters of 2018 and 2017, respectively. The allowance for loan losses as a percentage of loans was 1.97% and 2.19% at September 30, 2018 and December 31, 2017, respectively. The Company believes that its allowance for loan losses is appropriate as of September 30, 2018.

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**

##### Quarter Ended September 30, 2018 as Compared with Quarter Ended September 30, 2017

Non-interest income decreased \$77,000 for the third quarter of 2018 as compared with the third quarter of 2017. Income from other investments decreased \$122,000 from operations of the investment in a low income housing partnership as a result of decreased occupancy in 2018 as compared with 2017. This decrease was partially offset by trust department income and fees, which increased \$45,000 due to several new account relationships.

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Nine Months Ended September 30, 2018 as Compared with Nine Months Ended September 30, 2017

Non-interest income decreased \$697,000 for the first three quarters of 2018 as compared with the first three quarters of 2017 primarily as the prior year's results included a gain on liquidation, sales and calls of securities and higher income from other investments as well as the gain from death benefits from life insurance. These decreases were partially offset by trust department income and fees, which increased \$136,000 due to several new account relationships. The Company had opportunities to sell securities which generated gains in 2017 and, as a result, recognized \$137,000. Income from other investments decreased \$250,000 from operations of the investment in a low income housing partnership as a result of decreased occupancy in 2018 as compared with 2017. As a result of the death of a participant in the Company's deferred compensation plans during 2017, a non-recurring gain of \$429,000 from the redemption of bank owned life insurance was recorded.

**Non-interest expense**

Quarter Ended September 30, 2018 as Compared with Quarter Ended September 30, 2017

Total non-interest expense increased \$27,000 for the third quarter of 2018 as compared with the third quarter of 2017. Salaries and employee benefits decreased \$40,000 and other real estate expense decreased \$131,000, while net occupancy increased \$66,000, equipment rentals, depreciation and maintenance increased \$31,000, data processing increased \$37,000 and other expense increased \$57,000 in 2018 as compared with 2017.

Salaries and employee benefits decreased primarily due to attrition.

Net occupancy expense increased as result of adjustments to insurance costs.

Equipment rentals, depreciation and maintenance increased as a result of purchases of depreciable assets, primarily technology-related, and an increase in maintenance contracts related to technology services.

Data processing costs increased as a result of additional costs relating to technology upgrades.

ORE expense decreased as writedowns in the value of ORE and the repair costs associated with recent foreclosures were less in 2018.

Other expenses increased as a result of the increase in advertising and other costs largely due to the time in which the services were performed.

Nine Months Ended September 30, 2018 as Compared with Nine Months Ended September 30, 2017

Total non-interest expense decreased \$153,000 for the first three quarters of 2018 as compared with the first three quarters of 2017. Salaries and employee benefits decreased \$84,000, net occupancy decreased \$99,000 and other expense decreased \$173,000 while equipment rentals, depreciation and maintenance increased \$101,000 and data processing increased \$44,000 in 2018 as compared with 2017.

Salaries and employee benefits decreased primarily due to attrition.

Net occupancy expense decreased as result of the Company's efforts to decrease its telecommunication and insurance costs.

Equipment rentals, depreciation and maintenance increased as a result of purchases of depreciable assets, primarily technology-related, and an increase in maintenance contracts related to technology services.

Data processing costs increased as a result of additional costs relating to technology upgrades.

Other expense decreased in 2018 as the Company engaged consultants to assist with several projects related to improving I/T security and operations in the prior year.

### **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 generally be recorded.

For the year ended December 31, 2014, the Company estimated it would be able to carryback net operating losses and general business credits resulting in Federal refunds totaling \$300,000. Accordingly, a \$300,000 income tax receivable was recorded at December 31, 2014. Upon preparation of the amended 2011 and 2012 Federal tax returns, the actual refunds recoverable were \$642,000. As a result, the Company recorded an income tax benefit of \$338,000 during the second quarter of 2017 as an immaterial correction of an error.

### **FINANCIAL CONDITION**

Available for sale securities decreased \$24,252,000 at September 30, 2018, as compared with December 31, 2017 as maturities and unrealized losses exceeded investment purchases.

Loan decreased \$6,502,000 at September 30, 2018, as compared with December 31, 2017 as principal payments, maturities, charge-offs and foreclosures relating to existing loans outpaced new loans.

Total deposits decreased \$24,777,000 at September 30, 2018, as compared with December 31, 2017. 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. The increase in time deposits, \$100,000 or more, relates to customers reallocating their funds as the rates on time deposits have increased in 2018.



**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.

As of September 30, 2018, 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. As of January 1, 2018, the Company must have a capital conservation buffer above these requirements of 1.875% for 2018. 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 September 30, 2018 and December 31, 2017, are as follows (in thousands):

	Actual		For Capital Adequacy Purposes	
	Amount	Ratio	Amount	Ratio
September 30, 2018:				
Total Capital (to Risk Weighted Assets)	\$ 96,455	25.53%	\$ 30,220	8.00%
Common Equity Tier 1 Capital (to Risk Weighted Assets)	91,725	24.28%	16,999	4.50%
Tier 1 Capital (to Risk Weighted Assets)	91,725	24.28%	22,665	6.00%
Tier 1 Capital (to Average Assets)	91,725	14.45%	25,396	4.00%
December 31, 2017:				
Total Capital (to Risk Weighted Assets)	\$ 97,122	25.12%	\$ 30,930	8.00%
Common Equity Tier 1 Capital (to Risk Weighted Assets)	92,273	23.87%	17,398	4.50%
Tier 1 Capital (to Risk Weighted Assets)	92,273	23.87%	23,197	6.00%
Tier 1 Capital (to Average Assets)	92,273	13.79%	26,769	4.00%

The actual capital amounts and ratios and required minimum capital amounts and ratios for the Bank as of September 30, 2018 and December 31, 2017, are as follows (in thousands):

	Actual		For Capital Adequacy Purposes		To Be Well Capitalized	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
<b>September 30, 2018:</b>						
Total Capital (to Risk Weighted Assets)	\$ 93,161	24.81%	\$ 30,034	8.00%	\$ 37,543	10.00%
Common Equity Tier 1 Capital (to Risk Weighted Assets)	88,460	23.56%	16,894	4.50%	24,403	6.50%
Tier 1 Capital (to Risk Weighted Assets)	88,460	23.56%	22,526	6.00%	30,034	8.00%
Tier 1 Capital (to Average Assets)	88,460	13.96%	25,355	4.00%	31,694	5.00%
<b>December 31, 2017:</b>						
Total Capital (to Risk Weighted Assets)	\$ 92,493	24.04%	\$ 30,778	8.00%	\$ 38,473	10.00%
Common Equity Tier 1 Capital (to Risk Weighted Assets)	87,668	22.79%	17,313	4.50%	25,007	6.50%
Tier 1 Capital (to Risk Weighted Assets)	87,668	22.79%	23,084	6.00%	30,778	8.00%
Tier 1 Capital (to Average Assets)	87,668	13.47%	26,031	4.00%	32,539	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 2016, Management identified opportunities for improving information technology operations and security, 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 information technology operations and security, 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 September 30, 2018, 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, 2018 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 September 30, 2018, formatted in XBRL (Extensible Business Reporting Language): (i) Consolidated Statements of Condition at September 30, 2018 and December 31, 2017, (ii) Consolidated Statements of Income for the quarters and nine months ended September 30, 2018 and 2017, (iii) Consolidated Statements of Comprehensive Income (Loss) for the quarters and nine months ended September 30, 2018 and 2017, (iv) Consolidated Statement of Changes in Shareholders' Equity for the nine months ended September 30, 2018, (v) Consolidated Statements of Cash Flows for the nine months ended September 30, 2018 and 2017 and (vi) Notes to the Unaudited Consolidated Financial Statements for the nine months ended September 30, 2018 and 2017.

(b) Reports on Form 8-K

A Form 8-K was filed on July 23, 2018, July 25, 2018, August 3, 2018, September 26, 2018 and October 24, 2018.

**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 13, 2018

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

Date: November 13, 2018

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