

PEOPLES FINANCIAL CORP /MS/  
Form 10-Q  
November 13, 2017

**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, 2017

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

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

Large accelerated filer

Accelerated filer

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

Smaller reporting company

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, 2017, there were 15,000,000 shares of \$1 par value common stock authorized, with 5,123,186 shares issued and outstanding.

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

	<b>September 30, 2017 (unaudited)</b>	<b>December 31, 2016 (audited)</b>
<b>Assets</b>		
Cash and due from banks	\$ 42,278	\$ 41,116
Available for sale securities	245,788	233,578
Held to maturity securities, fair value of \$49,303 at September 30, 2017; \$46,935 at December 31, 2016	49,405	48,150
Other investments	2,729	2,693
Federal Home Loan Bank Stock, at cost	544	539
Loans	272,823	315,355
Less: Allowance for loan losses	6,152	5,466
Loans, net	266,671	309,889
Bank premises and equipment, net of accumulated depreciation	20,541	21,644
Other real estate	8,081	8,513
Accrued interest receivable	1,991	1,855
Cash surrender value of life insurance	18,153	19,249
Other assets	806	788
<b>Total assets</b>	<b>\$ 656,987</b>	<b>\$ 688,014</b>

## Peoples Financial Corporation and Subsidiaries

## Consolidated Statements of Condition (continued)

(in thousands except share data)

	September 30, 2017 (unaudited)	December 31, 2016 (audited)
<b>Liabilities and Shareholders Equity Liabilities:</b>		
Deposits:		
Demand, non-interest bearing	\$ 147,975	\$ 132,381
Savings and demand, interest bearing	310,725	364,975
Time, \$100,000 or more	55,719	38,650
Other time deposits	30,648	39,010
<b>Total deposits</b>	<b>545,067</b>	<b>575,016</b>
Borrowings from Federal Home Loan Bank	1,216	6,257
Employee and director benefit plans liabilities	17,217	16,768
Other liabilities	1,688	1,512
<b>Total liabilities</b>	<b>565,188</b>	<b>599,553</b>
<b>Shareholders Equity:</b>		
Common stock, \$1 par value, 15,000,000 shares authorized, 5,123,186 shares issued and outstanding at September 30, 2017 and December 31, 2016	5,123	5,123
Surplus	65,780	65,780
Undivided profits	20,730	19,318
Accumulated other comprehensive income (loss), net of tax	166	(1,760)
<b>Total shareholders equity</b>	<b>91,799</b>	<b>88,461</b>
<b>Total liabilities and shareholders equity</b>	<b>\$ 656,987</b>	<b>\$ 688,014</b>

See notes to consolidated financial statements.

**Peoples Financial Corporation and Subsidiaries**

**Consolidated Statements of Income**

(in thousands except per share data) (unaudited)

	<b>Three Months Ended</b>		<b>Nine Months Ended</b>	
	<b>September 30,</b>		<b>September 30,</b>	
	<b>2017</b>	<b>2016</b>	<b>2017</b>	<b>2016</b>
<b>Interest income:</b>				
Interest and fees on loans	\$ 3,165	\$ 3,568	\$ 9,734	\$ 10,833
Interest and dividends on securities:				
U.S. Treasuries	413	283	1,203	740
U.S. Government agencies	126	161	404	728
Mortgage-backed securities	343	137	876	414
States and political subdivisions	420	333	1,199	954
Corporate bonds		7	8	23
Other investments	8	9	14	19
Interest on balances due from depository institutions	148	95	384	212
<b>Total interest income</b>	<b>4,623</b>	<b>4,593</b>	<b>13,822</b>	<b>13,923</b>
<b>Interest expense:</b>				
Deposits	381	237	981	661
Borrowings from Federal Home Loan Bank	8	30	32	115
<b>Total interest expense</b>	<b>389</b>	<b>267</b>	<b>1,013</b>	<b>776</b>
<b>Net interest income</b>	<b>4,234</b>	<b>4,326</b>	<b>12,809</b>	<b>13,147</b>
<b>Provision for allowance for loan losses</b>	<b>29</b>		<b>85</b>	<b>137</b>
<b>Net interest income after provision for allowance for loan losses</b>	<b>\$ 4,205</b>	<b>\$ 4,326</b>	<b>\$ 12,724</b>	<b>\$ 13,010</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,	
	2017	2016	2017	2016
<b>Non-interest income:</b>				
Trust department income and fees	\$ 430	\$ 429	\$ 1,224	\$ 1,192
Service charges on deposit accounts	947	946	2,799	2,796
Gain on liquidation, sales and calls of securities		67	137	158
Income (loss) from other investments	7	(14)	36	(27)
Increase in cash surrender value of life insurance	98	102	326	295
Gain from death benefits from life insurance			429	
Other income	128	236	376	523
<b>Total non-interest income</b>	<b>1,610</b>	<b>1,766</b>	<b>5,327</b>	<b>4,937</b>
<b>Non-interest expense:</b>				
Salaries and employee benefits	2,746	2,776	8,344	8,305
Net occupancy	493	559	1,548	1,798
Equipment rentals, depreciation and maintenance	722	763	2,251	2,229
FDIC and state banking assessments	130	232	327	661
Data processing	322	334	972	1,006
ATM expense	141	147	399	422
Other real estate expense	305	26	635	500
Other expense	720	849	2,450	2,405
<b>Total non-interest expense</b>	<b>5,579</b>	<b>5,686</b>	<b>16,926</b>	<b>17,326</b>
<b>Income before income taxes</b>	<b>236</b>	<b>406</b>	<b>1,125</b>	<b>621</b>
Income tax expense (benefit)			(338)	78
<b>Net income</b>	<b>\$ 236</b>	<b>\$ 406</b>	<b>\$ 1,463</b>	<b>\$ 543</b>
<b>Basic and diluted earnings per share</b>	<b>\$ .05</b>	<b>\$ .08</b>	<b>\$ .29</b>	<b>\$ .10</b>
<b>Dividends declared per share</b>	<b>\$ .01</b>	<b>\$</b>	<b>\$ .01</b>	<b>\$</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</b>		<b>Nine Months Ended</b>	
	<b>September 30,</b>		<b>September 30,</b>	
	<b>2017</b>	<b>2016</b>	<b>2017</b>	<b>2016</b>
<b>Net income</b>	\$ 236	\$ 406	\$ 1,463	\$ 543
<b>Other comprehensive income (loss):</b>				
Net unrealized gain (loss) on available for sale securities	(319)	(598)	2,063	2,132
Reclassification adjustment for realized gain on available for sale securities called or sold		(67)	(137)	(158)
<b>Total other comprehensive income (loss)</b>	(319)	(665)	1,926	1,974
<b>Total comprehensive income (loss)</b>	\$ (83)	\$ (259)	\$ 3,389	\$ 2,517

See notes to consolidated financial statements.

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

(in thousands except share and per share data)

	Number of Common Shares	Common Stock	Surplus	Undivided Profits	Accumulated Other Comprehensive Income (Loss)	Total
<b>Balance, January 1, 2017</b>	5,123,186	\$ 5,123	\$ 65,780	\$ 19,318	\$ (1,760)	\$ 88,461
Net income				1,463		1,463
Dividend declared (\$.01 per share)				(51)		(51)
Other comprehensive income					1,926	1,926
<b>Balance, September 30, 2017</b>	5,123,186	\$ 5,123	\$ 65,780	\$ 20,730	\$ 166	\$ 91,799

Note: Balances as of January 1, 2017 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>2017</b>	<b>2016</b>
<b>Cash flows from operating activities:</b>		
<b>Net income</b>	\$ 1,463	\$ 543
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation	1,426	1,356
Provision for allowance for loan losses	85	137
Writedown of other real estate	397	420
(Gains) losses on sales of other real estate	95	(199)
(Income) loss from other investments	(36)	27
Gain from death benefits from life insurance	(429)	
Amortization of held to maturity securities	190	111
Amortization of available for sale securities	130	17
Gain on sales and calls of securities	(137)	(158)
Change in accrued interest receivable	(136)	155
Increase in cash surrender value of life insurance	(326)	(295)
Change in other assets	(18)	(274)
Change in other liabilities	574	217
<b>Net cash provided by operating activities</b>	<b>\$ 3,278</b>	<b>\$ 2,057</b>

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

	<b>Nine Months Ended September 30,</b>	
	<b>2017</b>	<b>2016</b>
<b>Cash flows from investing activities:</b>		
Proceeds from maturities, sales and calls of available for sale securities	\$ 58,201	\$ 141,834
Proceeds from maturities of held to maturity securities	7,725	510
Purchases of available for sale securities	(68,478)	(145,832)
Purchases of held to maturity securities	(9,170)	(17,120)
(Purchase) redemption of Federal Home Loan Bank stock	(5)	1,101
Proceeds from sales of other real estate	1,296	2,017
Loans, net change	41,777	10,431
Acquisition of bank premises and equipment	(323)	(583)
Investment in cash surrender value of life insurance	(78)	(85)
Proceeds from death benefits from life insurance	1,929	
<b>Net cash provided by (used in) investing activities</b>	<b>32,874</b>	<b>(7,727)</b>
<b>Cash flows from financing activities:</b>		
Demand and savings deposits, net change	(38,656)	47,707
Time deposits, net change	8,707	3,146
Borrowings from Federal Home Loan Bank		98,920
Repayments to Federal Home Loan Bank	(5,041)	(110,990)
<b>Net cash provided by (used in) financing activities</b>	<b>(34,990)</b>	<b>38,783</b>
<b>Net increase in cash and cash equivalents</b>	<b>1,162</b>	<b>33,113</b>
<b>Cash and cash equivalents, beginning of period</b>	<b>41,116</b>	<b>31,396</b>
<b>Cash and cash equivalents, end of period</b>	<b>\$ 42,278</b>	<b>\$ 64,509</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, 2017 and 2016

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, 2017 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 2016 Annual Report and Form 10-K.

The results of operations for the quarter or nine months ended September 30, 2017, 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, 2016.

New Accounting Pronouncements - In January 2017, the Financial Accounting Standards Board (the FASB) issued Accounting Standards Update (ASU) 2017-03, *Accounting Changes and Error Corrections (Topic 250) and Investments - Equity Method and Joint Ventures (Topic 323): Amendments to SEC Paragraphs Pursuant to Staff Announcements at the September 22, 2016 and November 17, 2016 EITF Meetings*. ASU 2017-03 incorporates into the Accounting Standards

Codification recent SEC guidance about disclosing the effect on financial statements of adopting the revenue, leases and credit losses standards. This update is effective upon issuance. The adoption of this ASU is not expected to have a material effect on the Company's financial position, results of operations or cash flows.

In February 2017, the FASB issued ASU 2017-05, *Other Income - Gains and Losses from the Derecognition of Nonfinancial Assets (Subtopic 610-20): Clarifying the Scope of Asset Derecognition Guidance and Accounting for Partial Sales of Nonfinancial Assets*. ASU 2017-05 conforms the derecognition guidance on nonfinancial assets with the model for transactions in the new revenue standard. This update will be effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2017. The adoption of this ASU is not expected to have a material effect on the Company's financial position, results of operations or cash flows.

In March 2017, the FASB issued ASU 2017-07, *Compensation - Retirement Benefits (Topic 715): Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost*. ASU 2017-07 amends the requirements related to the income statement presentation of the components of net periodic benefit cost for an entity's sponsored defined benefit pension and other postretirement plans. This update will be effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2017. The adoption of this ASU is not expected to have a material effect on the Company's financial position, results of operations or cash flows.

In March 2017, the FASB issued ASU 2017-08, *Receivables - Nonrefundable Fees and Other Costs (Subtopic 310-20): Premium Amortization on Purchased Callable Debt Securities*. ASU 2017-08 shortens the amortization period for the premium on such securities to the earliest call date. This update will be effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2018. The adoption of this ASU is not expected to have a material effect on the Company's financial position, results of operations or cash flows.

## 2. Earnings Per Share:

Per share data is based on the weighted average shares of common stock outstanding of 5,123,186 for the quarters and nine months ended September 30, 2017 and 2016.

## 3. Statements of Cash Flows:

The Company has defined cash and cash equivalents as cash and due from banks. The Company paid \$1,006,350 and \$761,440 for the nine months ended September 30, 2017 and 2016, respectively, for interest on deposits and borrowings. No income tax payments were made during the nine months ended September 30, 2017. Income tax payments of \$78,435 were made during the nine months ended September 30, 2016. Loans transferred to other real estate amounted to \$1,355,642 and \$1,758,764 during the nine months ended September 30, 2017 and 2016, respectively.

## 4. Investments:

The amortized cost and fair value of securities at September 30, 2017 and December 31, 2016, are as follows (in thousands):

September 30, 2017	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
<b>Available for sale securities:</b>				
<b>Debt securities:</b>				
U.S. Treasuries	\$ 134,806	\$ 5	\$ (1,234)	\$ 133,577
U.S. Government agencies	19,988	70	(86)	19,972
Mortgage-backed securities	77,415	349	(561)	77,203
States and political subdivisions	14,176	402		14,578
<b>Total debt securities</b>	<b>246,385</b>	<b>826</b>	<b>(1,881)</b>	<b>245,330</b>
Equity securities	458			458
<b>Total available for sale securities</b>	<b>\$ 246,843</b>	<b>\$ 826</b>	<b>\$ (1,881)</b>	<b>\$ 245,788</b>
<b>Held to maturity securities:</b>				
U.S. Government agencies	\$ 8,185	\$	\$ (220)	\$ 7,965
States and political subdivisions	41,220	424	(306)	41,338
<b>Total held to maturity securities</b>	<b>\$ 49,405</b>	<b>\$ 424</b>	<b>\$ (526)</b>	<b>\$ 49,303</b>

December 31, 2016	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Available for sale securities:				
Debt securities:				
U.S. Treasuries	\$ 149,676	\$ 39	\$ (2,091)	\$ 147,624
U.S. Government agencies	24,973	58	(206)	24,825
Mortgage-backed securities	43,939	74	(1,305)	42,708
States and political subdivisions	17,513	450		17,963
<b>Total debt securities</b>	<b>236,101</b>	<b>621</b>	<b>(3,602)</b>	<b>233,120</b>
Equity securities	458			458
<b>Total available for sale securities</b>	<b>\$ 236,559</b>	<b>\$ 621</b>	<b>\$ (3,602)</b>	<b>\$ 233,578</b>
Held to maturity securities:				
U.S. Government agencies	\$ 10,009	\$	\$ (315)	\$ 9,694
States and political subdivisions	36,677	29	(927)	35,779
Corporate bond	1,464		(2)	1,462
<b>Total held to maturity securities</b>	<b>\$ 48,150</b>	<b>\$ 29</b>	<b>\$ (1,244)</b>	<b>\$ 46,935</b>

The amortized cost and fair value of debt securities at September 30, 2017 (in thousands), by contractual maturity, are shown on the following page. 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
<b>Available for sale securities:</b>		
Due in one year or less	\$ 46,961	\$ 46,895
Due after one year through five years	98,693	98,384
Due after five years through ten years	22,983	22,496
Due after ten years	333	352
Mortgage-backed securities	77,415	77,203
<b>Totals</b>	<b>\$ 246,385</b>	<b>\$ 245,330</b>
<b>Held to maturity securities:</b>		
Due in one year or less	\$ 696	\$ 697
Due after one year through five years	11,641	11,724
Due after five years through ten years	20,588	20,576
Due after ten years	16,480	16,306
<b>Totals</b>	<b>\$ 49,405</b>	<b>\$ 49,303</b>

Available for sale and held to maturity securities with gross unrealized losses at September 30, 2017 and December 31, 2016, 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
September 30, 2017:						
U.S. Treasuries	\$ 113,777	\$ 1,058	\$ 9,815	\$ 176	\$ 123,592	\$ 1,234
U.S. Government agencies	8,085	90	9,783	216	17,868	306
Mortgage-backed securities	31,326	382	3,902	179	35,228	561
States and political subdivisions	4,729	168	4,054	138	8,783	306
<b>TOTAL</b>	<b>\$ 157,917</b>	<b>\$ 1,698</b>	<b>\$ 27,554</b>	<b>\$ 709</b>	<b>\$ 185,471</b>	<b>\$ 2,407</b>
December 31, 2016:						
U.S. Treasuries	\$ 97,634	\$ 2,091	\$	\$	\$ 97,634	\$ 2,091
U.S. Government agencies	24,478	521			24,478	521
Mortgage-backed securities	37,663	1,305			37,663	1,305
States and political subdivisions	24,627	926	589	1	25,216	927
Corporate bond			1,462	2	1,462	2
<b>TOTAL</b>	<b>\$ 184,402</b>	<b>\$ 4,843</b>	<b>\$ 2,051</b>	<b>\$ 3</b>	<b>\$ 186,453</b>	<b>\$ 4,846</b>

At September 30, 2017, 25 of 27 securities issued by the U.S. Treasury, 4 of the 6 securities issued by U.S. Government agencies, 27 of the 155 securities issued by states and political subdivisions and 16 of the 32 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 and \$29,250,806 during the nine months ended September 30, 2017 and 2016, respectively. Available for sale debt securities were sold or called for a realized gain of \$136,781 and \$157,918 for the nine months ended September 30, 2017 and 2016, respectively.

Securities with a fair value of \$180,107,293 and \$180,659,168 at September 30, 2017 and December 31, 2016, 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, 2017 and December 31, 2016, is as follows (in thousands):

	September 30, 2017	December 31, 2016
Gaming	\$ 18,824	\$ 31,311
Residential and land development	273	291
Real estate, construction	30,998	32,503
Real estate, mortgage	190,003	206,172
Commercial and industrial	26,009	37,035
Other	6,716	8,043
<b>Total</b>	<b>\$ 272,823</b>	<b>\$ 315,355</b>

The age analysis of the loan portfolio, segregated by class of loans, as of September 30, 2017 and December 31, 2016, is as follows (in thousands):

	Number of Days Past Due			Total Past Due	Current	Total Loans	Loans Past Due Greater Than 90 Days & Still Accruing
	30 - 59	60 - 89	Greater Than 90				
September 30, 2017:							
Gaming	\$	\$	\$	\$	\$ 18,824	\$ 18,824	\$
Residential and land development			273	273		273	
Real estate, construction	1,343	130	747	2,220	28,778	30,998	
Real estate, mortgage	4,640	139	7,815	12,594	177,409	190,003	256
Commercial and industrial	882	1,364	668	2,914	23,095	26,009	
Other	45	8		53	6,663	6,716	
Total	\$ 6,910	\$ 1,641	\$ 9,503	\$ 18,054	\$ 254,769	\$ 272,823	\$ 256
December 31, 2016:							
Gaming	\$	\$	\$	\$	\$ 31,311	\$ 31,311	\$
Residential and land development			291	291		291	
Real estate, construction	902	216	1,082	2,200	30,303	32,503	
Real estate, mortgage	4,608	1,923	4,471	11,002	195,170	206,172	
Commercial and industrial	867		8	875	36,160	37,035	
Other	44	36	80	160	7,883	8,043	
Total	\$ 6,421	\$ 2,175	\$ 5,932	\$ 14,528	\$ 300,827	\$ 315,355	\$

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, 2017 and December 31, 2016, is as follows (in thousands):

	Loans With A Grade Of:					Total
	A, B or C	S	D	E	F	
<b>September 30, 2017:</b>						
Gaming	\$ 18,824	\$	\$	\$	\$	\$ 18,824
Residential and land development				273		273
Real estate, construction	29,323		368	1,307		30,998
Real estate, mortgage	142,805	15,833	20,861	10,504		190,003
Commercial and industrial	13,720	9,132	271	2,886		26,009
Other	6,688		24	4		6,716
<b>Total</b>	<b>\$ 211,360</b>	<b>\$ 24,965</b>	<b>\$ 21,524</b>	<b>\$ 14,974</b>	<b>\$</b>	<b>\$ 272,823</b>
<b>December 31, 2016:</b>						
Gaming	\$ 31,311	\$	\$	\$	\$	\$ 31,311
Residential and land development				291		291
Real estate, construction	29,954	435	517	1,597		32,503
Real estate, mortgage	155,671	17,651	22,901	9,949		206,172
Commercial and industrial	13,926	21,680	867	562		37,035
Other	7,996		42	5		8,043
<b>Total</b>	<b>\$ 238,858</b>	<b>\$ 39,766</b>	<b>\$ 24,327</b>	<b>\$ 12,404</b>	<b>\$</b>	<b>\$ 315,355</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, 2017 and December 31, 2016, are as follows (in thousands):

	September 30, 2017	December 31, 2016
Residential and land development	\$ 273	\$ 291
Real estate, construction	1,307	1,598
Real estate, mortgage	9,992	9,445
Commercial and industrial	2,808	515
Other	4	5
Total	\$ 14,384	\$ 11,854

Prior to 2016, certain loans were modified by granting interest rate concessions to these customers with such loans being classified as troubled debt restructurings. During 2016 and 2017, the Company did not restructure any additional loans. Specific reserves of \$88,000 and \$100,000 were allocated to troubled debt restructurings as of September 30, 2017 and December 31, 2016, respectively. The Bank had no commitments to lend additional amounts to customers with outstanding loans classified as troubled debt restructurings as of September 30, 2017 and December 31, 2016.

Impaired loans, which include loans classified as nonaccrual and troubled debt restructurings, segregated by class of loans, as of September 30, 2017 and December 31, 2016, are as follows (in thousands):

	Unpaid Principal Balance	Recorded Investment	Related Allowance	Average Recorded Investment	Interest Income Recognized
<b>September 30, 2017:</b>					
With no related allowance recorded:					
Real estate, construction	\$ 1,562	\$ 1,088	\$	\$ 1,132	\$
Real estate, mortgage	9,354	8,382		9,053	21
Commercial and industrial	2,797	2,758		2,780	
Other	4	4		4	
<b>Total</b>	<b>13,717</b>	<b>12,232</b>		<b>12,969</b>	<b>21</b>
With a related allowance recorded:					
Residential and land development	273	273	49	278	
Real estate, construction	219	219	112	230	
Real estate, mortgage	3,653	2,769	722	2,751	23
Commercial and industrial	50	50	15	49	
<b>Total</b>	<b>4,195</b>	<b>3,311</b>	<b>898</b>	<b>3,308</b>	<b>23</b>
Total by class of loans:					
Residential and land development	273	273	49	278	
Real estate, construction	1,781	1,307	112	1,362	
Real estate, mortgage	13,007	11,151	722	11,804	44
Commercial and industrial	2,847	2,808	15	2,829	
Other	4	4		4	
<b>Total</b>	<b>\$ 17,912</b>	<b>\$ 15,543</b>	<b>\$ 898</b>	<b>\$ 16,277</b>	<b>\$ 44</b>

	Unpaid Principal Balance	Recorded Investment	Related Allowance	Average Recorded Investment	Interest Income Recognized
December 31, 2016:					
With no related allowance recorded:					
Real estate, construction	\$ 2,023	\$ 1,331	\$	\$ 1,395	\$
Real estate, mortgage	11,811	9,282		10,582	23
Commercial and industrial	553	515		538	
Total	14,387	11,128		12,515	23
With a related allowance recorded:					
Residential and land development	291	291	66	304	
Real estate, construction	267	267	141	283	
Real estate, mortgage	1,347	1,347	195	1,080	30
Other	5	5	1	1	
Total	1,910	1,910	403	1,668	30
Total by class of loans:					
Residential and land development	291	291	66	304	
Real estate, construction	2,290	1,598	141	1,678	
Real estate, mortgage	13,158	10,629	195	11,662	53
Commercial and industrial	553	515		538	
Other	5	5	1	1	
Total	\$ 16,297	\$ 13,038	\$ 403	\$ 14,183	\$ 53

## 6. Allowance for Loan Losses:

Transactions in the allowance for loan losses for the quarters and nine months ended September 30, 2017 and 2016, and the balances of loans, individually and collectively evaluated for impairment, as of September 30, 2017 and 2016, 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</b>							
<b>September 30, 2017:</b>							
<b>Allowance for Loan Losses:</b>							
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
<b>For the Quarter Ended</b>							
<b>September 30, 2017:</b>							
<b>Allowance for Loan Losses:</b>							
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
<b>Allowance for Loan Losses, September 30, 2017:</b>							
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
<b>Total Loans, September 30, 2017:</b>							
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

	Gaming	Residential and Land Development	Real Estate, Construction	Real Estate, Mortgage	Commercial and Industrial	Other	Total
For the Nine Months Ended September 30, 2016:							
Allowance for Loan Losses:							
Beginning balance	\$ 582	\$ 189	\$ 589	\$ 5,382	\$ 1,075	\$ 253	\$ 8,070
Charge-offs			(173)	(700)	(509)	(153)	(1,535)
Recoveries			57	107	61	50	275
Provision	48	20	(113)	(24)	127	79	137
Ending Balance	\$ 630	\$ 209	\$ 360	\$ 4,765	\$ 754	\$ 229	\$ 6,947
For the Quarter Ended September 30, 2016:							
Allowance for Loan Losses:							
Beginning Balance	\$ 582	\$ 202	\$ 375	\$ 4,976	\$ 718	\$ 256	\$ 7,109
Charge-offs				(147)		(59)	(206)
Recoveries			19	8	1	16	44
Provision	48	7	(34)	(72)	35	16	
Ending Balance	\$ 630	\$ 209	\$ 360	\$ 4,765	\$ 754	\$ 229	\$ 6,947
Allowance for Loan Losses, September 30, 2016:							
Ending balance: individually evaluated for impairment	\$	\$ 109	\$ 239	\$ 1,311	\$ 218	\$ 17	\$ 1,894
Ending balance: collectively evaluated for impairment	\$ 630	\$ 100	\$ 121	\$ 3,454	\$ 536	\$ 212	\$ 5,053
Total Loans, September 30, 2016:							
Ending balance: individually evaluated for impairment	\$	\$ 300	\$ 2,285	\$ 35,260	\$ 1,733	\$ 33	\$ 39,611
Ending balance: collectively evaluated for impairment	\$ 33,442	\$ 610	\$ 38,062	\$ 167,348	\$ 37,359	\$ 7,675	\$ 284,496

## 7. Deposits:

Time deposits of \$100,000 or more at December 31, 2016 included brokered deposits of \$5,000,000, which matured in 2017.

Time deposits of \$250,000 or more totaled approximately \$32,483,000 and \$25,143,000 at September 30, 2017 and December 31, 2016, respectively.

## 8. Shareholders Equity:



On September 20, 2017, the Company declared a dividend of \$ .01 per share. The dividend had a record date of October 2, 2017 and a payment date of October 13, 2017.

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, 2017 and December 31, 2016 are as follows (in thousands):

	Total	Fair Value Measurements Using		
		Level 1	Level 2	Level 3
<b>September 30, 2017:</b>				
U.S. Treasuries	\$ 133,577	\$	\$ 133,577	\$
U.S. Government agencies	19,972		19,972	
Mortgage-backed securities	77,203		77,203	
States and political subdivisions	14,578		14,578	
Equity securities	458		458	
<b>Total</b>	<b>\$ 245,788</b>	<b>\$</b>	<b>\$ 245,788</b>	<b>\$</b>
<b>December 31, 2016:</b>				
U.S. Treasuries	\$ 147,624	\$	\$ 147,624	\$
U.S. Government agencies	24,825		24,825	
Mortgage-backed securities	42,708		42,708	
States and political subdivisions	17,963		17,963	
Equity securities	458		458	
<b>Total</b>	<b>\$ 233,578</b>	<b>\$</b>	<b>\$ 233,578</b>	<b>\$</b>

Impaired loans, which are measured at fair value on a non-recurring basis, by level within the fair value hierarchy as of September 30, 2017 and December 31, 2016 are as follows (in thousands):

	Total	Fair Value Measurements Using		
		Level 1	Level 2	Level 3
September 30, 2017	\$ 5,134	\$	\$	\$ 5,134
December 31, 2016	5,006			5,006

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, 2017 and December 31, 2016 are as follows (in thousands):

		Fair Value Measurements Using		
	Total	Level 1	Level 2	Level 3
September 30, 2017	\$ 8,081	\$	\$	\$ 8,081
December 31, 2016	8,513			8,513

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 Months Ended September 30, 2017	For the Year Ended December 31, 2016
Balance, beginning of period	\$ 8,513	\$ 9,916
Loans transferred to ORE	1,356	1,903
Sales	(1,391)	(2,524)
Writedowns	(397)	(782)
Balance, end of period	\$ 8,081	\$ 8,513

The carrying value and estimated fair value of financial instruments, by level within the fair value hierarchy, at September 30, 2017 and December 31, 2016, are as follows (in thousands):

	Carrying Amount	Fair Value Measurements Using			Total
		Level 1	Level 2	Level 3	
<b>September 30, 2017:</b>					
<b>Financial Assets:</b>					
Cash and due from banks	\$ 42,278	\$ 42,278	\$	\$	\$ 42,278
Available for sale securities	245,788		245,788		245,788
Held to maturity securities	49,405		49,303		49,303
Other investments	2,729	2,729			2,729
Federal Home Loan Bank stock	544		544		544
Loans, net	266,671			262,170	262,170
Other real estate	8,081			8,081	8,081
Cash surrender value of life insurance	18,153		18,153		18,153
<b>Financial Liabilities:</b>					
<b>Deposits:</b>					
Non-interest bearing	147,975	147,975			147,975
Interest bearing	397,092			397,562	397,562
Borrowings from Federal Home Loan Bank	1,216		1,509		1,509

	Carrying Amount	Fair value Level 1	Measurements Level 2	Using Level 3	Total
<b>December 31, 2016:</b>					
<b>Financial Assets:</b>					
Cash and due from banks	\$ 41,116	\$ 41,116	\$	\$	\$ 41,116
Available for sale securities	233,578		233,578		233,578
Held to maturity securities	48,150		46,935		46,935
Other investments	2,693	2,693			2,693
Federal Home Loan Bank stock	539		539		539
Loans, net	309,889			313,613	313,613
Other real estate	8,513			8,513	8,513
Cash surrender value of life insurance	19,249		19,249		19,249
<b>Financial Liabilities:</b>					
<b>Deposits:</b>					
Non-interest bearing	132,381	132,381			132,381
Interest bearing	442,635			442,937	442,937
Borrowings from Federal Home Loan Bank	6,257		6,491		6,491

## **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, 2016.

### **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) has issued several new accounting standards updates for the first three quarters of 2017 which are disclosed in the Notes to Unaudited Consolidated Financial Statements. The Company does not generally expect that these updates will have a material effect on its financial position or results of operations but the effect of ASU 2016-13 is still being considered.



## **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, 2017 and 2016 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,	
	2017	2016	2017	2016
<b>Interest income reconciliation:</b>				
Interest income - taxable equivalent	\$ 4,751	\$ 4,753	\$ 14,232	\$ 14,401
Taxable equivalent adjustment	(128)	(160)	(410)	(478)
<b>Interest income (GAAP)</b>	<b>\$ 4,623</b>	<b>\$ 4,593</b>	<b>\$ 13,822</b>	<b>\$ 13,923</b>
<b>Net interest income reconciliation:</b>				
Net interest income - taxable equivalent	\$ 4,362	\$ 4,486	\$ 13,219	\$ 13,625
Taxable equivalent adjustment	(128)	(160)	(410)	(478)
<b>Net interest income (GAAP)</b>	<b>\$ 4,234</b>	<b>\$ 4,326</b>	<b>\$ 12,809</b>	<b>\$ 13,147</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 \$236,000 for the third quarter of 2017 compared with net income of \$406,000 for the third quarter of 2016 and net income of \$1,463,000 for the first three quarters of 2017 compared with net income of \$543,000 for the first three quarters of 2016. 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.

Managing the net interest margin in the Company's highly competitive market and in the 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 2017 as compared with the third quarter of 2016 decreased \$92,000 as the reduction in interest and fees on loans was offset by the increase in interest and dividends on securities. Net interest income for the three quarters ended September 30, 2017, decreased \$338,000 as compared with the three quarters ended September 30, 2016 as the reduction in interest and fees on loans decreased more than the increase in interest expense on deposits.

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 \$29,000 and \$85,000 for the third quarter and first three quarters of 2017, respectively, compared with no provision and \$137,000, respectively, for the third quarter and first three quarters of 2016. The Company is working diligently to address and reduce its non-performing assets. The Company's nonaccrual loans totaled \$14,384,000 and \$11,854,000 at September 30, 2017 and December 31, 2016, 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 \$156,000 and increased \$390,000 for the third quarter and first three quarters of 2017 as compared with 2016. The decrease for the third quarter of 2017 as compared with the third quarter of 2016 was primarily the result of the prior year including a gain from the sale of bank premises. The increase for the first three quarters of 2017 as compared with the first three quarters of 2016 was a result of the gain discussed in the Overview.

Non-interest expense decreased \$107,000 and \$400,000 for the third quarter and first three quarters of 2017 as compared with 2016 results. The decrease for the third quarter of 2017 was primarily the result of decreases in net occupancy expenses of \$66,000 and FDIC and state banking assessments of \$102,000, which were partially offset by an increase in Other real estate expense of \$279,000 as compared with 2016. This decrease for the first three quarters of 2017 was the result of decreases in net occupancy expenses of \$250,000 and FDIC and state banking assessments of \$334,000, which were partially offset by an increase in Other real estate expense of \$135,000 as compared with 2016.

Total assets at September 30, 2017 decreased \$31,027,000 as compared with December 31, 2016. Available for sale securities increased \$12,210,000 as excess funds were invested to increase earnings. Total loans decreased \$42,532,000 as principal payments, maturities, charge-offs and foreclosures relating to existing loans outpaced new loans. Total deposits decreased \$29,949,000 at September 30, 2017 as compared with December 31, 2016 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.

### Quarter Ended September 30, 2017 as Compared with Quarter Ended September 30, 2016

The Company's average interest-earning assets decreased approximately \$12,876,000, or 2%, from approximately \$604,008,000 for the third quarter of 2016 to approximately \$591,132,000 for the third quarter of 2017. Average held to maturity taxable securities increased approximately

\$21,538,000 and average available for sale taxable securities increased approximately \$46,819,000 as a result of the decrease in average balances due from financial institutions and average loans. Average balances due from financial institutions decreased \$29,325,000 as the Company's liquidity needs decreased. The Company's average loans decreased approximately \$44,389,000 as principal payments, maturities, charge-offs and foreclosures relating to existing loans outpaced new loans.

The average yield on earning assets increased by 6 basis points, from 3.15% for the third quarter of 2016 to 3.21% for the third quarter of 2017. The yield on average loans increased from 4.40% for the third quarter of 2016 to 4.53% for the third quarter of 2017 primarily as a result of the effect of the increase in prime rate during 2016 and 2017 on the Company's floating rate loans. The yield on average taxable available for sale securities increased from 1.27% for the third quarter of 2016 to 1.52% for the third quarter of 2017 as the Company has changed its investment strategy to improve yield while not compromising duration and credit risk.

Average interest-bearing liabilities decreased approximately \$10,639,000, or 2%, from approximately \$443,591,000 for the third quarter of 2016 to approximately \$432,952,000 for the third quarter of 2017. Average savings and interest-bearing DDA balances decreased \$7,850,000 primarily as a result of one large public fund reallocating most of their balance to another institution. Average borrowings from the Federal Home Loan Bank decreased approximately \$5,694,000 due to the reduced liquidity needs of the bank subsidiary.

The average rate paid on interest-bearing liabilities for the third quarter of 2016 was .24% as compared with .36% for the third quarter of 2017. The increase was the result of time deposit rates increasing in our trade area and the Company being able to pay off lower rate borrowings from FHLB.

The Company's net interest margin on a tax-equivalent basis, which is net interest income as a percentage of average earning assets, was 2.97% for the third quarter of 2016 as compared with 2.95% for the third quarter of 2017.

#### Nine Months Ended September 30, 2017 as Compared with Nine Months Ended September 30, 2016

The Company's average interest-earning assets increased approximately \$13,349,000, or 2%, from approximately \$592,372,000 for the first three quarters of 2016 to approximately \$605,721,000 for the first three quarters of 2017. Average held to maturity taxable securities increased approximately \$24,538,000 and average available for sale taxable securities increased approximately \$27,743,000 as a result of the decrease in average loans. The Company's average loans decreased approximately \$36,530,000 as principal payments, maturities, charge-offs and foreclosures relating to existing loans outpaced new loans.

The average yield on earning assets decreased by 11 basis points, from 3.24% for the first three quarters of 2016 to 3.13% for the first three quarters of 2017. This decrease was the result of the increase in volume in lower yielding assets, such as investment securities, as compared with higher yielding assets, such as loans.

Average interest-bearing liabilities increased approximately \$638,000, or 1%, from approximately \$446,475,000 for the first three quarters of 2016 to approximately \$447,113,000 for the first three quarters of 2017. Average savings and interest bearing DDA balances increased approximately \$4,605,000 and average time deposits increased \$3,483,000 primarily as customers in the casino industry and county and municipal entities reallocate their balances periodically. Average borrowings from the Federal Home Loan Bank decreased approximately \$7,450,000 due to the liquidity needs of the bank subsidiary.

The average rate paid on interest-bearing liabilities for the first three quarters of 2016 was .23% compared with .30% for the first three quarters of 2017 as a result of the increase in prime rate.

The Company's net interest margin on a tax-equivalent basis, which is net interest income as a percentage of average earning assets, was 3.07% for the first three quarters of 2016 as compared with 2.91% for the first three quarters of 2017.

The tables on the following pages analyze the changes in tax-equivalent net interest income for the quarters and nine months ended September 30, 2017 and 2016.

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

(In Thousands)

	Quarter Ended September 30, 2017			Quarter Ended September 30, 2016		
	Average Balance	Interest Earned/Paid	Rate	Average Balance	Interest Earned/Paid	Rate
Loans (2)(3)	\$ 279,771	\$ 3,165	4.53%	\$ 324,160	\$ 3,568	4.40%
Balances due from depository institutions	25,409	148	2.33%	54,734	95	0.69%
HTM:						
Taxable	30,131	207	2.75%	8,593	60	0.01%
Non taxable (1)	18,802	177	3.77%	19,981	191	3.82%
AFS:						
Taxable	221,196	842	1.52%	174,377	553	1.27%
Non taxable (1)	14,821	204	5.51%	20,422	277	5.43%
Other	1,002	8	3.19%	1,741	9	2.07%
Total	\$ 591,132	\$ 4,751	3.21%	\$ 604,008	\$ 4,753	3.15%
Savings & interest-bearing DDA	\$ 350,100	\$ 218	0.25%	\$ 357,950	\$ 116	0.13%
Time deposits	81,632	163	0.80%	78,727	121	0.61%
Borrowings from FHLB	1,220	8	2.62%	6,914	30	1.74%
Total	\$ 432,952	\$ 389	0.36%	\$ 443,591	\$ 267	0.24%
Net tax-equivalent spread			2.86%			2.91%
Net tax-equivalent margin on earning assets			2.95%			2.97%

(1) All interest earned is reported on a taxable equivalent basis using a tax rate of 34% in 2017 and 2016. See disclosure of Non-GAAP financial measures on pages 31 and 32.

(2) Loan fees of \$59 and \$119 for 2017 and 2016, respectively, are included in these figures.

(3) Includes nonaccrual loans.

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

(In Thousands)

	Nine Months Ended September 30, 2017			Nine Months Ended September 30, 2016		
	Average Balance	Interest Earned/Paid	Rate	Average Balance	Interest Earned/Paid	Rate
Loans (2)(3)	\$ 294,492	\$ 9,734	4.41%	\$ 331,022	\$ 10,833	4.36%
Balances due from depository institutions	34,050	384	1.50%	29,814	212	0.95%
HTM:						
Taxable	28,449	524	2.46%	3,911	61	2.08%
Non taxable (1)	19,239	541	3.75%	19,473	541	3.70%
AFS:						
Taxable	212,435	2,370	1.49%	184,692	1,870	1.35%
Non taxable (1)	16,055	665	5.52%	21,482	865	5.37%
Other	1,001	14	1.86%	1,978	19	1.28%
Total	\$ 605,721	\$ 14,232	3.13%	\$ 592,372	\$ 14,401	3.24%
Savings & interest-bearing DDA	\$ 364,732	\$ 535	0.20%	\$ 360,127	\$ 330	0.12%
Time deposits	80,928	446	0.73%	77,445	331	0.57%
Borrowings from FHLB	1,453	32	2.94%	8,903	115	1.72%
Total	\$ 447,113	\$ 1,013	0.30%	\$ 446,475	\$ 776	0.23%
Net tax-equivalent spread			2.83%			3.01%
Net tax-equivalent margin on earning assets			2.91%			3.07%

(1) All interest earned is reported on a taxable equivalent basis using a tax rate of 34% in 2017 and 2016. See disclosure of Non-GAAP financial measures on pages 31 and 32.

(2) Loan fees of \$238 and \$314 for 2017 and 2016, respectively, are included in these figures.

(3) Includes nonaccrual loans.



## Analysis of Changes in Interest Income and Interest Expense

(In Thousands)

	For the Quarter Ended September 30, 2017 compared with September 30, 2016			
	Volume	Rate	Rate/Volume	Total
<b>Interest earned on:</b>				
Loans	\$ (489)	\$ 99	\$ (13)	\$ (403)
Balances due from financial institutions	(51)	224	(120)	53
<b>Held to maturity securities:</b>				
Taxable	150	(1)	(2)	147
Non taxable	(11)	(3)		(14)
<b>Available for sale securities:</b>				
Taxable	148	111	30	289
Non taxable	(76)	4	(1)	(73)
Other	(4)	5	(2)	(1)
<b>Total</b>	<b>\$ (333)</b>	<b>\$ 439</b>	<b>\$ (108)</b>	<b>\$ (2)</b>
<b>Interest paid on:</b>				
Savings & interest-bearing DDA	\$ (3)	\$ 107	\$ (2)	\$ 102
Time deposits	4	36	2	42
Borrowings from FHLB	(25)	15	(12)	(22)
<b>Total</b>	<b>\$ (24)</b>	<b>\$ 158</b>	<b>\$ (12)</b>	<b>\$ 122</b>

## Analysis of Changes in Interest Income and Interest Expense

(In Thousands)

	For the Nine Months Ended			
	September 30, 2017 compared with September 30, 2016			
	Volume	Rate	Rate/Volume	Total
<b>Interest earned on:</b>				
Loans	\$ (1,195)	\$ 108	\$ (12)	\$ (1,099)
Balances due from financial institutions	30	124	18	172
<b>Held to maturity securities:</b>				
Taxable	383	11	69	463
Non taxable	(7)	7		
<b>Available for sale securities:</b>				
Taxable	281	190	29	500
Non taxable	(219)	25	(6)	(200)
Other	(9)	8	(4)	(5)
<b>Total</b>	<b>\$ (736)</b>	<b>\$ 473</b>	<b>\$ 94</b>	<b>\$ (169)</b>
<b>Interest paid on:</b>				
Savings & interest-bearing DDA	\$ 4	\$ 198	\$ 3	\$ 205
Time deposits	15	96	4	115
Borrowings from FHLB	(96)	81	(68)	(83)
<b>Total</b>	<b>\$ (77)</b>	<b>\$ 375</b>	<b>\$ (61)</b>	<b>\$ 237</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 \$14,384,000 and \$11,854,000 at September 30, 2017 and December 31, 2016, respectively, specific reserves of only \$810,000 and \$303,000, 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 \$29,000 for the third quarter of 2017 and \$85,000 and \$137,000 for the first three quarters of 2017 and 2016, respectively. The allowance for loan losses as a percentage of loans was 2.25% and 1.73% at September 30, 2017 and December 31, 2016, respectively. The Company believes that its allowance for loan losses is appropriate as of September 30, 2017.

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, 2017 as Compared with Quarter Ended September 30, 2016

Non-interest income decreased \$156,000 for the third quarter of 2017 as compared with the third quarter of 2016 primarily as the result of the decrease in gain on liquidation, sales and calls of securities and other income. The Company had opportunities to sell securities in order to generate gains in the prior year and, as a result, recognized \$67,000 in 2016. Other income decreased \$108,000 in 2017 as compared with 2016 primarily as a result of the prior year including a gain of \$88,000 from the sale of bank premises.

##### Nine Months Ended September 30, 2017 as Compared with Nine Months Ended September 30, 2016

Non-interest income increased \$390,000 for the first three quarters of 2017 as compared with the first three quarters of 2016 primarily as the result of the increase in income from other investments as well as the gain from death benefits from life insurance. These increases were partially offset by the decrease in other income of \$147,000 in 2017 as compared with 2016. Income from other investments increased \$63,000 from operations of the investment in a low income housing partnership as a result of increased occupancy in 2017 as compared with 2016. 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. Other income decreased \$108,000 in 2017 as compared with 2016 primarily as a result of the prior year including a gain of \$88,000 from the sale of bank premises.

### **Non-interest expense**

#### Quarter Ended September 30, 2017 as Compared with Quarter Ended September 30, 2016

Total non-interest expense decreased \$107,000 for the third quarter of 2017 as compared with the third quarter of 2016. Net occupancy decreased \$66,000, Equipment rentals, depreciation and maintenance decreased \$41,000, FDIC and state banking assessments decreased \$102,000 and other expense decreased \$129,000 while other real estate expense increased \$279,000 in 2017 as compared with 2016.

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

Equipment rentals, depreciation and maintenance primarily decreased as a result of the Company reducing its janitorial costs.

FDIC and state banking assessments decreased as the regulators decreased the premiums for deposit insurance in the current year.

ORE expense increased due to the increase in writedowns in the value of ORE.

Other expense decreased as a result of the reduction of legal, advertising and other costs largely due to the time in which services were performed.

#### Nine Months Ended September 30, 2017 as Compared with Nine Months Ended September 30, 2016

Total non-interest expense decreased \$400,000 for the first three quarters of 2017 as compared with the first three quarters of 2016. Net occupancy decreased \$250,000 and FDIC and state banking assessments decreased \$334,000, while other real estate expense increased \$135,000 in 2017 as compared with 2016.

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

FDIC and state banking assessments decreased as the regulators decreased the premiums for deposit insurance in the current year.

ORE expense increased due to the increase in writedowns in the value of ORE.

## **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.

The Company did record income tax expense of \$78,000 during the second quarter of 2016 relating to the resolution of a recent examination by the Internal Revenue Service.

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 increased \$12,210,000 at September 30, 2017, as compared with December 31, 2016. This is the result of the Company investing excess funds not needed currently for loans in order to improve earnings.

Loans decreased \$42,532,000 at September 30, 2017, as compared with December 31, 2016 as principal payments, maturities, charge-offs and foreclosures relating to existing loans outpaced new loans.

Total deposits decreased \$29,949,000 at September 30, 2017, as compared with December 31, 2016. 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.

## **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, 2017, 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, 2017, the Company must have a capital conservation buffer above these requirements of 1.25% for 2017. 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, 2017 and December 31, 2016, are as follows (in thousands):

	Actual		For Capital Adequacy Purposes	
	Amount	Ratio	Amount	Ratio
<b>September 30, 2017 :</b>				
Total Capital (to Risk Weighted Assets)	\$ 96,231	25.41%	\$ 30,293	8.00%
Common Equity Tier 1 Capital (to Risk Weighted Assets)	91,480	24.16%	17,040	4.50%
Tier 1 Capital (to Risk Weighted Assets)	91,480	24.16%	22,719	6.00%
Tier 1 Capital (to Average Assets)	91,480	13.13%	27,863	4.00%
<b>December 31, 2016:</b>				
Total Capital (to Risk Weighted Assets)	\$ 95,262	22.94%	\$ 33,220	8.00%
Common Equity Tier 1 Capital (to Risk Weighted Assets)	90,068	21.69%	18,687	4.50%
Tier 1 Capital (to Risk Weighted Assets)	90,068	21.69%	24,915	6.00%
Tier 1 Capital (to Average Assets)	90,068	13.12%	27,464	4.00%

The actual capital amounts and ratios and required minimum capital amounts and ratios for the Bank as of September 30, 2017 and December 31, 2016, are as follows (in thousands):

	For Capital Adequacy				To Be Well Capitalized	
	Actual		Purposes		Capitalized	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
<b>September 30, 2017 :</b>						
Total Capital (to Risk Weighted Assets)	\$ 92,980	24.68%	\$ 30,142	8.00%	\$ 37,678	10.00%
Common Equity Tier 1 Capital (to Risk Weighted Assets)	88,252	23.42%	16,955	4.50%	24,491	6.50%
Tier 1 Capital (to Risk Weighted Assets)	88,252	23.42%	22,607	6.00%	30,142	8.00%
Tier 1 Capital (to Average Assets)	88,252	13.13%	26,876	4.00%	33,596	5.00%
<b>December 31, 2016:</b>						
Total Capital (to Risk Weighted Assets)	\$ 91,882	22.29%	\$ 32,975	8.00%	\$ 41,219	10.00%
Common Equity Tier 1 Capital (to Risk Weighted Assets)	86,726	21.04%	18,548	4.50%	26,792	6.50%
Tier 1 Capital (to Risk Weighted Assets)	86,726	21.04%	24,731	6.00%	32,975	8.00%
Tier 1 Capital (to Average Assets)	86,726	12.47%	27,820	4.00%	34,775	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, 2017, 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, 2017 that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

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## 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, 2017, formatted in XBRL (Extensible Business Reporting Language): (i) Consolidated Statements of Condition at September 30, 2017 and December 31, 2016, (ii) Consolidated Statements of Income for the quarters and nine months ended September 30, 2017 and 2016, (iii) Consolidated Statements of Comprehensive Income for the quarters and nine months ended September 30, 2017 and 2016, (iv) Consolidated Statement of Changes in Shareholders' Equity for the nine months ended September 30, 2017, (v) Consolidated Statements of Cash Flows for the nine months ended September 30, 2017 and 2016 and (vi) Notes to the Unaudited Consolidated Financial Statements for the nine months ended September 30, 2017 and 2016.

#### (b) Reports on Form 8-K

A Form 8-K was filed on July 26, 2017, September 20, 2017 and October 25, 2017.



**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, 2017

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

Date: November 13, 2017

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