PEOPLES FINANCIAL CORP /MS/
Form 10-Q
November 13, 2013

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended September 30, 2013

or

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

Commission File Number 001-12103

PEOPLES FINANCIAL CORPORATION

(Exact name of registrant as specified in its charter)

Mississippi	**64-0709834**
(State or other jurisdiction of	**(I.R.S. Employer**

incorporation or organization)	**Identification No.)**
Lameuse and Howard Avenues, Biloxi, Mississippi	**39533**
(Address of principal executive offices)	**(Zip Code)**

(228) 435-5511

(Registrant s telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes x 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 x 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 x

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

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, 2013, 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)

	September 30, 2013 (Unaudited)	December 31, 2012 (Audited)
Assets		
Cash and due from banks	$ 34,642	$ 54,020
Available for sale securities	295,075	258,876
Held to maturity securities, fair value of $11,338 at September 30, 2013; $7,225 at December 31, 2012	11,797	7,125
Other investments	3,265	3,450
Federal Home Loan Bank Stock, at cost	3,065	2,380
Loans	396,422	431,083
Less: Allowance for loan losses	11,696	8,857
Loans, net	384,726	422,226
Bank premises and equipment, net of accumulated depreciation	25,693	26,222
Other real estate	9,426	7,008
Accrued interest receivable	2,671	2,895
Cash surrender value of life insurance	17,302	16,861
Prepaid FDIC assessments	264	1,705
Other assets	8,597	2,144
Total assets	$ 796,523	$ 804,912

Peoples Financial Corporation and Subsidiaries

Consolidated Statements of Condition (continued)

(in thousands except share data)

	September 30, 2013 (Unaudited)	December 31, 2012 (Audited)
Liabilities and Shareholders Equity		
Liabilities:		
Deposits:		
Demand, non-interest bearing	$ 118,003	$ 102,609
Savings and demand, interest bearing	233,010	232,401
Time, $100,000 or more	68,419	94,606
Other time deposits	43,532	46,103
Total deposits	462,964	475,719
Federal funds purchased and securities sold under agreements to repurchase	147,630	194,234
Borrowings from Federal Home Loan Bank	67,242	7,912
Employee and director benefit plans liabilities	12,749	12,162
Other liabilities	3,807	4,131
Total liabilities	694,392	694,158
Shareholders Equity:		
Common stock, $1 par value, 15,000,000 shares authorized, 5,123,186 and 5,136,918 shares issued and outstanding at September 30, 2013 and December 31, 2012, respectively	5,123	5,137
Surplus	65,780	65,780
Undivided profits	35,142	34,964
Accumulated other comprehensive income (loss), net of tax	(3,914)	4,873
Total shareholders equity	102,131	110,754
Total liabilities and shareholders equity	$ 796,523	$ 804,912

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,		Nine Months Ended September 30,	
	2013	**2012**	**2013**	**2012**
Interest income:				
Interest and fees on loans	$ 4,217	$ 4,637	$ 12,995	$ 13,789
Interest and dividends on securities:				
U.S. Treasuries	139	112	430	281
U.S. Government agencies	828	861	2,307	3,101
Mortgage-backed securities	228	82	458	233
States and political subdivisions	384	376	1,140	1,116
Other investments	6	10	12	15
Interest on federal funds sold	3	3	67	12
Total interest income	5,805	6,081	17,409	18,547
Interest expense:				
Deposits	293	318	928	1,162
Borrowings from Federal Home Loan Bank	43	60	124	179
Federal funds purchased and securities sold under agreements to repurchase	38	81	127	298
Total interest expense	374	459	1,179	1,639
Net interest income	5,431	5,622	16,230	16,908
Provision for allowance for loan losses	542	541	4,619	2,371
Net interest income after provision for allowance for loan losses	$ 4,889	$ 5,081	$ 11,611	$ 14,537

Peoples Financial Corporation and Subsidiaries

Consolidated Statements of Income (continued)

(in thousands except per share data)(unaudited)

	Three Months Ended September 30, 2013	Three Months Ended September 30, 2012	Nine Months Ended September 30, 2013	Nine Months Ended September 30, 2012
Non-interest income:				
Trust department income and fees	$ 368	$ 440	$ 1,062	$ 1,111
Service charges on deposit accounts	1,618	1,472	4,649	4,356
Gain on sales and calls of securities	3	336	258	1,301
Gain (loss) on other investments	36	(48)	45	(84)
Loss on impairment of other investments		(180)		(180)
Increase in cash surrender value of life insurance	121	119	364	366
Other income	160	164	460	450
Total non-interest income	2,306	2,303	6,838	7,320
Non-interest expense:				
Salaries and employee benefits	3,005	2,964	8,996	9,283
Net occupancy	544	610	1,780	1,885
Equipment rentals, depreciation and maintenance	722	731	2,164	2,385
FDIC assessments	162	449	607	1,334
Data processing	305	328	925	1,064
ATM expense	635	519	1,826	1,493
Other expense	1,041	983	2,742	2,694
Total non-interest expense	6,414	6,584	19,040	20,138
Income (loss) before income tax expense (benefit)	781	800	(591)	1,719
Income tax expense (benefit)	(105)	50	(936)	(97)
Net income	$ 886	$ 750	$ 345	$ 1,816
Basic and diluted earnings per share	$ .18	$ .14	$ .07	$ .35

Dividends declared per share	$		$	.10	$		$	.10

See notes to consolidated financial statements.

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Peoples Financial Corporation and Subsidiaries

Consolidated Statements of Comprehensive Income (Loss)

(in thousands)(unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2013	**2012**	**2013**	**2012**
Net income	$ 886	$ 750	$ 345	$ 1,816
Other comprehensive income (loss), net of tax:				
Net unrealized gain (loss) on available for sale securities, net of tax of $981 and $220 for the three months ended September 30, 2013 and 2012, respectively, and $4,439 and $655 for the nine months ended September 30, 2013 and 2012, respectively	(1,904)	427	(8,617)	1,272
Reclassification adjustment for realized gains on available for sale securities called or sold, net of tax of $1 and $114 for the three months ended September 30, 2013 and 2012, respectively, and $88 and $443 for the nine months ended September 30, 2013 and 2012, respectively	(2)	(222)	(170)	(858)
Total other comprehensive income (loss)	(1,906)	205	(8,787)	414
Total comprehensive income (loss)	$ (1,020)	$ 955	$ (8,442)	$ 2,230

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	Undivided Profits	Accumulated Other Comprehensive Income	Total
Balance, January 1, 2013	5,136,918	$ 5,137	$ 65,780	$ 34,964	$ 4,873	$ 110,754
Net income				345		345
Other comprehensive loss, net of tax					(8,787)	(8,787)
Retirement of common stock	(13,732)	(14)		(167)		(181)
Balance, September 30, 2013	5,123,186	$ 5,123	$ 65,780	$ 35,142	$ (3,914)	$ 102,131

Note: Balances as of January 1, 2013 were audited.

See notes to consolidated financial statements.

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Peoples Financial Corporation and Subsidiaries

Consolidated Statements of Cash Flows

(in thousands)(unaudited)

	Nine Months Ended September 30, 2013	2012
Cash flows from operating activities:		
Net income	$ 345	$ 1,816
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation	1,331	1,560
Provision for allowance for loan losses	4,619	2,371
Loss on sales of other real estate	59	27
Writedown of other real estate	46	153
Gain on sales of bank premises and equipment	(15)	
(Gain) loss on other investments	(45)	84
Loss on impairment on other investments		180
Gain on sales and calls of securities	(258)	(1,301)
Accretion of held to maturity securities	(2)	(1)
Change in accrued interest receivable	224	267
Increase in cash surrender value of life insurance	(364)	(366)
Change in other assets	756	642
Change in other liabilities	(1,393)	(22)
Net cash provided by operating activities	$ 5,303	$ 5,410

Peoples Financial Corporation and Subsidiaries

Consolidated Statements of Cash Flows (continued)

(in thousands)(unaudited)

	Nine Months Ended September 30, 2013	2012
Cash flows from investing activities:		
Proceeds from maturities, sales and calls of available for sale securities	$ 125,329	$ 298,643
Purchases of available for sale securities	(174,169)	(307,299)
Purchases of held to maturity securities	(4,670)	(5,561)
(Purchases) redemption of Federal Home Loan Bank stock	(685)	(225)
Redemption of other investments	230	36
Proceeds from sales of bank premises and equipment	19	
Proceeds from sales of other real estate	1,115	1,150
Insurance proceeds from casualty loss on other real estate	57	
Loans, net change	29,186	(8,894)
Acquisition of bank premises and equipment	(806)	(88)
Investment in cash surrender value of life insurance	(77)	(77)
Net cash used in investing activities	(24,471)	(22,315)
Cash flows from financing activities:		
Demand and savings deposits, net change	16,003	46,442
Time deposits, net change	(28,758)	(16,865)
Cash dividends		(514)
Retirement of common stock	(181)	
Borrowings from Federal Home Loan Bank	212,500	1,557,866
Repayments to Federal Home Loan Bank	(153,170)	(1,560,723)
Federal funds purchased and securities sold under agreements to repurchase, net change	(46,604)	(19,525)
Net cash provided by (used in) financing activities	(210)	6,681
Net decrease in cash and cash equivalents	(19,378)	(10,224)
Cash and cash equivalents, beginning of period	54,020	36,929
Cash and cash equivalents, end of period	$ 34,642	$ 26,705

See notes to consolidated financial statements.

PEOPLES FINANCIAL CORPORATION AND SUBSIDIARIES

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

For the Nine Months Ended September 30, 2013 and 2012

1. Basis of Presentation:

Peoples Financial Corporation (the Company) is a one-bank holding company headquartered in Biloxi, Mississippi. Its two operating subsidiaries are The Peoples Bank, Biloxi, Mississippi (the Bank), and PFC Service Corp. Its principal subsidiary is The Peoples Bank, Biloxi, Mississippi, which provides a full range of banking, financial and trust services to state, county and local government entities and individuals and small and commercial businesses operating in 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, 2013 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 2012 Annual Report and Form 10-K.

The results of operations for the quarter or nine months ended September 30, 2013, are not necessarily indicative of the results to be expected for the full year.

Use of Estimates - The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the reported period. Actual results could differ from those estimates. Material estimates common to the banking industry that are particularly susceptible to significant change in the near term include, but are not limited to, the determination of the allowance for loan losses, the valuation of other real estate acquired in connection with foreclosure or in satisfaction of loans and valuation allowances associated with the realization of deferred tax assets, which are based on future taxable income.

Summary of Significant Accounting Policies - The accounting and reporting policies of the Company conform with GAAP and general practices within the banking industry. There have been no material changes or developments in the application of principles or in our evaluation of the accounting estimates and the underlying assumptions or methodologies that we believe to be Critical Accounting Policies as disclosed in our Form 10-K for the year ended December 31, 2012.

2. Earnings Per Share:

Per share data is based on the weighted average shares of common stock outstanding of 5,123,316 and 5,136,918 for the quarters ended September 30, 2013 and 2012, respectively, and 5,130,811 and 5,136,918 for the nine months ended September 30, 2013 and 2012, respectively.

3. Statements of Cash Flows:

The Company has defined cash and cash equivalents as cash and due from banks. The Company paid $1,198,021 and $1,648,779 for the nine months ended September 30, 2013 and 2012, respectively, for interest on deposits and borrowings. Income tax payments of $810,000 and $615,000 were made during the nine months ended September 30, 2013 and 2012, respectively. Loans transferred to other real estate amounted to $3,695,825 and $2,545,780 during the nine months ended September 30, 2013 and 2012, respectively. Dividends payable of $513,692 as of December 31, 2011 were paid during the first quarter of 2012.

4. Investments:

The amortized cost and fair value of securities at September 30, 2013 and December 31, 2012, are as follows (in thousands):

September 30, 2013	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Available for sale securities:				
Debt securities:				
U.S. Treasuries	$ 49,626	$ 106	$ (815)	$ 48,917
U.S. Government agencies	165,761	819	(9,274)	157,306
Mortgage-backed securities	53,257	233	(1,065)	52,425
States and political subdivisions	34,516	1,263	(2)	35,777
Total debt securities	303,160	2,421	(11,156)	294,425
Equity securities	650			650
Total available for sale securities	$ 303,810	$ 2,421	$ (11,156)	$ 295,075
Held to maturity securities:				
States and political subdivisions	$ 11,797	$ 14	$ (473)	$ 11,338
Total held to maturity securities	$ 11,797	$ 14	$ (473)	$ 11,338

December 31, 2012	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Available for sale securities:				
Debt securities:				
U.S. Treasuries	$ 53,661	$ 490	$ (55)	$ 54,096
U.S. Government agencies	147,652	1,810	(364)	149,098
Mortgage-backed securities	16,903	538		17,441
States and political subdivisions	35,433	2,158		37,591
Total debt securities	253,649	4,996	(419)	258,226
Equity securities	650			650
Total available for sale securities	$ 254,299	$ 4,996	$ (419)	$ 258,876
Held to maturity securities:				
States and political subdivisions	$ 7,125	$ 112	$ (12)	$ 7,225
Total held to maturity securities	$ 7,125	$ 112	$ (12)	$ 7,225

The amortized cost and fair value of debt securities at September 30, 2013 (in thousands), by contractual maturity, are shown on the next 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
Available for sale securities:		
Due in one year or less	$ 21,798	$ 21,930
Due after one year through five years	59,022	59,258
Due after five years through ten years	74,949	74,516
Due after ten years	94,134	86,296
Mortgage-backed securities	53,257	52,425
Totals	$ 303,160	$ 294,425
Held to maturity securities:		
Due in one year or less	$ 1,012	$ 1,015
Due after one year through five years	1,774	1,772
Due after five years through ten years	5,562	5,425
Due after ten years	3,449	3,126
Totals	$ 11,797	$ 11,338

Available for Sale and Held to Maturity Securities with gross unrealized losses at September 30, 2013 and December 31, 2012, 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, 2013:						
U.S. Treasuries	$ 29,927	$ 815	$	$	$ 29,927	$ 815
U.S. Government agencies	119,480	9,274			119,480	9,274
Mortgage-backed securities	34,788	1,065			34,788	1,065
States and political subdivisions	7,974	475			7,974	475
TOTAL	$ 192,169	$ 11,629	$	$	$ 192,169	$ 11,629
December 31, 2012:						
U.S. Treasuries	$ 9,887	$ 55	$	$	$ 9,887	$ 55
U.S. Government agencies	30,335	364			30,335	364
States and political subdivisions	1,451	12			1,451	12
TOTAL	$ 41,673	$ 431	$	$	$ 41,673	$ 431

At September 30, 2013, 7 of the 12 securities issued by the U.S. Treasury, 25 of the 33 securities issued by U.S. Government agencies, 8 of the 13 mortgage-backed securities and 1 of the 111 securities issued by states and political subdivisions 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.

Securities with a fair value of $272,556,976 and $241,879,775 at September 30, 2013 and December 31, 2012, respectively, were pledged to secure public deposits, federal funds purchased and other balances required by law.

Proceeds from the sale of available for sale debt securities were $26,075,225 and $63,339,638 for the nine months ended September 30, 2013 and 2012, respectively. Available for sale debt securities were sold for a realized gain of $257,997 and $1,300,547 for the nine months ended September 30, 2013 and 2012, respectively.

5. Loans:

The composition of the loan portfolio at September 30, 2013 and December 31, 2012, is as follows (in thousands):

	September 30, 2013	December 31, 2012
Gaming	$ 42,567	$ 60,187
Residential and land development	26,810	27,338
Real estate, construction	44,605	52,586
Real estate, mortgage	239,020	246,420
Commercial and industrial	34,864	35,004
Other	8,556	9,548
Total	$ 396,422	$ 431,083

The age analysis of the loan portfolio, segregated by class of loans, as of September 30, 2013 and December 31, 2012, is as follows (in thousands):

	Number of Days Past Due						Loans Past Due Greater Than 90
	30 - 59	60 - 89	Greater Than 90	Total Past Due	Current	Total Loans	Days & Still Accruing
September 30, 2013:							
Gaming	$	$	$	$	$ 42,567	$ 42,567	$
Residential and land development	58		20,911	20,969	5,841	26,810	
Real estate, construction	2,403	1,788	2,243	6,434	38,171	44,605	15
Real estate, mortgage	7,374	2,771	5,748	15,893	223,127	239,020	251
Commercial and industrial	1,442	41	8	1,491	33,373	34,864	8
Other	94	7	28	129	8,427	8,556	29
Total	$ 11,371	$ 4,607	$ 28,938	$ 44,916	$ 351,506	$ 396,422	$ 303
December 31, 2012:							
Gaming	$	$ 1,721	$	$ 1,721	$ 58,466	$ 60,187	$
Residential and land development			5,765	5,765	21,573	27,338	
Real estate, construction	3,989	878	6,151	11,018	41,568	52,586	572
Real estate, mortgage	12,012	2,702	7,605	22,319	224,101	246,420	872
Commercial and industrial	1,804	79	107	1,990	33,014	35,004	
Other	127	26	1	154	9,394	9,548	1
Total	$ 17,932	$ 5,406	$ 19,629	$ 42,967	$ 388,116	$ 431,083	$ 1,445

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 - F is applied. A grade of A will generally be applied to loans for customers that are well known to the Company and that have excellent sources of repayment. A grade of B will generally be applied to loans for customers that have excellent sources of repayment which have no identifiable risk of collection. A grade of C will generally be applied to loans for customers that have adequate sources of repayment which have little identifiable risk of collection. Loans with a grade of C may be placed on the watch list if weaknesses are not resolved which could result in potential loss or for other circumstances that require monitoring. 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, 2013 and December 31, 2012, is as follows (in thousands):

	Loans With A Grade Of:					
	A or B	C	D	E	F	Total
September 30, 2013:						
Gaming	$ 26,179	$ 2,500	$	$ 13,888	$	$ 42,567
Residential and land development	4,292	1,544	58	20,916		26,810
Real estate, construction	38,251	784	2,300	3,270		44,605
Real estate, mortgage	205,851	4,476	17,400	11,293		239,020
Commercial and industrial	31,675	684	2,476	29		34,864
Other	8,450	25	52	29		8,556
Total	$ 314,698	$ 10,013	$ 22,286	$ 49,425	$	$ 396,422
December 31, 2012:						
Gaming	$ 27,530	$ 12,300	$ 4,108	$ 16,249	$	$ 60,187
Residential and land development	4,630	1,544	81	21,083		27,338
Real estate, construction	43,318	1,001	2,701	5,566		52,586
Real estate, mortgage	209,479	3,093	21,167	12,681		246,420
Commercial and industrial	32,036	442	2,312	214		35,004
Other	9,449	27	72			9,548
Total	$ 326,442	$ 18,407	$ 30,441	$ 55,793	$	$ 431,083

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, 2013 and December 31, 2012, are as follows (in thousands):

	September 30, 2013	December 31, 2012
Gaming	$ 12,016	$ 16,249
Residential and land development	20,916	21,083
Real estate, construction	2,863	5,171
Real estate, mortgage	9,800	11,174
Commercial and industrial		214
Total	$ 45,595	$ 53,891

The Company has modified certain loans by granting interest rate concessions to these customers. These loans are in compliance with their modified terms, are currently accruing and the Company has classified them as troubled debt restructurings. Troubled debt restructurings as of September 30, 2013 and December 31, 2012 were as follows (in thousands except for number of contracts):

	Number of Contracts	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment	Related Allowance
September 30, 2013:				
Real estate, construction	2	$ 900	$ 900	$ 276
Real estate, mortgage	3	9,048	9,048	827
Commercial and industrial	1	680	680	
Total	6	$ 10,628	$ 10,628	$ 1,103
December 31, 2012:				
Real estate, construction	3	$ 1,095	$ 1,095	$ 340
Real estate, mortgage	3	9,054	9,054	957
Commercial and industrial	1	702	702	
Total	7	$ 10,851	$ 10,851	$ 1,297

Impaired loans, which include loans classified as nonaccrual and troubled debt restructurings, segregated by class of loans, as of September 30, 2013 and December 31, 2012, are as follows (in thousands):

	Unpaid Principal Balance	Recorded Investment	Related Allowance	Average Recorded Investment	Interest Income Recognized
September 30, 2013:					
With no related allowance recorded:					
Gaming	$ 10,786	$ 10,786	$	$ 11,712	$
Residential and land development	4,430	4,430		4,478	
Real estate, construction	2,448	2,448		2,144	13
Real estate, mortgage	9,741	9,141		9,114	10
Commercial and industrial	680	680		692	17
Total	$ 28,085	$ 27,485	$	$ 28,140	$ 40
With a related allowance recorded:					
Gaming	$ 1,704	$ 1,230	$ 626	$ 1,346	$
Residential and land development	17,590	16,486	3,149	16,536	
Real estate, construction	1,315	1,315	424	1,255	14
Real estate, mortgage	9,707	9,707	1,338	9,812	212
Total	$ 30,316	$ 28,738	$ 5,537	$ 28,949	$ 226
Total by class of loans:					
Gaming	$ 12,490	$ 12,016	$ 626	$ 13,058	$
Residential and land development	22,020	20,916	3,149	21,014	
Real estate, construction	3,763	3,763	424	3,399	27
Real estate, mortgage	19,448	18,848	1,338	18,926	222
Commercial and industrial	680	680		692	17
Total	$ 58,401	$ 56,223	$ 5,537	$ 57,089	$ 266

	Unpaid Principal Balance	Recorded Investment	Related Allowance	Average Recorded Investment	Interest Income Recognized
December 31, 2012:					
With no related allowance recorded:					
Gaming	$ 14,528	$ 14,528	$	$ 14,869	$
Residential and land development	21,837	20,733		21,288	
Real estate, construction	4,635	4,580		3,833	
Real estate, mortgage	9,971	9,935		9,821	
Commercial and industrial	892	892		791	23
Total	$ 51,863	$ 50,668	$	$ 50,602	$ 23
With a related allowance recorded:					
Gaming	$ 1,721	$ 1,721	$ 1,100	$	$
Residential and land development	350	350	70	350	
Real estate, construction	1,694	1,686	663	1,314	8
Real estate, mortgage	10,893	10,293	1,229	10,199	319
Commercial and industrial	24	24	12		
Total	$ 14,682	$ 14,074	$ 3,074	$ 11,863	$ 327
Total by class of loans:					
Gaming	$ 16,249	$ 16,249	$ 1,100	$ 14,869	$
Residential and land development	22,187	21,083	70	21,638	
Real estate, construction	6,329	6,266	663	5,147	8
Real estate, mortgage	20,864	20,228	1,229	20,020	319
Commercial and industrial	916	916	12	791	23
Total	$ 66,545	$ 64,742	$ 3,074	$ 62,465	$ 350

6. Allowance for Loan Losses:

Transactions in the allowance for loan losses for the quarters and nine months ended September 30, 2013 and 2012, and the balances of loans, individually and collectively evaluated for impairment as of September 30, 2013 and 2012, are as follows (in thousands):

	Gaming	Residential and Land Development	Real Estate, Construction	Real Estate, Mortgage	Commercial and Industrial	Other	Total
For the Nine Months Ended September 30, 2013:							
Allowance for Loan Losses:							
Beginning Balance	$ 1,541	$ 200	$ 967	$ 5,273	$ 593	$ 283	$ 8,857
Charge-offs	(474)		(947)	(623)	(21)	(173)	(2,238)
Recoveries	65	67	79	150	24	73	458
Provision	(143)	3,068	586	999	4	105	4,619
Ending Balance	$ 989	$ 3,335	$ 685	$ 5,799	$ 600	$ 288	$ 11,696
For the Quarter Ended September 30, 2013:							
Allowance for Loan Losses:							
Beginning Balance	$ 986	$ 3,343	$ 1,330	$ 5,588	$ 627	$ 276	$ 12,150
Charge-offs			(900)	(342)	(21)	(43)	(1,306)
Recoveries	65		79	148	2	16	310
Provision	(62)	(8)	176	405	(8)	39	542
Ending Balance	$ 989	$ 3,335	$ 685	$ 5,799	$ 600	$ 288	$ 11,696
Allowance for loan losses, September 30, 2013:							
Ending balance: individually evaluated for impairment	$ 626	$ 3,149	$ 651	$ 2,128	$ 330	$ 33	$ 6,917
Ending balance: collectively evaluated for impairment	$ 363	$ 186	$ 34	$ 3,671	$ 270	$ 255	$ 4,779
Total Loans, September 30, 2013:							
Ending balance: individually evaluated for impairment	$ 13,888	$ 20,974	$ 5,570	$ 28,693	$ 2,505	$ 80	$ 71,710
Ending balance: collectively evaluated for impairment	$ 28,679	$ 5,836	$ 39,035	$ 210,327	$ 32,359	$ 8,476	$ 324,712

	Gaming	Residential and Land Development	Real Estate, Construction	Real Estate, Mortgage	Commercial and Industrial	Other	Total
For the Nine Months Ended September 30, 2012:							
Allowance for Loan Losses:							
Beginning Balance	$ 457	$ 1,081	$ 937	$ 4,800	$ 557	$ 304	$ 8,136
Charge-offs	(275)	(1,103)	(474)	(1,243)	(203)	(224)	(3,522)
Recoveries					27	76	103
Provision	313	223	31	1,543	117	144	2,371
Ending Balance	$ 495	$ 201	$ 494	$ 5,100	$ 498	$ 300	$ 7,088
For the Quarter Ended September 30, 2012:							
Allowance for Loan Losses:							
Beginning Balance	$ 474	$ 203	$ 449	$ 4,876	$ 457	$ 284	$ 6,743
Charge-offs				(141)	(43)	(45)	(229)
Recoveries					13	20	33
Provision	21	(2)	45	365	71	41	541
Ending Balance	$ 495	$ 201	$ 494	$ 5,100	$ 498	$ 300	$ 7,088
Allowance for loan losses, September 30, 2012:							
Ending balance: individually evaluated for impairment	$	$	$ 431	$ 1,798	$ 268	$ 38	$ 2,535
Ending balance: collectively evaluated for impairment	$ 495	$ 201	$ 63	$ 3,302	$ 230	$ 262	$ 4,553
Total Loans, September 30, 2012:							
Ending balance: individually evaluated for impairment	$ 24,816	$ 21,322	$ 8,714	$ 36,072	$ 2,787	$ 79	$ 93,790
Ending balance: collectively evaluated for impairment	$ 36,711	$ 6,242	$ 45,755	$ 211,739	$ 31,456	$ 9,643	$ 341,546

7. Deposits:

At September 30, 2013, time deposits of $100,000 or more include brokered deposits of $5,000,000, which mature in 2017.

8. Fair Value Measurements and Disclosures:

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

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

Fair Value Hierarchy

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

These levels are:

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

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

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

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

Cash and Due from Banks

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

Available for Sale Securities

The fair value of available for sale securities is based on quoted market prices. The Company s available for sale securities are reported at their estimated fair value, which is determined utilizing several sources. The primary source is Interactive Data Corporation, which utilizes pricing models that vary based on asset class and include available trade, bid and other market information and whose methodology includes broker quotes, proprietary models and vast descriptive databases. The other source for determining fair value is matrix pricing, which is a mathematical technique used widely in the industry to value debt securities without relying exclusively on quoted prices for the specific securities but rather by relying on the securities relationship to other benchmark securities. All of the Company s available for sale securities are Level 2 assets.

Held to Maturity Securities

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

Other Investments

The carrying amount shown as other investments approximates fair value.

Federal Home Loan Bank Stock

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

Loans

The fair value of fixed rate loans is estimated by discounting the future cash flows using the current rates at which similar loans would be made to borrowers with similar credit ratings for the remaining maturities. The cash flows considered in computing the fair value of such loans are segmented into categories relating to the nature of the contract and collateral based on contractual principal maturities. Appropriate adjustments are made to reflect probable credit losses. Cash flows have not been adjusted for such factors as prepayment risk or the effect of the maturity of balloon notes. The fair value of floating rate loans is estimated to be its carrying value. At each reporting period, the Company determines which loans are impaired. Accordingly, the Company s impaired loans are reported at their estimated fair value on a non-recurring basis. An allowance for each impaired loan, which are generally collateral-dependent, is calculated based on the fair value of its collateral. The fair value of the collateral is based on appraisals performed by third-party valuation specialists. Factors including the assumptions and techniques utilized by the appraiser are considered by Management. If the recorded investment in the impaired loan exceeds the measure of fair value of the collateral, a valuation allowance is recorded as a component of the allowance for loan losses. When the fair value of the collateral is based on an observable market price, the Company records the impaired loan as a non-recurring Level 2 asset. When an appraised value is not available or Management determines the fair value of the collateral is further impaired below the appraised value and there is no observable market price, the Company records the impaired loan as a non-recurring Level 3 asset.

Other Real Estate

In the course of lending operations, Management may determine that it is necessary to foreclose on the related collateral. Other real estate acquired through foreclosure is carried at fair value, less estimated costs to sell. The fair value of the collateral is based on appraisals performed by third-party valuation specialists. Factors including the assumptions and techniques utilized by the appraiser are considered by Management. If the current appraisal is more than one year old and/or the loan balance is more than $200,000, a new appraisal is obtained. Otherwise, the Bank s in-house property evaluator and Management will determine the fair value of the collateral, based on comparable sales, market conditions, Management s plans for disposition and other estimates of fair value obtained from principally independent sources, adjusted for estimated selling costs. When the fair value of the property is based on observable market price, the Company records the other real estate as a non-recurring Level 2 asset. When an appraised value is not available or Management determines the fair value of the other real estate is further impaired below the appraised value and there is no observable market price, the Company records the other real estate as a non-recurring Level 3 asset.

Cash Surrender Value of Life Insurance

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

Deposits

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

Federal Funds Purchased and Securities Sold under Agreements to Repurchase

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

Borrowings from Federal Home Loan Bank

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

Commitments to Extend Credit and Standby Letters of Credit

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

The balances of available for sale securities, which are the only assets measured at fair value on a recurring basis, by level within the fair value hierarchy and by investment type, as of September 30, 2013 and December 31, 2012 are as follows (in thousands):

		Fair Value Measurements Using		
	Total	Level 1	Level 2	Level 3
September 30, 2013:				
U.S. Treasuries	$ 48,917	$	$ 48,917	$
U.S. Government agencies	157,306		157,306	
Mortgage-backed securities	52,425		52,425	
States and political subdivisions	35,777		35,777	
Equity securities	650		650	
Total	$ 295,075	$	$ 295,075	$
December 31, 2012:				
U.S. Treasuries	$ 54,096	$	$ 54,096	$
U.S. Government agencies	149,098		149,098	
Mortgage-backed securities	17,441		17,441	
States and political subdivisions	37,591		37,591	
Equity securities	650		650	
Total	$ 258,876	$	$ 258,876	$

Impaired loans, which are measured at fair value on a non-recurring basis, by level within the fair value hierarchy as of September 30, 2013 and December 31, 2012 are as follows (in thousands):

		Fair Value Measurements Using		
	Total	Level 1	Level 2	Level 3
September 30, 2013	$ 23,498	$	$	$ 23,498

December 31, 2012	16,030	16,030

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

	For the Nine Months Ended September 30, 2013	For the Year Ended December 31, 2012
Balance, beginning of period	$ 16,030	$ 14,770
Additions to impaired loans and troubled debt restructurings	16,464	2,960
Principal payments, charge-offs and transfers to other real estate	(6,533)	(1,654)
Change in allowance for loan losses on impaired loans	(2,463)	(46)
Balance, end of period	$ 23,498	$ 16,030

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, 2013 and December 31, 2012 are as follows (in thousands):

		Fair Value Measurements Using		
	Total	Level 1	Level 2	Level 3
September 30, 2013	$ 9,426	$	$	$ 9,426
December 31, 2012	7,008			7,008

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, 2013	For the Year Ended December 31, 2012
Balance, beginning of period	$ 7,008	$ 6,153
Loans transferred to ORE	3,695	2,576
Sales	(1,174)	(1,568)
Writedowns	(46)	(153)
Insurance proceeds for casualty loss	(57)	

Balance, end of period	$	9,426	$	7,008

The carrying value and estimated fair value of assets and liabilities, by level within the fair value hierarchy, at September 30, 2013 and December 31, 2012, are as follows (in thousands):

	Carrying	Fair Value Measurements Using			
	Amount	Level 1	Level 2	Level 3	Total
September 30, 2013:					
Financial Assets:					
Cash and due from banks	$ 34,642	$ 34,642	$	$	$ 34,642
Available for sale securities	295,075		295,075		295,075
Held to maturity securities	11,797		11,338		11,338
Other investments	3,265	3,265			3,265
Federal Home Loan Bank stock	3,065		3,065		3,065
Loans, net	384,726			389,654	389,654
Other real estate	9,426			9,426	9,426
Cash surrender value of life insurance	17,302			17,302	17,302
Financial Liabilities:					
Deposits:					
Non-interest bearing	118,003	118,003			118,003
Interest bearing	344,961			346,078	346,078
Federal funds purchased and securities sold under agreements to repurchase	147,630	147,630			147,630
Borrowings from Federal Home Loan Bank	67,242		69,434		69,434
December 31, 2012:					
Financial Assets:					
Cash and due from banks	$ 54,020	$ 54,020	$	$	$ 54,020
Available for sale securities	258,876		258,876		258,876
Held to maturity securities	7,125		7,225		7,225
Other investments	3,450	3,450			3,450
Federal Home Loan Bank stock	2,380		2,380		2,380
Loans, net	422,226			425,627	425,627
Other real estate	7,008			7,008	7,008
Cash surrender value of life insurance	16,861			16,861	16,861
Financial Liabilities:					
Deposits:					
Non-interest bearing	102,609	102,609			102,609
Interest bearing	373,110			376,209	376,209
Federal funds purchased and securities sold under agreements to repurchase	194,234	194,234			194,234
Borrowings from Federal Home Loan Bank	7,912		10,271		10,271

9. Reclassifications:

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

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

The Company is a one-bank holding company headquartered in Biloxi, Mississippi. 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 its 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, 2012.

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

In January 2013, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) No. 2013-01, *Balance Sheet (Topic 210), Clarifying the Scope of Disclosures about Offsetting Assets and Liabilities*. The amendments limit the scope of ASU 2011-11, *Disclosures about Offsetting Assets and Liabilities*, to certain derivative instruments (including bifurcated embedded derivatives), repurchase agreements and reverse repurchase agreements, and securities borrowing and lending arrangements that are either (1) offset on the balance sheet or (2) subject to an enforceable master netting arrangement or similar agreement. This ASU amends the scope of FASB ASU No. 2011-11, *Disclosures about Offsetting Assets and Liabilities*, which requires additional disclosure regarding offsetting of assets and liabilities to enable users of financial statements to evaluate the effect or potential effect of netting arrangements on an entity s financial position. The effective date of the amendments coincides with that of ASU 2011-11 (i.e., for fiscal years beginning on or after January 1, 2013, and interim periods within those years). The amendments will be applied retrospectively for all comparative periods presented on the balance sheet. The adoption of the guidance did not have a material impact on the Company s financial position, results of operations or disclosures.

In February 2013, the FASB issued ASU No. 2013-02, *Reporting of Amounts Reclassified Out of Accumulated Other Comprehensive Income*. The amendments in this update require an entity to provide information about the amounts reclassified out of accumulated other comprehensive income by component and by the respective line items of net income. The standard was effective for fiscal years, and interim periods within those years, beginning after December 15, 2012. This guidance did not have a material impact on the Company s financial position or results of operations, and resulted in additional disclosures.

In July 2013, the FASB issued ASU No. 2013-11, *Income Taxes (Topic 740)*, which clarifies the presentation requirements of unrecognized tax benefits when a net operating loss carryforward, a similar tax loss, or a tax credit carryforward exists at the reporting date. The amendments in this ASU are effective for fiscal years, and interim periods within those years, beginning after December 15, 2014 and should be applied prospectively. 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.

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.

Allowance for loan losses:

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

Other Real Estate:

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

Employee Benefit Plans:

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

Income Taxes:

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

OVERVIEW

The Company is a community bank serving the financial and trust needs of its customers in its trade area of south Mississippi, southeast Louisiana and southwest Alabama. 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 recorded net income of $886,000 for the third quarter of 2013 compared with net income of $750,000 for the third quarter of 2012 and net income of $345,000 for the first three quarters of 2013 as compared with net income of $1,816,000 for the first three quarters of 2012. The provision for the allowance for loan losses was $542,000 for the third quarter of 2013 compared with $541,000 for the third quarter of 2012. The provision for the allowance for loan losses was $4,619,000 for the first three quarters of 2013 compared with $2,371,000 for the first three quarters of 2012. Current year results for the third quarter included a reduction in net interest income and a decrease in non-interest expense as compared with 2012 results. Current year results for the first three quarters included a reduction in net interest income, non-interest income and non-interest expense as compared with 2012 results.

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. Interest income decreased $276,000 and $1,138,000 for the third quarter and first three quarters of 2013 as compared with 2012. This decrease is the result of the decrease in loan commitment fees and the decrease in the volume of loans in 2013 as compared with 2012. Interest expense decreased $85,000 and $460,000 for the third quarter and first three quarters of 2013 as compared with 2012 primarily due to a reduction in the cost of funds.

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 and national economy continues to negatively impact collateral values and borrowers ability to repay their loans. The Company s nonaccrual loans totaled $45,595,000 and $53,891,000 at September 30, 2013 and December 31, 2012, respectively. Most of these loans are collateral-dependent, and the Company has rigorously evaluated the value of its collateral to determine potential losses. The Company is working diligently to reduce past due and nonaccrual loans. As part of resolving problem loans, foreclosures have increased in 2013 with Other Real Estate increasing to $9,426,000 at September 30, 2013.

Non-interest income increased $3,000 for the third quarter of 2013 as compared with 2012 results and decreased $482,000 for the first three quarters of 2013 as compared with 2012 results. The decrease was primarily the result of decreased gains on sales and calls of securities in 2013 as compared with 2012.

Non-interest expense decreased $170,000 for the third quarter of 2013 as compared with 2012 results and decreased $1,098,000 for the first three quarters ended September 30, 2013 as compared with

2012 results. These decreases were the result of decreases in depreciation, FDIC assessments and data processing costs in 2013 as compared with 2012.

Total assets at September 30, 2013 decreased $8,389,000 as compared with December 31, 2012. Available for sale securities increased $36,199,000 at September 30, 2013 as compared with December 31, 2012, with funds available from the net decrease in loans of $34,661,000. Total deposits decreased $12,755,000 at September 30, 2013 as compared with December 31, 2012. During the third quarter of 2013, brokered deposits, which are reported as Time deposits of $100,000 or more, of $23,612,000 matured. Federal funds purchased and securities sold under agreements to repurchase decreased $46,604,000 as customers reallocated their funds from a non-deposit account. Borrowings from the Federal Home Loan Bank increased at September 30, 2013 as compared with December 31, 2012, as a result of the liquidity needs of the bank subsidiary.

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.

<u>Quarter Ended September 30, 2013 as Compared with Quarter Ended September 30, 2012</u>

The Company s average interest earning assets decreased approximately $28,620,000, or 4%, from approximately $739,873,000 for the third quarter of 2012 to approximately $711,253,000 for the third quarter of 2013. The Company s average balance sheet decreased primarily as loans decreased during the quarter as principal payments, maturities, charge-offs and foreclosures relating to existing loans have outpaced new loans.

The average yield on earning assets decreased by 1 basis point, from 3.39% for the third quarter of 2012 to 3.38% for the third quarter of 2013. The yield on loans has been impacted by reduced loan fees and a decrease in loans earning interest. The Company has more recently purchased securities with maturities of up to fifteen years, with call provisions, to improve its yield on these assets. Future security purchases may be of shorter duration in anticipation of rising rates in the future.

Average interest bearing liabilities decreased approximately $27,037,000, or 5%, from approximately $591,759,000 for the third quarter of 2012 to approximately $564,722,000 for the third quarter of 2013. The decrease in CD s is primarily attributable to the maturity of brokered accounts during the third quarter of 2013. The decrease in borrowings from the Federal Home Loan Bank was due to the liquidity needs of the bank subsidiary during the quarter.

The average rate paid on interest bearing liabilities decreased 5 basis points, from .31% for the third quarter of 2012 to .26% for the third quarter of 2013. The current unprecedented low rate environment which exists on a national and local level has caused customers to generally tolerate lower interest rates in return for less risk. The Company believes that it is unlikely that its cost of funds can be materially reduced further; however, any opportunity to do so will be considered.

The Company s net interest margin on a tax-equivalent basis, which is net income as a percentage of average earning assets, was 3.17% for the quarter ended September 30, 2013, up 3 basis points from 3.14% for the quarter ended September 30, 2012.

Nine Months Ended September 30, 2013 as Compared with Nine Months Ended September 30, 2012

The Company s average interest earning assets decreased approximately $18,174,000, or 2%, from approximately $758,464,000 for the first three quarters of 2012 to approximately $740,290,000 for the first three quarters of 2013. The Company s average balance sheet decreased as investments and loans decreased during the nine month periods. Pledging requirements for public funds decreased in 2013, allowing for a reduction in available for sale securities. Loans have decreased as principal payments, maturities, charge-offs and foreclosures relating to existing loans have outpaced new loans.

The average yield on earning assets decreased by 12 basis points, from 3.36% for the first three quarters of 2012 to 3.24% for the first three quarters of 2013. The yield on loans has been impacted by reduced loan fees and a decrease in loans earning interest. The Company has more recently purchased securities with maturities of up to fifteen years, with call provisions, to improve its yield on these assets. Future security purchases may be of shorter duration in anticipation of rising rates in the future.

Average interest bearing liabilities decreased approximately $25,567,000, or 4%, from approximately $616,149,000 for the first three quarters of 2012 to approximately $590,582,000 for the first three quarters of 2013. The decrease was primarily related to the maturity of brokered CD s and reduced borrowings from the Federal Home Loan Bank, which decreased due to the liquidity needs of the bank subsidiary.

The average rate paid on interest bearing liabilities decreased 8 basis points, from .35% for the first three quarters of 2012 to .27% for the first three quarters of 2013. The current unprecedented low rate environment which exists on a national and local level has caused customers to tolerate lower interest rates in return for less risk. The Company believes that it is unlikely that its cost of funds can be materially reduced further; however, any opportunity to do so will be considered.

The Company s net interest margin on a tax-equivalent basis, which is net income as a percentage of average earning assets, was 3.03% for the nine months ended September 30, 2013, down 4 basis points from 3.07% for the three quarters ended September 30, 2012.

The tables on the following pages analyze the changes in tax-equivalent net interest income for the quarters ended September 30, 2013 and 2012 and the nine months ended September 30, 2013 and 2012.

Analysis of Average Balances, Interest Earned/Paid and Yield

(In Thousands)

	Three Months Ended September 30, 2013			Three Months Ended September 30, 2012		
	Average Balance	Interest Earned/Paid	Rate	Average Balance	Interest Earned/Paid	Rate
Loans (2)(3)	$ 400,355	$ 4,217	4.21%	$ 430,241	$ 4,637	4.31%
Federal funds sold	7,805	3	0.15%	5,193	3	0.23%
HTM:						
Non taxable (1)	11,788	97	3.29%	5,719	57	3.99%
AFS:						
Taxable	253,553	1,195	1.89%	255,497	1,054	1.65%
Non taxable (1)	35,905	485	5.40%	39,151	513	5.24%
Other	1,847	6	1.30%	4,072	10	0.98%
Total	$ 711,253	$ 6,003	3.38%	$ 739,873	$ 6,274	3.39%
Savings & interest-bearing DDA	$ 237,141	$ 42	0.07%	$ 232,016	$ 66	0.11%
CD s	120,737	251	0.83%	149,169	252	0.68%
Federal funds purchased	188,932	38	0.08%	159,273	81	0.20%
FHLB advances	17,912	43	0.96%	51,301	60	0.47%
Total	$ 564,722	$ 374	0.26%	$ 591,759	$ 459	0.31%
Net tax-equivalent margin on earning assets			3.17%			3.14%

(1) All interest earned is reported on a taxable equivalent basis using a tax rate of 34% in 2013 and 2012.
(2) Loan fees of $104 and $160 for 2013 and 2012, 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, 2013			Nine Months Ended September 30, 2012		
	Average Balance	Interest Earned/Paid	Rate	Average Balance	Interest Earned/Paid	Rate
Loans (2)(3)	$ 410,921	$ 12,995	4.22%	$ 428,944	$ 13,789	4.29%
Federal funds sold	34,371	67	0.26%	6,184	12	0.26%
HTM:						
Non taxable (1)	9,412	259	3.67%	3,876	121	4.16%
AFS:						
Taxable	246,918	3,195	1.73%	275,638	3,615	1.75%
Non taxable (1)	36,955	1,468	5.30%	39,745	1,569	5.26%
Other	1,713	12	0.93%	4,077	15	0.49%
Total	$ 740,290	$ 17,996	3.24%	$ 758,464	$ 19,121	3.36%
Savings & interest-bearing DDA	$ 253,401	$ 139	0.07%	$ 231,942	$ 367	0.21%
CD s	128,608	789	0.82%	151,464	795	0.70%
Federal funds purchased	197,328	127	0.09%	171,456	298	0.23%
FHLB advances	11,245	124	1.47%	61,287	179	0.39%
Total	$ 590,582	$ 1,179	0.27%	$ 616,149	$ 1,639	0.35%
Net tax-equivalent margin on earning assets			3.03%			3.07%

(1) All interest earned is reported on a taxable equivalent basis using a tax rate of 34% in 2013 and 2012.
(2) Loan fees of $350 and $549 for 2013 and 2012, respectively, are included in these figures.
(3) Includes nonaccrual loans.

Analysis of Changes in Interest Income and Interest Expense

(In Thousands)

	For the Three Months Ended September 30, 2013 compared with September 30, 2012			
	Volume	Rate	Rate/Volume	Total
Interest earned on:				
Loans	$ (322)	$ (105)	$ 7	$ (420)
Federal funds sold	2	(1)	(1)	
Held to maturity securities:				
Non taxable	60	(10)	(10)	40
Available for sale securities:				
Taxable	(8)	150	(1)	141
Non taxable	(42)	16	(2)	(28)
Other	(5)	3	(2)	(4)
Total	$ (315)	$ 53	$ (9)	$ (271)
Interest paid on:				
Savings & interest-bearing DDA	$ 2	$ (25)	$ (1)	$ (24)
CD s	(48)	58	(11)	(1)
Federal funds purchased	15	(49)	(9)	(43)
FHLB advances	(39)	63	(41)	(17)
Total	$ (70)	$ 47	$ (62)	$ (85)

Analysis of Changes in Interest Income and Interest Expense

(In Thousands)

	For the Nine Months Ended September 30, 2013 compared with September 30, 2012			
	Volume	Rate	Rate/Volume	Total
Interest earned on:				
Loans	$ (579)	$ (224)	$ 9	$ (794)
Federal funds sold	54	1		55
Held to maturity securities:				
Non taxable	173	(14)	(21)	138
Available for sale securities:				
Taxable	(377)	(48)	5	(420)
Non taxable	(110)	10	(1)	(101)
Other	(9)	14	(8)	(3)
Total	$ (848)	$ (261)	$ (16)	$ (1,125)
Interest paid on:				
Savings & interest-bearing DDA	$ 34	$ (240)	$ (22)	$ (228)
CD s	(120)	134	(20)	(6)
Federal funds purchased	45	(188)	(28)	(171)
FHLB advances	(146)	497	(406)	(55)
Total	$ (187)	$ 203	$ (476)	$ (460)

Provision for Loan Losses

In the normal course of business, the Company assumes risk in extending credit to its customers. This credit risk is managed through compliance with the loan policy, which is approved by the Board of Directors. The policy establishes guidelines relating to underwriting standards, including but not limited to financial analysis, collateral valuation, lending limits, pricing considerations and loan grading. The Company s Loan Review and Special Assets Departments play key roles in monitoring the loan portfolio and managing problem loans. New loans and, on a periodic basis, existing loans are reviewed to evaluate compliance with the loan policy. Loan customers in concentrated industries such as gaming and hotel/motel, as well as the exposure for out of area; residential and land development; construction and commercial real estate loans; and their direct and indirect impact on its operations are evaluated on a monthly basis. Loan delinquencies and deposit overdrafts are closely monitored in order to identify developing problems as early as possible. Lenders experienced in workout scenarios consult with loan officers and customers to address non-performing loans. A watch list of credits which pose a potential loss to the Company is prepared based on the loan grading system. This list forms the foundation of the Company s allowance for

loan loss computation.

Management relies on its guidelines and existing methodology to monitor the performance of its loan portfolio and identify and estimate potential losses based on the best available information. The potential effect resulting from the economic downturn on a national and local level, the decline in real estate values and actual losses incurred by the Company were key factors in our analysis. Much of the Company s loan portfolio is collateral-dependent, requiring careful consideration of changes in the value of the collateral.

The Company s on-going, systematic evaluation resulted in the Company recording a provision for loan losses of $542,000 and $541,000 for the third quarters of 2013 and 2012, respectively, and $4,619,000 and $2,371,000 for the first three quarters of 2013 and 2012, respectively. The allowance for loan losses as a percentage of loans was 2.95% and 2.05% at September 30, 2013 and December 31, 2012, respectively.

The Company s analysis includes evaluating the current values of collateral securing all nonaccrual loans. Included in nonaccrual loans is one out of area residential development loan with a balance of $15,295,000 at September 30, 2013. This loan was on nonaccrual for two years without a specific reserve. Specific conditions which developed during the second quarter of 2013 resulted in the Company assigning a $3,000,000 specific reserve to this credit. Even though nonaccrual loans were $45,595,000 and $53,891,000 at September 30, 2013 and December 31, 2012, respectively, specific reserves of only $4,434,000 and $1,777,000, 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 believes that its allowance for loan losses is appropriate as of September 30, 2013.

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, 2013 as Compared with Quarter Ended September 30, 2012

Non-interest income increased $3,000 for the third quarter of 2013 as compared with the third quarter of 2012.

Trust department income and fees decreased $72,000 in 2013 as compared with 2012 as a result of the decrease in market value, on which fees are based, of personal trust accounts.

Service charges on deposit accounts increased by $146,000 during the third quarter of 2013 as compared with the third quarter of 2012. Fees from service charges increased $33,000 as a result of the Company raising per account and per transaction fees during the third quarter of 2013. NSF fee income decreased $44,000 and ATM fee income increased $150,000. While NSF fee fluctuations are difficult to predict or analyze, it appears that customers may change their overdraft activity based on general economic conditions. ATM fee income increased primarily from an increase in transactions at off-site ATMs at casinos, which have seen some increase in their business in recent months.

During the third quarter of 2013, gains from sales and calls of securities decreased $333,000 in comparison with the third quarter of 2012 as sales were executed when proceeds would be maximized.

Income from other investments increased $84,000 for the third quarter of 2013 as compared with the third quarter of 2012.

The Company had a loss from impairment of its other investments of $180,000 in 2012.

Nine Months Ended September 30, 2013 as Compared with Nine Months Ended September 30, 2012

Non-interest income decreased $482,000 for the first three quarters of 2013 as compared with the first three quarters of 2012.

Trust department income and fees decreased $49,000 in 2013 as compared with 2012 as a result of the decrease in market value, on which fees are based, of personal trust accounts.

Service charges on deposit accounts increased by $293,000 during the first three quarters of 2013 as compared with the first three quarters of 2012. Fees from service charges increased $16,000 as a result of the Company raising per account and per transaction fees during the third quarter of 2013. NSF fee income decreased $127,000 and ATM fee income increased $391,000. While NSF fee fluctuations are difficult to predict or analyze, it appears that customers may change their overdraft activity based on general economic conditions. ATM fee income increased primarily from an increase in transactions at off-site ATMs at casinos, which have seen some increase in their business in recent months.

During 2013, gains from sales and calls of securities decreased $1,043,000 in comparison with 2012 as sales were executed when proceeds would be maximized.

Income from other investments increased $129,000 in 2013 as compared with 2012.

The Company had a loss from impairment of its other investments of $180,000 in 2012.

Non-interest expense

Quarter Ended September 30, 2013 as Compared with Quarter Ended September 30, 2012

Total non-interest expense decreased $170,000 for the third quarter of 2013 as compared with the third quarter of 2012. Salaries and employee benefits increased $41,000; net occupancy decreased $66,000; FDIC assessments decreased $287,000; data processing expenses decreased $23,000, ATM expense increased $116,000 and other expense increased $58,000 for the third quarter of 2013 as compared with the third quarter of 2012.

The increase in salaries and employee benefits was primarily the net result of an increase in salaries and decrease in costs relating to benefit plans. Salaries increased $106,000 in the third quarter of 2013 as compared with the third quarter of 2012 due to merit raises. Costs associated with the Company s benefit plans decreased $70,000 as a result of over accrual of these costs earlier in 2013.

The decrease in net occupancy expenses was primarily the result of a decrease in property taxes, insurance and telephone costs. Property tax expense decreased $36,000 in 2013 as compared with 2012 as the Company had overaccrued such expense in the first three quarters of 2012. Insurance expense decreased $21,000 in 2013 as compared with 2012 as a result of the refund of previously paid premiums. Telephone costs were $21,000 higher in 2012 as a result of additional telecommunication services. These decreases were partially offset by an increase in utility expenses of $12,000 in 2013 as compared with 2012.

FDIC assessments decreased as a result of the change in estimate of the prepaid assessment which was identified during the fourth quarter of 2012.

Data processing costs decreased in 2013 as the prior year s costs included several additional services and projects.

ATM expenses increased in 2013 as a result of increased ATM activity in the current year.

Other expense increased in 2013 as a result of costs incurred to produce a new advertising campaign.

Nine Months Ended September 30, 2013 as Compared with Nine Months Ended September 30, 2012

Total non-interest expense decreased $1,098,000 for the first three quarters of 2013 as compared with the first three quarters of 2012. Salaries and employee benefits decreased $287,000; net occupancy decreased $105,000; Equipment rentals, depreciation and maintenance decreased $221,000; FDIC assessments decreased $727,000; data processing expenses decreased $139,000; ATM expense increased $333,000 and other expense increased $48,000 for the first three quarters of 2013 as compared with the first three quarters of 2012.

The decrease in salaries and employee benefits was primarily the net result of an increase in salaries and decrease in costs relating to benefit plans. Salaries increased $127,000 in 2013 as compared with the third quarter of 2012 due to merit raises. Costs associated with the Company s benefit plans decreased $422,000 as a result of over accrual of these costs earlier in 2013.

The decrease in net occupancy expenses was primarily the result of a decrease in property taxes. Property tax expense decreased $108,000 in 2013 as compared with 2012 as the Company had overaccrued such expense in the first three quarters of 2012.

The decrease in equipment rentals, depreciation and maintenance expense was primarily the result of a decrease in depreciation and maintenance costs. Depreciation costs have decreased by $229,000 in 2013, as computer and other equipment acquired after Hurricane Katrina in 2005 are now fully depreciated.

FDIC assessments decreased as a result of the change in estimate of the prepaid assessment which was identified during the fourth quarter of 2012.

Data processing costs decreased in 2013 as the prior year s costs included several additional services and projects.

ATM expenses increased in 2013 as a result of increased ATM activity in the current year.

Other expense increased in 2013 as a result of costs incurred to produce a new advertising campaign.

Income Taxes (Benefit)

Income taxes have been impacted by non-taxable income and federal tax credits during the quarters and nine months ended September 30, 2013 and 2012, as follows (in thousands except rate):

	Three Months Ended September 30,			
	2013		2012	
	Tax	Rate	Tax	Rate
Taxes at statutory rate	$ 265	34	$ 272	34
Increase (decrease) resulting from:				
Tax-exempt interest income	(249)	(32)	(103)	(13)
Income from BOLI	(42)	(5)	(41)	(5)
Federal tax credits	(74)	(9)	(91)	(11)
Other	(5)	(1)	13	1
Total income taxes (benefit)	$ (105)	(13)	$ 50	6

	Nine Months Ended September 30,			
	2013		2012	
	Tax	Rate	Tax	Rate
Taxes at statutory rate	$ (201)	(34)	$ 584	34
Increase (decrease) resulting from:				
Tax-exempt interest income	(395)	(66)	(303)	(18)
Income from BOLI	(124)	(21)	(124)	(7)
Federal tax credits	(222)	(38)	(274)	(16)
Other	6	1	20	1
Total income taxes (benefit)	$ (936)	(158)	$ (97)	(6)

FINANCIAL CONDITION

Available for sale securities increased $36,199,000 at September 30, 2013, compared with December 31, 2012. Funds available from maturities and sales of available for sale securities and the decrease in loans were invested in available for sale securities. The Company recorded an unrealized loss of $12,899,000 on its available for sale securities for the nine months ended September 30, 2013 as a result of fluctuations in market values.

Held to maturity securities increased $4,672,000 at September 30, 2013, compared with December 31, 2012, as the Company opted to classify some of its investment purchases during 2013 as held to maturity.

Other investments decreased $185,000 at September 30, 2013, as compared with December 31, 2012, primarily as a result of a liquidating distribution of $230,000.

The Company increased its investment in Federal Home Loan Bank (FHLB) stock by $685,000 at September 30, 2013 as compared with December 31, 2012 to increase its borrowing capacity from FHLB during the period.

Loans decreased $34,661,000 at September 30, 2013 compared with December 31, 2012, as maturities, charge-offs and principal reductions of existing loans exceeded new loans.

Other real estate (ORE) increased $2,418,000 at September 30, 2013 as compared with December 31, 2012. Loans totaling $3,695,000 were transferred into ORE while $1,174,000 was sold for a loss of $59,000 during the first nine months of 2013.

Prepaid FDIC assessments decreased by $1,441,000 at September 30, 2013 as compared with December 31, 2012 as a result of the amortization of these costs and reimbursement of $1,177,000 from the FDIC of the remaining balance of its prepaid assessment.

Other assets increased $6,453,000 at September 30, 2013 as compared with December 31, 2012 as deferred tax assets increased $5,768,000 as the decrease in fair value of available for sale securities reduced an unrealized gain and other prepaid assets and receivables increased $685,000.

Total deposits decreased $12,755,000 at September 30, 2013, as compared with December 31, 2012. 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. In addition, brokered deposits of $23,612,000 matured during the third quarter of 2013.

Federal funds purchased and securities sold under agreements to repurchase decreased $46,604,000 at September 30, 2013 as compared with December 31, 2012 as several county and municipal entities reallocated their balances from a non-deposit account during 2013.

Borrowings from Federal Home Loan Bank increased $59,330,000 in the management of the Company s liquidity position.

Employee and director benefit plans liabilities increased $587,000 at September 30, 2013 as compared with December 31, 2012 due to deferred compensation benefits earned by officers and directors during 2013.

Other liabilities decreased $324,000 at September 30, 2013 as compared with December 31, 2012 as a result of the payment of property tax and certain officer incentives which had been accrued at December 31, 2012.

SHAREHOLDERS EQUITY AND CAPITAL ADEQUACY

Strength, security and stability have been the hallmark of the Company since its founding in 1985 and of its bank subsidiary since its founding in 1896. A strong capital foundation is fundamental to the continuing prosperity of the Company and the security of its customers and shareholders.

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

As of September 30, 2013, the most recent notification from the Federal Deposit Insurance Corporation categorized the bank subsidiary as well capitalized under the regulatory framework for prompt corrective action. To be categorized as well capitalized, the bank subsidiary must have a Total risk-based capital ratio of 10.00% or greater, a Tier 1 risk-based capital ratio of 6.00% or greater and a Leverage capital ratio of 5.00% or greater. There are no conditions or events since that notification that Management believes have changed the bank subsidiary s category.

The actual capital amounts and ratios and required minimum capital amounts and ratios for the Company as of September 30, 2013 and December 31, 2012, are as follows (in thousands):

	Actual		For Capital Adequacy Purposes	
	Amount	Ratio	Amount	Ratio
September 30, 2013:				
Total Capital (to Risk Weighted Assets)	$ 112,311	22.10%	$ 40,663	8.00%
Tier 1 Capital (to Risk Weighted Assets)	105,892	20.85%	20,331	4.00%
Tier 1 Capital (to Average Assets)	105,892	13.28%	31,906	4.00%
December 31, 2012:				
Total Capital (to Risk Weighted Assets)	$ 112,342	21.29%	$ 42,216	8.00%
Tier 1 Capital (to Risk Weighted Assets)	105,728	20.04%	21,108	4.00%
Tier 1 Capital (to Average Assets)	105,728	13.07%	32,361	4.00%

The actual capital amounts and ratios and required minimum capital amounts and ratios for the Bank as of September 30, 2013 and December 31, 2012, are as follows (in thousands):

	Actual		For Capital Adequacy Purposes		To Be Well Capitalized	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
September 30, 2013:						
Total Capital (to Risk Weighted Assets)	$ 108,024	21.28%	$ 40,602	8.00%	$ 50,753	10.00%
Tier 1 Capital (to Risk Weighted Assets)	101,614	20.02%	20,301	4.00%	30,452	6.00%
Tier 1 Capital (to Average Assets)	101,614	12.88%	31,552	4.00%	39,440	5.00%
December 31, 2012:						
Total Capital (to Risk Weighted Assets)	$ 107,885	20.47%	$ 42,148	8.00%	$ 52,685	10.00%
Tier 1 Capital (to Risk Weighted Assets)	101,241	19.22%	21,074	4.00%	31,611	6.00%
Tier 1 Capital (to Average Assets)	101,241	12.62%	32,086	4.00%	40,108	5.00%

In addition to monitoring its risk-based capital ratios, the Company also determines the primary capital ratio on a quarterly basis. This ratio was 14.04% at September 30, 2013, which is well above the regulatory minimum of 6.00%. Management continues to emphasize the importance of maintaining the appropriate capital levels of the Company and has established the goal of maintaining its primary capital ratio at 8.00%, which is the minimum requirement for classification as being well-capitalized by the banking regulatory authorities.

LIQUIDITY

Liquidity represents the Company s ability to adequately provide funds to satisfy demands from depositors, borrowers and other commitments by either converting assets to cash or accessing new or existing sources of funds. Management monitors these funds requirements in such a manner as to satisfy these demands and provide the maximum earnings on its earning assets. The Company manages and monitors its liquidity position through a number of methods, including through the computation of liquidity risk targets and the preparation of various analyses of its funding sources and utilization of those sources on a monthly basis. The Company also uses proforma liquidity projections which are updated on a 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 2009, Management identified opportunities for improving risk management, addressing asset quality concerns, managing concentrations of credit risk and ensuring sufficient liquidity at the Bank as a result of its own investigation as well as examinations performed by certain bank regulatory agencies. In concert with the regulators, the Company and the Bank identified specific corrective steps and actions to enhance its risk management, asset quality and liquidity policies, controls and procedures. The Company and the Bank may not declare or pay any cash dividends without the prior written approval of their regulators.

Item 4: Controls and Procedures

As of September 30, 2013, 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, 2013 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, 2013, formatted in XBRL (Extensible Business Reporting Language): (i) Consolidated Statements of Condition at September 30, 2013 and December 31, 2012, (ii) Consolidated Statements of Income for the quarters and nine months ended September 30, 2013 and 2012, (iii) Consolidated Statements of Comprehensive Income for the quarters and nine months ended September 30, 2013 and 2012, (iv) Statement of Changes in Shareholders Equity for the nine months ended September 30, 2013, (v) Consolidated Statements of Cash Flows for the nine months ended September 30, 2013 and 2012 and (vi) Notes to the Unaudited Consolidated Financial Statements for the nine months ended September 30, 2013 and 2012.

(b) Reports on Form 8-K

A Form 8-K was filed on July 24, 2013 and October 23, 2013.

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, 2013

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

Date: November 13, 2013

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