

PEOPLES FINANCIAL CORP /MS/

Form 10-Q

November 06, 2009

**Table of Contents**

**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, 2009**

**or**

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

**Commission File Number 001-12103  
PEOPLES FINANCIAL CORPORATION  
(Exact name of registrant as specified in its charter)**

Mississippi

64-0709834

(State or other jurisdiction of incorporation or organization)

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

Lameuse and Howard Avenues, Biloxi, Mississippi

39533

(Address of principal executive offices)

(Zip Code)

(228) 435-5511

(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes  No

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

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

Large accelerated filer  Accelerated filer  Non-accelerated filer  Smaller reporting company   
filer

(Do not check if a smaller reporting company)

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

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the last practicable date. Peoples Financial Corporation has only one class of common stock authorized. At October 30, 2009, there were 15,000,000 shares of \$1 par value common stock authorized, with 5,151,697 shares issued and outstanding.



**TABLE OF CONTENTS**

Part 1 Financial Information

Item 1: Financial Statements

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

Item 4: Controls and Procedures

PART II OTHER INFORMATION

Item 1: Legal Proceedings

Item 6 Exhibits and Reports on Form 8-K

SIGNATURES

EX-31.1

EX-31.2

EX-32.1

EX-32.2

---

**Table of Contents****Part 1 Financial Information****Item 1: Financial Statements**

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

	<b>September 30, 2009 (Unaudited)</b>	<b>December 31, 2008 (Audited)</b>
<b>Assets</b>		
Cash and due from banks	\$ 25,792,612	\$ 34,015,590
Federal funds sold		4,000
Available for sale securities	336,308,381	340,462,072
Held to maturity securities, fair value of \$3,348,512 at September 30, 2009; \$3,438,108 at December 31, 2008	3,201,224	3,394,212
Other investments	3,999,662	3,889,324
Federal Home Loan Bank Stock, at cost	3,523,800	2,070,700
Loans	466,022,263	467,377,039
Less: Allowance for loan losses	8,106,588	11,113,575
Loans, net	457,915,675	456,263,464
Bank premises and equipment, net of accumulated depreciation	31,890,315	33,600,170
Accrued interest receivable	4,983,018	5,444,767
Cash surrender value of life insurance	15,154,066	14,688,160
Other real estate	2,745,468	397,182
Other assets	2,967,593	2,177,860
<b>Total assets</b>	<b>\$ 888,481,814</b>	<b>\$ 896,407,501</b>

**Table of Contents**

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

	<b>September 30, 2009 (Unaudited)</b>	<b>December 31, 2008 (Audited)</b>
<b>Liabilities &amp; Shareholders Equity</b>		
<b>Liabilities:</b>		
Deposits:		
Demand, non-interest bearing	\$ 103,784,343	\$ 109,033,184
Savings and demand, interest bearing	223,838,840	239,990,238
Time, \$100,000 or more	160,687,218	104,540,112
Other time deposits	53,256,808	56,912,002
<b>Total deposits</b>	<b>541,567,209</b>	<b>510,475,536</b>
Federal funds purchased and securities sold under agreements to repurchase	188,483,055	226,609,231
Borrowings from Federal Home Loan Bank	36,872,633	36,937,686
Other liabilities	15,904,593	15,384,934
<b>Total liabilities</b>	<b>782,827,490</b>	<b>789,407,387</b>
<b>Shareholders Equity:</b>		
Common stock, \$1 par value, 15,000,000 shares authorized, 5,151,697 and 5,279,268 shares issued and outstanding at September 30, 2009 and December 31, 2008, respectively	5,151,697	5,279,268
Surplus	65,780,254	65,780,254
Undivided profits	33,025,827	33,412,596
Accumulated other comprehensive income, net of tax	1,696,546	2,527,996
<b>Total shareholders equity</b>	<b>105,654,324</b>	<b>107,000,114</b>
<b>Total liabilities &amp; shareholders equity</b>	<b>\$ 888,481,814</b>	<b>\$ 896,407,501</b>

See selected notes to consolidated financial statements.

3

---

**Table of Contents**

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

	<b>Three Months Ended</b>		<b>Nine Months Ended September</b>	
	<b>September 30,</b>		<b>30,</b>	
	<b>2009</b>	<b>2008</b>	<b>2009</b>	<b>2008</b>
<b>Interest income:</b>				
Interest and fees on loans	\$5,028,179	\$ 6,603,096	\$15,232,634	\$20,711,343
Interest and dividends on securities:				
U.S. Treasury	243,566	748,056	1,019,885	2,338,282
U.S. Government agencies	2,704,828	2,568,752	7,474,592	8,283,083
Mortgage-backed securities	388,091	421,063	1,179,745	1,317,989
States and political subdivisions	291,065	273,419	903,488	782,665
Other investments	9,673	42,475	16,567	143,455
Interest on federal funds sold	5,194	49,549	6,631	111,620
<b>Total interest income</b>	<b>8,670,596</b>	<b>10,706,410</b>	<b>25,833,542</b>	<b>33,688,437</b>
<b>Interest expense:</b>				
Deposits	1,072,368	2,273,965	4,026,055	8,111,706
Long-term borrowings	141,723	103,726	413,500	343,491
Federal funds purchased and securities sold under agreements to repurchase	437,897	1,111,474	1,531,569	3,731,166
<b>Total interest expense</b>	<b>1,651,988</b>	<b>3,489,165</b>	<b>5,971,124</b>	<b>12,186,363</b>
<b>Net interest income</b>	<b>7,018,608</b>	<b>7,217,245</b>	<b>19,862,418</b>	<b>21,502,074</b>
<b>Provision for allowance for losses on loans</b>	<b>1,875,000</b>	<b>2,001,000</b>	<b>3,725,000</b>	<b>2,095,000</b>



<b>Net interest income after provision for allowance for losses on loans</b>	\$5,143,608	\$ 5,216,245	\$16,137,418	\$19,407,074
--	-------------	--------------	--------------	--------------

4

---

**Table of Contents**

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2009	2008	2009	2008
<b>Non-interest income:</b>				
Trust department income and fees	\$ 355,982	\$ 407,643	\$ 1,017,998	\$ 1,236,758
Service charges on deposit accounts	1,692,387	1,717,985	5,057,784	5,139,820
Gain on sales, liquidation, or calls of securities	265,247	249,000	402,046	364,277
Other income	281,810	436,610	906,395	1,238,890
<b>Total non-interest income</b>	<b>2,595,426</b>	<b>2,811,238</b>	<b>7,384,223</b>	<b>7,979,745</b>
<b>Non-interest expense:</b>				
Salaries and employee benefits	3,557,067	3,564,471	10,631,766	10,641,717
Net occupancy	564,631	538,799	1,757,734	1,545,957
Rentals, depreciation and maintenance	939,523	950,180	2,844,079	2,744,481
Other expense	1,608,703	4,572,677	5,075,278	7,722,910
<b>Total non-interest expense</b>	<b>6,669,924</b>	<b>9,626,127</b>	<b>20,308,857</b>	<b>22,655,065</b>
<b>Income before income taxes</b>	<b>1,069,110</b>	<b>(1,598,644)</b>	<b>3,212,784</b>	<b>4,731,754</b>
Income taxes	95,000	(545,000)	335,000	1,518,000
<b>Net Income</b>	<b>\$ 974,110</b>	<b>\$(1,053,644)</b>	<b>\$ 2,877,784</b>	<b>\$ 3,213,754</b>
<b>Basic and diluted earnings per share</b>	<b>\$ .19</b>	<b>\$ (.20)</b>	<b>\$ .56</b>	<b>\$ .60</b>

See selected notes to consolidated financial statements.



**Table of Contents**

**Peoples Financial Corporation and Subsidiaries**  
**Consolidated Statement of Shareholders Equity**

	Number of Common Shares	Common Stock	Surplus	Accumulated			Total
				Undivided Profits	Other Comprehensive Income	Comprehensive Income	
Balance, January 1, 2009	5,279,268	\$ 5,279,268	\$ 65,780,254	\$ 33,412,596	\$ 2,527,996		\$ 107,000,114
Comprehensive Income:							
Net income				2,877,784		\$ 2,877,784	2,877,784
Net unrealized loss on available for sale securities, net of tax					(1,096,800)	(1,096,800)	(1,096,800)
Reclassification adjustment for available for sale securities called or sold in current year, net of tax					265,350	265,350	265,350
Total comprehensive income						\$ 2,046,334	
Effect of stock retirement on accrued dividends				4,774			4,774
Dividend declared, (\$ .20 per share)				(1,030,339)			(1,030,339)
Retirement of stock	(127,571)	(127,571)		(2,238,988)			(2,366,559)

Balance, September 30, 2009	5,151,697	\$ 5,151,697	\$ 65,780,254	\$ 33,025,827	\$ 1,696,546	\$ 105,654,324
-----------------------------------	-----------	--------------	---------------	---------------	--------------	----------------

Note: Balances as of January 1, 2009 were audited.  
See selected notes to consolidated financial statements.

6

---

**Table of Contents**

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

	<b>Nine Months Ended September</b>	
	<b>2009</b>	<b>30,</b> <b>2008</b>
<b>Cash flows from operating activities:</b>		
Net income	\$ 2,877,784	\$ 3,213,754
Adjustment to reconcile net income to net cash provided by operating activities:		
Depreciation	1,798,500	1,777,500
Provision for allowance for loan losses	3,725,000	2,095,000
Loss on impairment of equity securities	149,517	2,964,000
Gain on other investments	(110,338)	
Gain on sale of bank premises		(142,607)
Gain on sale of other real estate	3,000	
Gain on sales and calls of securities	(402,046)	(364,277)
Change in accrued interest receivable	461,749	2,280,314
Change in other assets	(801,830)	725,810
Change in other liabilities	2,540,113	(1,009,809)
<b>Net cash provided by operating activities</b>	<b>10,241,449</b>	<b>11,539,685</b>
<b>Cash flows from investing activities:</b>		
Proceeds from maturities, sales, liquidation and calls of available for sale securities	218,568,260	200,027,056
Investment in available for sale securities	(215,425,390)	(110,080,676)
Proceeds from maturities of held to maturity securities	195,000	1,240,000
Investment in held to maturity securities	(2,012)	(3,514)
Purchases of other investments		(3,160,000)
(Purchase) redemption of Federal Home Loan Bank Stock	(1,453,100)	200
Proceeds from sales of other real estate	326,076	19,500
Loans, net change	(8,054,574)	(12,424,936)
Proceeds from sale of bank premises		266,812
Acquisition of premises and equipment	(88,645)	(1,727,877)
Other assets	(453,808)	(990,201)
<b>Net cash provided by (used in) investing activities</b>	<b>\$ (6,388,193)</b>	<b>\$ 73,166,364</b>

**Table of Contents**

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

	<b>Nine Months Ended September</b>	
	<b>30,</b>	
	<b>2009</b>	<b>2008</b>
<b>Cash flows from financing activities:</b>		
Demand and savings deposits, net change	\$ (21,400,239)	\$ 36,197,357
Time deposits, net change	52,491,912	(67,790,579)
Cash dividends	(2,614,119)	(3,003,342)
Retirement of common stock	(2,366,559)	(2,311,173)
Borrowings from Federal Home Loan Bank	219,906,300	16,500,000
Repayments to Federal Home Loan Bank	(219,971,353)	(16,622,103)
Federal funds purchased and securities sold under agreements to repurchase, net change	(38,126,176)	(18,916,423)
<b>Net cash used in financing activities</b>	<b>(12,080,234)</b>	<b>(55,946,263)</b>
<b>Net increase (decrease) in cash and cash equivalents</b>	<b>(8,226,978)</b>	<b>28,759,786</b>
<b>Cash and cash equivalents, beginning of period</b>	<b>34,019,590</b>	<b>34,935,370</b>
<b>Cash and cash equivalents, end of period</b>	<b>\$ 25,792,612</b>	<b>\$ 63,695,156</b>

See selected notes to consolidated financial statements.

**Table of Contents**

PEOPLES FINANCIAL CORPORATION AND SUBSIDIARIES  
SELECTED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
For the Nine Months Ended September 30, 2009 and 2008

**1. Basis of Presentation:**

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, the financial position of Peoples Financial Corporation and its subsidiaries (the Company ) as of September 30, 2009 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 2008 Annual Report and Form 10-K.

The results of operations for the nine months ended September 30, 2009, 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 accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the reported period. Actual results could differ from those estimates.

**Summary of Significant Accounting Policies** The accounting and reporting policies of the Company conform with accounting principles generally accepted in the United States of America 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, 2008.

**Subsequent events** The Company has performed an evaluation of subsequent events through November 6, 2009, which is the date the financial statements were issued.

**2. Earnings Per Share:**

Per share data is based on the weighted average shares of common stock outstanding of 5,176,744 and 5,359,690 for the nine months ended September 30, 2009 and 2008, respectively, and 5,151,697 and 5,322,595 for the quarters ended September 30, 2009 and 2008, respectively.

**3. Statements of Cash Flows:**

The Company has defined cash and cash equivalents to include cash and due from banks and federal funds sold. The Company paid \$6,094,012 and \$13,051,262 for the nine months ended September 30, 2009 and 2008, respectively, for interest on deposits and borrowings. Income tax payments of \$520,000 and \$1,725,000 were made during the nine months ended September 30, 2009 and 2008, respectively. Loans in the amount of \$2,677,363 and \$371,626 were transferred to other real estate during the nine months ended September 30, 2009 and 2008, respectively.



**Table of Contents**

## 4. Investments:

The amortized cost and estimated fair value of securities at September 30, 2009 and December 31, 2008, respectively, were as follows:

	Amortized cost	Gross unrealized gains	Gross unrealized losses	Estimated fair value
September 30, 2009				
Available for sale securities:				
Debt securities:				
U.S. Treasury	\$ 23,984,082	\$ 886,218	\$	\$ 24,870,300
U.S. Government agencies	245,396,069	1,958,436	(1,113,840)	246,240,665
Mortgage-backed securities	26,869,670	1,180,543		28,050,213
States and political subdivisions	35,327,093	1,375,902	(205,775)	36,497,220
Total debt securities	331,576,914	5,401,099	(1,319,615)	335,658,398
Equity securities	649,983			649,983
Total available for sale securities	\$ 332,226,897	\$ 5,401,099	\$ (1,319,615)	\$ 336,308,381
Held to maturity securities:				
States and political subdivisions	\$ 3,201,224	\$ 147,288	\$	\$ 3,348,512
Total held to maturity securities	\$ 3,201,224	\$ 147,288	\$	\$ 3,348,512

**Table of Contents**

	Amortized cost	Gross unrealized gains	Gross unrealized losses	Estimated fair value
December 31, 2008				
Available for sale securities:				
Debt securities:				
U.S. Treasury	\$ 64,963,243	\$ 1,746,597	\$	\$ 66,709,840
U.S. Government agencies	208,917,636	3,552,215	(74,020)	212,395,831
Mortgage-backed securities	28,992,858	788,218		29,781,076
States and political subdivisions	31,594,000	316,874	(985,049)	30,925,825
Total debt securities	334,467,737	6,403,904	(1,059,069)	339,812,572
Equity securities	649,500			649,500
Total available for sale securities	\$ 335,117,237	\$ 6,403,904	\$ (1,059,069)	\$ 340,462,072
Held to maturity securities:				
States and political subdivisions	\$ 3,394,212	\$ 52,382	\$ (8,486)	\$ 3,438,108
Total held to maturity securities	\$ 3,394,212	\$ 52,382	\$ (8,486)	\$ 3,438,108

The balances of available for sale securities, which are the only assets measured at fair value on a recurring basis, by level within the hierarchy as of September 30, 2009 and December 31, 2008 were as follows:

	Total	Fair Value Measurement Using		
		Level 1	Level 2	Level 3
September 30, 2009	\$ 336,308,381		\$ 336,308,381	
December 31, 2008	340,462,072		340,462,072	

At September 30, 2009, available for sale securities with an amortized cost of \$332,226,897 were reported at a fair value, net of unrealized gains and losses, of \$336,308,381. The net change in unrealized gains and losses of \$1,362,150 was included in comprehensive income during the first nine months of 2009. At December 31, 2008, available for sale securities with an amortized cost of \$335,117,237 were reported at a fair value, net of unrealized gains and losses, of \$340,462,072. The net change in unrealized gains and losses of \$2,439,567 was included in comprehensive income during the year ended December 31, 2008.

**Table of Contents**

The amortized cost and estimated fair value of debt securities at September 30, 2009, by contractual maturity, are shown below. Expected maturities will differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

	Amortized cost	Estimated fair value
Available for sale securities:		
Due in one year or less	\$ 20,538,102	\$ 20,934,035
Due after one year through five years	88,857,795	90,896,980
Due after five years through ten years	69,951,725	70,484,280
Due after ten years	125,359,622	125,292,890
Mortgage-backed securities	26,869,670	28,050,213
Totals	\$ 331,576,914	\$ 335,658,398
Held to maturity securities:		
Due in one year or less	\$ 304,966	\$ 308,938
Due after one year through five years	1,779,362	1,879,774
Due after five years through ten years	1,116,896	1,159,800
Totals	\$ 3,201,224	\$ 3,348,512

Securities with gross unrealized losses at September 30, 2009 and December 31, 2008, respectively, aggregated by investment category and length of time that individual securities have been in a continuous loss position are as follows:

	Less Than Twelve Months		Over Twelve Months		Total	
	Fair Value	Gross Unrealized Loss	Fair Value	Gross Unrealized Loss	Fair Value	Gross Unrealized Loss
September 30, 2009						
U.S. Government Agencies	\$ 82,893,991	\$ 1,113,840	\$	\$	\$ 82,893,991	\$ 1,113,840
States and political subdivisions	6,112,320	101,484	2,533,876	104,291	8,646,196	205,775
TOTAL	\$ 89,006,311	\$ 1,215,324	\$ 2,533,876	\$ 104,291	\$ 91,540,187	\$ 1,319,615

**Table of Contents**

	Less Than Twelve Months		Over Twelve Months		Total	
	Fair Value	Gross Unrealized Loss	Fair Value	Gross Unrealized Loss	Fair Value	Gross Unrealized Loss
December 31, 2008:						
U.S. Government Agencies	\$ 10,780,995	\$ 74,020	\$	\$	\$ 10,780,995	\$ 74,020
States and political subdivisions	16,545,087	739,918	2,825,811	253,617	19,370,898	993,535
<b>TOTAL</b>	<b>\$ 27,326,082</b>	<b>\$ 813,938</b>	<b>\$ 2,825,811</b>	<b>\$ 253,617</b>	<b>\$ 30,151,893</b>	<b>\$ 1,067,555</b>

Management evaluates securities for other-than-temporary impairment on a monthly basis. In performing this evaluation, the length of time and the extent to which the fair value has been less than cost and the fact that the Company's securities are primarily issued by U.S. Treasury and U.S. Government Agencies are considered. In addition, the Company assesses the cause of the decline in value and the intent and ability of the Company to hold these securities until maturity. While some available for sale securities have been sold for liquidity purposes, the Company has traditionally held its securities, including those classified as available for sale, until maturity. As a result of this evaluation, the Company has determined that the declines summarized in the table above are not deemed to be other-than-temporary.

#### 5. Past Due and Impaired Loans:

Loans past due ninety days or more and still accruing interest were \$1,304,734 and \$2,340,190 at September 30, 2009 and December 31, 2008, respectively.

Impaired loans include performing and non-performing loans for which full payment of principal or interest is not expected. At September 30, 2009 and December 31, 2008, performing loans which were classified as impaired loans totaled \$11,125,507 and \$11,864,285, respectively. At September 30, 2009 and December 31, 2008, non-performing loans which were classified as impaired loans included nonaccrual loans which amounted to \$25,256,847 and \$15,553,447, respectively.

The total average recorded investment in impaired loans amounted to approximately \$29,730,349 and \$28,189,747 at September 30, 2009 and December 31, 2008, respectively. The Company had \$5,328,547 and \$7,345,022 of specific allowance related to impaired loans at September 30, 2009 and December 31, 2008, respectively. Interest income recognized on impaired loans was \$394,160 and \$833,055 during the nine months ended September 30, 2009 and the year ended December 31, 2008, respectively. Interest income recognized on impaired loans if the Company had used the cash-basis method of accounting would have been \$384,791 and \$686,129 during the nine months ended September 30, 2009 and the year ended December 31, 2008, respectively.

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

**Table of Contents**

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. Accordingly, the Company's impaired loans are reported at their estimated fair value on a non-recurring basis.

The balances of impaired loans, which are measured at fair value on a non-recurring basis, by level within the hierarchy as of September 30, 2009 and December 31, 2008 were as follows:

	Total	Fair Value Measurement Using		
		Level 1	Level 2	Level 3
September 30, 2009	\$ 31,053,807		\$ 31,053,807	
December 31, 2008	20,072,210		20,072,210	

At September 30, 2009, impaired loans with a carrying amount of \$36,382,354 were written down to their fair value of \$31,053,807 through a \$5,328,547 charge to the provision for loan losses in prior periods. At December 31, 2008, impaired loans with a carrying amount of \$27,417,732 were written down to their fair value of \$20,072,210 through a \$7,345,022 charge to the provision for loan losses in prior periods.

When Management determines that it has sustained a loss on a loan, it may be 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. Accordingly, the Company's other real estate is reported at its estimated fair value on a non-recurring basis.

The balances of other real estate, which are measured at fair value on a non-recurring basis, by level within the hierarchy as of September 30, 2009 and December 31, 2008 were as follows:

	Total	Fair Value Measurement Using		
		Level 1	Level 2	Level 3
September 30, 2009	\$ 2,745,468		\$ 2,745,468	
December 31, 2008	397,182		397,182	

**Table of Contents**

## 6. Allowance for Loan Losses:

Transactions in the allowance for loan losses were as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2009	2008	2009	2008
Balance, beginning of period	\$ 9,797,881	\$ 9,327,780	\$11,113,575	\$ 9,378,137
Recoveries	5,140	52,754	334,774	331,884
Loans charged off	(3,571,433)	(398,954)	(7,066,761)	(822,441)
Provision for allowance for loan losses	1,875,000	2,001,000	3,725,000	2,095,000
Balance, end of period	\$ 8,106,588	\$10,982,580	\$ 8,106,588	\$10,982,580

## 7. Other Comprehensive Income:

The income tax effect from the unrealized loss on available for sale securities on accumulated other comprehensive income was \$428,323 at September 30, 2009.

## 8. Notes Payable:

On March 11, 2009, the Company opened a \$2,500,000 line of credit with Mississippi National Banker's Bank. The line, which is secured by the common stock of the Company's bank subsidiary, bears interest at Wall Street Prime, with a floor of 4.00%. Quarterly interest payments are required under the line with all principal and accrued interest being due at maturity, which is March 11, 2010. There was no outstanding balance at September 30, 2009.

## 9. Federal Reserve Bank Discount Window Approval:

During the second quarter of 2009, the Company's bank subsidiary received approval to participate in the Federal Reserve Bank Discount Window Primary Credit Program. The borrowing limit, which was \$62,900,000 at September 30, 2009, is based on the amount of collateral pledged, with certain loans from the bank's portfolio serving as collateral. Borrowings bear interest at 25 basis points over the current federal funds rate. Borrowings may have a maturity date between one and ninety days. There was no outstanding balance at September 30, 2009.

## 10. Shareholders' Equity:

During the first quarter of 2009, the Company completed the repurchase and retirement of its common stock under a stock repurchase plan approved by its Board of Directors (Board) on September 24, 2008. A total of 132,589 shares were purchased and retired under this plan.

On February 25, 2009, the Board approved the repurchase of up to 3%, or approximately 150,000 shares, of its common stock. As of September 30, 2009, 19,245 shares had been repurchased and retired under this plan.

**Table of Contents**

On June 24, 2009, the Board approved a semi-annual dividend of \$ .20 per share with a record date of July 8, 2009 and distribution date of July 15, 2009.

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

The carrying amounts and estimated fair value for financial assets and financial liabilities at September 30, 2009 and December 31, 2008, respectively, were as follows:

	September 30, 2009		December 31, 2008	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
<b>Financial Assets:</b>				
Cash and due from banks	\$ 25,792,612	\$ 25,792,612	\$ 34,015,590	\$ 34,015,590
Federal funds sold			4,000	4,000
Available for sale securities	336,308,381	336,308,381	340,462,072	340,462,072
Held to maturity securities	3,201,224	3,348,512	3,394,212	3,438,108
Other investments	3,999,662	3,999,662	3,889,324	3,889,324
Federal Home Loan Bank stock	3,523,800	3,523,800	2,070,700	2,070,700
Loans, net	457,915,675	463,544,454	456,263,464	461,112,530
Cash surrender value	15,154,066	15,154,066	14,688,160	14,688,160
<b>Financial Liabilities:</b>				
<b>Deposits:</b>				
Non-interest bearing	103,784,343	103,784,343	109,033,184	109,033,184
Interest bearing	437,782,866	438,448,036	401,442,352	402,361,440
Total deposits	541,567,209	542,232,379	510,475,536	511,394,624
Federal funds purchased and securities sold under agreements to repurchase	188,483,055	188,483,055	226,609,231	226,609,231
Borrowings from Federal Home Loan Bank	36,872,633	37,529,000	36,937,686	37,547,000

**12. New Accounting Pronouncements:**

In June 2009, the Financial Accounting Standards Board ( FASB ) issued an accounting standard which established the Accounting Standards Codification ( Codification or ASC ) to become the single source of authoritative U.S. generally accepted accounting principles ( GAAP ) recognized by the FASB to be applied by nongovernmental entities, with the exception of guidance issued by the SEC and its staff. All guidance contained in the Codification carries an equal level of authority. The Codification is not intended to change GAAP, but rather is expected to simplify accounting research by reorganizing current GAAP into approximately 90 accounting topics. The switch to the ASC affects the way companies refer to GAAP in financial statements and accounting policies. Citing particular content in the ASC involves specifying the unique numeric path to the content through the Topic, Subtopic, Section and Paragraph structure. The Company adopted this accounting standard in preparing the Consolidated Financial Statements for the period ended September 30, 2009. The adoption of this accounting standard, which was subsequently codified into ASC Topic 105, Generally Accepted Accounting Principles, had no impact on the Company's financial statements. New authoritative accounting guidance under ASC Topic 815, Derivatives and Hedging, amends prior guidance to amend and enhance the disclosure requirements for derivatives and hedging to

**Table of Contents**

provide greater transparency about (i) how and why an entity uses derivative instruments, (ii) how derivative instruments and related hedge items are accounted for under ASC Topic 815, and (iii) how derivative instruments and related hedged items affect an entity's financial position, results of operations and cash flows. To meet those objectives, ASC Topic 815 requires qualitative disclosures about objectives and strategies for using derivative instruments, quantitative disclosures about fair values of derivative instruments and their gains and losses and disclosures about credit-risk-related contingent features of the derivative instruments and their potential impact on an entity's liquidity. ASC Topic 815 was effective on January 1, 2009, and did not have a significant impact on the Company's financial statements.

New authoritative accounting guidance under ASC Topic 855, *Subsequent Events*, establishes general standards of accounting for and disclosure of events that occur after the balance sheet date but before financial statements are issued or available to be issued. ASC Topic 855 defines (i) the period after the balance sheet date during which a reporting entity's management should evaluate events or transactions that may occur for potential recognition or disclosure in the financial statements, (ii) the circumstances under which an entity should recognize events or transactions occurring after the balance sheet date in its financial statements, and (iii) the disclosures an entity should make about events or transactions that occurred after the balance sheet date. ASC Topic 855 became effective for the Company's financial statements for periods ending after June 15, 2009, and did not have a significant impact on the Company's financial statements.

New authoritative accounting guidance under ASC Topic 820, *Fair Value Measurements and Disclosures*, affirms that the objective of fair value when the market for an asset is not active is the price that would be received to sell the asset in an orderly transaction, and clarifies and includes additional factors for determining whether there has been a significant decrease in market activity for an asset when the market for that asset is not active. ASC Topic 820 requires an entity to base its conclusion about whether a transaction was not orderly on the weight of the evidence. The new accounting guidance amended prior guidance to expand certain disclosure requirements. The Company adopted the new authoritative accounting guidance under ASC Topic 820 during the first quarter of 2009. Adoption of the new guidance did not have a significant impact on the Company's financial statements.

Further new authoritative accounting guidance (Accounting Standards Update No. 2009-5) under ASC Topic 820 provides guidance for measuring the fair value of a liability in circumstances in which a quoted price in an active market for the identical liability is not available. In such instances, a reporting entity is required to measure fair value utilizing a valuation technique that uses (i) the quoted price of the identical liability when traded as an asset, (ii) quoted prices for similar liabilities or similar liabilities when traded as assets, or (iii) another valuation technique that is consistent with the existing principles of ASC Topic 820, such as an income approach or market approach. The new authoritative accounting guidance also clarifies that when estimating the fair value of a liability, a reporting entity is not required to include a separate input or adjustment to other inputs relating to the existence of a restriction that prevents the transfer of the liability. The foregoing new authoritative accounting guidance under ASC Topic 820 will be effective for the Company's financial statements



**Table of Contents**

beginning October 1, 2009, and is not expected to have a significant impact on the Company's financial statements. New authoritative accounting guidance under ASC Topic 825, Financial Instruments, requires an entity to provide disclosures about the fair value of financial instruments in interim financial information and amends prior guidance to require those disclosures in summarized financial information at interim reporting periods. The Company adopted this accounting standard in preparing its financial statements for the period ended June 30, 2009. As ASC Topic 825 amended only the disclosure requirements about the fair value of financial instruments in interim periods, the adoption had no impact on the Company's financial statements.

New authoritative accounting guidance under ASC Topic 320, Investments - Debt and Equity Securities, amended other-than-temporary impairment ( OTTI ) guidance in GAAP for debt securities by requiring a write-down when fair value is below amortized cost in circumstances where: (1) an entity has the intent to sell a security; (2) it is more likely than not that an entity will be required to sell the security before recovery of its amortized cost basis; or (3) an entity does not expect to recover the entire amortized cost basis of the security. If an entity intends to sell a security or if it is more likely than not that the entity will be required to sell the security before recovery, an OTTI write-down is recognized in earnings equal to the entire difference between the security's amortized cost basis and its fair value. If an entity does not intend to sell the security or it is not more likely than not that it will be required to sell the security before recovery, the OTTI write-down is separated into an amount representing credit loss, which is recognized in earnings, and an amount related to all other factors, which is recognized in other comprehensive income. This accounting standard does not amend existing recognition and measurement guidance related to OTTI write-downs of equity securities. This accounting standard also extends disclosure requirements related to debt and equity securities to interim reporting periods. ASC Topic 320 became effective for the Company's financial statements for periods ending after June 15, 2009, and did not have a significant impact on the Company's financial statements.

**13. 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.

**Table of Contents**

**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. 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 in Harrison, Hancock, Stone and Jackson counties in Mississippi.

The following presents Management's discussion and analysis of the consolidated financial condition and results of operations of Peoples Financial Corporation and Subsidiaries. These comments should be considered in combination with the Consolidated Financial Statements and Notes to Consolidated Financial Statements included in this report on Form 10-Q and the Consolidated Financial Statements, Notes to Consolidated Financial Statements and Management's Discussion and Analysis included in the Company's Form 10-K for the year ended December 31, 2008.

**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.

**Critical Accounting Policies**

Certain critical accounting policies affect the more significant estimates and assumptions used in the preparation of the consolidated financial statements. The Company's single most critical accounting policy relates to its allowance for loan losses, which reflects the estimated losses resulting from the inability of its borrowers to make loan payments. If there was a deterioration of any of the factors considered by Management in evaluating the allowance for loan losses, the estimate of loss would be updated, and additional provisions for loan losses may be required.

**Table of Contents**

**OVERVIEW**

Net income for the third quarter of 2009 was \$974,110 compared with a net loss of \$1,053,644 for the third quarter of 2008, an increase in earnings of \$2,027,754. Earnings in the third quarter of 2009 included an increase in FDIC assessments of \$200,264 over 2008's results. In the third quarter of 2008, the Company recorded a charge to earnings for the impairment of its investment in Federal Home Loan Mortgage Corporation ( FHLMC ) preferred stock of \$2,964,000.

Net income for the first nine months 2009 was \$2,877,784 compared with \$3,213,754 for the first nine months of 2008. Earnings for the nine months ended September 30, 2009 and 2008 were impacted by the provision for loan losses, the impairment loss of \$2,964,000 recognized in the third quarter of 2008 and increased FDIC insurance assessments in 2009. The provision for the allowance for losses on loans was \$3,725,000 in 2009 as compared with \$2,095,000 in 2008. FDIC assessments for the nine months ended September 30, 2009 were \$729,968 more than in the nine months ended September 30, 2008.

Monitoring asset quality and addressing potential losses in our loan portfolio continues to be emphasized during these tough economic times. The Company charged-off \$7,066,761 in loans during the first nine months of 2009 as compared with only \$822,441 for the same period in 2008. Approximately 64% of the charge-offs in 2009 related to three credit relationships in the residential development industry. Nonaccrual loans increased to \$25,256,847 at September 30, 2009 as compared with \$15,553,447 at December 31, 2008. This large increase is primarily attributable to the placement of one loan in the amount of \$11,000,000 on nonaccrual at September 30, 2009. This credit is a performing loan, but was classified as nonaccrual by the banking regulators in their annual shared national credit review in the third quarter of 2009.

**RESULTS OF OPERATIONS**

**Net Interest Income**

Net interest income, the amount by which interest income on loans, investments and other interest earning assets exceeds interest expense on deposits and other borrowed funds, is the single largest component of the Company's income. Management's objective is to provide the largest possible amount of income while balancing interest rate, credit, liquidity and capital risk. Changes in the volume and mix of interest earning assets and interest-bearing liabilities combined with changes in market rates of interest directly affect net interest income.

The Federal Reserve, through the Federal Open Market Committee (the Committee), dropped the discount rate by a total of 200 basis points during the first quarter of 2008, and by another 200 basis points during the following three quarters of 2008. The Committee's actions were their attempt to stabilize financial markets as well as to stimulate the national economy and flow of capital. Typically, changes in the discount rate result in corresponding changes in prime interest rates. The impact of these rate reductions was significant to the Company's financial condition and results of operations.

**Table of Contents**

**Quarter Ended September 30, 2009 as Compared with Quarter Ended September 30, 2008**

The Company's average interest earning assets increased approximately \$18,752,000, or 2%, from approximately \$804,323,000 for the third quarter of 2008 to approximately \$823,075,000 for the third quarter of 2009.

The average yield on earning assets decreased 110 basis points, from 5.39% for the third quarter of 2008 to 4.29% for the third quarter of 2009. The Company's loan portfolio generally has a 40%/60% blend of fixed/floating rate term. This results in the Company being more asset sensitive to market interest rates and generally is the cause of the decrease in interest income. The Company also lost interest income of approximately \$43,000 due to loans being on nonaccrual during the quarter.

Average interest bearing liabilities increased approximately \$31,110,000, or 5%, from approximately \$662,140,000 for the third quarter of 2008 to approximately \$693,250,000 for the third quarter of 2009. The average rate paid on interest bearing liabilities decreased 116 basis points, from 2.11% for the third quarter of 2008 to .95% for the third quarter of 2009.

The Company's net interest margin on a tax-equivalent basis, which is net interest income as a percentage of average earning assets, was 3.48% at September 30, 2009, down 18 basis points from 3.66% at September 30, 2008.

**Nine Months Ended September 30, 2009 as Compared with Nine Months Ended September 30, 2008**

The Company's average interest earning assets increased approximately \$14,519,000, or 2%, from approximately \$812,956,000 for the first nine months of 2008 to approximately \$827,475,000 for the first nine months of 2009.

Also as a result of the Committee's actions, the average yield on earning assets decreased 135 basis points, from 5.59% for the first nine months of 2008 to 4.24% for the first nine months of 2009. The Company's loan portfolio generally has a 40%/60% blend of fixed/floating rate term. This results in the Company being more asset sensitive to market interest rates and generally is the cause of the decrease in interest income. The Company also lost interest income of approximately \$334,000 due to loans being on nonaccrual during the first nine months of 2009.

Average interest bearing liabilities increased approximately \$19,976,000, or 3%, from approximately \$670,219,000 for the first nine months of 2008 to approximately \$690,195,000 for the first nine months of 2009. The average rate paid on interest bearing liabilities decreased 127 basis points, from 2.42% for the first nine months of 2008 to 1.15% for the first nine months of 2009.

The Company's net interest margin on a tax-equivalent basis, which is net interest income as a percentage of average earning assets, was 3.28% at September 30, 2009, down 31 basis points from 3.59% at September 30, 2008.

The tables on the following pages analyze the changes in tax-equivalent net interest income for the quarters ended September 30, 2009 and 2008 and the nine months ended September 30, 2009 and 2008.

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

	Three Months Ended September 30, 2009			Three Months Ended September 30, 2008		
	Average Balance	Interest Earned/Paid	Rate	Average Balance	Interest Earned/Paid	Rate
Loans (2)(3)	\$ 466,954	\$ 5,028	4.30%	\$ 472,088	\$ 6,603	5.59%
Federal Funds Sold	7,631	5	0.26%	11,397	50	1.75%
HTM:						
Non taxable (1)	3,201	39	4.87%	3,393	52	6.13%
AFS:						
Taxable	306,267	3,336	4.36%	285,869	3,738	5.23%
Non taxable (1)	34,848	402	4.61%	24,214	362	5.98%
Other	4,174	10	0.96%	7,362	42	2.82%
Total	\$ 823,075	\$ 8,820	4.29%	\$ 804,323	\$ 10,847	5.39%
Savings & interest- bearing DDA	\$ 225,233	\$ 303	0.54%	\$ 254,513	\$ 972	1.53%
CD s	203,479	769	1.51%	184,393	1,303	2.83%
Federal funds purchased	209,578	437	0.83%	215,548	1,111	2.06%
FHLB advances	54,960	142	1.03%	7,686	103	5.36%
Total	\$ 693,250	\$ 1,651	0.95%	\$ 662,140	\$ 3,489	2.11%
Net tax-equivalent yield on earning assets			3.48%			3.66%

(1) All interest earned is reported on a taxable equivalent basis using a tax rate of 34% in 2009 and 2008.

- (2) Loan fees of \$107,898 and \$183,079 for 2009 and 2008, respectively, are included in these figures.
  
- (3) Includes nonaccrual loans.

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

	Nine Months Ended September 30, 2009			Nine Months Ended September 30, 2008		
	Average Balance	Interest Earned/Paid	Rate	Average Balance	Interest Earned/Paid	Rate
Loans (2)(3)	\$ 470,290	\$ 15,233	4.32%	\$ 461,948	\$ 20,711	5.98%
Federal Funds Sold	3,409	7	0.27%	7,024	112	2.12%
HTM:						
Non taxable (1)	3,286	129	5.23%	3,791	178	6.26%
AFS:						
Taxable	313,690	9,674	4.11%	309,603	11,939	5.14%
Non taxable (1)	33,645	1,239	4.91%	23,166	1,008	5.80%
Other	3,155	17	0.72%	7,424	143	2.57%
Total	\$ 827,475	\$ 26,299	4.24%	\$ 812,956	\$ 34,091	5.59%
Savings & interest- bearing DDA	\$ 235,388	\$ 1,540	0.87%	\$ 253,197	\$ 3,032	1.60%
CD s	198,821	2,486	1.67%	201,571	5,080	3.36%
Federal funds purchased	222,447	1,532	0.92%	207,612	3,731	2.40%
FHLB advances	33,539	413	1.64%	7,839	343	5.83%
Total	\$ 690,195	\$ 5,971	1.15%	\$ 670,219	\$ 12,186	2.42%
Net tax-equivalent yield on earning assets			3.28%			3.59%

(1) All interest earned is reported on a taxable equivalent basis using a tax rate of 34% in 2009 and 2008.

- (2) Loan fees of \$395,114 and \$592,391 for 2009 and 2008, respectively, are included in these figures.
  
- (3) Includes nonaccrual loans.



**Table of Contents**

**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. A loan review process further assists with evaluating credit quality and assessing potential performance issues. Loan delinquencies and deposit overdrafts are closely monitored in order to identify developing problems as early as possible. In addition, the Company continuously monitors its relationships with its loan customers in concentrated industries such as gaming and hotel/motel, as well as the exposure for out of area, construction and land development, and commercial real estate loans, and their direct and indirect impact on its operations. A watch list of credits which pose a potential loss to the Company is prepared based on the loan grading system. This list forms the foundation of the Company's allowance for loan loss computation.

With the recent economic downturn and its impact in the housing market during the last year, the Company has closely evaluated its residential development loan portfolio. Potential losses on these loans have been estimated based on the best available information. The Company has charged-off \$7,067,238 during the first three quarters of 2009, \$4,548,423 of which related to residential developments. Based on its on-going analysis, the Company recorded a provision for loan losses of \$1,875,000 during the third quarter of 2009 and \$3,725,000 for the nine months ended September 30, 2009 in order to adequately provide for further potential losses. Of the allowance for loan losses of \$8,106,588 at September 30, 2009, approximately 43%, or \$3,501,647, related to three credit relationships.

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**

Total non-interest income decreased \$215,812 for the third quarter of 2009 as compared with the third quarter of 2008. Contributing to this decrease is the reduction in trust department income and fees of \$51,661 as a result of the decrease in market value, on which fees are based, of personal trust accounts. Total non-interest income also was impacted by the decrease in other income of \$154,800 for the third quarter of 2009 as compared with the third quarter of 2008 due largely to the gain from the sale of the bank subsidiary's merchant card portfolio in 2008.

Total non-interest income decreased \$595,522 for the first nine months of 2009 as compared with the first nine months of 2008. Contributing to this decrease is the reduction in trust department income and fees of \$218,760 as a result of the decrease in market value, on which fees are based, of personal trust accounts. A loss of \$149,517 on the Company's investment in preferred stock of an unaffiliated bank holding company was recognized as the FDIC closed that company's bank subsidiary during

**Table of Contents**

2009. Other income during the first nine months of 2008 included gains from the sale of bank premises of \$142,607.

**Non-interest expense**

Total non-interest expense decreased \$2,956,203 for the third quarter of 2009 as compared with the third quarter of 2008. During the third quarter of 2008, the Company recorded a charge to earnings for the impairment of its investment in FHLMC preferred stock of \$2,964,000, which is included in Other Expense.

Total non-interest expense decreased \$2,346,208 for the first nine months of 2009 as compared with the first nine months of 2008 as occupancy expense and other expense increased.

Occupancy expenses increased \$211,777 for the first nine months of 2009 compared with the first nine months of 2008. Contributing to this increase was an increase in insurance costs of \$107,550 and telephone expense of \$71,613. Included in the decrease of \$2,647,632 in other expense for the first nine months of 2009 as compared with the first nine months of 2008 are the impairment charge on the FHLMC preferred stock of \$2,964,000 in 2008.

**Income Taxes**

Income taxes increased \$640,000 for the third quarter of 2009 as compared with the third quarter of 2008, and decreased \$1,183,000 for the first nine months of 2009 as compared with the first nine months of 2008. These fluctuations were the result of the overall increase in taxable earnings for the third quarter of 2009 as compared with the third quarter of 2008 and the overall decrease in taxable earnings for first nine months of 2009 as compared with the first nine months of 2008, respectively. Other factors in these fluctuations were the increase in non-taxable income as a component of total income and the effect of tax credits in 2009.

**FINANCIAL CONDITION**

The Company increased its investment in Federal Home Loan Bank ( FHLB ) stock to \$3,523,800 as a prerequisite to increasing its borrowing with the FHLB.

**Table of Contents**

The composition of the loan portfolio was as follows:

	September 30, 2009	December 31, 2008
Real estate, construction	\$ 99,936,020	\$ 118,455,302
Real estate, mortgage	300,622,822	290,458,002
Loans to finance agricultural production	2,028,883	3,177,723
Commercial and industrial loans	50,036,294	43,311,552
Loans to individuals for household, family and other consumer expenditures	9,979,166	10,201,518
Obligations of states and political subdivisions	3,419,078	1,733,194
All other loans		39,748
Total	\$466,022,263	\$ 467,377,039

Accrued interest receivable decreased \$461,749 during the first nine months of 2009 as a result of the decrease in the yield on interest-earning assets.

Other real estate increased \$2,348,286 at September 30, 2009 as compared with December 31, 2008 as a result of the foreclosure on non-performing loans. Of the total increase, \$1,794,983 related to one credit relationship.

Other assets increased \$789,733 at September 30, 2009 as compared with December 31, 2008. Income taxes receivable increased by \$661,571 at September 30 as a result of tax credits.

Total deposits increased \$31,091,673 at September 30, 2009, as compared with December 31, 2008. Fluctuations among the different types of deposits represent recurring activity for the Company. During the first nine months of 2009, time deposits of \$100,000 or more have increased by \$56,147,106 as a result of the acquisition of \$55,342,000 in brokered deposits. In October 2009, \$20,000,000 of these brokered deposits matured.

Federal funds purchased and securities sold under agreements to repurchase primarily include the bank subsidiary's funds management account, which is a non-deposit product. Balances in the funds management accounts decreased \$30,025,640 at September 30, 2009, as compared with December 31, 2008, as the result of the periodic reallocation of funds by certain customers between deposit products and non-deposit products.

**SHAREHOLDERS EQUITY AND CAPITAL ADEQUACY**

As a part of its on-going stock repurchase program, the Company repurchased and retired 127,571 shares of its common stock, at a total repurchase price of \$2,366,559 during the first nine months of 2009.

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

**Table of Contents**

the continuing prosperity of the Company and the security of its customers and shareholders. One measure of capital adequacy is the primary capital ratio which was 12.61% at September 30, 2009, 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. 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 Federal Home Loan Bank, federal funds sold and federal funds purchased are utilized by the Company to manage its daily liquidity position. During the second quarter of 2009, the Company was approved to participate in the Federal Reserve Bank Discount Window Primary Credit Program and may draw upon this resource for liquidity as needed. During the third quarter of 2009, the Company successfully tested this liquidity source.

**REGULATORY MATTERS**

During the quarter ended September 30, 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 the result of its own investigation as well as examinations performed by certain bank regulatory agencies. In concert with the regulators, the Company has identified specific corrective steps and actions to enhance its risk management, asset quality and liquidity policies, controls and procedures. The Bank, without the prior written approval of its regulators, may not declare or pay any cash dividends.

**Item 4: Controls and Procedures**

As of September 30, 2009, 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.

**Table of Contents**

There were no changes in the Company's internal control over financial reporting that occurred during the period ended September 30, 2009 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 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

(b) Reports on Form 8-K

A Form 8-K was filed on July 22, 2009, and October 20, 2009.

**Table of Contents**

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 6, 2009

By: /s/ Chevis C. Swetman

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

Date: November 6, 2009

By: /s/ Lauri A. Wood

Lauri A. Wood  
Chief Financial Officer and Controller  
(principal financial and accounting officer)

29