

PEOPLES FINANCIAL CORP /MS/  
Form 10-Q  
November 13, 2012

# 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, 2012

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)

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(State or other jurisdiction of

(I.R.S. Employer

incorporation or organization)

Identification No.)

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

39533  
(Zip Code)

(228) 435-5511

(Registrant's telephone number, including area code)

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

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

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

Large accelerated filer

Accelerated filer

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

Smaller reporting company

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

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the last practicable date. Peoples Financial Corporation has only one class of common stock authorized. At October 31, 2012, there were 15,000,000 shares of \$1 par value common stock authorized, with 5,136,918 shares issued and outstanding.

**Part 1 Financial Information****Item 1: Financial Statements****Peoples Financial Corporation and Subsidiaries****Consolidated Statements of Condition**

	September 30, 2012 (Unaudited)	December 31, 2011 (Audited)
<b>Assets</b>		
Cash and due from banks	\$ 26,704,262	\$ 36,928,657
Available for sale securities	289,495,573	278,918,481
Held to maturity securities, fair value of \$7,078,544 at September 30, 2012; \$1,492,374 at December 31, 2011	6,990,774	1,428,887
Other investments	3,629,820	3,930,300
Federal Home Loan Bank Stock, at cost	2,806,000	2,580,700
Loans	435,336,359	432,407,286
Less: Allowance for loan losses	7,087,821	8,135,622
Loans, net	428,248,538	424,271,664
Bank premises and equipment, net of accumulated depreciation	26,563,735	28,035,308
Other real estate	7,368,534	6,153,238
Accrued interest receivable	2,430,919	2,698,241
Cash surrender value of life insurance	16,639,718	16,196,368
Prepaid FDIC assessments	862,025	2,096,320
Other assets	1,694,387	913,926
<b>Total assets</b>	<b>\$ 813,434,285</b>	<b>\$ 804,152,090</b>

## Peoples Financial Corporation and Subsidiaries

## Consolidated Statements of Condition (continued)

	September 30, 2012 (Unaudited)	December 31, 2011 (Audited)
<b>Liabilities &amp; Shareholders Equity</b>		
<b>Liabilities:</b>		
Deposits:		
Demand, non-interest bearing	\$ 117,399,669	\$ 97,581,073
Savings and demand, interest bearing	231,942,190	205,318,859
Time, \$100,000 or more	101,856,702	115,014,220
Other time deposits	46,817,681	50,524,930
Total deposits	498,016,242	468,439,082
Federal funds purchased and securities sold under agreements to repurchase	138,075,746	157,600,967
Borrowings from Federal Home Loan Bank	50,467,310	53,323,568
Employee and director benefit plans liabilities	12,210,528	11,310,607
Other liabilities	3,495,793	4,025,565
<b>Total liabilities</b>	<b>702,265,619</b>	<b>694,699,789</b>
<b>Shareholders Equity:</b>		
Common stock, \$1 par value, 15,000,000 shares authorized, 5,136,918 shares issued and outstanding at September 30, 2012 and December 31, 2011	5,136,918	5,136,918
Surplus	65,780,254	65,780,254
Undivided profits	34,653,238	33,350,861
Accumulated other comprehensive income, net of tax	5,598,256	5,184,268
<b>Total shareholders equity</b>	<b>111,168,666</b>	<b>109,452,301</b>
<b>Total liabilities &amp; shareholders equity</b>	<b>\$ 813,434,285</b>	<b>\$ 804,152,090</b>

See accompanying notes to consolidated financial statements.

## Peoples Financial Corporation and Subsidiaries

## Consolidated Statements of Income

(Unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	2011	2012	2011
<b>Interest income:</b>				
Interest and fees on loans	\$ 4,637,139	\$ 4,456,517	\$ 13,789,155	\$ 13,744,465
Interest and dividends on securities:				
U.S. Treasuries	112,485	54,069	281,710	181,198
U.S. Government agencies	860,464	1,254,858	3,100,819	4,405,916
Mortgage-backed securities	81,828	37,773	232,824	68,730
States and political subdivisions	375,892	339,376	1,115,727	1,068,833
Other investments	10,189	12,351	14,939	20,990
Interest on federal funds sold	3,085	1,686	12,151	6,425
<b>Total interest income</b>	<b>6,081,082</b>	<b>6,156,630</b>	<b>18,547,325</b>	<b>19,496,557</b>
<b>Interest expense:</b>				
Deposits	318,252	510,585	1,162,198	1,864,702
Borrowings from Federal Home Loan Bank	59,578	39,967	178,699	135,434
Federal funds purchased and securities sold under agreements to repurchase	80,935	173,859	298,007	515,427
<b>Total interest expense</b>	<b>458,765</b>	<b>724,411</b>	<b>1,638,904</b>	<b>2,515,563</b>
<b>Net interest income</b>	<b>5,622,317</b>	<b>5,432,219</b>	<b>16,908,421</b>	<b>16,980,994</b>
<b>Provision for allowance for loan losses</b>	<b>541,000</b>	<b>544,000</b>	<b>2,371,000</b>	<b>1,731,000</b>
<b>Net interest income after provision for allowance for loan losses</b>	<b>\$ 5,081,317</b>	<b>\$ 4,888,219</b>	<b>\$ 14,537,421</b>	<b>\$ 15,249,994</b>

## Peoples Financial Corporation and Subsidiaries

## Consolidated Statements of Income (continued) (unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	2011	2012	2011
<b>Non-interest income:</b>				
Trust department income and fees	\$ 439,550	\$ 361,346	\$ 1,111,442	\$ 1,031,269
Service charges on deposit accounts	1,471,593	1,493,674	4,355,828	4,367,848
Gain on sales and calls of securities	336,372	786,353	1,300,547	793,527
Income (loss) on other investments	(47,637)		(84,480)	10,124
Loss on impairment of other investments	(180,000)		(180,000)	
Increase in cash surrender value of life insurance	119,242	123,798	365,916	381,478
Gain on death benefits from life insurance		80,621		469,740
Other income	164,375	114,438	450,577	380,476
<b>Total non-interest income</b>	<b>2,303,495</b>	<b>2,960,230</b>	<b>7,319,830</b>	<b>7,434,462</b>
<b>Non-interest expense:</b>				
Salaries and employee benefits	2,963,848	3,393,984	9,283,245	10,165,371
Net occupancy	610,366	573,274	1,884,654	1,842,444
Equipment rentals, depreciation and maintenance	731,009	739,997	2,385,085	2,562,209
FDIC assessments	449,479	430,204	1,333,962	1,273,116
Data processing	327,790	251,545	1,064,379	544,405
ATM Expense	519,009	517,992	1,492,832	1,522,374
Other expense	983,751	1,511,777	2,694,025	3,439,444
<b>Total non-interest expense</b>	<b>6,585,252</b>	<b>7,418,773</b>	<b>20,138,182</b>	<b>21,349,363</b>
<b>Income before income tax expense (benefit)</b>	<b>799,560</b>	<b>429,676</b>	<b>1,719,069</b>	<b>1,335,093</b>
Income tax expense (benefit)	50,000	(148,000)	(97,000)	(490,000)
<b>Net income</b>	<b>\$ 749,560</b>	<b>\$ 577,676</b>	<b>\$ 1,816,069</b>	<b>\$ 1,825,093</b>
<b>Basic and diluted earnings per share</b>	<b>\$ .14</b>	<b>\$ .12</b>	<b>\$ .35</b>	<b>\$ .36</b>
<b>Dividends declared per share</b>	<b>\$ .10</b>	<b>\$ .10</b>	<b>\$ .10</b>	<b>\$ .09</b>

See accompanying notes to consolidated financial statements.

## Peoples Financial Corporation and Subsidiaries

## Consolidated Statements of Comprehensive Income

(Unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	2011	2012	2011
Net Income	\$ 749,560	\$ 577,676	\$ 1,816,069	\$ 1,825,093
Other comprehensive income (loss), net of tax:				
Net unrealized gain on available for sale securities, net of taxes of \$219,846 and \$672,014 for the three months ended September 30, 2012 and 2011, respectively, and \$655,453 and \$2,888,617 for the nine months ended September 30, 2012 and 2011, respectively	426,759	1,304,498	1,272,349	5,607,316
Reclassification adjustments on available for sale securities called or sold in current year, net of taxes of \$114,367 and \$267,360 for the three months ended September 30, 2012 and 2011, respectively, and \$442,186 and \$269,799 for the nine months ended September 30, 2012 and 2011, respectively	(222,005)	(518,993)	(858,361)	(523,728)
Total other comprehensive income	204,754	785,505	413,988	5,083,588
Total comprehensive income	\$ 954,314	\$ 1,363,181	\$ 2,230,057	\$ 6,908,681

See accompanying notes to consolidated financial statements.

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

	Number of Common Shares	Common Stock	Surplus	Undivided Profits	Accumulated Other Comprehensive Income	Total
Balance, January 1, 2012	5,136,918	\$ 5,136,918	\$ 65,780,254	\$ 33,350,861	\$ 5,184,268	\$ 109,452,301
Net income				1,816,069		1,816,069
Other comprehensive income, net of tax					413,988	413,988
Cash dividends (\$ .10 per share)				(513,692)		(513,692)
Balance, September 30, 2012	5,136,918	\$ 5,136,918	\$ 65,780,254	\$ 34,653,238	\$ 5,598,256	\$ 111,168,666

Note: Balances as of January 1, 2012 were audited.

See accompanying notes to consolidated financial statements.



## Peoples Financial Corporation and Subsidiaries

## Consolidated Statements of Cash Flows

(Unaudited)

	Nine Months Ended September 30,	
	2012	2011
<b>Cash flows from operating activities:</b>		
<b>Net income</b>	\$ 1,816,069	\$ 1,825,093
Adjustment to reconcile net income to net cash provided by operating activities:		
Depreciation	1,559,500	1,670,000
Provision for allowance for loan losses	2,371,000	1,731,000
Writedown of other real estate	153,300	666,006
Loss on sales of other real estate	27,123	57,891
(Income) loss on other investments	84,480	(10,124)
Loss on impairment of other investments	180,000	
Gain on sales and calls of securities	(1,300,547)	(793,527)
Accretion of held to maturity securities	(926)	(2,160)
Change in accrued interest receivable	267,322	589,507
Gain on death benefits from life insurance		(469,740)
Increase in cash surrender value of life insurance	(365,916)	(381,478)
Change in other assets	654,815	3,512,853
Change in other liabilities	(22,237)	107,537
<b>Net cash provided by operating activities</b>	<b>\$ 5,423,983</b>	<b>\$ 8,502,858</b>

## Peoples Financial Corporation and Subsidiaries

## Consolidated Statements of Cash Flows (continued) (unaudited)

	Nine Months Ended September 30,	
	2012	2011
<b>Cash flows from investing activities:</b>		
Proceeds from maturities, sales and calls of available for sale securities	\$ 298,642,897	\$ 257,158,575
Purchases of available for sale securities	(307,299,154)	(265,848,144)
Purchases of held to maturity securities	(5,560,961)	
Redemption of other investments	36,000	93,040
(Purchases) redemption of Federal Home Loan Bank stock	(225,300)	566,600
Proceeds from sales of other real estate	1,150,061	1,201,025
Loans, net change	(8,893,654)	(16,758,709)
Acquisition of premises and equipment	(87,927)	(445,787)
Proceeds from death benefits from life insurance		804,882
Investment in cash surrender value of life insurance	(77,435)	(68,966)
Investment in other assets	(14,894)	
<b>Net cash used in investing activities</b>	<b>(22,330,367)</b>	<b>(23,297,484)</b>
<b>Cash flows from financing activities:</b>		
Demand and savings deposits, net change	46,441,927	27,973,134
Time deposits, net change	(16,864,767)	(24,258,558)
Cash dividends	(513,692)	(924,646)
Retirement of common stock		(192,560)
Borrowings from Federal Home Loan Bank	1,557,866,339	460,700,115
Repayments to Federal Home Loan Bank	(1,560,722,597)	(473,555,559)
Federal funds purchased and securities sold under agreements to repurchase, net change	(19,525,221)	32,838,648
<b>Net cash provided by financing activities</b>	<b>6,681,989</b>	<b>22,580,574</b>
<b>Net increase (decrease) in cash and cash equivalents</b>	<b>(10,224,395)</b>	<b>7,785,948</b>
<b>Cash and cash equivalents, beginning of period</b>	<b>36,928,657</b>	<b>24,146,939</b>
<b>Cash and cash equivalents, end of period</b>	<b>\$ 26,704,262</b>	<b>\$ 31,932,887</b>

See accompanying notes to consolidated financial statements.

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PEOPLES FINANCIAL CORPORATION AND SUBSIDIARIES

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

For the Nine Months Ended September 30, 2012 and 2011

## Basis of Presentation

### 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, 2012 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 2011 Annual Report and Form 10-K.

The results of operations for the quarter ended September 30, 2012, 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, 2011.

## Earnings Per Share

### 2. Earnings Per Share:

Per share data is based on the weighted average shares of common stock outstanding of 5,136,918 for the nine months ended September 30, 2012 and 2011.

## Statements of Cash Flows

### 3. Statements of Cash Flows:

The Company has defined cash and cash equivalents as cash and due from banks. The Company paid \$1,648,779 and \$2,551,707 for the nine months ended September 30, 2012 and 2011, respectively, for interest on deposits and borrowings. Income tax payments of \$615,000 and \$235,000 were made during the nine months ended September 30, 2012 and 2011. Loans transferred to other real estate amounted to \$2,545,780 and \$3,143,510 during the nine months ended September 30, 2012 and 2011, respectively. Dividends payable of \$513,692 and \$462,323 as of December 31, 2011 and 2010, were paid during the nine months ended September 30, 2012 and 2011, respectively.

## Investments

### 4. Investments:

The amortized cost and fair value of securities at September 30, 2012 and December 31, 2011, are as follows:

September 30, 2012	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Available for sale securities:				
Debt securities:				
U.S. Treasuries	\$ 73,756,742	\$ 490,349	\$ (35,991)	\$ 74,211,100
U.S. Government agencies	154,922,636	1,956,457	(23,650)	156,855,443
Mortgage-backed securities	18,274,043	583,441		18,857,484
States and political subdivisions	36,625,315	2,296,248		38,921,563
<b>Total debt securities</b>	<b>283,578,736</b>	<b>5,326,495</b>	<b>(59,641)</b>	<b>288,845,590</b>
Equity securities	649,983			649,983
<b>Total available for sale securities</b>	<b>\$ 284,228,719</b>	<b>\$ 5,326,495</b>	<b>\$ (59,641)</b>	<b>\$ 289,495,573</b>
Held to maturity securities:				
States and political subdivisions	\$ 6,990,774	\$ 103,954	\$ (16,184)	\$ 7,078,544
<b>Total held to maturity securities</b>	<b>\$ 6,990,774</b>	<b>\$ 103,954</b>	<b>\$ (16,184)</b>	<b>\$ 7,078,544</b>

December 31, 2011	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
<b>Available for sale securities:</b>				
<b>Debt securities:</b>				
U.S. Treasuries	\$ 53,994,598	\$ 33,297	\$ (18,284)	\$ 54,009,611
U.S. Government agencies	176,985,676	2,220,753	(26,144)	179,180,285
Mortgage-backed securities	4,727,055	274,100		5,001,155
States and political subdivisions	37,914,334	2,163,113		40,077,447
<b>Total debt securities</b>	<b>273,621,663</b>	<b>4,691,263</b>	<b>(44,428)</b>	<b>278,268,498</b>
Equity securities	649,983			649,983
<b>Total available for sale securities</b>	<b>\$ 274,271,646</b>	<b>\$ 4,691,263</b>	<b>\$ (44,428)</b>	<b>\$ 278,918,481</b>
<b>Held to maturity securities:</b>				
States and political subdivisions	\$ 1,428,887	\$ 63,487	\$	\$ 1,492,374
<b>Total held to maturity securities</b>	<b>\$ 1,428,887</b>	<b>\$ 63,487</b>	<b>\$</b>	<b>\$ 1,492,374</b>

The amortized cost and fair value of debt securities at September 30, 2012, 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.

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	Amortized Cost	Fair Value
<b>Available for sale securities:</b>		
Due in one year or less	\$ 30,903,330	\$ 30,911,991
Due after one year through five years	70,717,979	71,728,223
Due after five years through ten years	104,387,928	107,172,901
Due after ten years	59,295,456	60,174,991
Mortgage-backed securities	18,274,043	18,857,484
<b>Totals</b>	<b>\$ 283,578,736</b>	<b>\$ 288,845,590</b>
<b>Held to maturity securities:</b>		
Due in one year or less	\$ 169,913	\$ 171,098
Due after one year through five years	1,545,424	1,590,728
Due after five years through ten years	1,206,284	1,226,805
Due after ten years	4,069,153	4,089,913
<b>Totals</b>	<b>\$ 6,990,774</b>	<b>\$ 7,078,544</b>

Available for Sale and Held to Maturity Securities with gross unrealized losses at September 30, 2012 and December 31, 2011, 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 Losses	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses
<b>September 30, 2012:</b>						
U.S. Treasuries	\$ 4,939,050	\$ 35,991	\$	\$	\$ 4,939,050	\$ 35,991
U.S. Government agencies	14,976,350	23,650			14,976,350	23,650
States and political subdivisions	1,849,270	16,184			1,849,270	16,184
<b>TOTAL</b>	<b>\$ 21,764,670</b>	<b>\$ 75,825</b>	<b>\$</b>	<b>\$</b>	<b>\$ 21,764,670</b>	<b>\$ 75,825</b>
<b>December 31, 2011:</b>						
U.S. Treasuries	\$ 16,975,720	\$ 18,284	\$	\$	\$ 16,975,720	\$ 18,284
U.S. Government agencies	15,075,582	26,144			15,075,582	26,144
<b>TOTAL</b>	<b>\$ 32,051,302</b>	<b>\$ 44,428</b>	<b>\$</b>	<b>\$</b>	<b>\$ 32,051,302</b>	<b>\$ 44,428</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, the fact that the Company's securities are primarily issued by U.S. Treasury and U.S. Government Agencies and the cause of the decline in value are considered. In addition, the Company does not intend to sell and it is not more likely than not that it will be required to sell these securities before maturity. While some available for sale securities have been sold for liquidity purposes or for gains, the Company has traditionally held its securities, including those classified as available for sale, until maturity. As a result of the evaluation of these securities, the Company has determined that the unrealized losses summarized in the tables above are not deemed to be other-than-temporary.

Proceeds from sales of available for sale debt securities were \$63,339,638 and \$49,589,184 for the nine months ended September 30, 2012 and 2011, respectively. Available for sale debt securities were sold and called for realized gains of \$1,300,547 and \$793,527 for the nine months ended September 30, 2012 and 2011, respectively.

## Loans

### 5. Loans:

The composition of the loan portfolio at September 30, 2012 and December 31, 2011, is as follows:

	September 30, 2012	December 31, 2011
Gaming	\$ 61,526,795	\$ 57,219,236
Residential and land development	27,564,595	29,026,076
Real estate, construction	54,468,649	61,041,510
Real estate, mortgage	247,810,747	238,411,440
Commercial and industrial	34,243,696	33,950,494
Other	9,721,877	12,758,530
<b>Total</b>	<b>\$ 435,336,359</b>	<b>\$ 432,407,286</b>

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The age analysis of the loan portfolio, segregated by class of loans, as of September 30, 2012 and December 31, 2011, is as follows:

	Number of Days Past Due				Current	Total Loans	Loans Past Due Greater Than 90 Days & Still Accruing
	30 - 59	60 - 89	Greater Than 90	Total Past Due			
<b>September 30, 2012:</b>							
Gaming	\$	\$	\$	\$	\$ 61,526,795	\$ 61,526,795	\$
Residential and land development			1,597,039	1,597,039	25,967,556	27,564,595	
Real estate, construction	889,032	2,430,321	4,608,815	7,928,168	46,540,481	54,468,649	42,690
Real estate, mortgage	8,238,425	1,131,587	6,680,030	16,050,042	231,760,705	247,810,747	124,208
Commercial and industrial	1,407,304	148,306		1,555,610	32,688,086	34,243,696	
Other	111,819	26,571		138,390	9,583,487	9,721,877	
<b>Total</b>	<b>\$ 10,646,580</b>	<b>\$ 3,736,785</b>	<b>\$ 12,885,884</b>	<b>\$ 27,269,249</b>	<b>\$ 408,067,110</b>	<b>\$ 435,336,359</b>	<b>\$ 166,898</b>
<b>December 31, 2011:</b>							
Gaming	\$	\$	\$	\$	\$ 57,219,236	\$ 57,219,236	\$
Residential and land development			24,161,722	24,161,722	4,864,354	29,026,076	
Real estate, construction	2,084,061	1,394,738	6,364,135	9,842,934	51,198,576	61,041,510	368,524
Real estate, mortgage	13,569,639	2,340,776	12,963,395	28,873,810	209,537,630	238,411,440	1,314,317
Commercial and industrial	1,536,073	166,070	387,963	2,090,106	31,860,388	33,950,494	142,125
Other	183,900	22,665	130,576	337,141	12,421,389	12,758,530	
<b>Total</b>	<b>\$ 17,373,673</b>	<b>\$ 3,924,249</b>	<b>\$ 44,007,791</b>	<b>\$ 65,305,713</b>	<b>\$ 367,101,573</b>	<b>\$ 432,407,286</b>	<b>\$ 1,824,966</b>

The Company monitors the credit quality of its loan portfolio through the use of a loan grading system. A score of 1 - 5 is assigned to the loan on factors including repayment ability, trends in net worth and/or financial condition of the borrower and guarantors, employment stability, management ability, loan to value fluctuations, the type and structure of the loan, conformity of the loan to bank policy and payment performance. Based on the total score, a loan grade of A - 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. 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. All loans 90 days or more past due are rated E. 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. All loans 180 days or more past due are rated F and charged off unless the Bank is in the process of collection.



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An analysis of the loan portfolio by loan grade, segregated by class of loans, as of September 30, 2012 and December 31, 2011, is as follows:

	Loans With A Grade Of:				Total
	A or B	C	D	E	
<b>September 30, 2012:</b>					
Gaming	\$ 25,400,422	\$ 11,310,459	\$ 10,101,187	\$ 14,714,727	\$ 61,526,795
Residential and land development	4,699,193	1,543,824		21,321,578	27,564,595
Real estate, construction	45,704,010	50,901	2,884,154	5,829,584	54,468,649
Real estate, mortgage	216,805,053	2,079,330	14,941,898	13,984,466	247,810,747
Commercial and industrial	23,652,013	658,085	9,846,869	86,729	34,243,696
Other	9,418,159	224,747	78,971		9,721,877
<b>Total</b>	<b>\$ 325,678,850</b>	<b>\$ 15,867,346</b>	<b>\$ 37,853,079</b>	<b>\$ 55,937,084</b>	<b>\$ 435,336,359</b>
<b>December 31, 2011:</b>					
Gaming	\$ 41,816,764	\$	\$	\$ 15,402,472	\$ 57,219,236
Residential and land development	4,865,153		50,545	24,110,378	29,026,076
Real estate, construction	50,797,910	357,114	3,695,437	6,191,049	61,041,510
Real estate, mortgage	197,509,767	2,862,368	25,869,734	12,169,571	238,411,440
Commercial and industrial	23,972,076	6,551,489	3,077,347	349,582	33,950,494
Other	12,266,764	40,454	384,146	67,166	12,758,530
<b>Total</b>	<b>\$ 331,228,434</b>	<b>\$ 9,811,425</b>	<b>\$ 33,077,209</b>	<b>\$ 58,290,218</b>	<b>\$ 432,407,286</b>

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Total loans on nonaccrual as of September 30, 2012 and December 31, 2011, are as follows:

	September 30, 2012	December 31, 2011
Gaming	\$ 14,714,727	\$ 15,402,472
Residential and land development	21,321,578	24,110,378
Real estate, construction	5,334,588	6,041,822
Real estate, mortgage	12,460,378	11,661,628
Commercial and industrial	86,729	245,839
Other		130,576
<b>Total</b>	<b>\$ 53,918,000</b>	<b>\$ 57,592,715</b>

The Company has modified certain loans by granting interest rate concessions to these customers. These loans are in compliance with their modified terms, are currently accruing and the Company has classified them as troubled debt restructurings. Troubled debt restructurings as of September 30, 2012 and December 31, 2011 were as follows:

	Number of Contracts	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment	Related Allowance
<b>September 30, 2012:</b>				
Real estate, construction	1	\$ 182,164	\$ 182,164	\$ 87,000
Real estate, mortgage	3	9,072,049	9,072,049	951,000
Commercial and industrial	1	705,262	705,262	
<b>Total</b>	<b>5</b>	<b>\$ 9,959,475</b>	<b>\$ 9,959,475</b>	<b>\$ 1,038,000</b>
<b>December 31, 2011:</b>				
Real estate, construction	3	\$ 1,075,176	\$ 1,075,176	\$ 112,000
Real estate, mortgage	5	9,915,672	9,915,672	809,000
Commercial and industrial	1	706,336	706,336	
<b>Total</b>	<b>9</b>	<b>\$ 11,697,184</b>	<b>\$ 11,697,184</b>	<b>\$ 921,000</b>

During the nine months ended September 30, 2012, four loans which had been classified as troubled debt restructurings at December 31, 2011 became in default of their modified terms and were placed on nonaccrual. These loans included two loans that were included in the real estate construction segment with a total balance of \$891,986 and two loans that were included in the real estate mortgage segment with a total balance of \$1,018,076 as of December 31, 2011.

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Impaired loans, which include loans classified as nonaccrual and troubled debt restructurings, segregated by class of loans, as of September 30, 2012 and December 31, 2011, are as follows:

	Unpaid Principal Balance	Recorded Investment	Related Allowance	Average Recorded Investment
<b>September 30, 2012:</b>				
<b>With no related allowance recorded:</b>				
Gaming	\$ 14,714,727	\$ 14,714,727	\$	\$ 14,961,193
Residential and land development	22,424,909	21,321,578		21,888,818
Real estate, construction	4,695,700	4,632,144		4,166,807
Real estate, mortgage	11,038,312	11,002,083		10,486,090
Commercial and industrial	791,991	791,991		793,228
<b>Total</b>	<b>\$ 53,665,639</b>	<b>\$ 52,462,523</b>	<b>\$</b>	<b>\$ 52,296,136</b>
<b>With a related allowance recorded:</b>				
Real estate, construction	\$ 884,608	\$ 884,608	\$ 247,000	\$ 904,909
Real estate, mortgage	11,129,858	10,530,344	1,276,300	10,627,717
<b>Total</b>	<b>\$ 12,014,466</b>	<b>\$ 11,414,952</b>	<b>\$ 1,523,300</b>	<b>\$ 11,532,626</b>
<b>Total by class of loans:</b>				
Gaming	\$ 14,714,727	\$ 14,714,727	\$	\$ 14,961,193
Residential and land development	22,424,909	21,321,578		21,888,818
Real estate, construction	5,580,308	5,516,752	247,000	5,071,716
Real estate, mortgage	22,168,170	21,532,427	1,276,300	21,113,807
Commercial and industrial	791,991	791,991		793,228
<b>Total</b>	<b>\$ 65,680,105</b>	<b>\$ 63,877,475</b>	<b>\$ 1,523,300</b>	<b>\$ 63,828,762</b>

	Unpaid Principal Balance	Recorded Investment	Related Allowance	Average Recorded Investment
December 31, 2011:				
With no related allowance recorded:				
Gaming	\$ 15,402,472	\$ 15,402,472	\$	\$ 12,488,307
Residential and land development	24,940,695	21,745,946		7,382,320
Real estate, construction	4,743,490	4,711,470		297,328
Real estate, mortgage	9,965,290	9,956,982		1,110,547
Commercial and industrial	864,485	864,485		412,683
Other	5,308	5,308		
<b>Total</b>	<b>\$ 55,921,740</b>	<b>\$ 52,686,663</b>	<b>\$</b>	<b>\$ 21,691,185</b>
With a related allowance recorded:				
Gaming	\$	\$	\$	\$
Residential and land development	2,364,432	2,364,432	900,000	
Real estate, construction	2,405,528	2,405,528	720,000	184,519
Real estate, mortgage	12,550,318	11,620,318	1,314,011	5,971,190
Commercial and industrial	87,690	87,690	76,818	
Other	125,268	125,268	16,900	30,733
<b>Total</b>	<b>\$ 17,533,236</b>	<b>\$ 16,603,236</b>	<b>\$ 3,027,729</b>	<b>\$ 6,186,442</b>
Total by class of loans:				
Gaming	\$ 15,402,472	\$ 15,402,472	\$	\$ 12,488,307
Residential and land development	27,305,127	24,110,378	900,000	7,382,320
Real estate, construction	7,149,018	7,116,998	720,000	481,847
Real estate, mortgage	22,515,608	21,577,300	1,314,011	7,081,737
Commercial and industrial	952,175	952,175	76,818	412,683
Other	130,576	130,576	16,900	30,733
<b>Total</b>	<b>\$ 73,454,976</b>	<b>\$ 69,289,899</b>	<b>\$ 3,027,729</b>	<b>\$ 27,877,627</b>

Interest income of \$260,935 and \$211,188 was recognized on impaired loans for the nine months ended September 30, 2012 and the year ended December 31, 2011.

Allowance for Loan Losses

6. Allowance for Loan Losses:

Transactions in the allowance for loan losses for the quarters and nine months ended September 30, 2012 and 2011, and the balances of loans, individually and collectively evaluated for impairment as of September 30, 2012 and 2011, are as follows (in thousands):

	Gaming	Residential and Land Development	Real Estate, Construction	Real Estate, Mortgage	Commercial and Industrial	Other	Total
<b>For the Nine Months Ended September 30, 2012:</b>							
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
<b>For the Quarter Ended September 30, 2012:</b>							
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
<b>Allowance for loan losses, September 30, 2012:</b>							
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
<b>Total Loans, September 30, 2012:</b>							
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

	Gaming	Residential and Land Development	Real Estate, Construction	Real Estate, Mortgage	Commercial and Industrial	Other	Total
For the Nine Months Ended September 30, 2011:							
Allowance for Loan Losses:							
Beginning Balance	\$ 466	\$ 1,069	\$ 1,020	\$ 3,413	\$ 480	\$ 202	\$ 6,650
Charge-offs			(275)	(1,098)	(46)	(144)	(1,563)
Recoveries	35		32	46	17	76	206
Provision	(118)	(514)	280	1,705	234	144	1,731
Ending Balance	\$ 383	\$ 555	\$ 1,057	\$ 4,066	\$ 685	\$ 278	\$ 7,024
For the Quarter Ended September 30, 2011:							
Allowance for Loan Losses:							
Beginning Balance	\$ 252	\$ 530	\$ 1,034	\$ 4,141	\$ 491	\$ 266	\$ 6,714
Charge-offs			(64)	(142)		(41)	(247)
Recoveries						13	13
Provision	131	25	87	67	194	40	544
Ending Balance	\$ 383	\$ 555	\$ 1,057	\$ 4,066	\$ 685	\$ 278	\$ 7,024
Allowance for loan losses, September 30, 2011:							
Ending balance: individually evaluated for impairment	\$	\$	\$ 249	\$ 1,876	\$ 402	\$ 60	\$ 2,587
Ending balance: collectively evaluated for impairment	\$ 383	\$ 555	\$ 808	\$ 2,190	\$ 283	\$ 218	\$ 4,437
Total Loans, September 30, 2011:							
Ending balance: individually evaluated for impairment	\$ 15,589	\$ 23,712	\$ 24,248	\$ 38,295	\$ 8,185	\$ 3,626	\$ 113,655
Ending balance: collectively evaluated for impairment	\$ 22,003	\$ 5,354	\$ 40,102	\$ 202,981	\$ 28,751	\$ 9,311	\$ 308,502

## Deposits

### 7. Deposits:

At September 30, 2012, time deposits of \$100,000 or more include brokered deposits of \$28,612,000. Of the total brokered deposits, \$23,612,000 matures in 2013 and the remaining balance matures in 2017.

## Shareholders' Equity

### 8. Shareholders' Equity:

On July 25, 2012, the Board of Directors of the Company declared a semi-annual dividend of \$ .10 per share. The dividend has a record date of August 10, 2012 and a distribution date of August 17, 2012.

Accumulated Other Comprehensive Income

9. Accumulated Other Comprehensive Income:

At September 30, 2012, accumulated other comprehensive income included the unrealized gain on available for sale securities of \$3,490,233, net of tax of \$1,797,999, and the gain from the unfunded post-retirement benefit obligation of \$2,108,023, net of tax of \$1,085,528.

## Fair Value Measurements and Disclosures

### 10. 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. The Company records impaired loans 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. The Company records 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, 2012 and December 31, 2011 are as follows:

	Total	Fair Value Measurement Using		
		Level 1	Level 2	Level 3
<b>September 30, 2012:</b>				
U.S. Treasuries	\$ 74,211,100	\$	\$ 74,211,100	\$
U.S. Government agencies	156,855,443		156,855,443	
Mortgage-backed securities	18,857,484		18,857,484	
States and political subdivisions	38,921,563		38,921,563	
Equity securities	649,983		649,983	
<b>Total</b>	<b>\$ 289,495,573</b>	<b>\$</b>	<b>\$ 289,495,573</b>	<b>\$</b>
<b>December 31, 2011:</b>				
U.S. Treasuries	\$ 54,009,611	\$	\$ 54,009,611	\$
U.S. Government agencies	179,180,285		179,180,285	
Mortgage-backed securities	5,001,155		5,001,155	
States and political subdivisions	40,077,447		40,077,447	
Equity securities	649,983		649,983	
<b>Total</b>	<b>\$ 278,918,481</b>	<b>\$</b>	<b>\$ 278,918,481</b>	<b>\$</b>

Impaired loans, which are measured at fair value on a non-recurring basis, by level within the fair value hierarchy as of September 30, 2012 and December 31, 2011 are as follows:

	Total	Fair Value Measurement Using		
		Level 1	Level 2	Level 3
September 30, 2012	\$ 62,354,174	\$	\$	\$ 62,354,174
December 31, 2011	66,262,170			66,262,170

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

	For the Nine Months Ended September 30, 2012	For the Year Ended December 31, 2011
Balance, beginning of period	\$ 66,262,170	\$ 14,294,758
Additions to impaired loans and troubled debt restructurings	3,104,851	61,165,501
Principal payments, charge-offs and transfers to other real estate	(8,517,276)	(7,115,192)
Change in allowance for loan losses on impaired loans	1,504,429	(2,082,897)
Balance, end of period	\$ 62,354,174	\$ 66,262,170

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, 2012 and December 31, 2011 are as follows:

	Total	Fair Value Measurement Using		
		Level 1	Level 2	Level 3
September 30, 2012	\$ 7,368,534	\$	\$	\$ 7,368,534
December 31, 2011	6,153,238			6,153,238

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

	For the Nine Months Ended September 30, 2012	For the Year Ended December 31, 2011
Balance, beginning of period	\$ 6,153,238	\$ 5,744,150
Loans transferred to ORE	2,545,780	3,221,510
Sales	(1,177,184)	(2,101,416)
Writedowns	(153,300)	(711,006)
Balance, end of period	\$ 7,368,534	\$ 6,153,238

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The carrying value and estimated fair value of assets and liabilities, by level within the fair value hierarchy, at September 30, 2012 and December 31, 2011, are as follows:

	Carrying Amount	Fair Value Measurement Using			Total
		Level 1	Level 2	Level 3	
<b>September 30, 2012:</b>					
<b>Assets:</b>					
Cash and due from banks	\$ 26,704,262	\$ 26,704,262	\$	\$	\$ 26,704,262
Available for sale securities	289,495,573		289,495,573		289,495,573
Held to maturity securities	6,990,774		7,078,544		7,078,544
Other investments	3,629,820	3,629,820			3,629,820
Federal Home Loan Bank stock	2,806,000		2,806,000		2,806,000
Loans, net	428,248,538			431,624,965	431,624,965
Other real estate	7,368,534			7,368,534	7,368,534
Cash surrender value of life insurance	16,639,718			16,639,718	16,639,718
<b>Liabilities:</b>					
<b>Deposits:</b>					
Non-interest bearing	117,399,669	117,399,669			117,399,669
Interest bearing	380,616,573		383,093,058		383,093,058
Federal funds purchased and securities sold under agreements to repurchase	138,075,746	138,075,746			138,075,746
Borrowings from Federal Home Loan Bank	50,467,310		53,138,097		53,138,097
<b>December 31, 2011:</b>					
<b>Assets:</b>					
Cash and due from banks	\$ 36,928,657	\$ 36,928,657	\$	\$	\$ 36,928,657
Available for sale securities	278,918,481		278,918,481		278,918,481
Held to maturity securities	1,428,887		1,492,374		1,492,374
Other investments	3,930,300	3,930,300			3,930,300
Federal Home Loan Bank stock	2,580,700		2,580,700		2,580,700
Loans, net	424,271,664			427,880,554	427,880,554
Other real estate	6,153,238			6,153,238	6,153,238
Cash surrender value of life insurance	16,196,368			16,196,368	16,196,368
<b>Liabilities:</b>					
<b>Deposits:</b>					
Non-interest bearing	97,581,073	97,581,073			97,581,073
Interest bearing	370,858,009		372,018,592		372,018,592
Federal funds purchased and securities sold under agreements to repurchase	157,600,967	157,600,967			157,600,967
Borrowings from Federal Home Loan Bank	53,323,568		55,013,522		55,013,522

## Reclassifications

### 10. 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, 2011.

### **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**

There were no new accounting standards updates issued during the nine months ended September 30, 2012. The Company did implement the disclosure requirements relating to the presentation of comprehensive income as set forth in Accounting Standards Update 2011 - 5.

### **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 determination. 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 generally accepted accounting principles. 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.

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 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. Although Hurricane Isaac struck the trade area in August of 2012, there was minimal impact to the Company and its customers. 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.

Net income for the third quarter of 2012 was \$749,560 compared with \$577,676 for the third quarter of 2011. While non-interest income decreased \$656,735 in 2012 as compared with 2011, net interest income increased \$190,098 and non-interest expense decreased \$833,521 and income taxes increased \$198,000 as taxable income increased. Interest expense decreased as the Company was able to reduce its cost of funds. Results for 2011 included increased gains on sales and calls of securities and the gain on death benefits from life insurance as compared with 2012. During 2012, the Company had losses on its other investments. Non-interest expense decreased in 2012 as a result of the impact of the voluntary early retirement program and decreased costs associated with foreclosed property.

Net income for the first nine months of 2012 was \$1,816,069 compared with \$1,825,093 for the first nine months of 2011. While non-interest income decreased \$114,632 in 2012 as compared with 2011, the provision for loan losses increased \$640,000 and non-interest expense decreased \$1,211,181 and income tax benefit decreased \$393,000 as taxable income increased. Results for 2012 included increased gains on sales and calls of securities and a loss on the Company's other investments. During 2011, the Company had a gain on death benefits from life insurance. Non-interest expense decreased in 2012 as salaries and employee benefits decreased as a result of the impact of the voluntary early retirement program and other expense decreased as costs associated with foreclosed property declined. These decreases in non-interest expense were partially offset by an increase in data processing costs as the Company outsourced its computer operations in June of 2011.

Monitoring asset quality, estimating potential losses in our loan portfolio and addressing non-performing loans continue to be emphasized during these difficult economic times. Borrowers' ability to repay has been significantly impacted by these conditions, which has resulted in nonaccrual loans totaling \$53,918,000 and \$57,592,715 at September 30, 2012 and December 31, 2011, respectively. Most of these loans are collateral-dependent, and the Company has rigorously evaluated the value of its collateral to determine potential losses. During the second quarter of 2012,

the Company increased the specific reserve on one credit relationship by \$800,000 as well as reporting a number of other smaller adjustments in specific reserves to other loans. As a result, the provision for loan losses increased to \$2,371,000 for the first nine months of 2012 from \$1,731,000 for the first nine months of 2011. The provision for loan losses was \$541,000 and \$544,000 for the quarters ended September 30, 2012 and 2011, respectively.

Total assets at September 30, 2012 increased \$9,282,195 as compared with December 31, 2011.

Available for sale securities increased \$10,577,092 at September 30, 2012 as compared with December 31, 2011. Securities were purchased as public fund balances increased significantly during the first quarter of 2012. Balances in our non-deposit sweep accounts, reported as federal funds purchased and securities sold under agreements to repurchase, decreased \$19,525,221 at September 30, 2012 as compared with December 31, 2011, as these customers reallocate their balances to deposit accounts or due to normal seasonal activity.

## **RESULTS OF OPERATIONS**

### **Net Interest Income**

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

#### Quarter Ended September 30, 2012 as Compared with Quarter Ended September 30, 2011

The Company's average interest earning assets increased approximately \$18,756,000, or 3%, from approximately \$721,117,000 for the third quarter of 2011 to approximately \$739,873,000 for the third quarter of 2012. The Company's average balance sheet increased as new loans have outpaced principal payments, maturities, charge-offs and foreclosures relating to existing loans and proceeds from maturing taxable available for sale securities were used to paydown borrowings.

The average yield on earning assets decreased by 12 basis points, from 3.51% for the third quarter of 2011 to 3.39% for the third quarter of 2012, with the biggest impact to the yield on taxable available for sale securities. The Company's investment and liquidity strategy has been to invest most of the proceeds from sales, calls and maturities of securities in similar securities. As a result, the yield on taxable available for sale securities decreased from 1.95% for the third quarter of 2011 to 1.65% for the third quarter of 2012. 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 2014. The yield on loans has decreased due to the increase in loans on nonaccrual during the last quarter of 2011 and the first nine months of 2012.

Average interest bearing liabilities increased approximately \$5,170,000, or 1%, from approximately \$586,589,000 for the third quarter of 2011 to approximately \$591,759,000 for the third quarter of 2012. The increase was primarily related to borrowings from the Federal Home Loan Bank, which increased due to the liquidity needs of the bank subsidiary.



The average rate paid on interest bearing liabilities decreased 18 basis points, from .49% for the third quarter of 2011 to .31% for the third quarter of 2012. Rates paid on deposit accounts and non-deposit accounts, which are reported as federal funds purchased and securities sold under agreements to repurchase, have decreased in 2012. 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 3.14% for the quarter ended September 30, 2012, up 3 basis points from 3.11% for the quarter ended September 30, 2011.

Nine Months Ended September 30, 2012 as Compared with Nine Months Ended September 30, 2011

The Company's average interest earning assets increased approximately \$36,139,000, or 5%, from approximately \$722,325,000 for the first nine months of 2011 to approximately \$758,464,000 for the first nine months of 2012. The Company's average loan balance increased as new loans have outpaced principal payments, maturities, charge-offs and foreclosures relating to existing loans.

The average yield on earning assets decreased by 34 basis points, from 3.70% for the first nine months of 2011 to 3.36% for the first nine months of 2012, with the biggest impact to the yield on taxable available for sale securities. The Company's investment and liquidity strategy has been to invest most of the proceeds from sales, calls and maturities of securities in similar securities. As a result, the yield on taxable available for sale securities decreased from 2.27% for the first nine months of 2011 to 1.75% for the first nine months of 2012. 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 2014. The yield on loans has decreased due to the increase in loans on nonaccrual during the last quarter of 2011 and the first nine months of 2012.

Average interest bearing liabilities increased approximately \$27,712,000, or 5%, from approximately \$588,437,000 for the first nine months of 2011 to approximately \$616,149,000 for the first nine months of 2012. The increase was primarily related to borrowings from the Federal Home Loan Bank, which increased due to the liquidity needs of the bank subsidiary.

The average rate paid on interest bearing liabilities decreased 22 basis points, from .57% for the first nine months of 2011 to .35% for the first nine months of 2012. Rates paid on deposit accounts and non-deposit accounts, which are reported as federal funds purchased and securities sold under agreements to repurchase, have decreased in 2012. 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 3.07% for the nine months ended September 30, 2012, down 17 basis points from 3.24% for the nine months ended September 30, 2011.

The tables on the following pages analyze the changes in tax-equivalent net interest income for the quarters ended September 30, 2012 and 2011 and the nine months ended September 30, 2012 and 2011.

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

(In Thousands)

	Three Months Ended September 30, 2012			Three Months Ended September 30, 2011		
	Average Balance	Interest Earned/Paid	Rate	Average Balance	Interest Earned/Paid	Rate
Loans (2)(3)	\$ 430,241	\$ 4,637	4.31%	\$ 399,409	\$ 4,456	4.46%
Federal Funds Sold	5,193	3	0.23%	2,851	2	0.28%
HTM:						
Non taxable (1)	5,719	57	3.99%	1,917	25	5.22%
AFS:						
Taxable	255,497	1,054	1.65%	276,372	1,347	1.95%
Non taxable (1)	39,151	513	5.24%	38,127	486	5.10%
Other	4,072	10	0.98%	2,441	12	1.97%
<b>Total</b>	<b>\$ 739,873</b>	<b>\$ 6,274</b>	<b>3.39%</b>	<b>\$ 721,117</b>	<b>\$ 6,328</b>	<b>3.51%</b>
Savings & interest-bearing DDA	\$ 232,016	\$ 66	0.11%	\$ 223,237	\$ 159	0.28%
CD s	149,169	252	0.68%	163,790	351	0.86%
Federal funds purchased	159,273	81	0.20%	173,348	174	0.40%
FHLB advances	51,301	60	0.47%	26,214	40	0.61%
<b>Total</b>	<b>\$ 591,759</b>	<b>\$ 459</b>	<b>0.31%</b>	<b>\$ 586,589</b>	<b>\$ 724</b>	<b>0.49%</b>
<b>Net tax-equivalent margin on earning assets</b>			<b>3.14%</b>			<b>3.11%</b>

- (1) All interest earned is reported on a taxable equivalent basis using a tax rate of 34% in 2012 and 2011.  
(2) Loan fees of \$160 and \$154 for 2012 and 2011, 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, 2012			Nine Months Ended September 30, 2011		
	Average Balance	Interest Earned/Paid	Rate	Average Balance	Interest Earned/Paid	Rate
Loans (2)(3)	\$ 428,944	\$ 13,789	4.29%	\$ 399,465	\$ 13,744	4.59%
Federal Funds Sold	6,184	12	0.26%	4,858	6	0.16%
HTM:						
Non taxable (1)	3,876	121	4.16%	1,916	80	5.57%
AFS:						
Taxable	275,638	3,615	1.75%	273,062	4,656	2.27%
Non taxable (1)	39,745	1,569	5.26%	40,208	1,539	5.10%
Other	4,077	15	0.49%	2,816	21	0.99%
<b>Total</b>	<b>\$ 758,464</b>	<b>\$ 19,121</b>	<b>3.36%</b>	<b>\$ 722,325</b>	<b>\$ 20,046</b>	<b>3.70%</b>
Savings & interest-bearing DDA	\$ 231,942	\$ 367	0.21%	\$ 230,217	\$ 684	0.40%
CD s	151,464	795	0.70%	171,424	1,181	0.92%
Federal funds purchased	171,456	298	0.23%	152,444	515	0.45%
FHLB advances	61,287	179	0.39%	34,352	135	0.52%
<b>Total</b>	<b>\$ 616,149</b>	<b>\$ 1,639</b>	<b>0.35%</b>	<b>\$ 588,437</b>	<b>\$ 2,515</b>	<b>0.57%</b>
Net tax-equivalent margin on earning assets			3.07%			3.24%

- (1) All interest earned is reported on a taxable equivalent basis using a tax rate of 34% in 2012 and 2011.  
(2) Loan fees of \$549 and \$517 for 2012 and 2011, respectively, are included in these figures.  
(3) Includes nonaccrual loans.

## Analysis of Changes in Interest Income and Interest Expense

(In Thousands)

	For the Quarter Ended			
	September 30, 2012	September 30, 2012 compared with September 30, 2011		September 30, 2011
	Volume	Rate	Rate/Volume	Total
<b>Interest earned on:</b>				
Loans	\$ 344	\$ (150)	\$ (13)	\$ 181
Federal funds sold	2	(1)		1
Held to maturity securities:				
Non taxable	50	(6)	(12)	32
Available for sale securities:				
Taxable	(102)	(207)	16	(293)
Non taxable	13	13	1	27
Other	8	(6)	(4)	(2)
<b>Total</b>	<b>\$ 315</b>	<b>\$ (357)</b>	<b>\$ (12)</b>	<b>\$ (54)</b>
<b>Interest paid on:</b>				
Savings & interest-bearing deposits	\$ 6	\$ (95)	\$ (4)	\$ (93)
CD s	(31)	(74)	6	(99)
Federal funds purchased	(14)	(87)	8	(93)
FHLB advances	38	(9)	(9)	20
<b>Total</b>	<b>\$ (1)</b>	<b>\$ (265)</b>	<b>\$ 1</b>	<b>\$ (265)</b>

## Analysis of Changes in Interest Income and Interest Expense

(In Thousands)

	For the Nine Months Ended			
	September 30, 2012 compared with September 30, 2011			
	Volume	Rate	Rate/Volume	Total
<b>Interest earned on:</b>				
Loans	\$ 1,014	\$ (899)	\$ (70)	\$ 45
Federal funds sold	2	3	1	6
Held to maturity securities:				
Non taxable	82	(20)	(21)	41
Available for sale securities:				
Taxable	44	(1,065)	(20)	(1,041)
Non taxable	(18)	48		30
Other	9	(10)	(5)	(6)
<b>Total</b>	<b>\$ 1,133</b>	<b>\$ (1,943)</b>	<b>\$ (115)</b>	<b>\$ (925)</b>
<b>Interest paid on:</b>				
Savings & interest-bearing deposits	\$ 5	\$ (321)	\$ (1)	\$ (317)
CD s	(138)	(282)	34	(386)
Federal funds purchased	64	(252)	(29)	(217)
FHLB advances	105	(33)	(28)	44
<b>Total</b>	<b>\$ 36</b>	<b>\$ (888)</b>	<b>\$ (24)</b>	<b>\$ (876)</b>

**Provision for Loan Losses**

In the normal course of business, the Company assumes risk in extending credit to its customers. This credit risk is managed through compliance with the loan policy, which is approved by the Board of Directors. The policy establishes guidelines relating to underwriting standards, including but not limited to financial analysis, collateral valuation, lending limits, pricing considerations and loan grading. 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. The Company 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, land, development, construction and commercial real estate loans, and their direct and indirect impact on its operations on a monthly basis. 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 \$541,000 and \$544,000 for the third quarters of 2012 and 2011, respectively, and \$2,371,000 and \$1,731,000 for the first nine months of 2012 and 2011, respectively. The allowance for loan losses as a percentage of loans was 1.62% and 1.75% at September 30, 2012 and December 31, 2011, respectively. The Company's evaluation includes evaluating the current values of collateral securing all nonaccrual loans. Even though nonaccrual loans grew to \$53,918,000 and \$57,592,715 at September 30, 2012 and December 31, 2011, respectively, specific reserves of only \$485,300 and \$2,106,729, 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, 2012.

The allowance for loan losses is an estimate, and as such, events may occur in the future which may affect its accuracy. The Company anticipates that it is possible that additional information will be gathered in future quarters which may require an adjustment to the allowance for loan losses. Management will continue to closely monitor its portfolio and take such action as it deems appropriate to accurately report its financial condition and results of operations.

#### **Non-interest income**

Non-interest income decreased \$656,735 for the third quarter of 2012 as compared with the third quarter of 2011. Trust department income and fees increased \$78,204 as a result of fees relating to several large estates. During the third quarter of 2012, gains from sales and calls of securities decreased \$449,981 in comparison with the third quarter of 2011 as sales were executed when proceeds would be maximized. Results for the third quarter of 2012 included a loss on other investments of \$47,637 as well as a loss from impairment of these investments of \$180,000. Gains from the redemption of life insurance were \$80,621 for the third quarter of 2011.

Non-interest income decreased \$114,632 for the first nine months of 2012 as compared with the first nine months of 2011. Trust department income and fees increased \$80,173 as a result of fees relating to several large estates. During the first nine months of 2012, gains from sales and calls of securities increased \$507,020 in comparison with the first nine months of 2011 as sales were executed when proceeds would be maximized. The Company had a loss on other investments of \$84,480 in 2012 as compared with income of \$10,124 in 2011. There was also a loss from impairment of other investments of \$180,000 in 2012. Gains from the redemption of life insurance were \$469,740 for the first nine months of 2011.

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

Total non-interest expense decreased \$833,521 for the third quarter of 2012 as compared with the third quarter of 2011. Salaries and employee benefits decreased \$430,136; data processing expenses increased \$76,245 and other expenses decreased \$528,026 for the third quarter of 2012 as compared with the second quarter of 2011.

Salaries decreased \$194,341 in the third quarter of 2012 as compared with the third quarter of 2011 as the employee census continues to decrease from attrition and the impact of the 2011 voluntary early retirement package. Expenses relating to the retiree health plan decreased \$227,460 as a result of amendments made to the plan which require plan participants to utilize drug benefits and health insurance coverage available under Medicare.

Data processing costs increased in 2012 as a result of the outsourcing of these activities during the second quarter of 2011.

Included in other expense in 2012 are expenses relating to the ORE portfolio which decreased \$539,362 as compared with 2011. In 2011, the Company recorded write downs of several of these properties to their fair value, less estimated cost to sell.

Total non-interest expense decreased \$1,211,181 for the first nine months of 2012 as compared with the first nine months of 2011. Salaries and employee benefits decreased \$882,126; equipment rentals, depreciation and maintenance decreased \$177,124; data processing expenses increased \$519,974 and other expenses decreased \$745,419 for the first nine months of 2012 as compared with the first nine months of 2011.

Salaries decreased \$527,070 in the first nine months of 2012 as compared with the first nine months of 2011 as the employee census continues to decrease from attrition and the impact of the 2011 voluntary early retirement package. Expenses relating to the retiree health plan decreased \$413,587 as a result of amendments made to the plan which require plan participants to utilize drug benefits and health insurance coverage available under Medicare.

Equipment maintenance and servicing decreased \$94,793 in 2012 due to the timing of payment for these services. Depreciation costs have decreased by \$108,000 in 2012, as computer and other equipment acquired after Hurricane Katrina in 2005 are now fully depreciated.

Data processing costs increased in 2012 as a result of the outsourcing of these activities during the second quarter of 2011.

Included in other expense are expenses relating to the ORE portfolio which decreased \$493,337 in 2012 a result of the write down of several of these properties to their fair value, less estimated cost to sell in 2011. The remaining net increase in other expense is primarily due to the timing of various services.



**Income Tax Expense (Benefit)**

Income taxes have been impacted by non-taxable income and federal tax credits during the quarters and nine months ended September 30, 2012 and 2011, as follows:

	Quarters Ended September 30,			
	2012		2011	
	Tax	Rate	Tax	Rate
Taxes at statutory rate	\$ 271,850	34	\$ 146,090	34
Increase (decrease) resulting from:				
Tax-exempt interest income	(102,699)	(13)	(122,539)	(29)
Income from BOLI	(40,542)	(5)	(69,502)	(16)
Federal tax credits	(91,410)	(11)	(91,410)	(21)
Other	12,801	1	(10,639)	(2)
<b>Total income taxes (benefit)</b>	<b>\$ 50,000</b>	<b>6</b>	<b>\$ (148,000)</b>	<b>(34)</b>

	Nine Months Ended September 30,			
	2012		2011	
	Tax	Rate	Tax	Rate
Taxes at statutory rate	\$ 584,483	34	\$ 453,932	34
Increase (decrease) resulting from:				
Tax-exempt interest income	(303,203)	(18)	(385,968)	(29)
Income from BOLI	(124,411)	(7)	(289,414)	(22)
Federal tax credits	(274,230)	(16)	(274,230)	(21)
Other	20,361	1	5,680	1
<b>Total income taxes (benefit)</b>	<b>\$ (97,000)</b>	<b>(6)</b>	<b>\$ (490,000)</b>	<b>(37)</b>

**FINANCIAL CONDITION**

Available for sale securities increased \$10,577,092 at September 30, 2012, compared with December 31, 2011, as a large increase in funds in a non-deposit product during the first quarter were invested in these securities.

Held to maturity securities increased \$5,561,887 at September 30, 2012, compared with December 31, 2011, as the Company opted to classify some of its investment purchases during the current year as held to maturity.

The investment in Federal Home Loan Bank ( FHLB ) stock increased \$225,300 at September 30, 2012 as compared with December 31, 2011 so that the Company could increase its borrowing capacity from the FHLB during the period.

Other real estate ( ORE ) increased \$1,215,296 at September 30, 2012 as compared with December 31, 2011. Loans totaling \$2,545,780 were transferred into ORE while \$1,177,184 was sold for a loss of \$27,123 and write downs of ORE to fair value of \$153,300 were recorded during the first nine months of 2012.

Prepaid FDIC assessments decreased by \$1,234,295 at September 30, 2012 as compared with December 31, 2011 as a result of the amortization of these costs.

Other assets increased \$780,461 at September 30, 2012 as compared with December 31, 2011 primarily as income taxes receivable increased \$180,000 due to overpayments during 2011, corporate trust fees accrued for 2012 increased \$355,623 and deferred taxes increased \$186,000. Deferred taxes were impacted by the increase in liabilities for employee benefit plans and depreciation.

Total deposits increased \$29,577,160 at September 30, 2012, as compared with December 31, 2011. 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.

Federal funds purchased and securities sold under agreements to repurchase decreased \$19,525,221 at September 30, 2012 as compared with December 31, 2011 as several county and municipal entities decreased their balances in a non-deposit account during 2012.

Borrowings from the FHLB decreased \$2,856,258 at September 30, 2012 as compared with December 31, 2011 based on the liquidity needs of the bank subsidiary.

Employee and director benefit plans liabilities increased \$899,921 at September 30, 2012 as compared with December 31, 2011 due to the deferred compensation benefits earned by officers and directors during 2012.

Other liabilities decreased \$529,772 at September 30, 2012 as compared with December 31, 2011 as a result of the payment of officer incentives and director fees which had been accrued at December 31, 2011.

#### **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, 2012, 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, 2012 and December 31, 2011, are as follows (in thousands):

	Actual Amount	Ratio	For Capital Adequacy Purposes Amount	Ratio
<b>September 30, 2012:</b>				
Total Capital (to Risk Weighted Assets)	\$ 112,218	20.64%	\$ 43,496	8.00%
Tier 1 Capital (to Risk Weighted Assets)	105,417	19.39%	21,748	4.00%
Tier 1 Capital (to Average Assets)	105,417	12.66%	33,315	4.00%
<b>December 31, 2011:</b>				
Total Capital (to Risk Weighted Assets)	\$ 110,762	20.86%	\$ 42,475	8.00%
Tier 1 Capital (to Risk Weighted Assets)	104,116	19.61%	21,238	4.00%
Tier 1 Capital (to Average Assets)	104,116	12.84%	32,436	4.00%

The actual capital amounts and ratios and required minimum capital amounts and ratios for the Bank as of September 30, 2012 and December 31, 2011, are as follows (in thousands):

	Actual Amount	Ratio	For Capital Adequacy Purposes Amount	Ratio	To Be Well Capitalized Amount	Ratio
<b>September 30, 2012:</b>						
Total Capital (to Risk Weighted Assets)	\$ 107,722	19.84%	\$ 43,430	8.00%	\$ 54,287	10.00%
Tier 1 Capital (to Risk Weighted Assets)	100,933	18.59%	21,715	4.00%	32,572	6.00%
Tier 1 Capital (to Average Assets)	100,933	12.35%	32,699	4.00%	40,873	5.00%
<b>December 31, 2011:</b>						
Total Capital (to Risk Weighted Assets)	\$ 108,149	20.40%	\$ 42,413	8.00%	\$ 53,014	10.00%
Tier 1 Capital (to Risk Weighted Assets)	101,503	19.15%	21,207	4.00%	31,809	6.00%
Tier 1 Capital (to Average Assets)	101,503	12.56%	32,332	4.00%	40,407	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 14.49% at September 30, 2012, 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, 2012, 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, 2012 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, 2012, formatted in XBRL (Extensible Business Reporting Language): (i) Consolidated Statements of Condition at September 30, 2012 and December 31, 2011, (ii) Consolidated Statements of Income for the quarters and nine months ended September 30, 2012 and 2011, (iii) Consolidated Statements of Comprehensive Income for the quarters and nine months ended September 30, 2012 and 2011, (iv) Statement of Changes in Shareholders' Equity for the nine months ended September 30, 2012, (v) Consolidated Statements of Cash Flows for the nine months ended September 30, 2012 and 2011 and (vi) Notes to the Unaudited Consolidated Financial Statements for the nine months ended September 30, 2012 and 2011.

(b) Reports on Form 8-K

A Form 8-K was filed on July 25, 2012, July 27, 2012 and October 24, 2012.

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, 2012

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

Date: November 13, 2012

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