

PEOPLES FINANCIAL CORP /MS/  
Form 10-K  
March 13, 2019  
Table of Contents

UNITED STATES SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

**FORM 10-K**

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15 (d) OF THE SECURITIES EXCHANGE ACT OF 1934

OR

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

For the fiscal year ended December 31, 2018      Commission File Number 001-12103

PEOPLES FINANCIAL CORPORATION

(Exact name of registrant as specified in its charter)

Mississippi  
(State or other jurisdiction of incorporation or organization)

64-0709834  
(I.R.S. Employer Identification Number)

Lameuse and Howard Avenues, Biloxi, Mississippi 39533  
(Address of principal executive offices) (Zip code)

228-435-5511  
(Registrant's telephone number, including area code)

Securities registered pursuant to Section 12 (b) of the Act:

Name of Each Exchange on

Title of Each Class

Which Registered

None

None

Securities registered pursuant to Section 12 (g) of the Act:

Common, \$1.00 Par Value

(Title of each class)

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.  
YES \_\_\_ NO X

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Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. YES \_\_\_ NO  X

Note - Checking the box above will not relieve any registrant required to file reports pursuant to Section 13 or 15(d) of the Exchange Act from their obligations under those Sections.

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

Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit such files). Yes  X  No \_\_\_

Indicate by check mark if disclosure of delinquent filers pursuant to item 405 (§ 229.405 of this chapter) of Regulation S-K is not contained herein, and will not be contained, to the best of the Registrant's knowledge in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to the Form 10-K.  X

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

Large accelerated filer \_\_\_ Accelerated filer \_\_\_ Non-Accelerated filer \_\_\_ Smaller reporting company  X  Emerging growth company \_\_\_

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

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). YES \_\_\_ NO  X

At June 30, 2018, the aggregate market value of the registrant's voting stock held by non-affiliates was approximately \$62,914,000.

On February 15, 2019, the registrant had outstanding 4,943,186 shares of common stock, par value of \$1.00 per share.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the Registrant's Definitive Proxy Statement issued in connection with the Annual Meeting of Shareholders to be held April 24, 2019, are incorporated by reference into Part III of this report.

**Table of Contents**

Peoples Financial Corporation

Form 10-K

Index

**PART I**

|          |                                  |    |
|----------|----------------------------------|----|
| Item 1.  | <u>DESCRIPTION OF BUSINESS</u>   | 3  |
| Item 1A. | <u>RISK FACTORS</u>              | 36 |
| Item 1B. | <u>UNRESOLVED STAFF COMMENTS</u> | 45 |
| Item 2.  | <u>PROPERTIES</u>                | 45 |
| Item 3.  | <u>LEGAL PROCEEDINGS</u>         | 45 |
| Item 4.  | <u>MINE SAFETY DISCLOSURES</u>   | 45 |

**PART II**

|          |   |     |
|----------|---|-----|
| Item 5.  | <u>MARKET FOR THE REGISTRANT'S COMMON EQUITY, RELATED SHAREHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES</u> | 46  |
| Item 6.  | <u>SELECTED FINANCIAL DATA</u>  | 47  |
| Item 7.  | <u>MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS</u>                            | 48  |
| Item 7A. | <u>QUANTITATIVE AND QUALITATIVE DISCLOSURE ABOUT MARKET RISK</u>  | 61  |
| Item 8.  | <u>FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA</u>  | 61  |
| Item 9.  | <u>CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE</u>                             | 112 |
| Item 9A. | <u>CONTROLS AND PROCEDURES</u>  | 112 |
| Item 9B. | <u>OTHER INFORMATION</u>  | 112 |

**Part III**

|          |   |     |
|----------|---|-----|
| Item 10. | <u>DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE</u>   | 113 |
| Item 11. | <u>EXECUTIVE COMPENSATION</u>   | 113 |
| Item 12. | <u>SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS</u> | 113 |
| Item 13. | <u>CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS AND DIRECTOR INDEPENDENCE</u>                       | 113 |
| Item 14. | <u>PRINCIPAL ACCOUNTING FEES AND SERVICES</u>   | 113 |

**PART IV**

|          |   |     |
|----------|---|-----|
| Item 15. | <u>EXHIBITS AND FINANCIAL STATEMENT SCHEDULES</u> | 114 |
|----------|---|-----|

**Table of Contents**

**PART I**

**ITEM 1 - DESCRIPTION OF BUSINESS**

**BACKGROUND AND CURRENT OPERATIONS**

**General**

Peoples Financial Corporation (the Company) was organized as a one bank holding company in 1985. The Company is headquartered in Biloxi, Mississippi. At December 31, 2018, the Company operated in the state of Mississippi through its wholly-owned subsidiary, The Peoples Bank, Biloxi, Mississippi (the Bank). The Company is engaged, through this subsidiary, in the banking business. The Bank is the Company's principal asset and primary source of revenue.

The Main Office, operations center and asset management and trust services of the Bank are located in downtown Biloxi, MS. At December 31, 2018, the Bank also had 17 branches located throughout Harrison, Hancock, Jackson and Stone Counties. The Bank has automated teller machines (ATM) at its Main Office, all branch locations and at numerous non-proprietary locations.

**The Bank Subsidiary**

The Company's wholly-owned bank subsidiary was originally chartered in 1896 in Biloxi, Mississippi, as The Peoples Bank of Biloxi. The Bank is a state chartered bank whose deposits are insured under the Federal Deposit Insurance Act. The Bank is not a member of the Federal Reserve System. The legal name of the Bank was changed to The Peoples Bank, Biloxi, Mississippi, during 1991.

Most of the Bank's business originates from Harrison, Hancock, Stone and Jackson Counties in Mississippi; however, some business is obtained from other counties in southern Mississippi, southern Louisiana and southern Alabama.

**Nonbank Subsidiary**

In 1985, PFC Service Corp. (PFC) was chartered and began operations as the second wholly-owned subsidiary of Peoples Financial Corporation. The purpose of PFC was principally the leasing of automobiles and equipment. PFC is inactive at this time.

**Products And Services**

The Bank currently offers a variety of services to individuals and small to middle market businesses within its trade area. The Company's trade area is defined as those portions of Mississippi, Louisiana and Alabama which are within a fifty mile radius of the Waveland, Wiggins and Gautier branches, the bank subsidiary's three most outlying locations.

The Bank's primary lending focus is to offer business, commercial, real estate, construction, personal and installment loans, with an emphasis on commercial lending. The Bank's exposure for out of area, residential and land development, construction and commercial real estate loans as well as concentrations in the hotel/motel and gaming industries are monitored by the Company.



## Table of Contents

Each loan officer has board approved lending limits on the principal amount of secured and unsecured loans that can be approved for a single borrower without prior approval of the senior credit committee. All loans, however, must meet the credit underwriting standards and loan policies of the Bank.

Deposit services include interest bearing and non-interest bearing checking accounts, savings accounts, certificates of deposit, and IRA accounts. The Bank generally provides depository accounts to individuals; small and middle market businesses; and state, county and local government entities in its trade area at interest rates consistent with market conditions.

The Bank's Asset Management and Trust Services Department ( Trust Department ) offers personal trust, agencies and estate services, including living and testamentary trusts, executorships, guardianships, and conservatorships. Benefit accounts maintained by the Trust Department primarily include self-directed individual retirement accounts. Escrow management, stock transfer and bond paying agency accounts are available to corporate customers.

The Bank also offers a variety of other services including safe deposit box rental, wire transfer services, night drop facilities, collection services, cash management and internet banking. The Bank has 30 ATMs at its branch locations and other off-site, non-proprietary locations, providing bank customers access to their depository accounts. The Bank is a member of the PULSE network.

There has been no significant change in the kind of services offered by the Bank during the last three fiscal years.

## Customers

The Bank has a large number of customers acquired over a period of many years and is not dependent upon a single customer or upon a few customers. The Bank also provides services to customers representing a wide variety of industries including seafood, retail, hospitality, hotel/motel, gaming and construction. While the Company has pursued external growth strategies on a limited basis, its primary focus has been on internal growth by the Bank through the establishment of new branch locations and an emphasis on strong customer relationships.

## Employees

At December 31, 2018, the Bank employed 147 full-time employees and 8 part-time employees. The Company has no employees who are not employees of the bank subsidiary. Through the Bank, employees receive salaries and benefits, which include 401(k) and ESOP plans, cafeteria plan, and life, health and disability insurance. The Company considers its relationship with its employees to be good.

## Competition

The Bank is in direct competition with numerous local and regional commercial banks as well as other non-bank institutions. Interest rates paid and charged on deposits and loans are the primary competitive factors within the Bank's trade area. The Bank also competes for deposits and loans with insurance companies, finance companies, brokerage houses and credit unions. The principal competitive factors in the markets for deposits and loans are interest rates paid and charged. The

## Table of Contents

Company also competes through efficiency, quality of customer service, the range of services and products it provides, the convenience of its branch and ATM locations and the accessibility of its staff. The Bank intends to continue its strategy of being a local, community bank offering traditional bank services and providing quality service in its local trade area.

## Miscellaneous

The Bank holds no patents, licenses (other than licenses required to be obtained from appropriate bank regulatory agencies), franchises or concessions.

The Bank has not engaged in any research activities relating to the development of new services or the improvement of existing services except in the normal course of its business activities. The Bank presently has no plans for any new line of business requiring the investment of a material amount of total assets.

## Available Information

The Company maintains an internet website at [www.thepeoples.com](http://www.thepeoples.com). The Company's Annual Report to Shareholders is available on the Company's website. Also available through the website is a link to the Company's filings with the Securities and Exchange Commission (SEC). Information on the Company's website is not incorporated into this Annual Report on Form 10-K or the Company's other securities filings and is not part of them.

## REGULATION AND SUPERVISION

### General

The Company is subject to regulation and supervision by the Board of Governors of the Federal Reserve System and the Federal Reserve Bank of Atlanta (Federal Reserve). The Company is required to file semi-annual reports with the Federal Reserve and such other information as the Federal Reserve may require. The Federal Reserve also conducts examinations of the Company.

The Bank Holding Company Act requires every bank holding company to obtain the prior approval of the Federal Reserve before:

it may acquire direct or indirect ownership or control of any voting shares of any other bank holding company if, after the acquisition, the bank holding company will directly or indirectly own or control more than 5% of the voting shares of the other bank holding company;

it may acquire direct or indirect ownership or control of any voting shares of any bank if, after the acquisition, the bank holding company will directly or indirectly own or control more than 5% of the voting shares of the bank;

it or any of its subsidiaries, other than a bank, may acquire all or substantially all of the assets of any bank; or

**Table of Contents**

it may merge or consolidate with any other bank holding company.

The Bank Holding Company Act further provides that the Federal Reserve may not approve any transaction that would result in a monopoly or that would substantially lessen competition in the banking business, unless the public interest in meeting the needs of the communities to be served outweighs the anti-competitive effects. The Federal Reserve is also required to consider the financial and managerial resources and future prospects of the bank holding companies and banks involved and the convenience and needs of the communities to be served. Consideration of financial resources generally focuses on capital adequacy, and consideration of convenience and needs issues focuses, in part, on the performance under the Community Reinvestment Act of 1977, both of which are discussed below in more detail.

Subject to various exceptions, the Bank Holding Company Act and the Change in Bank Control Act, together with related regulations, require Federal Reserve approval prior to any person or company acquiring control of a bank holding company. Control is conclusively presumed to exist if an individual or company acquires 25% or more of any class of voting securities of a bank holding company. Control is also presumed to exist, although rebuttable, if a person or company acquires 10% or more, but less than 25%, of any class of voting securities and either:

the bank holding company has registered securities under Section 12 of the Exchange Act of 1934, as amended ( Exchange Act ); or

no other person owns a greater percentage of that class of voting securities immediately after the transaction.

The Company's common stock is registered under Section 12 of the Exchange Act. The regulations provide a procedure for challenging rebuttable presumptions of control.

The Bank Holding Company Act generally prohibits a bank holding company from engaging in activities other than banking, managing or controlling banks or other permissible subsidiaries and acquiring or retaining direct or indirect control of any company engaged in any activities other than activities closely related to banking or managing or controlling banks. In determining whether a particular activity is permissible, the Federal Reserve considers whether performing the activity can be expected to produce benefits to the public that outweigh possible adverse effects, such as undue concentration of resources, decreased or unfair competition, conflicts of interest or unsound banking practices. The Federal Reserve has the power to order a bank holding company or its subsidiaries to terminate any activity or control of any subsidiary when the continuation of the activity or control constitutes a serious risk to the financial safety, soundness or stability of any bank subsidiary of that bank holding company.

The Bank is incorporated under the laws of the State of Mississippi and is subject to the applicable provisions of Mississippi banking laws and the laws of the various states in which it operates, as well as federal law. The Bank is subject to the supervision of the Mississippi Department of Banking and Consumer Finance ( MDBCF ) and to regular examinations by that department. Deposits in the Bank are insured by the Federal Deposit Insurance Corporation (the FDIC ) and, therefore, the Bank is subject to the provisions of the Federal Deposit Insurance Act and to examination by the FDIC.



## Table of Contents

Federal Reserve policy historically has required bank holding companies to act as a source of strength to their bank subsidiaries and to commit capital and financial resources to support those subsidiaries. The Dodd-Frank Wall Street Reform and Consumer Protection Act (the Dodd-Frank Act ) codifies this policy as a statutory requirement. This support may be required by the Federal Reserve at times when the Company might otherwise determine not to provide it. In addition, if a bank holding company commits to a federal bank regulator that it will maintain the capital of its bank subsidiary, whether in response to the Federal Reserve s invoking its source-of-strength authority or in response to other regulatory measures, that commitment will be assumed by the bankruptcy trustee and the bank will be entitled to priority payment in respect of that commitment, ahead of other creditors of the bank holding company.

In addition, the Company is required to file certain reports with, and otherwise comply with the rules and regulations of, the SEC under federal securities laws. The common stock of the Company is listed on the OTCQX Best Market, such listing subjecting the Company to compliance with the market s requirements with respect to reporting and other rules and regulations.

### The Dodd-Frank Act

The Dodd-Frank Act, enacted in 2010, significantly restructured financial regulation in the United States, including through the creation of a new resolution authority, mandating higher capital and liquidity requirements, requiring banks to pay increased fees to regulatory agencies, and through numerous other provisions intended to strengthen the financial services sector.

The Dodd-Frank Act established the Consumer Financial Protection Bureau ( CFPB ), which has extensive regulatory and enforcement powers over consumer financial products and services, and the Financial Stability Oversight Council, which has oversight authority for monitoring and regulating systemic risk. In addition, the Dodd-Frank Act altered the authority and duties of the federal banking and securities regulatory agencies, implemented certain corporate governance requirements for all public companies, including financial institutions, with regard to executive compensation, proxy access by shareholders, and certain whistleblower provisions, and restricted certain proprietary trading and hedge fund and private equity activities of banks and their affiliates. The Dodd-Frank Act also required the issuance of numerous implementing regulations, many of which have not yet been issued.

In January 2013, the CFPB issued final regulations governing mainly consumer mortgage lending. One rule imposes additional requirements on lenders, including rules designed to require lenders to ensure borrowers ability to repay their mortgage. The CFPB also finalized a rule on escrow accounts for higher priced mortgage loans and a rule expanding the scope of the high-cost mortgage provision in the Truth in Lending Act. The CFPB also issued final rules implementing provisions of the Dodd-Frank Act that relate to mortgage servicing. In November 2013, the CFPB issued a final rule on integrated mortgage disclosures under the Truth in Lending Act and the Real Estate Settlement Procedures Act, compliance with which was required by August 1, 2015.

## Table of Contents

The Dodd-Frank Act authorizes national and state banks to establish de novo branches in other states to the same extent as a bank chartered by that state would be so permitted. Previously, banks could only establish branches in other states if the host state expressly permitted out-of-state banks to establish branches in that state. Accordingly, banks are now able to enter new markets more freely.

Recently, the CFPB and banking regulatory agencies have increasingly used a general consumer protection statute to address unethical or otherwise bad business practices that may not necessarily fall directly under the purview of a specific banking or consumer finance law. Prior to the Dodd-Frank Act, there was little formal guidance to provide insight to the parameters for compliance with the unfair or deceptive acts or practices ( UDAP ) law. However, the UDAP provisions have been expanded under the Dodd-Frank Act to apply to unfair, deceptive or abusive acts or practices, which has been delegated to the CFPB for supervision.

Many aspects of the Dodd-Frank Act are subject to further rulemaking and will take effect over several years. Additionally, many provisions of the Dodd-Frank Act were amended by the Economic Growth, Regulatory Relief and Consumer Protection Act ( EGRRCPA ) enacted in 2018, but like the Dodd-Frank Act, several of those provisions are subject to further rulemaking that has not yet been enacted. The overall financial impact on the Company and its subsidiaries or the financial services industry generally cannot be anticipated at this time.

## Dividends

The Company is a legal entity that is separate and distinct from its subsidiaries. The primary source of funds for dividends paid to the Company's shareholders are dividends paid to the Company by the Bank. Various federal and state laws limit the amount of dividends that the Bank may pay to the Company without regulatory approval. Under Mississippi law, the Bank must obtain non-objection of the Commissioner of the Mississippi Department of Banking and Consumer Finance ( MDBCF ) prior to paying any dividend on the Bank's common stock. In addition, the Bank may not pay any dividends if, after paying the dividend, it would be undercapitalized under applicable capital requirements. The FDIC also has the authority to prohibit the Bank from engaging in business practices that the FDIC considers to be unsafe or unsound, which, depending on the financial condition of the Bank, could include the payment of dividends.

In addition, the Federal Reserve has the authority to prohibit the payment of dividends by a bank holding company if its actions constitute unsafe or unsound practices. The Federal Reserve has issued a policy statement, Supervisory Release 09-4, on the payment of cash dividends by bank holding companies, which outlines the Federal Reserve's view that a bank holding company that is experiencing earnings weaknesses or other financial pressures should not pay cash dividends that exceed its net income, that are inconsistent with its capital position, or that could only be funded in ways that weaken its financial health, such as by borrowing or selling assets. The Federal Reserve has indicated that, in some instances, it may be appropriate for a bank holding company to eliminate its dividends.

## Table of Contents

### Capital

The Federal Reserve has issued risk-based capital ratio and leverage ratio guidelines for bank holding companies. The risk-based capital ratio guidelines establish a systematic analytical framework that:

makes regulatory capital requirements sensitive to differences in risk profiles among banking organizations;

takes off-balance sheet exposures into explicit account in assessing capital adequacy; and

minimizes disincentives to holding liquid, low-risk assets.

Under the guidelines and related policies, bank holding companies must maintain capital sufficient to meet both a risk-based asset ratio test and a leverage ratio test on a consolidated basis. The risk-based ratio is determined by allocating assets and specified off-balance sheet commitments into four weighted categories, with higher weighting assigned to categories perceived as representing greater risk. The risk-based ratio represents capital divided by total risk-weighted assets. The leverage ratio is core capital divided by total assets adjusted as specified in the guidelines. The Bank is subject to substantially similar capital requirements promulgated by the FDIC.

Generally, under the applicable guidelines, a financial institution's capital is divided into two tiers. Total capital is Tier 1 plus Tier 2 capital. These two tiers are:

Tier 1, or core capital, that includes total equity plus qualifying capital securities and minority interests, excluding unrealized gains and losses accumulated in other comprehensive income, and non-qualifying intangible and servicing assets; and

Tier 2, or supplementary capital, includes, among other things, cumulative and limited-life preferred stock, mandatory convertible securities, qualifying subordinated debt, and the allowance for credit losses, up to 1.25% of risk-weighted assets.

The Federal Reserve and the other federal banking regulators require that all intangible assets (net of deferred tax), except originated or purchased mortgage-servicing rights, non-mortgage servicing assets, and purchased credit card relationships, be deducted from Tier 1 capital. However, the total amount of these items included in Total capital cannot exceed 100% of an institution's Tier 1 capital.

The guidelines also provided that bank holding companies experiencing internal growth or making acquisitions would be expected to maintain strong capital positions substantially above the minimum supervisory levels without significant reliance on intangible assets. Furthermore, the Federal Reserve indicated that it would consider a tangible Tier 1 capital leverage ratio (deducting all intangibles) and other indicators of capital strength in evaluating proposals for expansion or new activities.

Failure to meet applicable capital guidelines could subject the financial institution to a variety of enforcement remedies available to the federal regulatory authorities. These include limitations on



## Table of Contents

the ability to pay dividends, the issuance of a capital directive to increase capital, and the termination of deposit insurance by the FDIC. In addition, the financial institution could be subject to the measures described below under

Prompt Corrective Action as applicable to under-capitalized institutions. Certain provisions of the EGRRCPA have the potential to limit the application of the guidelines to the Company and the Bank if certain elections are made by the Company or Bank, subject to further rulemaking that has not yet been enacted.

## New Capital Rules

On July 2, 2013, the Federal Reserve approved the final rule for BASEL III capital requirements for all bank holding companies chartered in the United States. The rule was subsequently approved by the FDIC on July 9, 2013, and made applicable to the Bank as well. The rule implements in the United States certain of the Basel III regulatory capital reforms from the Basel Committee on Banking Supervision and certain changes required by the Dodd-Frank Act. The major provisions of the new rule applicable to the Company and the Bank are:

The new rule implements higher minimum capital requirements, includes a new common equity Tier 1 capital requirement, and establishes criteria that instruments must meet in order to be considered common equity Tier 1 capital, additional Tier 1 capital, or Tier 2 capital. These enhancements both improve the quality and increase the quantity of capital required to be held by banking organizations, better equipping the United States banking system to deal with adverse economic conditions.

The new minimum capital to risk-weighted assets requirements are a common equity Tier 1 capital ratio of 4.5% and a Tier 1 capital ratio of 6.0% which is an increase from 4.0%, and a total capital ratio that remains at 8.0%. The minimum leverage ratio (Tier 1 capital to total assets) is 4.0%.

The new rule improves the quality of capital by implementing changes to the definition of capital. Among the most important changes are stricter eligibility criteria for regulatory capital instruments that would disallow the inclusion of instruments such as trust preferred securities in Tier 1 capital going forward, and new constraints on the inclusion of minority interests, mortgage-servicing assets, deferred tax assets, and certain investments in the capital of unconsolidated financial institutions. In addition, the new rule requires that most regulatory capital deductions be made from common equity Tier 1 capital.

Under the new rule, in order to avoid limitations on capital distributions, including dividend payments and certain discretionary bonus payments to executive officers, a banking organization must hold a capital conservation buffer composed of common equity Tier 1 capital above its minimum risk-based capital requirements. This buffer will help to ensure that banking organizations conserve capital when it is most needed, allowing them to better weather periods of economic stress. The buffer is measured relative to risk weighted assets. Phase-in of the capital conservation buffer requirements began on January 1, 2016. Subsequent to the completion of a phase-in period, a banking organization with a buffer greater than 2.5% would not be subject to limits on capital distributions or discretionary bonus payments; however, a banking organization with a buffer of less than 2.5% would be subject to increasingly stringent limitations as the buffer approaches zero. The new rule

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**Table of Contents**

also prohibits a banking organization from making distributions or discretionary bonus payments during any quarter if its eligible retained income is negative in that quarter and its capital conservation buffer ratio was less than 2.5% at the beginning of the quarter. When the new rule is fully phased in, the minimum capital requirements plus the capital conservation buffer will exceed the prompt corrective action well-capitalized thresholds.

The new rule also increases the risk weights for past-due loans, certain commercial real estate loans, and some equity exposures, and makes selected other changes in risk weights and credit conversion factors.

The transition period for implementation of Basel III is January 1, 2015, through December 31, 2018. Certain provisions of the EGRRCPA have the potential to limit the application of BASEL III to the Company and the Bank if certain elections are made by the Company or Bank, subject to further rulemaking that has not yet been enacted.

**Prompt Corrective Action**

The Federal Deposit Insurance Corporation Improvement Act of 1991, known as FDICIA, requires federal banking regulatory authorities to take prompt corrective action with respect to depository institutions that do not meet minimum capital requirements. For these purposes, FDICIA establishes five capital tiers: well-capitalized, adequately-capitalized, under-capitalized, significantly under-capitalized, and critically under-capitalized.

An institution is deemed to be:

well-capitalized if it has a total risk-based capital ratio of 10% or greater, a Tier 1 risk-based capital ratio of 8% or greater (6% before January 1, 2015), a Tier 1 leverage ratio of 5% or greater, and, after January 1, 2015, a common equity Tier 1 capital ratio of 6.5% or greater, and is not subject to a regulatory order, agreement, or directive to meet and maintain a specific capital level for any capital measure;

adequately-capitalized if it has a total risk-based capital ratio of 8% or greater, a Tier 1 risk-based capital ratio of 6% or greater (4% before January 1, 2015), generally, a Tier 1 leverage ratio of 4% or greater, and, after January 1, 2015, a common equity Tier 1 capital ratio of 4.5% or greater, and the institution does not meet the definition of a well-capitalized institution;

under-capitalized if it does not meet one or more of the adequately-capitalized tests;

significantly under-capitalized if it has a total risk-based capital ratio that is less than 6%, a Tier 1 risk-based capital ratio that is less than 4% (less than 3% before January 1, 2015), a Tier 1 leverage ratio that is less than 3%, and, after January 1, 2015, a common equity Tier 1 capital ratio that is less than 3%; and

critically under-capitalized if it has a ratio of tangible equity, as defined in the regulations, to total assets that is equal to or less than 2%.

## Table of Contents

Throughout 2018, the Bank's regulatory capital ratios were in excess of the levels established for well-capitalized institutions.

FDICIA generally prohibits a depository institution from making any capital distribution, including payment of a cash dividend or paying any management fee to its holding company, if the depository institution would be under-capitalized after such payment. Under-capitalized institutions are subject to growth limitations and are required by the appropriate federal banking agency to submit a capital restoration plan. If any depository institution subsidiary of a holding company is required to submit a capital restoration plan, the holding company would be required to provide a limited guarantee regarding compliance with the plan as a condition of approval of such plan.

If an under-capitalized institution fails to submit an acceptable plan, it is treated as if it is significantly under-capitalized. Significantly under-capitalized institutions may be subject to a number of requirements and restrictions, including orders to sell sufficient voting stock to become adequately-capitalized, requirements to reduce total assets, and cessation of receipt of deposits from correspondent banks.

Critically under-capitalized institutions may not, beginning 60 days after becoming critically under-capitalized, make any payment of principal or interest on their subordinated debt. In addition, critically under-capitalized institutions are subject to appointment of a receiver or conservator within 90 days of becoming so classified.

Under FDICIA, a depository institution that is not well-capitalized is generally prohibited from accepting brokered deposits and offering interest rates on deposits higher than the prevailing rate in its market. As previously stated, the Bank is well-capitalized and the FDICIA brokered deposit rule did not adversely affect its ability to accept brokered deposits. Certain provisions of the EGRRCPA have the potential to limit the application of FDICIA and prompt corrective action to the Company and the Bank if certain elections are made by the Company or Bank, subject to further rulemaking that has not yet been enacted.

## Interstate Banking and Branching Legislation

Federal law allows banks to establish and operate a de novo branch in a state other than the bank's home state if the law of the state where the branch is to be located would permit establishment of the branch if the bank were chartered by that state, subject to standard regulatory review and approval requirements. Federal law also allows the Bank to acquire an existing branch in a state in which the bank is not headquartered and does not maintain a branch if the FDIC and MDBCFC approve the branch or acquisition, and if the law of the state in which the branch is located or to be located would permit the establishment of the branch if the bank were chartered by that state.

Once a bank has established branches in a state through an interstate merger transaction or through de novo branching, the bank may then establish and acquire additional branches within that state to the same extent that a state chartered bank is allowed to establish or acquire branches within the state.

## Table of Contents

Under the Bank Holding Company Act, a bank holding company may not directly or indirectly acquire ownership or control of more than 5% of the voting shares or substantially all of the assets of any bank holding company or bank or merge or consolidate with another bank holding company without the prior approval of the Federal Reserve. Current federal law authorizes interstate acquisitions of banks and bank holding companies without geographic limitation. Furthermore, a bank headquartered in one state is authorized to merge with a bank headquartered in another state, as long as neither of the states have opted out of such interstate merger authority prior to such date, and subject to any state requirement that the target bank shall have been in existence and operating for a minimum period of time, not to exceed five years, and subject to certain deposit market-share limitations.

## FDIC Insurance

The deposits of the Bank are insured by the Deposit Insurance Fund (the DIF), which the FDIC administers. The Dodd-Frank Act permanently increased deposit insurance on most accounts to \$250,000. To fund the DIF, FDIC-insured banks are required to pay deposit insurance assessments to the FDIC. For institutions like the Bank with less than \$10 billion in assets, the amount of the assessment is based on its risk classification. The higher an institution's risk classification, the higher its rate of assessments (on the assumption that such institutions pose a greater risk of loss to the DIF). An institution's risk classification is assigned based on its capital levels and the level of supervisory concern that the institution poses to the regulators. In addition, the FDIC can impose special assessments in certain instances.

In addition, all institutions with deposits insured by the FDIC must pay assessments to fund interest payments on bonds issued by the Financing Corporation, a mixed-ownership government corporation established as a financing vehicle for the Federal Savings & Loan Insurance Corporation. The annualized assessment rate for the first quarter of fiscal 2019 is .60% of the assessment base and is adjusted quarterly. These assessments will continue until the bonds mature in 2019.

The FDIC may terminate the deposit insurance of any insured depository institution, including the Bank, if it determines after a hearing that the institution has engaged or is engaging in unsafe or unsound practices, is in an unsafe or unsound condition to continue operations or has violated any applicable law, regulation, order or any condition imposed by an agreement with the FDIC. If the FDIC terminates an institution's deposit insurance, accounts insured at the time of the termination, less withdrawals, will continue to be insured for a period of six months to two years, as determined by the FDIC.

## Affiliate Transactions

The Bank is subject to Regulation W, which comprehensively implements statutory restrictions on transactions between a bank and its affiliates. Regulation W combines the Federal Reserve's interpretations and exemptions relating to Sections 23A and 23B of the Federal Reserve Act. Regulation W and Section 23A place limits on the amount of loans or extensions of credit to, investments in, or certain other transactions with affiliates, and on the amount of advances to third parties collateralized by the securities or obligations of affiliates. In general, the Bank's affiliates are the Company and its non-bank subsidiary.



## Table of Contents

Regulation W and Section 23B prohibit, among other things, a bank from engaging in certain transactions with affiliates unless the transactions are on terms substantially the same, or at least as favorable to the bank, as those prevailing at the time for comparable transactions with non-affiliated companies.

The Bank is also subject to certain restrictions on extensions of credit to executive officers, directors, certain principal shareholders and their related interests. Such extensions of credit must be made on substantially the same terms, including interest rates and collateral, as those prevailing at the time for comparable transactions with third parties and must not involve more than the normal risk of repayment or present other unfavorable features.

## The Community Reinvestment Act

The Community Reinvestment Act of 1977 ( CRA ) and its implementing regulations provide an incentive for regulated financial institutions to meet the credit needs of their local community or communities, including low and moderate income neighborhoods, consistent with the safe and sound operation of such financial institutions. The regulations provide that the appropriate regulatory authority will assess reports under CRA in connection with applications for establishment of domestic branches, acquisitions of banks or mergers involving bank holding companies. An unsatisfactory rating under CRA may serve as a basis to deny an application to acquire or establish a new bank, to establish a new branch or to expand banking services. As of December 31, 2018, the Bank had a satisfactory rating under CRA.

## Patriot Act

The Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism Act of 2001, as extended and revised by the PATRIOT Improvement and Reauthorization Act of 2005 (the Patriot Act ), requires each financial institution to: (i) establish an anti-money laundering program; (ii) establish due diligence policies, procedures and controls with respect to its private banking accounts and correspondent banking accounts involving foreign individuals and certain foreign financial institutions; and (iii) avoid establishing, maintaining, administering or managing correspondent accounts in the United States for, or on behalf of, foreign financial institutions that do not have a physical presence in any country. The Patriot Act also requires that financial institutions follow certain minimum standards to verify the identity of customers, both foreign and domestic, when a customer opens an account. In addition, the Patriot Act contains a provision encouraging cooperation among financial institutions, regulatory authorities and law enforcement authorities with respect to individuals, entities and organizations engaged in, or reasonably suspected of engaging in, terrorist acts or money laundering activities. Federal banking regulators are required, when reviewing bank holding company acquisition and bank merger applications, to take into account the effectiveness of the anti-money laundering activities of the applicants.

## Consumer Privacy and Other Consumer Protection Laws

The Bank, like all other financial institutions, is required to maintain the privacy of its customers' non-public, personal information. Such privacy requirements direct financial institutions to:

provide notice to customers regarding privacy policies and practices;

### Table of Contents

inform customers regarding the conditions under which their non-public personal information may be disclosed to non-affiliated third parties; and

give customers an option to prevent disclosure of such information to non-affiliated third parties.

Under the Fair and Accurate Credit Transactions Act of 2003, the Bank's customers may also opt out of information sharing between and among the Bank and its affiliates.

The Bank is also subject, in connection with its deposit, lending and leasing activities, to numerous federal and state laws aimed at protecting consumers, including the Home Mortgage Disclosure Act, the Real Estate Settlement Procedures Act, the Equal Credit Opportunity Act, the Truth in Lending Act, the Truth-in-Savings Act, the Fair Housing Act, the Fair Credit Reporting Act, the Electronic Funds Transfer Act, the Currency and Foreign Transactions Reporting Act, the National Flood Insurance Act, the Flood Protection Act, the Bank Secrecy Act, laws and regulations governing unfair, deceptive, and/or abuse acts and practices, the Servicemembers Civil Relief Act, the Housing and Economic Recovery Act, and the Credit Card Accountability Act, among others, as well as various state laws.

### Incentive Compensation

In 2010, the Federal Reserve issued guidance on incentive compensation policies intended to ensure that the incentive compensation policies of banking organizations do not undermine the safety and soundness of such organizations by encouraging excessive risk-taking. The guidance, which covers all employees that have the ability to materially affect the risk profile of an organization, either individually or as part of a group, is based upon the key principles that a banking organization's incentive compensation arrangements should (i) provide incentives that do not encourage risk-taking beyond the organization's ability to effectively identify and manage risks, (ii) be compatible with effective internal controls and risk management, and (iii) be supported by strong corporate governance, including active and effective oversight by the organization's board of directors.

Any deficiencies in compensation practices that are identified may be incorporated into the organization's supervisory ratings, which can affect its ability to make acquisitions or perform other actions. The guidance also provides that enforcement actions may be taken against a banking organization if its incentive compensation arrangements or related risk-management control or governance processes pose a risk to the organization's safety and soundness and the organization is not taking prompt and effective measures to correct the deficiencies.

The scope and content of banking regulators' policies on executive compensation are continuing to develop and are likely to continue evolving in the near future. It cannot be determined at this time whether compliance with such policies will adversely affect the Company's ability to hire, retain and motivate its key employees.

### Sarbanes-Oxley

The Sarbanes-Oxley Act of 2002 is applicable to all companies with equity or debt securities registered under the Exchange Act. In particular, the Sarbanes-Oxley Act established: (i)

## Table of Contents

requirements for audit committees, including independence, expertise and responsibilities; (ii) certification and related responsibilities regarding financial statements for the Chief Executive Officer and Chief Financial Officer of the reporting company; (iii) standards for auditors and regulation of audits; (iv) disclosure and reporting obligations for the reporting company and its directors and executive officers; and (v) civil and criminal penalties for violation of the securities laws.

## Effect of Governmental Policies

The Company and the Bank are affected by the policies of regulatory authorities, including the Federal Reserve, the FDIC, and the MDBCF. An important function of the Federal Reserve is to regulate the national money supply. Among the instruments of monetary policy used by the Federal Reserve are: (i) purchases and sales of U.S. government and other securities in the marketplace; (ii) changes in the discount rate, which is the rate any depository institution must pay to borrow from the Federal Reserve; (iii) changes in the reserve requirements of depository institutions; and (iv) indirectly, changes in the federal funds rate, which is the rate at which depository institutions lend money to each other overnight. These instruments are intended to influence economic and monetary growth, interest rate levels, and inflation.

The monetary policies of the Federal Reserve and other governmental policies have had a significant effect on the operating results of commercial banks in the past and are expected to continue to do so in the future. Because of changing conditions in the national and international economy and in the money markets, as well as the result of actions by monetary and fiscal authorities, it is not possible to predict with certainty future changes in interest rates, deposit levels, loan demand, or the business and results of operations of the Company and the Bank, or whether changing economic conditions will have a positive or negative effect on operations and earnings.

## Other Proposals

Bills occasionally are introduced in the United States Congress and the Mississippi State Legislature and other state legislatures, and regulations occasionally are proposed by the Company's regulatory agencies, any of which could affect the businesses, financial results, and financial condition of the Company or the Bank. Generally it cannot be predicted whether or in what form any particular proposals will be adopted or the extent to which the Company and the Bank may be affected.

## Summary

The foregoing discussion sets forth certain material elements of the regulatory framework applicable to the Company and the Bank. This discussion is a brief summary of the regulatory environment in which the Company and its subsidiaries operate and is not designed to be a complete discussion of all statutes and regulations affecting such operations. Regulation of financial institutions is intended primarily for the protection of depositors, the deposit insurance fund and the banking system, and generally is not intended for the protection of shareholders. Changes in applicable laws, and their application by regulatory agencies, cannot necessarily be predicted, but could have a material effect on the business and results of the Company and its subsidiaries.

Table of Contents

SUPPLEMENTAL STATISTICAL INFORMATION

Schedules I-A through VII present certain statistical information regarding the Company. This information is not audited and should be read in conjunction with the Company's Consolidated Financial Statements and Notes to Consolidated Financial Statements found in Item 8 of this Annual Report on Form 10-K.

Distribution of Assets, Liabilities and Shareholders Equity and Interest Rates and Differentials

Net Interest Income, the difference between Interest Income and Interest Expense, is the most significant component of the Company's earnings. For interest analytical purposes, Management adjusts Net Interest Income to a taxable equivalent basis using a Federal Income Tax rate of 21% in 2018 and 34% in 2017 and 2016 on tax-exempt items (primarily interest on municipal securities).

Another significant statistic in the analysis of Net Interest Income is the net yield on earning assets. The net yield is the difference between the rate of interest earned on earning assets and the effective rate paid for all funds, non-interest bearing as well as interest bearing. Since a portion of the Bank's deposits do not bear interest, such as demand deposits, the rate paid for all funds is lower than the rate on interest bearing liabilities alone.

Recognizing the importance of interest differential to total earnings, Management places great emphasis on managing interest rate spreads. Although interest differential is affected by national, regional and local economic conditions, including the level of credit demand and interest rates, there are significant opportunities to influence interest differential through appropriate loan and investment policies which are designed to maximize the differential while maintaining sufficient liquidity and availability of incremental funds for purposes of meeting existing commitments and investment in lending and investment opportunities that may arise.

The information included in Schedule I-F presents the change in interest income and interest expense along with the reason(s) for these changes. The change attributable to volume is computed as the change in volume times the old rate. The change attributable to rate is computed as the change in rate times the old volume. The change in rate/volume is computed as the change in rate times the change in volume.

Credit Risk Management and Loan Loss Experience

In the normal course of business, the Bank assumes risks in extending credit. The Bank manages these risks through its lending policies, credit underwriting analysis, appraisal requirements, concentration and exposure limits, loan review procedures and the diversification of its loan portfolio. Although it is not possible to predict loan losses with complete accuracy, Management constantly reviews the characteristics of the loan portfolio to determine its overall risk profile and quality.

Constant attention to the quality of the loan portfolio is achieved by the loan review process. Throughout this ongoing process, Management is advised of the condition of individual loans and of the quality profile of the entire loan portfolio. Any loan or portion thereof which is classified

## Table of Contents

loss by regulatory examiners or which is determined by Management to be uncollectible because of such factors as the borrower's failure to pay interest or principal, the borrower's financial condition, economic conditions in the borrower's industry or the inadequacy of underlying collateral, is charged-off.

Provisions are charged to operating expense based upon historical loss experience, and additional amounts are provided when, in the opinion of Management, such provisions are not adequate based upon the current factors affecting loan collectability.

The allocation of the allowance for loan losses by loan category is based on the factors mentioned in the preceding paragraphs. Accordingly, since all of these factors are subject to change, the allocation is not necessarily indicative of the breakdown of future losses. In June 2016, the FASB issued Accounting Standards Update (ASU) 2016-03, *Financial Instruments - Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments*, which replaces the current incurred loss impairment methodology with a methodology that reflects all current expected credit losses (CECL) and requires consideration of a broader range of reasonable and supportable information to determine credit loss estimates. The Company intends to adopt ASU 2016-13 during the first quarter of 2020, and adoption of this ASU could materially affect its allowance for loan loss methodology, including the calculation of its provision for loan losses. For additional details regarding the pending adoption of this accounting pronouncement, see Note A Business and Summary of Significant Accounting Policies included in Part II, Item 8. Financial Statements and Supplementary Data of this report.

Further information concerning the provision for loan losses and the allowance for loan losses is presented in Management's Discussion and Analysis in Item 7 of this Annual Report on Form 10-K and in Note A Business and Summary of Significant Accounting Policies to the 2018 Consolidated Financial Statements in Item 8 of this Annual Report on Form 10-K.

## Return on Equity and Assets

The Company's results and key ratios for 2014-2018 are summarized in the Selected Financial Data in Item 6 and Management's Discussion and Analysis in Item 7 of this Annual Report on Form 10-K.

## Dividends

The Company paid a cash dividend of \$ .02 and \$ .01 per share for the years ended December 31, 2018 and 2017, respectively. The Company did not pay a dividend during the year ended December 31, 2016.

**Table of Contents**

## SCHEDULE I-A

## Distribution of Average Assets, Liabilities and Shareholders' Equity (1) (In thousands)

| For the Years Ended December 31,                  | 2018              | 2017              | 2016              |
|---|-------------------|-------------------|-------------------|
| <b>ASSETS:</b>                                    |                   |                   |                   |
| Cash and due from banks                           | \$ 23,113         | \$ 32,457         | \$ 39,580         |
| Available for sale securities:                    |                   |                   |                   |
| Taxable securities                                | 220,076           | 217,059           | 188,512           |
| Non-taxable securities                            | 13,055            | 15,677            | 20,902            |
| Other securities                                  | 1,519             | 1,014             | 1,732             |
| Held to maturity securities:                      |                   |                   |                   |
| Taxable securities                                | 33,864            | 29,389            | 8,562             |
| Non-taxable securities                            | 18,208            | 19,082            | 19,596            |
| Other investments                                 | 2,811             | 2,735             | 2,693             |
| Net loans (2)                                     | 268,019           | 284,541           | 320,383           |
| Balances due from depository institutions         | 9,498             | 27,819            | 31,559            |
| Other assets                                      | 51,114            | 50,342            | 53,077            |
| <b>TOTAL ASSETS</b>                               | <b>\$ 641,277</b> | <b>\$ 680,115</b> | <b>\$ 686,596</b> |
| <b>LIABILITIES AND SHAREHOLDERS' EQUITY:</b>      |                   |                   |                   |
| Non-interest bearing deposits                     | \$ 121,055        | \$ 132,748        | \$ 129,788        |
| Interest bearing deposits                         | 401,365           | 435,390           | 437,445           |
| Total deposits                                    | 522,420           | 568,138           | 567,233           |
| Other liabilities                                 | 33,731            | 21,063            | 26,554            |
| Total liabilities                                 | 556,151           | 589,201           | 593,787           |
| Shareholders' equity                              | 85,126            | 90,914            | 92,809            |
| <b>TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY</b> | <b>\$ 641,277</b> | <b>\$ 680,115</b> | <b>\$ 686,596</b> |

(1) All averages are computed on a daily basis.

(2) Gross loans and discounts, net of unearned income and allowance for loan losses.



**Table of Contents****SCHEDULE I-B****Average (1) Amount Outstanding for Major Categories of Interest Earning Assets****And Interest Bearing Liabilities (In thousands)**

| For the Years Ended December 31,                 | 2018              | 2017              | 2016              |
|--|-------------------|-------------------|-------------------|
| <b>INTEREST EARNING ASSETS:</b>                  |                   |                   |                   |
| Loans (2)  | \$ 273,724        | \$ 290,329        | \$ 327,819        |
| Balances due from depository institutions        | 9,498             | 27,819            | 31,559            |
| Available for sale securities:                   |                   |                   |                   |
| Taxable securities                               | 220,076           | 217,059           | 188,512           |
| Non-taxable securities                           | 13,055            | 15,677            | 20,902            |
| Other securities                                 | 1,519             | 1,014             | 1,732             |
| Held to maturity securities:                     |                   |                   |                   |
| Taxable securities                               | 33,864            | 29,389            | 8,562             |
| Non-taxable securities                           | 18,208            | 19,082            | 19,596            |
| <b>TOTAL INTEREST EARNING ASSETS</b>             | <b>\$ 569,944</b> | <b>\$ 600,369</b> | <b>\$ 598,682</b> |
| <b>INTEREST BEARING LIABILITIES:</b>             |                   |                   |                   |
| Savings and negotiable interest bearing deposits | \$ 317,197        | \$ 353,352        | \$ 359,801        |
| Time deposits                                    | 84,168            | 82,038            | 77,644            |
| Federal funds purchased                          | 369               | 354               |                   |
| Borrowings from FHLB                             | 13,044            | 1,883             | 8,240             |
| <b>TOTAL INTEREST BEARING LIABILITIES</b>        | <b>\$ 414,778</b> | <b>\$ 437,627</b> | <b>\$ 445,685</b> |

(1) All averages are computed on a daily basis.

(2) Net of unearned income. Includes nonaccrual loans



**Table of Contents**

## SCHEDULE I-C

## Interest Earned or Paid on Major Categories of Interest Earning Assets

## And Interest Bearing Liabilities (In thousands)

| For the Years Ended December 31,                 | 2018             | 2017             | 2016             |
|--|------------------|------------------|------------------|
| <b>INTEREST EARNED ON:</b>                       |                  |                  |                  |
| Loans  | \$ 13,265        | \$ 12,970        | \$ 14,232        |
| Balances due from depository institutions        | 205              | 420              | 277              |
| Available for sale securities:                   |                  |                  |                  |
| Taxable securities                               | 4,349            | 3,298            | 2,558            |
| Non-taxable securities                           | 608              | 864              | 1,123            |
| Other securities                                 | 22               | 26               | 22               |
| Held to maturity securities:                     |                  |                  |                  |
| Taxable securities                               | 970              | 753              | 184              |
| Non-taxable securities                           | 580              | 717              | 725              |
| <b>TOTAL INTEREST EARNED (1)</b>                 | <b>\$ 19,999</b> | <b>\$ 19,048</b> | <b>\$ 19,121</b> |
| <b>INTEREST PAID ON:</b>                         |                  |                  |                  |
| Savings and negotiable interest bearing deposits | \$ 1,468         | \$ 736           | \$ 437           |
| Time deposits                                    | 886              | 637              | 457              |
| Federal funds purchased                          | 10               | 3                |                  |
| Other borrowed funds                             | 294              | 47               | 131              |
| <b>TOTAL INTEREST PAID</b>                       | <b>\$ 2,658</b>  | <b>\$ 1,423</b>  | <b>\$ 1,025</b>  |

(1) All interest earned is reported on a taxable equivalent basis using a tax rate of 21% for 2018 and 34% for 2017 and 2016. See disclosure of non-GAAP financial measures on pages 50 and 51.

**Table of Contents**

## SCHEDULE I-D

Average Interest Rate Earned or Paid for Major Categories of  
Interest Earning Assets And Interest Bearing Liabilities

| For the Years Ended December 31,                 | 2018         | 2017         | 2016         |
|--|--------------|--------------|--------------|
| <b>AVERAGE RATE EARNED ON:</b>                   |              |              |              |
| Loans  | 4.85%        | 4.47%        | 4.34%        |
| Balances due from depository institutions        | 2.16%        | 1.51%        | .88%         |
| Available for sale securities:                   |              |              |              |
| Taxable securities                               | 1.98%        | 1.52%        | 1.36%        |
| Non-taxable securities                           | 4.66%        | 5.51%        | 5.37%        |
| Other securities                                 | 1.45%        | 2.56%        | 1.27%        |
| Held to maturity securities:                     |              |              |              |
| Taxable securities                               | 2.86%        | 2.56%        | 2.15%        |
| Non-taxable securities                           | 3.19%        | 3.76%        | 3.70%        |
| <b>TOTAL (weighted average rate)(1)</b>          | <b>3.51%</b> | <b>3.17%</b> | <b>3.19%</b> |
| <b>AVERAGE RATE PAID ON:</b>                     |              |              |              |
| Savings and negotiable interest bearing deposits | .46%         | .21%         | .12%         |
| Time deposits                                    | 1.05%        | .78%         | .59%         |
| Federal funds purchased                          | 2.71%        | .85%         |              |
| Other borrowed funds                             | 2.25%        | 2.50%        | 1.59%        |
| <b>TOTAL (weighted average rate)</b>             | <b>.64%</b>  | <b>.33%</b>  | <b>.23%</b>  |

(1) All interest earned is reported on a taxable equivalent basis using a tax rate of 21% for 2018 and 34% for 2017 and 2016. See disclosure of non-GAAP financial measures on pages 50 and 51.

**Table of Contents**

## SCHEDULE I-E

## Net Interest Earnings and Net Yield on Interest Earning Assets

(In thousands, except percentages)

| For the Years Ended December 31,     | 2018      | 2017      | 2016      |
|--------------------------------------|-----------|-----------|-----------|
| Total interest income (1)            | \$ 19,999 | \$ 19,048 | \$ 19,121 |
| Total interest expense               | 2,658     | 1,423     | 1,025     |
| Net interest earnings                | \$ 17,341 | \$ 17,625 | \$ 18,096 |
| Net yield on interest earning assets | 3.04%     | 2.94%     | 3.02%     |

(1) All interest earned is reported on a taxable equivalent basis using a tax rate of 21% for 2018 and 34% for 2017 and 2016. See disclosure of non-GAAP financial measures on pages 50 and 51.

**Table of Contents**

## SCHEDULE I-F

## Analysis of Changes in Interest Income and Interest Expense

(In thousands)

| For the Years Ended December 31,                 | 2018             | 2017             | Increase<br>(Decrease) | Volume            | Rate            | Rate/Volume     |
|--|------------------|------------------|------------------------|-------------------|-----------------|-----------------|
| <b>INTEREST EARNED ON:</b>                       |                  |                  |                        |                   |                 |                 |
| Loans (1)  | \$ 13,265        | \$ 12,970        | \$ 295                 | \$ (742)          | \$ 1,100        | \$ (63)         |
| Balances due from depository institutions        | 205              | 420              | (215)                  | (277)             | 180             | (118)           |
| Available for sale securities:                   |                  |                  |                        |                   |                 |                 |
| Taxable securities                               | 4,349            | 3,298            | 1,051                  | 46                | 991             | 14              |
| Non-taxable securities                           | 608              | 864              | (256)                  | (145)             | (134)           | 23              |
| Other securities                                 | 22               | 26               | (4)                    | 13                | (11)            | (6)             |
| Held to maturity securities:                     |                  |                  |                        |                   |                 |                 |
| Taxable securities                               | 970              | 753              | 217                    | 115               | 89              | 13              |
| Non-taxable securities                           | 580              | 717              | (137)                  | (33)              | (109)           | 5               |
| <b>TOTAL INTEREST EARNED (2)</b>                 | <b>\$ 19,999</b> | <b>\$ 19,048</b> | <b>\$ 951</b>          | <b>\$ (1,023)</b> | <b>\$ 2,106</b> | <b>\$ (132)</b> |
| <b>INTEREST PAID ON:</b>                         |                  |                  |                        |                   |                 |                 |
| Savings and negotiable interest bearing deposits | \$ 1,468         | \$ 736           | \$ 732                 | \$ (75)           | \$ 899          | \$ (92)         |
| Time deposits                                    | 886              | 637              | 249                    | 17                | 227             | 5               |
| Federal funds purchased                          | 10               | 3                | 7                      | 1                 | 6               |                 |
| Other borrowed funds                             | 294              | 47               | 247                    | 279               | (5)             | (27)            |
| <b>TOTAL INTEREST PAID</b>                       | <b>\$ 2,658</b>  | <b>\$ 1,423</b>  | <b>\$ 1,235</b>        | <b>\$ 222</b>     | <b>\$ 1,127</b> | <b>\$ (114)</b> |

(1) Loan fees of \$310 and \$338 for 2018 and 2017, respectively, are included in these figures.

(2) All interest earned is reported on a taxable equivalent basis using a tax rate of 21% for 2018 and 34% for 2017. See disclosure of non-GAAP financial measures on pages 50 and 51.

**Table of Contents**

## SCHEDULE I-F (continued)

## Analysis of Changes in Interest Income and Interest Expense

(In thousands)

| For the Years Ended December 31,                 | 2017             | 2016             | Increase<br>(Decrease) | Volume            | Rate            | Rate/Volume    |
|--|------------------|------------------|------------------------|-------------------|-----------------|----------------|
| <b>INTEREST EARNED ON:</b>                       |                  |                  |                        |                   |                 |                |
| Loans (1)  | \$ 12,970        | \$ 14,232        | \$ (1,262)             | \$ (1,628)        | \$ 413          | \$ (47)        |
| Balances due from depository institutions        | 420              | 277              | 143                    | (33)              | 199             | (23)           |
| Available for sale securities:                   |                  |                  |                        |                   |                 |                |
| Taxable securities                               | 3,298            | 2,558            | 740                    | 387               | 306             | 47             |
| Non-taxable securities                           | 864              | 1,123            | (259)                  | (281)             | 29              | (7)            |
| Other securities                                 | 26               | 22               | 4                      | (10)              | 23              | (9)            |
| Held to maturity securities:                     |                  |                  |                        |                   |                 |                |
| Taxable securities                               | 753              | 184              | 569                    | 448               | 35              | 86             |
| Non-taxable securities                           | 717              | 725              | (8)                    | (19)              | 11              |                |
| <b>TOTAL INTEREST EARNED (2)</b>                 | <b>\$ 19,048</b> | <b>\$ 19,121</b> | <b>\$ (73)</b>         | <b>\$ (1,136)</b> | <b>\$ 1,016</b> | <b>\$ 47</b>   |
| <b>INTEREST PAID ON:</b>                         |                  |                  |                        |                   |                 |                |
| Savings and negotiable interest bearing deposits | \$ 736           | \$ 437           | \$ 299                 | \$ (8)            | \$ 312          | \$ (5)         |
| Time deposits                                    | 637              | 457              | 180                    | 26                | 146             | 8              |
| Federal funds purchased                          | 3                |                  | 3                      | 3                 |                 |                |
| Other borrowed funds                             | 47               | 131              | (84)                   | (95)              | 42              | (31)           |
| <b>TOTAL INTEREST PAID</b>                       | <b>\$ 1,423</b>  | <b>\$ 1,025</b>  | <b>\$ 398</b>          | <b>\$ (74)</b>    | <b>\$ 500</b>   | <b>\$ (28)</b> |

(1) Loan fees of \$338 and \$389 for 2017 and 2016, respectively, are included in these figures.

(2) All interest earned is reported on a taxable equivalent basis using a tax rate of 34% for 2017 and 2016. See disclosure of non-GAAP financial measures on pages 50 and 51.

**Table of Contents**

## SCHEDULE II-A

## Book Value of Securities Portfolio

(In thousands)

| December 31,  | 2018              | 2017              | 2016              |
|---|-------------------|-------------------|-------------------|
| <b>Available for sale securities:</b>                                       |                   |                   |                   |
| U.S. Treasuries, U.S. Government agencies and<br>Mortgage-backed securities | \$ 211,014        | \$ 230,736        | \$ 215,157        |
| States and political subdivisions   | 11,096            | 14,470            | 17,963            |
| <b>Total</b>  | <b>\$ 222,110</b> | <b>\$ 245,206</b> | <b>\$ 233,120</b> |
| <b>Held to maturity securities:</b>   |                   |                   |                   |
| U.S. Government Agencies  | \$ 8,185          | \$ 8,185          | \$ 10,009         |
| States and political subdivisions   | 46,413            | 42,978            | 36,677            |
| Corporate bonds   |                   |                   | 1,464             |
| <b>Total</b>  | <b>\$ 54,598</b>  | <b>\$ 51,163</b>  | <b>\$ 48,150</b>  |

Table of Contents

## SCHEDULE II-B

## Maturity of Securities Portfolio at December 31, 2018

## And Weighted Average Yields of Such Securities

(In thousands, except percentage data)

| December 31,   | Within one year  |              | Maturity<br>After one year but<br>within five years |              | After five years but<br>within ten years |              | After ten years  |              |
|--|------------------|--------------|---|--------------|--|--------------|------------------|--------------|
|  | Amount           | Yield        | Amount  | Yield        | Amount                                   | Yield        | Amount           | Yield        |
| <b>Available for sale securities:</b>  |                  |              |   |              |  |              |                  |              |
| U.S. Treasuries, U.S.<br>Government agencies and<br>Mortgage-backed securities | \$ 24,770        | 1.29%        | \$ 72,059   | 1.61%        | \$ 31,165                                | 2.23%        | \$ 83,020        | 3.37%        |
| States and political<br>subdivisions   | 3,205            | 4.11%        | 6,907   | 3.76%        | 639                                      | 3.61%        | 345              | 4.20%        |
| <b>Total</b>   | <b>\$ 27,975</b> | <b>2.13%</b> | <b>\$ 78,966</b>                                    | <b>2.00%</b> | <b>\$ 31,804</b>                         | <b>2.23%</b> | <b>\$ 83,365</b> | <b>3.37%</b> |
| <b>Held to maturity securities:</b>  |                  |              |   |              |  |              |                  |              |
| U.S. Government agencies   | \$               |              | \$ 3,185  | 2.00%        | \$ 5,000                                 | 2.04%        | \$               |              |
| States and political<br>subdivisions   | 2,523            | 3.27%        | 16,584  | 2.43%        | 13,316                                   | 2.94%        | 13,990           | 3.37%        |
| <b>Total</b>   | <b>\$ 2,523</b>  | <b>3.27%</b> | <b>\$ 19,769</b>                                    | <b>2.37%</b> | <b>\$ 18,316</b>                         | <b>2.76%</b> | <b>\$ 13,990</b> | <b>3.37%</b> |

Note: The weighted average yields are calculated on the basis of cost. Average yields on investments in states and political subdivisions are based on their contractual yield. Available for sale securities are stated at fair value and held to maturity securities are stated at amortized cost.

**Table of Contents**

## SCHEDULE III-A

## Loan Portfolio

## Loans by Type Outstanding (1) (In thousands)

| December 31,   | 2018       | 2017       | 2016       | 2015       | 2014       |
|--|------------|------------|------------|------------|------------|
| Real estate, construction  | \$ 34,229  | \$ 32,211  | \$ 32,794  | \$ 36,347  | \$ 44,129  |
| Real estate, mortgage  | 197,113    | 206,528    | 226,157    | 243,540    | 266,158    |
| Loans to finance agricultural production                                   |            |            |            | 30         | 1,230      |
| Commercial and industrial  | 35,076     | 35,174     | 48,361     | 50,520     | 37,441     |
| Loans to individuals for household, family and other consumer expenditures | 5,694      | 5,310      | 6,264      | 6,548      | 7,538      |
| Obligations of states and political subdivisions                           | 956        | 839        | 1,646      | 428        | 5,462      |
| All other loans  | 278        | 387        | 133        | 144        | 449        |
| Total  | \$ 273,346 | \$ 280,449 | \$ 315,355 | \$ 337,557 | \$ 362,407 |

(1) No foreign debt outstanding.



Table of Contents

## SCHEDULE III-B

## Maturities and Sensitivity to Changes in

Interest Rates of the Loan Portfolio as of December 31, 2018

(In thousands)

| December 31,  | Maturity         |                                  |                   | Total             |
|---|------------------|----------------------------------|-------------------|-------------------|
|   | One year or less | Over one year<br>through 5 years | Over 5 years      |                   |
| Real estate, construction   | \$ 2,650         | \$ 14,565                        | \$ 17,014         | \$ 34,229         |
| Real estate, mortgage   | 3,450            | 82,964                           | 110,699           | 197,113           |
| Commercial and industrial   | 93               | 32,580                           | 2,403             | 35,076            |
| Loans to individuals for household,<br>family and other consumer expenditures | 56               | 5,215                            | 423               | 5,694             |
| Obligations of states and political<br>subdivisions                           |                  | 226                              | 730               | 956               |
| All other loans   |                  | 191                              | 87                | 278               |
| <b>Total</b>  | <b>\$ 6,249</b>  | <b>\$ 135,741</b>                | <b>\$ 131,356</b> | <b>\$ 273,346</b> |
| Loans with pre-determined interest rates                                      | \$ 1,657         | \$ 100,771                       | \$ 81,671         | \$ 184,099        |
| Loans with floating interest rates  | 4,592            | 34,970                           | 49,685            | 89,247            |
| <b>Total</b>  | <b>\$ 6,249</b>  | <b>\$ 135,741</b>                | <b>\$ 131,356</b> | <b>\$ 273,346</b> |

**Table of Contents**

## SCHEDULE III-C

## Non-Performing Loans (In thousands)

| December 31,                                  | 2018     | 2017      | 2016      | 2015      | 2014      |
|---|----------|-----------|-----------|-----------|-----------|
| Loans accounted for on a nonaccrual basis (1) | \$ 8,250 | \$ 13,810 | \$ 11,854 | \$ 15,186 | \$ 33,298 |

Loans which are contractually past due 90 or more days as to interest or principal payment, but are not included above

|    |     |     |
|----|-----|-----|
| 55 | 146 | 763 |
|----|-----|-----|

(1) The Bank places loans on a nonaccrual status when, in the opinion of Management, they possess sufficient uncertainty as to timely collection of interest or principal so as to preclude the recognition in reported earnings of some or all of the contractual interest. See Note A Business and Summary of Significant Accounting Policies and Note C Loans to the 2018 Consolidated Financial Statements in Item 8 in this Annual Report on Form 10-K for discussion of impaired loans.

**Table of Contents**

## SCHEDULE IV-A

## Summary of Loan Loss Expenses

(In thousands, except percentage data)

| December 31,  | 2018       | 2017       | 2016       | 2015       | 2014       |
|---|------------|------------|------------|------------|------------|
| Average amount of loans outstanding (1)(2)                  | \$ 273,724 | \$ 290,329 | \$ 327,819 | \$ 356,294 | \$ 362,649 |
| Balance of allowance for loan losses at beginning of period | \$ 6,153   | \$ 5,466   | \$ 8,070   | \$ 9,206   | \$ 8,934   |
| Loans charged-off:  |            |            |            |            |            |
| Commercial, financial and agricultural                      | 372        | 36         | 509        | 275        | 4,930      |
| Consumer and other  | 1,038      | 243        | 3,013      | 3,833      | 2,800      |
| Total loans charged-off                                     | 1,410      | 279        | 3,522      | 4,108      | 7,730      |
| Recoveries of loans:  |            |            |            |            |            |
| Commercial, financial and agricultural                      | 112        | 11         | 62         | 19         | 277        |
| Consumer and other  | 363        | 839        | 288        | 371        | 321        |
| Total recoveries  | 475        | 850        | 350        | 390        | 598        |
| Net loans charged-off (recovered)                           | 935        | (571)      | 3,172      | 3,718      | 7,132      |
| Provision for loan losses charged to operating expense      | 122        | 116        | 568        | 2,582      | 7,404      |
| Balance of allowance for loan losses at end                 | \$ 5,340   | \$ 6,153   | \$ 5,466   | \$ 8,070   | \$ 9,206   |

of period

|   |       |        |       |       |       |
|---|-------|--------|-------|-------|-------|
| Ratio of net charge-offs during period to average loans outstanding | 0.34% | (.20%) | 0.97% | 1.04% | 1.97% |
|---|-------|--------|-------|-------|-------|

- (1) Net of unearned income.
- (2) Includes nonaccrual loans.

Table of Contents

## SCHEDULE IV-B

## Allocation of the Allowance for Loan Losses

(In thousands except percentage data)

| December 31,  | 2018     |                                    | 2017     |                                    | 2016     |                                    | 2015     |                                    | 2014     |                                    |
|---|----------|------------------------------------|----------|------------------------------------|----------|------------------------------------|----------|------------------------------------|----------|------------------------------------|
|   | Amount   | % of<br>Loans to<br>Total<br>Loans | Amount   | % of<br>Loans to<br>Total<br>Loans | Amount   | % of<br>Loans to<br>Total<br>Loans | Amount   | % of<br>Loans to<br>Total<br>Loans | Amount   | % of<br>Loans to<br>Total<br>Loans |
| Real estate,<br>construction  | \$ 428   | 12                                 | \$ 242   | 11                                 | \$ 262   | 10                                 | \$ 778   | 11                                 | \$ 1,110 | 12                                 |
| Real estate,<br>mortgage  | 4,181    | 72                                 | 4,574    | 73                                 | 4,150    | 71                                 | 5,964    | 70                                 | 7,182    | 73                                 |
| Loans to<br>finance<br>agricultural<br>production   |          |                                    |          |                                    |          |                                    | 1        | 1                                  | 2        | 1                                  |
| Commercial<br>and industrial  | 599      | 12                                 | 1,161    | 12                                 | 850      | 15                                 | 1,075    | 14                                 | 587      | 10                                 |
| Loans to<br>individuals<br>for<br>household,<br>family and<br>other<br>consumer<br>expenditures | 128      | 2                                  | 174      | 2                                  | 200      | 2                                  | 247      | 2                                  | 282      | 2                                  |
| Obligations<br>of states and<br>political<br>subdivisions                                       | 1        | 1                                  | 1        | 1                                  |          | 1                                  |          | 1                                  |          | 1                                  |
| All other<br>loans  | 3        | 1                                  | 1        | 1                                  | 4        | 1                                  | 5        | 1                                  | 43       | 1                                  |
| Total   | \$ 5,340 | 100                                | \$ 6,153 | 100                                | \$ 5,466 | 100                                | \$ 8,070 | 100                                | \$ 9,206 | 100                                |

**Table of Contents**

## SCHEDULE V

## Summary of Average Deposits and Their Yields

(In thousands, except percentage data)

| Years Ended December 31,                                 | 2018              |             | 2017              |             | 2016              |             |
|--|-------------------|-------------|-------------------|-------------|-------------------|-------------|
|  | Amount            | Rate        | Amount            | Rate        | Amount            | Rate        |
| Demand deposits in domestic offices                      | \$ 121,055        | N/A         | \$ 132,748        | N/A         | \$ 129,788        | N/A         |
| Negotiable interest bearing deposits in domestic offices | 257,750           | .55%        | 295,413           | .24%        | 300,306           | .14%        |
| Savings deposits in domestic offices                     | 59,447            | .09%        | 57,939            | .05%        | 59,495            | .05%        |
| Time deposits in domestic offices                        | 84,168            | 1.05%       | 82,038            | .78%        | 77,644            | .59%        |
| <b>Total</b>   | <b>\$ 522,420</b> | <b>.73%</b> | <b>\$ 568,138</b> | <b>.49%</b> | <b>\$ 567,233</b> | <b>.36%</b> |

Certificates of deposit in amounts of \$100,000 or more by the amount of time remaining until maturity as of December 31, 2018, are as follows (in thousands):

## Remaining maturity:

|                                 |                  |
|---------------------------------|------------------|
| 3 months or less                | \$ 19,350        |
| Over 3 months through 6 months  | 10,800           |
| Over 6 months through 12 months | 8,000            |
| Over 12 months                  | 14,637           |
| <b>Total</b>                    | <b>\$ 52,787</b> |

**Table of Contents**

## SCHEDULE VI

## Short Term Borrowings

(In thousands, except percentage data)

|  | 2018      | 2017      | 2016     |
|--|-----------|-----------|----------|
| Balance, December 31,                            | \$ 35,000 | \$ 10,000 | \$ 5,000 |
| Weighted average interest rate at December 31,   | 2.65%     | 1.45%     | 1.11%    |
| Maximum outstanding at any month-end during year | \$ 35,000 | \$ 11,198 | \$ 8,383 |
| Average amount outstanding during year           | \$ 13,044 | \$ 1,883  | \$ 8,240 |
| Weighted average interest rate                   | 2.27%     | 2.44%     | 1.59%    |

Note: Short term borrowings include federal funds purchased from other banks and short term borrowings from the Federal Home Loan Bank.

**Table of Contents**

## SCHEDULE VII

## Interest Sensitivity/Gap Analysis

(In thousands)

| December 31, 2018:             | 0 - 3 Months      | 4 - 12 Months    | 1 - 5 Years       | Over 5 Years      | Total             |
|--------------------------------|-------------------|------------------|-------------------|-------------------|-------------------|
| <b>ASSETS:</b>                 |                   |                  |                   |                   |                   |
| Loans (1)                      | \$ 91,599         | \$ 12,229        | \$ 82,223         | \$ 79,045         | \$ 265,096        |
| Available for sale securities  | 4,996             | 22,979           | 78,966            | 115,169           | 222,110           |
| Held to maturity securities    | 520               | 2,003            | 19,769            | 32,306            | 54,598            |
| <b>Totals</b>                  | <b>\$ 97,115</b>  | <b>\$ 37,211</b> | <b>\$ 180,958</b> | <b>\$ 226,520</b> | <b>\$ 541,804</b> |
| <b>FUNDING SOURCES:</b>        |                   |                  |                   |                   |                   |
| Interest bearing deposits      | \$ 304,367        | \$ 29,307        | \$ 25,320         | \$                | \$ 358,994        |
| Borrowings from FHLB           | 35,013            | 49               | 261               | 819               | 36,142            |
| <b>Totals</b>                  | <b>\$ 339,380</b> | <b>\$ 29,356</b> | <b>\$ 25,581</b>  | <b>\$ 819</b>     | <b>\$ 395,136</b> |
| <b>REPRICING/MATURITY GAP:</b> |                   |                  |                   |                   |                   |
| Period                         | \$ (242,265)      | \$ 7,855         | \$ 155,377        | \$ 225,701        |                   |
| Cumulative                     | (242,265)         | (234,410)        | (79,033)          | 146,668           |                   |
| Cumulative Gap/Total Assets    | (39%)             | (38%)            | (13%)             | 24%               |                   |

(1) Amounts stated include fixed and variable rate loans that are still accruing interest. Variable rate loans are included in the next period in which they are subject to a change in rate. The principal portions of scheduled payments on fixed instruments are included in the period in which they become due or mature.

**Capital Resources**

Information about the Company's capital resources is included in Note J Shareholders' Equity to the 2018 Consolidated Financial Statements in this Annual Report on Form 10-K.





**Table of Contents**

**ITEM 1a - RISK FACTORS**

An investment in the Company's stock involves a number of risks. Investors should carefully consider the following risks as well as the other information in this Annual Report on Form 10-K and the documents incorporated by reference before making an investment decision. The realization of any of the risks described below could have a material adverse effect on the Company and the price of its common stock.

**RISKS RELATING TO THE COMPANY'S BUSINESS**

Greater than expected loan losses may adversely affect the Company's earnings.

The Company's investment and loan portfolio subject the Company to credit risk. Credit losses are always inherent in the banking business but the continuing challenging economic environment in the Company's trade area presents even more exposure to loss. The Company makes various assumptions and judgments about the collectibility of its loan portfolio and provides an allowance for loan losses based on a number of factors. The Company believes that its current allowance for loan losses is adequate and appropriate. However, if the Company's assumptions or judgments prove to be incorrect, the allowance for loan losses may not be sufficient to cover actual loan losses. In the event that our loan customers do not repay their loans according to the terms of the loans, and the collateral securing the repayment of these loans is insufficient to cover any remaining loan balances, the Company could experience significant loan losses or increase the provision for loan losses or both, which could have a material adverse effect on its operating results. In fact, these conditions were a significant cause of the net losses experienced by the Company in prior years. The actual amount of future provisions for loan losses cannot be determined at this time and may vary from the amounts of past provisions.

The Company has a high concentration of loans secured by real estate, and a downturn in the real estate market could materially and adversely affect earnings.

A significant portion of the Company's loan portfolio is dependent on real estate. At December 31, 2018, approximately 85% of the Company's loans had real estate as a primary or secondary component of collateral. The collateral in each case provides an alternate source of repayment if the borrower defaults and may deteriorate in value during the time the credit is extended. Further deterioration in the value of real estate generally or in the Company's trade area specifically could significantly impair the value of the collateral and restrict the ability to sell the collateral upon foreclosure. Furthermore, it is likely that the Company would be required to increase the provision for loan losses. If the Company were required to liquidate the collateral securing a loan to satisfy the debt during a period of reduced real estate value or to increase the allowance for loan losses, the Company's profitability and financial condition could be adversely impacted.

The Company has a high concentration of exposure to a number of industries.

The Company has concentrations of loan exposure to the hotel/motel and gaming industries. At December 31, 2018, these exposures were approximately \$44,112,000 and \$25,767,000 or 16% and 9%, respectively, of the total loan portfolio. Economic conditions have negatively impacted tourism, which is one of the major factors for success in these industries. Given the size of these relationships, a significant loss in either of these portfolios could materially and adversely affect the Company's earnings.

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**Table of Contents**

The continuing economic downturn or a natural disaster, especially one affecting the Company's trade area, could adversely affect the Company.

The Company's trade area includes the Mississippi Gulf Coast and portions of southeast Louisiana and southwest Alabama. With the exception of a number of credits that are considered out of area, the Company's credit exposure is generally limited to the Mississippi Gulf Coast. Although the national economy has shown signs of improvement, local conditions appear to be lagging this trend. As a result, the Company is at risk from continuing adverse business developments in its trade area, including declining real estate value, increasing loan delinquencies, personal and business bankruptcies and unemployment rates. The recent decline in oil prices has effected the economy in southeast Louisiana and may negatively impact the entire trade area. The Company is also at risk to weather-related disasters including hurricanes, floods and tornadoes. If the economy in the Company's trade area experiences a natural disaster or worsening economic conditions, our operating results could be negatively impacted.

Economic factors could negatively impact the Company's liquidity.

In addition to funds provided by its banking activities such as deposits, loan payments and proceeds from the maturity of investment securities, the Company's liquidity needs have traditionally been met through the purchase of federal funds, often on an unsecured basis, and advances from the Federal Home Loan Bank ( FHLB ). Disruption in the financial markets in previous years negatively impacted the availability of these unsecured funds. As a result, the Company increased its borrowing lines with the FHLB and secured approval to participate in the Federal Reserve's Discount Window Primary Credit Program.

The Company is subject to industry competition which may have an impact on its success.

The profitability of the Company depends on its ability to compete successfully. The Company operates in a highly competitive financial services environment. Certain competitors are larger and may have more resources than the Company. The Company faces competition in its trade area from other commercial banks, savings and loan associations, credit unions, internet banks, finance companies, insurance companies, brokerage and investment banking firms and other financial intermediaries. Some of these non-bank competitors are not subject to the same extensive regulations that govern the Company or the Bank and may have greater flexibility in competing for business. Increased competition could require the Company to increase the rates paid on deposits or lower the rates offered on loans, which could adversely affect and also limit future growth and earnings prospects.

The Company's profitability is vulnerable to interest rate fluctuations.

The Company's profitability is dependent to a large extent on net interest income, which is the difference between interest income on interest-earning assets, such as loans and investment securities, and interest expense on interest-bearing liabilities, such as deposits and borrowings. The Company is asset sensitive to market interest rates, as its assets reprice more quickly to changes in interest rates than do its liabilities. Interest rates dropped by the unprecedented amount of 400 basis points during 2008 as the Federal Reserve, through its Federal Open Market

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**Table of Contents**

Committee, attempted to stabilize the financial markets, reduce the effects of the recession and stimulate the economy. In 2016, 2017 and 2018, the Federal Reserve increased the discount rate 125 basis points with the fed funds and prime interest rates increasing as a result. Discount or fed funds rate changes that occur in 2019 may affect the Company's earnings in the current year and/or in the future.

**Changes in the policies of monetary authorities and other government action could adversely affect the Company's profitability.**

Many factors affect the demand for loans and the ability to attract deposits, including changes in government economic and monetary policies, particularly by the Federal Reserve, modifications to tax, banking and credit laws and regulations, national, state and local economic growth rates and employment rates. Previous legislation such as Emergency Economic Stabilization Act of 2008 ( EESA ) and American Recovery and Reinvestment Act of 2009 ( ARRA ) were passed to address issues facing certain financial institutions, improve the general availability of credit for consumers and businesses, stimulate the national economy and promote long-term growth and stability. Further regulation impacting the Company and its operations include The Dodd-Frank Act, which was passed to increase transparency, accountability and oversight over financial firms and products as well as to provide protection to consumers. The new capital requirements under BASEL III raise minimum capital requirements, change the definition of capital, create a capital conservation buffer and increase risk weights for certain assets and exposures. There can be no assurance that EESA, ARRA, Dodd-Frank or BASEL III will achieve their intended purposes. Furthermore, their failure could result in continuing or worsening economic and market conditions, and this could adversely affect our operations.

**The Company is subject to regulation by various federal and state entities.**

The Company is subject to the regulations of the SEC, the Federal Reserve Board, the FDIC and the MDBCF. New regulations issued by these agencies, including but not limited to those relating to the Patriot Act, the Bank Secrecy Act, The Dodd-Frank Act and the Consumer Financial Protection Bureau, may adversely affect the Company's ability to carry on its business activities. The Company is also subject to various other federal and state laws and certain changes in these laws and regulations may adversely affect the Company's operations. Noncompliance with certain of these regulations may impact the Company's business plans or result in sanctions by regulatory agencies and/or civil money penalties, which could have a material adverse effect on the Company's business, financial condition and results of operations. While the Company has policies and procedures designed to prevent any such violations, it cannot assure that such violations will be prevented.

The Company is also subject to laws, regulations and standards relating to corporate governance and public disclosure, including the Sarbanes-Oxley Act of 2002, as well as the accounting rules and regulations of the SEC and the Financial Accounting Standards Board. Changes in accounting rules could adversely affect the reported financial statements or results of operations of the Company and may also require additional effort or cost to implement.

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**Table of Contents**

There may be risks resulting from extensive use of models in the Company's business.

The Company relies on quantitative models to measure risks and to estimate certain financial values. Models may be used in such processes as determining the pricing of various products, developing presentations made to market analysts and others, creating loans and extending credit, measuring interest rate and other market risks, predicting losses, assessing capital adequacy, calculating regulatory capital levels and estimating the fair value of financial instruments and balance sheet items. These models reflect assumptions that may not be accurate, particularly in times of market stress or other unforeseen circumstances. Even if these assumptions are adequate, the models may prove to be inadequate or inaccurate because of other flaws in their design or their implementation. If models for determining interest rate risk and asset-liability management are inadequate, the Company may incur increased or unexpected losses upon changes in market interest rates or other market measures. If models for determining probable loan losses are inadequate, the allowance for loan losses may not be sufficient to support future charge-offs. If models to measure the fair value of financial instruments are inadequate, the fair value of such financial instruments may fluctuate unexpectedly or may not accurately reflect what the company could realize upon sale or settlement of such financial instruments. Any such failure in the analytical or forecasting models could have a material adverse effect on the Company's financial condition or results of operations.

Also, information the Company provides to its regulators based on poorly designed or implemented models could be inaccurate or misleading. Certain decisions that the regulators make, including those related to capital distributions and dividends to the Company's shareholders, could be adversely affected due to the regulator's perception that the quality of the Company's models used to generate the relevant information is insufficient.

The use of third-party service providers by the Company and the Bank and other ongoing third-party business relationships are subject to increasing regulatory requirements and attention.

The Company and the Bank regularly use third-party service providers and subcontractors as part of their businesses. The Company also has substantial ongoing business relationships with partners and other third-parties, and relies on certain third-parties to provide products and services necessary to maintain day-to-day operations. These types of third-party relationships are subject to increasingly demanding regulatory requirements and attention by regulators, including the FRB, OCC, CFPB and FDIC. Under regulatory guidance, the Company and the Bank are required to apply stringent due diligence, conduct ongoing monitoring and maintain effective control over third-party service providers and subcontractors and other ongoing third-party business relationships. The Company expects that the regulators will hold it responsible for deficiencies in its oversight and control of its third-party relationships and in the performance of the parties with which the Company or the Bank has these relationships. The Company and the Bank maintain a system of policies and procedures designed to ensure adequate due diligence is performed and to monitor vendor risks. While the Company believes these policies and procedures effectively mitigate risk, if the regulators conclude that the Company or the Bank has not exercised adequate oversight and control over third-party service providers and subcontractors or other ongoing third-party business relationships or that such third-parties have not performed appropriately, the Company and the Bank could be subject to enforcement actions, including civil monetary penalties or other administrative or judicial penalties or fines as well as requirements for customer remediation.

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**Table of Contents**

The Company's controls and procedures may fail or be circumvented.

The Company's internal controls, disclosures controls and procedures, and corporate governance policies and procedures are based in part on assumptions, and can provide only reasonable, not absolute, assurances that the objectives of the system are met. Any failure or circumvention of the Company's controls and procedures or failure to comply with the regulations related to controls and procedures could have a material adverse effect on the Company's business, financial condition and results of operations.

The Dodd-Frank Act and other legislative and regulatory initiatives relating to the financial services industry could materially affect the Company's results of operations, financial condition, liquidity or the market price of the Company's Common Stock.

The Dodd-Frank Act, as implemented by the regulations currently being promulgated by various federal regulatory agencies, along with other regulatory initiatives relating to the financial services industry, could materially affect the Company's results of operations, financial condition, liquidity or the market price of the Company's common stock. The Company is unable to completely evaluate these potential effects at this time. It is also possible that these measures could adversely affect the creditworthiness of counterparties, which could increase the Company's risk profile.

The Company may be subject to more stringent capital and liquidity requirements which would adversely affect its net income and future growth.

The Dodd-Frank Act applies the same leverage and risk-based capital requirements that apply to insured depository institutions to most bank holding companies, which, among other things, will change the way in which hybrid securities, such as trust preferred securities, are treated for purposes of determining a bank holding company's regulatory capital. On June 14, 2011, the federal banking agencies published a final rule regarding minimum leverage and risk-based capital requirements for banks and bank holding companies consistent with the requirements of Section 171 of the Dodd-Frank Act. For a more detailed description of the minimum capital requirements see "Supervision and Regulation - Capital Standards". The Dodd-Frank Act also increased regulatory oversight, supervision and examination of banks, bank holding companies and their respective subsidiaries by the appropriate regulatory agency. These requirements, and any other new regulations, could adversely affect the Company's ability to pay dividends, or could require the Company to reduce business levels or to raise capital, including in ways that may adversely affect the Company's results of operations or financial condition.

In addition, on September 12, 2010, the Group of Governors and Heads of Supervision, the oversight body of the Basel Committee on Banking Supervision, announced agreement on the calibration and phase-in arrangements for a strengthened set of capital requirements, known as Basel III. In 2013, regulators adopted enhancements to U.S. capital standards based on Basel III. The revised standards create a new emphasis on Tier 1 common equity, modify eligibility criteria for regulatory capital instruments, and modify the methodology for calculating risk-weighted assets. The revised standards require the following:

## Table of Contents

*Tier 1 Common Equity.* For all supervised financial institutions, including the Company and the Bank, the ratio of Tier 1 common equity to risk-weighted assets ( Tier 1 Common Equity Capital ratio ) must be at least 4.5%. To be well capitalized the Tier 1 Common Equity Capital ratio must be at least 6.5%. If a capital conservation buffer of an additional 2.5% above the minimum 4.5% (or 7% overall) is not maintained, special restrictions would apply to capital distributions, such as dividends and stock repurchases, and on certain compensatory bonuses. Tier 1 common equity capital consists of core components of Tier 1 capital: common stock plus retained earnings net of goodwill, other intangible assets, and certain other required deduction items.

*Tier 1 Capital Ratio.* For all banking organizations, including the Bank, the ratio of Tier 1 capital to risk-weighted assets must be at least 6%. The threshold is raised from the current 4%, and the risk-weighting method is changed as mentioned above. To be well capitalized the Tier 1 capital ratio must be at least 8%.

*Total Capital Ratio.* For all supervised financial institutions, including the Company and the Bank, the ratio of total capital to risk-weighted assets must be at least 8%. Although this threshold is unchanged from current requirements, as mentioned above the method for risk-weighting assets has been changed. As a result of that method change, many banks could have experienced a reduction in this ratio if the change had been effective immediately when the rules were adopted.

*Leverage Ratio Base.* For all banking organizations, including the Bank, the leverage ratio must be at least 4%. To be well capitalized the leverage ratio must be at least 5%.

*Leverage Ratio Supplemental.* For the largest internationally active banking organizations, not including the Bank, a minimum supplementary leverage ratio must be maintained that takes into account certain off-balance sheet exposures.

The revised standards took effect on January 1, 2014 for the larger, so-called advanced-approaches institutions, and on January 1, 2015 for all other institutions, including the Company and the Bank. The capital conservation buffer requirement is subject to a phase-in period.

Additionally, ASU 2016-13, *Financial Instruments - Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments*, which implements CECL as a new impairment model based on expected credit losses, will require the Company and the Bank to recognize all expected credit losses over the life of a loan based on historical experience, current conditions and reasonable and supportable forecasts. CECL generally is expected to result in earlier recognition of credit losses, which would increase reserves and decrease capital. The Company cannot predict the impact of CECL on its reserves and capital; however, the impact could be material.

The regulatory capital rules applicable to the Company and the Bank may continue to evolve. Additionally, certain provisions of the EGRRCPA have the potential to limit the application of current capital rules to the Company and the Bank if certain elections are made by the Company or Bank, subject to further rulemaking that has not yet been enacted. Management cannot predict the effect that any changes to current capital requirements would have on the Company and the Bank.





## Table of Contents

Future increases in minimum capital requirements could adversely affect the Company's net income. Furthermore, the Company's failure to comply with the minimum capital requirements could result in regulators taking formal or informal actions against the Company which could restrict future growth or operations.

### The Company relies heavily on technology and computer systems, and disruptions of, failures of, advances in and changes in technology could significantly affect business.

As is customary in the banking industry, the Company is dependent upon automated and non-automated systems to record and process our transaction volume. This poses the risk that technical system flaws, employee errors or tampering or manipulation of those systems by employees, customers or outsiders will result in losses. Any such losses, which may be difficult to detect, could adversely affect the Company's financial condition or results of operations. In addition, the occurrence of such a loss could expose the Company to reputational risk, the loss of customer business, additional regulatory scrutiny or civil litigation and possible financial liability. The Company may also be subject to disruptions of operating systems arising from events that are beyond our control, such as computer viruses, communication and energy disruption and unethical individuals with technological ability to cause disruptions or failures of data processing systems. The Company's ability to compete depends on the ability to continue to adapt to changes in technology on a timely and cost-effective basis to meet customers' demands. The ability of the Company and the Bank to effectively utilize new technologies to address customer needs and create operating efficiencies could materially affect future prospects. Management cannot provide any assurances that the Company will be successful in utilizing such new technologies. Incorporation of new products and services, such as internet and mobile banking services, may require significant resources and expose the Company and the Bank to additional risks, including cybersecurity risk.

### Changes in accounting standards may affect how the Company reports its financial condition and results of operations.

The Company's accounting policies and methods are fundamental to how it records and reports its financial condition and results of operations. From time to time, the Financial Accounting Standards Board (the "FASB") changes the financial accounting and reporting standards that govern the preparation of the Company's financial statements. The most recent economic recession resulted in increased scrutiny of accounting standards by regulators and legislators, particularly as they relate to fair value accounting principles. In addition, ongoing efforts to achieve convergence between U.S. generally accepted accounting principles ("GAAP") and International Financial Reporting Standards may result in changes to GAAP. Any such changes can be difficult to predict and can materially affect how the Company records and reports its financial condition or results of operations. For example, in June 2016, the FASB issued Accounting Standards Update ("ASU") 2016-13 *Financial Instruments - Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments*, which replaces the current incurred loss impairment methodology with a methodology that reflects all current expected credit losses ("CECL") and requires consideration of a broader range of reasonable and supportable information

## Table of Contents

to determine credit loss estimates. The Company intends to adopt ASU 2016-13 during the first quarter of 2020, and adoption of this ASU could materially affect its allowance for loan loss methodology, financial condition, capital levels and results of operations, including expenses the Company may incur in implementing this ASU. For additional details regarding recently adopted and pending accounting pronouncements, see Note A – Business and Summary of Significant Accounting Policies included in Part II. Item 8. Financial Statements and Supplementary Data of this report.

## RISKS RELATING TO AN INVESTMENT IN THE COMPANY'S COMMON STOCK

### Securities issued by the Company are not FDIC insured.

The Company's common stock is not a savings or deposit account or other obligation of the Bank and is not insured by the FDIC, the Bank Insurance Fund or any other government agency or instrumentality, or any private insurer and is subject to investment risk, including the possible loss of principal.

### The directors of the Company and executive management own a significant number of shares of stock, allowing further control over business and corporate affairs.

The Company's directors and executive officers beneficially own approximately 10% of the outstanding common stock of Peoples Financial Corporation. As a result, in addition to their day-to-day management roles, they will be able to exercise significant influence on the Company's business as shareholders, including influence over election of the Board and the authorization of other corporate actions requiring shareholder approval.

### The Company's stock price can be volatile.

Stock price volatility may make it more difficult for you to sell your common stock when you want and at prices you find attractive. The Company's stock price can fluctuate significantly in response to a variety of factors including, among other things:

actual or anticipated variations in quarterly results of operations;

recommendations by securities analysts;

operating and stock price performance of other companies that investors deem comparable to the Company;

news reports relating to trends, concerns and other issues in the banking and financial services industry;

perceptions in the marketplace regarding the Company or its competitors;

new technology used, or services offered, by competitors;



## Table of Contents

significant acquisitions or business combinations, strategic partnerships, joint ventures or capital commitments by or involving the Company or its competitors;

failure to integrate acquisitions or realize anticipated benefits from acquisitions;

changes in government regulations; and

geopolitical conditions such as acts or threats of terrorism or military conflicts.

Additionally, general market fluctuations, industry factors and general economic and political conditions and events, such as economic slowdowns or recessions, interest rate changes or credit loss trends, could also cause the Company's stock price to decrease regardless of operating results.

The trading volume in the Company's common stock is less than that of other larger bank holding companies.

The Company's common stock is listed for trading on The OTCQX Best Market. The average daily trading volume in the Company's common stock is low, generally less than that of many of its competitors and other larger bank holding companies. A public trading market having the desired characteristics of depth, liquidity and orderliness depends on the presence in the marketplace of willing buyers and sellers of the Company's common stock at any given time. This presence depends on the individual decisions of investors and general economic and market conditions over which the Company has no control. Given the lower trading volume of the Company's common stock, significant sales of the Company's common stock, or the expectation of these sales, could cause volatility in the price of the Company's common stock.

Provisions of the Company's articles of incorporation and bylaws, Mississippi law and state and federal banking regulations could delay or prevent a takeover by a third party.

Certain provisions of the Company's articles of incorporation and bylaws and of state and federal law may make it more difficult for someone to acquire control of the Company. Under federal law, subject to certain exemptions, a person, entity or group must notify the federal banking agencies before acquiring 10% or more of the outstanding voting stock of a bank holding company, including the Company's shares. Banking agencies review the acquisition to determine if it will result in a change of control. The banking agencies have 60 days to act on the notice, and take into account several factors, including the resources of the acquirer and the antitrust effects of the acquisition. There are also Mississippi statutory provisions and provisions in the Company's articles of incorporation and bylaws that may be used to delay or block a takeover attempt. As a result, these statutory provisions and provisions in the Company's articles and bylaws could result in the Company being less attractive to a potential acquirer.

The Company's future ability to pay dividends is subject to restrictions.

Since the Company is a holding company with no significant assets other than the Bank, the Company has no material source of funds other than dividends received from the Bank. Therefore, the ability to pay dividends to the shareholders will depend on the Bank's ability to pay dividends to the Company. Moreover, banks and bank holding companies are both subject to certain federal and state regulatory restrictions on cash dividends. Currently, the Federal Reserve, the FDIC and the MDBCF must approve the declaration and payment of dividends by the Company and the Bank, respectively.



**Table of Contents**

**ITEM 1b - UNRESOLVED STAFF COMMENTS**

None.

**ITEM 2 - PROPERTIES**

The principal properties of the Company are its 18 business locations, including the Main Office, which is located at 152 Lameuse Street in Biloxi, MS, 39530. The Armed Forces Retirement Home ( AFRH ) Branch located at 1800 Beach Drive, Gulfport, MS 39507, is located in space provided by the AFRH. The Keesler Branch located at 1507 Meadows Drive, Keesler AFB, MS 39534, is rented from the Department of Defense. All other branch locations are owned by the Company. The addresses of the other branch locations are:

|                               |   |
|-------------------------------|---|
| Bay St. Louis Office          | 408 Highway 90 East, Bay St. Louis, MS 39520      |
| Cedar Lake Office             | 1740 Pops Ferry Road, Biloxi, MS 39532            |
| Diamondhead Office            | 5429 West Aloha Drive, Diamondhead, MS 39525      |
| D Iberville-St. Martin Office | 10491 Lemoyne Boulevard, D Iberville, MS 39540    |
| Downtown Gulfport Office      | 1105 30th Avenue, Gulfport, MS 39501              |
| Gautier Office                | 2609 Highway 90, Gautier, MS 39553                |
| Handsboro Office              | 0412 E. Pass Road, Gulfport, MS 39507             |
| Long Beach Office             | 298 Jeff Davis Avenue, Long Beach, MS 39560       |
| Ocean Springs Office          | 2015 Bienville Boulevard, Ocean Springs, MS 39564 |
| Orange Grove Office           | 12020 Highway 49 North, Gulfport, MS 39503        |
| Pass Christian Office         | 301 East Second Street, Pass Christian, MS 39571  |
| Saucier Office                | 17689 Second Street, Saucier, MS 39574            |
| Waveland Office               | 470 Highway 90, Waveland, MS 39576                |
| West Biloxi Office            | 2560 Pass Road, Biloxi, MS 39531                  |
| Wiggins Office                | 1312 S. Magnolia Drive, Wiggins, MS 39577         |

**ITEM 3 - LEGAL PROCEEDINGS**

Information relating to legal proceedings is included in Note M Contingencies to the 2018 Consolidated Financial Statements which is in Item 8 in this Annual Report on Form 10-K.

**ITEM 4 - MINE SAFETY DISCLOSURES**

Not applicable.

Table of Contents**PART II****ITEM 5 - MARKET FOR THE REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES**

Dividends to the Company's shareholders can generally be paid only from dividends paid to the Company by its bank subsidiary. Consequently, dividends are dependent upon the earnings, capital needs, regulatory policies and statutory limitations affecting the bank subsidiary. The Company and the bank subsidiary may not declare or pay any cash dividends without prior written approval of their regulators.

At December 31, 2018, there were 433 holders of the common stock of the Company, which does not reflect persons or entities that hold the common stock in nominee or street name through various brokerage firms. At December 31, 2018, there were 4,943,186 shares issued and outstanding.

The Company's stock is traded under the symbol PFBX. Until December 15, 2017, the stock was traded on the NASDAQ Capital Market (NASDAQ). To reduce costs, the Company delisted from NASDAQ and began trading on the OTCQX Best Market (OTCQX) on December 18, 2017.

The following table sets forth the high and low bid prices of the Company's common stock for the periods indicated by NASDAQ for all quarters in 2017 and by OTCQX for the fourth quarter of 2017 and all quarters in 2018. The quotations reflect inter-dealer prices, without retail mark-up, mark-down or commission and may not necessarily represent actual transactions.

| Year | Quarter      | High     | Low      | Dividend<br>Per share |
|------|--------------|----------|----------|-----------------------|
| 2018 | 1st          | \$ 14.70 | \$ 12.60 |                       |
|      | 2nd          | 14.25    | 13.65    | .01                   |
|      | 3rd          | 14.08    | 12.95    |                       |
|      | 4th          | 13.50    | 11.20    | .01                   |
| 2017 | 1st          | \$ 16.35 | \$ 13.80 |                       |
|      | 2nd          | 15.27    | 12.60    |                       |
|      | 3rd          | 14.95    | 12.85    | .01                   |
|      | 4th - NASDAQ | 15.30    | 12.05    |                       |
|      | 4th - OTCQX  | 13.25    | 12.21    |                       |

**Table of Contents****ITEM 6 - SELECTED FINANCIAL DATA (In thousands except per share data)**

|   | 2018       | 2017       | 2016       | 2015       | 2014        |
|---|------------|------------|------------|------------|-------------|
| <b>Balance Sheet Summary</b>                        |            |            |            |            |             |
| Total assets  | \$ 616,786 | \$ 650,424 | \$ 688,014 | \$ 641,004 | \$ 668,895  |
| Available for sale securities                       | 222,110    | 245,664    | 233,578    | 202,807    | 215,122     |
| Held to maturity securities                         | 54,598     | 51,163     | 48,150     | 19,025     | 17,784      |
| Loans, net of unearned discount                     | 273,346    | 280,449    | 315,355    | 337,557    | 362,407     |
| Deposits  | 473,506    | 529,570    | 575,016    | 512,707    | 516,920     |
| Borrowings from FHLB                                | 36,142     | 11,198     | 6,257      | 18,409     | 38,708      |
| Shareholders equity                                 | 86,934     | 89,499     | 88,461     | 91,839     | 94,951      |
| <b>Summary of Operations</b>                        |            |            |            |            |             |
| Interest income                                     | \$ 19,750  | \$ 18,503  | \$ 18,493  | \$ 19,311  | \$ 22,156   |
| Interest expense                                    | 2,658      | 1,423      | 1,025      | 875        | 1,441       |
| Net interest income                                 | 17,092     | 17,080     | 17,468     | 18,436     | 20,715      |
| Provision for loan losses                           | 122        | 116        | 568        | 2,582      | 7,404       |
| Net interest income after provision for loan losses | 16,970     | 16,964     | 16,900     | 15,854     | 13,311      |
| Non-interest income                                 | 6,103      | 6,965      | 6,549      | 6,898      | 8,619       |
| Non-interest expense                                | 22,480     | 22,251     | 23,204     | 28,106     | 27,208      |
| Income (loss) before taxes                          | 593        | 1,678      | 245        | (5,354)    | (5,278)     |
| Income tax expense (benefit)                        | (36)       | (1,080)    | 78         | (762)      | 4,726       |
| Net income (loss)                                   | \$ 629     | \$ 2,758   | \$ 167     | \$ (4,592) | \$ (10,004) |
| <b>Per Share Data</b>                               |            |            |            |            |             |
| Basic and diluted earnings (loss) per share         | \$ .13     | \$ .54     | \$ .03     | (\$ .90)   | (\$ 1.95)   |
| Dividends per share                                 | .02        | .01        |            |            | .10         |
| Book value  | 17.59      | 17.84      | 17.27      | 17.93      | 18.53       |
| Weighted average number of shares                   | 5,031,778  | 5,123,076  | 5,123,186  | 5,123,186  | 5,123,186   |
| <b>Selected Ratios</b>                              |            |            |            |            |             |
| Return on average assets                            | 0.10%      | 0.41%      | 0.02%      | (.69%)     | (1.38%)     |
| Return on average equity                            | 0.73%      | 3.08%      | 0.19%      | (4.92%)    | (10.31%)    |
| Primary capital to average assets                   | 14.43%     | 14.34%     | 13.99%     | 15.06%     | 14.38%      |
| Risk-based capital ratios:                          |            |            |            |            |             |
| Tier 1  | 24.05%     | 23.87%     | 21.69%     | 20.58%     | 20.70%      |
| Total   | 25.30%     | 25.12%     | 22.94%     | 21.83%     | 21.95%      |



**Table of Contents**

**ITEM 7 - MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

Peoples Financial Corporation (the Company) is a one-bank holding company headquartered in Biloxi, Mississippi. The following presents Management's discussion and analysis of the consolidated financial condition and results of operations of the Company and its consolidated subsidiaries for the years ended December 31, 2018, 2017 and 2016. These comments highlight the significant events for these years and should be considered in combination with the Consolidated Financial Statements and Notes to Consolidated Financial Statements included in this annual report.

**FORWARD-LOOKING INFORMATION**

Congress passed the Private Securities Litigation Act of 1995 in an effort to encourage corporations to provide information about a company's anticipated future financial performance. This act provides a safe harbor for such disclosure which protects the companies from unwarranted litigation if actual results are different from management expectations. This report contains forward-looking statements and reflects industry conditions, company performance and financial results. These forward-looking statements are subject to a number of factors and uncertainties which could cause the Company's actual results and experience to differ from the anticipated results and expectations expressed in such forward-looking statements. Such factors and uncertainties include, but are not limited to: changes in interest rates and market prices, changes in local economic and business conditions, increased competition for deposits and loans, a deviation in actual experience from the underlying assumptions used to determine and establish the allowance for loan losses, changes in the availability of funds resulting from reduced liquidity, changes in government regulations and acts of terrorism, weather or other events beyond the Company's control.

**NEW ACCOUNTING PRONOUNCEMENTS**

The Financial Accounting Standards Board (FASB) issued new accounting standards updates in 2018, which have been disclosed in Note A to the Consolidated Financial Statements. The Company does not expect that these updates discussed in the Notes will have a material impact on its financial position, results of operations or cash flows. The Company adopted Accounting Standards Update 2014-09, *Revenue from Contract with Customers (Topic 606)* and Accounting Standards Update 2018-03, *Technical Corrections and Improvements to Financial Instruments - Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities, that Clarifies the Guidance in ASU No. 2016-01, Financial Instruments - Overall (Subtopic 825-10)*, effective January 1, 2018, neither of which had a material effect on its financial position, results of operations or cash flows. The Company is currently working on the implementation of Accounting Standards Update 2016-13, *Financial Instruments-Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments*. Further disclosure relating to these efforts is included in Note A.

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**Table of Contents**

**CRITICAL ACCOUNTING POLICIES**

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America ( GAAP ) requires Management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. The Company evaluates these estimates and assumptions on an on-going basis using historical experience and other factors, including the current economic environment. We adjust such estimates and assumptions when facts and circumstances dictate. Certain critical accounting policies affect the more significant estimates and assumptions used in the preparation of the consolidated financial statements.

**Investments**

Investments which are classified as available for sale are stated at fair value. A decline in the market value of an investment below cost that is deemed to be other-than-temporary is charged to earnings for the decline in value deemed to be credit related and a new cost basis in the security is established. The decline in value attributed to non-credit related factors is recognized in other comprehensive income. The determination of the fair value of securities may require Management to develop estimates and assumptions regarding the amount and timing of cash flows.

**Allowance for Loan Losses**

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

## **Table of Contents**

### **Other Real Estate**

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

### **Employee Benefit Plans**

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

### **Income Taxes**

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

### **GAAP Reconciliation and Explanation**

This report contains non-GAAP financial measures determined by methods other than in accordance with GAAP. Such non-GAAP financial measures include taxable equivalent interest income and taxable equivalent net interest income. Management uses these non-GAAP financial measures because it believes they are useful for evaluating our operations and performance over periods of time, as well as in managing and evaluating our business and in discussions about our operations and performance. Management believes these non-GAAP financial measures provide users of our financial information with a meaningful measure for assessing our financial results, as well as comparison to financial results for prior periods. These non-GAAP financial measures should not be considered as a substitute for operating results determined in accordance with GAAP and may not be comparable to other similarly titled financial measures used by other companies.

**Table of Contents**

A reconciliation of these operating performance measures to GAAP performance measures for the years ended December 31, 2018, 2017 and 2016 is below.

**RECONCILIATION OF NON-GAAP PERFORMANCE MEASURES**

(in thousands)

| <b>Years Ended December 31,</b>            | <b>2018</b>      | <b>2017</b>      | <b>2016</b>      |
|--|------------------|------------------|------------------|
| <b>Interest income reconciliation:</b>     |                  |                  |                  |
| Interest income - taxable equivalent       | \$ 19,999        | \$ 19,048        | \$ 19,121        |
| Taxable equivalent adjustment              | (249)            | (545)            | (628)            |
| <b>Interest income (GAAP)</b>              | <b>\$ 19,750</b> | <b>\$ 18,503</b> | <b>\$ 18,493</b> |
| <b>Net interest income reconciliation:</b> |                  |                  |                  |
| Net interest income - taxable equivalent   | \$ 17,341        | \$ 17,625        | \$ 18,096        |
| Taxable equivalent adjustment              | (249)            | (545)            | (628)            |
| <b>Net interest income (GAAP)</b>          | <b>\$ 17,092</b> | <b>\$ 17,080</b> | <b>\$ 17,468</b> |

**OVERVIEW**

The Company is a community bank serving the financial and trust needs of its customers in our trade area, which is defined as those portions of Mississippi, Louisiana and Alabama which are within a fifty-mile radius of the Waveland, Wiggins and Gautier branches, the bank subsidiary's three most outlying locations. Maintaining a strong core deposit base and providing commercial and real estate lending in our trade area are the traditional focuses of the Company. Growth has largely been achieved through de novo branching activity, and it is expected that these strategies will continue to be emphasized in the future.

The Company recorded net income of \$629,000 for 2018 compared with net income of \$2,758,000 and \$167,000 for 2017 and 2016, respectively. Results in 2018 included a significant loss from other investments and increased expenses related to other real estate as compared with 2017. Results in 2017 were significantly impacted by the continuing decrease in the provision for the allowance for loan losses, a non-recurring gain from the redemption of death benefits on bank owned life insurance and a tax benefit as compared with 2016.

Managing the net interest margin in the Company's highly competitive market continues to be very challenging. In 2018, interest income increased as interest and fees on loans increased \$295,000 and interest on mortgage-backed securities improved \$1,313,000 as compared with 2017. This increase however was almost entirely offset by the increase in interest expense in the current year. While the decrease in interest and fees on loans of \$1,262,000 was offset by an increase on interest and dividends on securities of \$1,130,000, net interest income was also impacted by the increase in interest expense of \$398,000 for 2017 as compared with 2016. The increase in interest expense on deposits resulted from the increase in cost of funds during 2017.



## **Table of Contents**

Monitoring asset quality, estimating potential losses in our loan portfolio and addressing non-performing loans continue to be emphasized as the local economy has negatively impacted collateral values and borrowers' ability to repay their loans. The Company's nonaccrual loans totaled \$8,250,000 and \$13,810,000 at December 31, 2018 and 2017, respectively. Most of these loans are collateral-dependent, and the Company has rigorously evaluated the value of its collateral to determine potential losses. The Company is working diligently to address and reduce its non-performing assets, and some stability in collateral values has occurred. The provision for the allowance for loan losses was \$122,000, \$116,000 and \$568,000 for 2018, 2017 and 2016, respectively.

Non-interest income decreased \$862,000 for 2018 as compared with 2017 and increased \$416,000 for 2017 as compared with 2016. Results for 2018 included a \$274,000 loss from other investments. Results for 2017 included a non-recurring gain of \$429,000 from the redemption of death benefits on bank owned life insurance.

Non-interest expense increased \$229,000 for 2018 as compared with 2017 and decreased \$953,000 for 2017 as compared with 2016. The increase in 2018 was primarily the result of increased writedowns of other real estate of \$304,000. The decrease for 2017 was primarily the result of a decrease in net occupancy of \$202,000 and the decrease in FDIC and state banking assessments of \$477,000.

In 2018 and 2017, the Company recorded an income tax benefit as a result of the release of a part of its valuation allowance on deferred assets and the correction of refunds for prior years. Income tax expense in 2016 related to the resolution of an examination by the Internal Revenue Service.

## **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.

#### **2018 as compared with 2017**

The Company's average interest-earning assets decreased approximately \$30,425,000, or 5%, from approximately \$600,369,000 for 2017 to approximately \$569,944,000 for 2018. Average loans decreased approximately \$16,605,000 due to principal payments, maturities, charge-offs and foreclosures on existing loans significantly exceeding new loans. Average balances due from depository institutions decreased approximately \$18,321,000 based on the liquidity needs of the bank subsidiary. The average yield on interest-earning assets was 3.17% for 2017 compared with

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**Table of Contents**

3.51% for 2018. The yield on average loans increased from 4.47% for 2017 to 4.85% for 2018 as a result of the increase in prime rate during 2017 and 2018. The yield on taxable available for sale securities increased from 1.52% for 2017 to 1.98% for 2018 as the Company changed its investment strategy to improve yield while not compromising duration and credit risk.

Average interest-bearing liabilities decreased approximately \$22,849,000, or 5%, from approximately \$437,627,000 for 2017 to approximately \$414,778,000 for 2018. Average savings and interest-bearing DDA balances decreased approximately \$36,155,000 primarily as several large commercial customers relocated their funds to other institutions in the current year. Average borrowings from the Federal Home Loan Bank ( FHLB ) increased approximately \$11,161,000 due to the liquidity needs of the bank subsidiary. The average rate paid on interest-bearing liabilities increased 31 basis points, from .33% for 2017 to .64% for 2018. This increase was the result of increased rates.

The Company's net interest margin on a tax-equivalent basis, which is net interest income as a percentage of average earning assets, was 2.94% for 2017 as compared with 3.04% for 2018.

**2017 as compared with 2016**

The Company's average interest-earning assets increased approximately \$1,687,000, or .28%, from approximately \$598,682,000 for 2016 to approximately \$600,369,000 for 2017. Average loans decreased approximately \$37,490,000 due to principal payments, maturities, charge-offs and foreclosures on existing loans significantly exceeding new loans. Average taxable held to maturity securities increased approximately \$20,827,000 and average taxable available for sale securities increased approximately \$28,547,000 as funds not needed for liquidity and lending needs were invested in securities. The average yield on interest-earning assets was 3.19% for 2016 compared with 3.17% for 2017. The yield on average loans increased from 4.34% for 2016 to 4.47% for 2017 as a result of the increase in prime rate during 2016 and 2017. The yield on taxable held to maturity securities increased from 2.15% for 2016 to 2.56% for 2017 and taxable available for sale securities increased from 1.36% for 2016 to 1.52% for 2017 as the Company changed its investment strategy to improve yield while not compromising duration and credit risk.

Average interest-bearing liabilities decreased approximately \$8,058,000, or 2%, from approximately \$445,685,000 for 2016 to approximately \$437,627,000 for 2017. Average borrowings from the FHLB decreased due to the reduced liquidity needs of the bank subsidiary. The average rate paid on interest-bearing liabilities increased 10 basis points, from .23% for 2016 to .33% for 2017. This increase was the result of time deposit rates increasing in our trade area and the Company paying off lower rate borrowings from the FHLB.

The Company's net interest margin on a tax-equivalent basis, which is net interest income as a percentage of average earning assets, was 3.02% for 2016 as compared with 2.94% for 2017.

The following tables analyze the changes in tax-equivalent net interest income for the years ended December 31, 2018, 2017 and 2016.

**Table of Contents****ANALYSIS OF AVERAGE BALANCES, INTEREST EARNED/PAID AND YIELD**

(in thousands)

|                         | 2018       |             |       | 2017       |             |       | 2016       |             |
|-------------------------|------------|-------------|-------|------------|-------------|-------|------------|-------------|
|                         | Average    | Interest    |       | Average    | Interest    |       | Average    | Interest    |
| (2)                     | Balance    | Earned/Paid | Rate  | Balance    | Earned/Paid | Rate  | Balance    | Earned/Paid |
|                         | \$ 273,724 | \$ 13,265   | 4.85% | \$ 290,329 | \$ 12,970   | 4.47% | \$ 327,819 | \$ 14,232   |
| due<br>pository<br>ns   | 9,498      | 205         | 2.16% | 27,819     | 420         | 1.51% | 31,559     | 277         |
|                         | 33,864     | 970         | 2.86% | 29,389     | 753         | 2.56% | 8,562      | 184         |
| ble (3)                 | 18,208     | 580         | 3.19% | 19,082     | 717         | 3.76% | 19,596     | 725         |
| e for                   |            |             |       |            |             |       |            |             |
|                         | 220,076    | 4,349       | 1.98% | 217,059    | 3,298       | 1.52% | 188,512    | 2,558       |
| ble (3)                 | 13,055     | 608         | 4.66% | 15,677     | 864         | 5.51% | 20,902     | 1,123       |
|                         | 1,519      | 22          | 1.45% | 1,014      | 26          | 2.56% | 1,732      | 22          |
|                         | \$ 569,944 | \$ 19,999   | 3.51% | \$ 600,369 | \$ 19,048   | 3.17% | \$ 598,682 | \$ 19,121   |
| and<br>bearing          | \$ 317,197 | \$ 1,468    | 0.46% | \$ 353,352 | \$ 736      | 0.21% | \$ 359,801 | \$ 437      |
| osits                   | 84,168     | 886         | 1.05% | 82,038     | 637         | 0.78% | 77,644     | 457         |
| unds<br>d and<br>s sold |            |             |       |            |             |       |            |             |
| nts to<br>se            | 369        | 10          | 2.71% | 354        | 3           | 0.85% |            |             |
| gs<br>LB                | 13,044     | 294         | 2.25% | 1,883      | 47          | 2.50% | 8,240      | 131         |
|                         | \$ 414,778 | \$ 2,658    | 0.64% | \$ 437,627 | \$ 1,423    | 0.33% | \$ 445,685 | \$ 1,025    |



|                            |       |       |
|----------------------------|-------|-------|
| Equivalent                 | 2.87% | 2.84% |
| Equivalent<br>on<br>Assets | 3.04% | 2.94% |

- (1) Loan fees of \$310, \$338 and \$389 for 2018, 2017 and 2016, respectively, are included in these figures.
- (2) Includes nonaccrual loans.
- (3) All interest earned is reported on a taxable equivalent basis using a tax rate of 21% in 2018 and 34% in 2017 and 2016. See disclosure of Non-GAAP financial measures on pages 50 and 51.

**Table of Contents****ANALYSIS OF CHANGES IN INTEREST INCOME AND EXPENSE**

(in thousands)

|   | For the Year Ended                                |                 |                 |                 |
|---|---|-----------------|-----------------|-----------------|
|   | December 31, 2018 Compared With December 31, 2017 |                 |                 |                 |
|   | Volume  | Rate            | Rate/Volume     | Total           |
| <b>Interest earned on:</b>                |   |                 |                 |                 |
| Loans                                     | \$ (742)  | \$ 1,100        | \$ (63)         | \$ 295          |
| Balances due from depository institutions | (277)   | 180             | (118)           | (215)           |
| <b>Held to maturity securities:</b>       |   |                 |                 |                 |
| Taxable                                   | 115   | 89              | 13              | 217             |
| Non taxable                               | (33)  | (109)           | 5               | (137)           |
| <b>Available for sale securities:</b>     |   |                 |                 |                 |
| Taxable                                   | 46  | 991             | 14              | 1,051           |
| Non taxable                               | (145)   | (134)           | 23              | (256)           |
| Other                                     | 13  | (11)            | (6)             | (4)             |
| <b>Total</b>                              | <b>\$ (1,023)</b>                                 | <b>\$ 2,106</b> | <b>\$ (132)</b> | <b>\$ 951</b>   |
| <b>Interest paid on:</b>                  |   |                 |                 |                 |
| Savings and interest-bearing DDA          | \$ (75)   | \$ 899          | \$ (92)         | \$ 732          |
| Time deposits                             | 17  | 227             | 5               | 249             |
| Federal funds purchased                   | 1   | 6               |                 | 7               |
| Borrowings from FHLB                      | 279   | (5)             | (27)            | 247             |
| <b>Total</b>                              | <b>\$ 222</b>                                     | <b>\$ 1,127</b> | <b>\$ (114)</b> | <b>\$ 1,235</b> |

**Table of Contents****ANALYSIS OF CHANGES IN INTEREST INCOME AND EXPENSE**

(in thousands)

|   | For the Year Ended |                 |                                 |                |
|---|--------------------|-----------------|---------------------------------|----------------|
|   | December 31, 2017  |                 | Compared With December 31, 2016 |                |
|   | Volume             | Rate            | Rate/Volume                     | Total          |
| <b>Interest earned on:</b>                |                    |                 |                                 |                |
| Loans                                     | \$ (1,628)         | \$ 413          | \$ (47)                         | \$ (1,262)     |
| Balances due from depository institutions | (33)               | 199             | (23)                            | 143            |
| <b>Held to maturity securities:</b>       |                    |                 |                                 |                |
| Taxable                                   | 448                | 35              | 86                              | 569            |
| Non taxable                               | (19)               | 11              |                                 | (8)            |
| <b>Available for sale securities:</b>     |                    |                 |                                 |                |
| Taxable                                   | 387                | 306             | 47                              | 740            |
| Non taxable                               | (281)              | 29              | (7)                             | (259)          |
| Other                                     | (10)               | 23              | (9)                             | 4              |
| <b>Total</b>                              | <b>\$ (1,136)</b>  | <b>\$ 1,016</b> | <b>\$ 47</b>                    | <b>\$ (73)</b> |
| <b>Interest paid on:</b>                  |                    |                 |                                 |                |
| Savings and interest-bearing DDA          | \$ (8)             | \$ 312          | \$ (5)                          | \$ 299         |
| Time deposits                             | 26                 | 146             | 8                               | 180            |
| Federal funds purchased                   | 3                  |                 |                                 | 3              |
| Borrowings from FHLB                      | (95)               | 42              | (31)                            | (84)           |
| <b>Total</b>                              | <b>\$ (74)</b>     | <b>\$ 500</b>   | <b>\$ (28)</b>                  | <b>\$ 398</b>  |

**Provision for Allowance for Loan Losses**

In the normal course of business, the Company assumes risk in extending credit to its customers. This credit risk is managed through compliance with the loan policy, which is approved by the Board of Directors. The policy establishes guidelines relating to underwriting standards, including but not limited to financial analysis, collateral valuation, lending limits, pricing considerations and loan grading. The Company's Loan Review and Special Assets Departments play key roles in monitoring the loan portfolio and managing problem loans. New loans and, on a periodic basis, existing loans are reviewed to evaluate compliance with the loan policy. Loan customers in concentrated industries such as gaming and hotel/motel, as well as the exposure for out of area; residential and land development; construction and commercial real estate loans, and their direct



**Table of Contents**

and indirect impact on the Company's operations are evaluated on a monthly basis. Loan delinquencies and deposit overdrafts are closely monitored in order to identify developing problems as early as possible. Lenders experienced in workout scenarios consult with loan officers and customers to address non-performing loans. A monthly 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 to identify and estimate potential losses based on the best available information. The potential effect of declines 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. Note A to the Consolidated Financial Statements discloses a summary of the accounting principles applicable to impaired and nonaccrual loans as well as the allowance for loan losses. Note C to the Consolidated Financial Statements presents additional analyses of the composition, aging, credit quality and performance of the loan portfolio as well as the transactions in the allowance for loan losses.

The Company's analysis includes evaluating the current value of collateral securing all nonaccrual loans. Nonaccrual loans totaled \$8,250,000 and \$13,810,000 with specific reserves on these loans of \$315,000 and \$1,125,000 as of December 31, 2018 and 2017, respectively. The specific reserves allocated to nonaccrual loans are relatively low as collateral values appear sufficient to cover loan losses or the loan balances have been charged down to their realizable value.

The Company's on-going, systematic evaluation resulted in the Company recording a total provision for the allowance for loan losses of \$122,000, \$116,000 and \$568,000 in 2018, 2017 and 2016, respectively. As a result of receiving new information and updated appraisals on several collateral-dependent loans, the Company increased the specific provision for several loans in its real estate, mortgage portfolio in 2017. This increase was partially offset by a large recovery in its residential and land development portfolio during the year. As a result of receiving new information and updated appraisals on several collateral-dependent loans, the Company increased its provision for loan losses during 2016. The new appraisals caused Management to update the evaluation of these loans and increase the loan loss provision for several non-performing loans in its residential development and commercial real estate segments. The allowance for loan losses as a percentage of loans was 1.95%, 2.19% and 1.73% at December 31, 2018, 2017 and 2016, respectively. The Company believes that its allowance for loan losses is appropriate as of December 31, 2018.

The allowance for loan losses is an estimate, and as such, events may occur in the future which may affect its accuracy. The Company anticipates that it is possible that additional information will be gathered in the future 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.

## **Table of Contents**

### **Non-interest Income**

#### **2018 as compared with 2017**

Total non-interest income decreased \$862,000 in 2018 as compared with 2017. Gains on liquidation, sales and calls of securities decreased \$134,000 as the Company had opportunities to sell securities which generated gains in 2017. Income from other investments decreased \$316,000 in 2018 as compared with 2017 as operations of an investment in a low-income housing partnership declined as a result of decreased occupancy. Prior year's results included a gain of \$429,000 from the redemption of death benefits on bank owned life insurance.

#### **2017 as compared with 2016**

Total non-interest income increased \$416,000 in 2017 as compared with 2016. This increase was primarily a result of the gain of \$429,000 from the redemption of death benefits on bank owned life insurance in 2017. Income from other investments increased \$93,000 in 2017 as compared with 2016 as operations of an investment in a low income housing partnership improved as a result of increased occupancy. These increases were partially offset by a decrease in other income as 2016 results included a gain of \$88,000 from the sale of bank premises.

### **Non-interest Expense**

#### **2018 as compared with 2017**

Total non-interest expense increased \$229,000 in 2018 as compared with 2017. Net occupancy costs decreased \$117,000 as liability insurance premiums decreased \$71,000 as the Company reduced some of its coverage and telecommunications costs decreased \$88,000 as the Company eliminated some redundant resources. Equipment rentals, depreciation and maintenance increased \$128,000 primarily as a result of purchases of depreciable assets, primarily technology-related, and an increase in maintenance contracts related to technology services. Other expense increased \$276,000 as a result of the decrease in non-recurring consulting fees of \$164,000, the decrease in FDIC and state banking assessments of \$176,000 as a result of reduced assessment rate and the increase in other real estate expenses of \$514,000, largely due to writedowns of ORE to new appraised values.

#### **2017 as compared with 2016**

Total non-interest expense decreased \$953,000 in 2017 as compared with 2016. Salaries and employee benefits decreased \$139,000 primarily as a result of decreased health insurance costs due to decreased claims. Net occupancy costs decreased \$202,000 as liability insurance premiums decreased \$125,000 as the Company reduced some of its coverage and as telecommunications costs decreased \$81,000 as the Company eliminated some redundant resources. FDIC and state banking assessments decreased \$477,000 as the regulators decreased the premiums for deposit insurance in 2018.

## **Table of Contents**

### **Income Taxes**

The Company recognized an income tax benefit of \$36,000 and \$1,080,000 in 2018 and 2017, respectively, and income tax expense of \$78,000 in 2016. During 2014, Management established a valuation allowance against its net deferred tax asset of approximately \$8,140,000. As of December 31, 2018, the valuation allowance is still in place. The 2018 and 2017 benefits were the result of the impact of the elimination of the alternative minimum tax credit carryforwards from new tax legislation and the correction of refunds for prior years. Note I to the Consolidated Financial Statements presents a reconciliation of income taxes for these three years and further analysis of the valuation allowance.

### **FINANCIAL CONDITION**

Cash and due from banks decreased \$8,090,000 at December 31, 2018 compared with December 31, 2017 due to the bank subsidiary's liquidity position.

Available for sale securities decreased \$23,096,000 at December 31, 2018 compared with December 31, 2017 as the maturities and unrealized losses exceeded investment purchases.

Loans decreased \$7,103,000 at December 31, 2018 compared with December 31, 2017, as principal payments, maturities, charge-offs and foreclosures on existing loans exceeded new loans.

Total deposits decreased \$56,064,000 at December 31, 2018, as compared with December 31, 2017. Typically, significant increases or decreases in total deposits and/or significant fluctuations among the different types of deposits from year to year are anticipated by Management as customers in the casino industry and county and municipal entities reallocate their resources periodically. Savings and demand, interest bearing balances specifically decreased \$39,506,000 at December 31, 2018 as compared with December 31, 2017 as one public customer transferred a large balance to another financial institution.

Borrowings from the FHLB increased \$24,944,000 at December 31, 2018 as compared with December 31, 2017 based on the liquidity needs of the bank subsidiary.

### **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 primary and risk-based capital ratios are important indicators of the strength of a Company's capital. These figures are presented in the Five-Year Comparative Summary of Selected Financial Information. The Company has established the goal of being classified as "well-capitalized" by the banking regulatory authorities.

## **Table of Contents**

Significant transactions affecting shareholders' equity during 2018 are described in Note J to the Consolidated Financial Statements. The Statement of Changes in Shareholders' Equity also presents all activity in the Company's equity accounts.

## **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. Note L to the Consolidated Financial Statements discloses information relating to financial instruments with off-balance-sheet risk, including letters of credit and outstanding unused loan commitments. The Company closely monitors the potential effects of funding these commitments on its liquidity position. Management monitors these funding requirements in such a manner as to satisfy these demands and to provide the maximum return on its earning assets.

The Company monitors and manages its liquidity position diligently 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 continuous basis in the management of its liquidity needs and also conducts contingency testing on its liquidity plan. The Company has also been approved to participate in the Federal Reserve's Discount Window Primary Credit Program, which it intends to use only as a contingency. Management carefully monitors its liquidity needs, particularly relating to potentially volatile deposits, and the Company has encountered no problems with meeting its liquidity needs.

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. The Company also uses other sources of funds, including borrowings from the FHLB. The Company generally anticipates relying on deposits, purchases of federal funds and borrowings from the FHLB for its liquidity needs in 2019.

## **REGULATORY MATTERS**

During 2016, Management identified opportunities for improving information technology operations and security, risk management and earnings, addressing asset quality concerns, analyzing and assessing the Bank's management and staffing needs, and managing concentrations of credit risk as a result of its own investigation as well as examinations performed by certain bank regulatory agencies. In concert with the regulators, the Company has identified specific corrective steps and actions to enhance its information technology operations and security, risk management, earnings, asset quality and staffing. The Company and the Bank may not declare or pay any cash dividends without the prior written approval of their regulators.



**Table of Contents****OFF-BALANCE SHEET ARRANGEMENTS**

The Company is a party to off-balance-sheet arrangements in the normal course of business to meet the financing needs of its customers. The Company uses the same credit policies in making commitments and conditional obligations as it does for on-balance-sheet arrangements. Since some of the commitments and irrevocable letters of credit may expire without being drawn upon, the total amount does not necessarily represent future cash requirements. As discussed previously, the Company carefully monitors its liquidity needs and considers its cash requirements, especially for loan commitments, in making decisions on investments and obtaining funds from its other sources. Further information relating to off-balance-sheet instruments can be found in Note L to the Consolidated Financial Statements.

**ITEM 7A - QUANTITATIVE AND QUALITATIVE DISCLOSURE ABOUT MARKET RISK**

As a smaller reporting company, the Company is not required to provide this information.

**ITEM 8 - FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA**

|  |     |
|--|-----|
| <u>Consolidated Statements of Condition as of December 31, 2018 and 2017</u>                                       | 62  |
| <u>Consolidated Statements of Income for the years ended December 31, 2018, 2017 and 2016</u>                      | 64  |
| <u>Consolidated Statements of Comprehensive Income (Loss) for the years ended December 31, 2018, 2017 and 2016</u> | 66  |
| <u>Consolidated Statements of Changes in Shareholders' Equity for the years ended December 31, 2018 and 2017</u>   | 67  |
| <u>Consolidated Statements of Cash Flows for the years ended December 31, 2018, 2017 and 2016</u>                  | 68  |
| <u>Notes to the Consolidated Financial Statements</u>  | 70  |
| <u>Report of Independent Registered Public Accounting Firm</u>   | 111 |

**Table of Contents****Peoples Financial Corporation and Subsidiaries****Consolidated Statements of Condition****(in thousands except share data)**

| <b>December 31,</b>   | <b>2018</b>       | <b>2017</b>       |
|---|-------------------|-------------------|
| <b>Assets</b>   |                   |                   |
| Cash and due from banks   | \$ 17,191         | \$ 25,281         |
| Available for sale securities   | 222,110           | 245,206           |
| Held to maturity securities, fair value of \$53,459 - 2018; \$50,538 - 2017 | 54,598            | 51,163            |
| Other investments   | 2,811             | 3,193             |
| Federal Home Loan Bank Stock, at cost                                       | 2,069             | 1,370             |
| <b>Loans</b>  | <b>273,346</b>    | <b>280,449</b>    |
| Less: Allowance for loan losses   | 5,340             | 6,153             |
| <b>Loans, net</b>   | <b>268,006</b>    | <b>274,296</b>    |
| Bank premises and equipment, net of accumulated depreciation                | 18,879            | 20,153            |
| Other real estate   | 8,943             | 8,232             |
| Accrued interest receivable   | 1,956             | 1,904             |
| Cash surrender value of life insurance                                      | 18,841            | 18,301            |
| Other assets  | 1,382             | 1,325             |
| <b>Total assets</b>   | <b>\$ 616,786</b> | <b>\$ 650,424</b> |

**Table of Contents**

**Peoples Financial Corporation and Subsidiaries**  
**Consolidated Statements of Condition (continued)**  
(in thousands except share data)

| <b>December 31,</b>  | <b>2018</b>       | <b>2017</b>       |
|--|-------------------|-------------------|
| <b>Liabilities and Shareholders Equity</b>   |                   |                   |
| <b>Liabilities:</b>  |                   |                   |
| Deposits:  |                   |                   |
| Demand, non-interest bearing   | \$ 114,512        | \$ 127,274        |
| Savings and demand, interest bearing   | 278,772           | 318,278           |
| Time, \$100,000 or more  | 52,787            | 43,991            |
| Other time deposits  | 27,435            | 40,027            |
| <b>Total deposits</b>  | <b>473,506</b>    | <b>529,570</b>    |
| Borrowings from Federal Home Loan Bank   | 36,142            | 11,198            |
| Employee and director benefit plans liabilities  | 18,415            | 18,370            |
| Other liabilities  | 1,789             | 1,787             |
| <b>Total liabilities</b>   | <b>529,852</b>    | <b>560,925</b>    |
| <b>Shareholders Equity:</b>  |                   |                   |
| Common stock, \$1 par value, 15,000,000 shares authorized, 4,943,186 shares issued and outstanding at December 31, 2018 and 5,083,186 shares issued and outstanding at December 31, 2017 | 4,943             | 5,083             |
| Surplus  | 65,780            | 65,780            |
| Undivided profits  | 20,324            | 21,563            |
| Accumulated other comprehensive loss   | (4,113)           | (2,927)           |
| <b>Total shareholders equity</b>   | <b>86,934</b>     | <b>89,499</b>     |
| <b>Total liabilities and shareholders equity</b>   | <b>\$ 616,786</b> | <b>\$ 650,424</b> |

See Notes to Consolidated Financial Statements.



Table of Contents

## Peoples Financial Corporation and Subsidiaries

## Consolidated Statements of Income

(in thousands except per share data)

| Years Ended December 31,   | 2018             | 2017             | 2016             |
|--|------------------|------------------|------------------|
| <b>Interest income:</b>  |                  |                  |                  |
| Interest and fees on loans   | \$ 13,265        | \$ 12,970        | \$ 14,232        |
| <b>Interest and dividends on securities:</b>                               |                  |                  |                  |
| U. S. Treasuries   | 1,410            | 1,602            | 1,133            |
| U.S. Government agencies   | 471              | 531              | 872              |
| Mortgage-backed securities   | 2,633            | 1,320            | 600              |
| States and political subdivisions  | 1,744            | 1,634            | 1,325            |
| Other investments  | 22               | 26               | 53               |
| Interest on balances due from depository institutions                      | 205              | 420              | 278              |
| <b>Total interest income</b>   | <b>19,750</b>    | <b>18,503</b>    | <b>18,493</b>    |
| <b>Interest expense:</b>   |                  |                  |                  |
| Deposits   | 2,354            | 1,373            | 894              |
| Federal funds purchased and securities sold under agreements to repurchase | 10               | 3                |                  |
| Borrowings from Federal Home Loan Bank                                     | 294              | 47               | 131              |
| <b>Total interest expense</b>  | <b>2,658</b>     | <b>1,423</b>     | <b>1,025</b>     |
| <b>Net interest income</b>   | <b>17,092</b>    | <b>17,080</b>    | <b>17,468</b>    |
| <b>Provision for allowance for loan losses</b>                             | <b>122</b>       | <b>116</b>       | <b>568</b>       |
| <b>Net interest income after provision for allowance for loan losses</b>   | <b>\$ 16,970</b> | <b>\$ 16,964</b> | <b>\$ 16,900</b> |



**Table of Contents****Peoples Financial Corporation and Subsidiaries****Consolidated Statements of Income (continued)****(in thousands except per share data)**

| <b>Years Ended December 31,</b>                    | <b>2018</b>   | <b>2017</b>     | <b>2016</b>   |
|--|---------------|-----------------|---------------|
| <b>Non-interest income:</b>                        |               |                 |               |
| Trust department income and fees                   | 1,708         | 1,689           | 1,614         |
| Service charges on deposit accounts                | 3,737         | 3,732           | 3,763         |
| Gain on liquidation, sales and calls of securities |               | 134             | 158           |
| Gain on sales of other investments                 | 17            |                 |               |
| Income (loss) from other investments               | (274)         | 42              | (51)          |
| Increase in cash surrender value of life insurance | 455           | 458             | 406           |
| Gain from death benefits from life insurance       |               | 429             |               |
| Other income                                       | 460           | 481             | 659           |
| <b>Total non-interest income</b>                   | <b>6,103</b>  | <b>6,965</b>    | <b>6,549</b>  |
| <b>Non-interest expense:</b>                       |               |                 |               |
| Salaries and employee benefits                     | 10,891        | 10,949          | 11,088        |
| Net occupancy                                      | 2,004         | 2,121           | 2,323         |
| Equipment rentals, depreciation and maintenance    | 3,134         | 3,006           | 2,954         |
| Other expense                                      | 6,451         | 6,175           | 6,839         |
| <b>Total non-interest expense</b>                  | <b>22,480</b> | <b>22,251</b>   | <b>23,204</b> |
| <b>Income before income taxes</b>                  | <b>593</b>    | <b>1,678</b>    | <b>245</b>    |
| Income tax (benefit) expense                       | (36)          | (1,080)         | 78            |
| <b>Net income</b>                                  | <b>\$ 629</b> | <b>\$ 2,758</b> | <b>\$ 167</b> |

|   |    |     |    |     |    |     |
|---|----|-----|----|-----|----|-----|
| <b>Basic and diluted earnings per share</b> | \$ | .13 | \$ | .54 | \$ | .03 |
| <b>Dividends declared per share</b>         | \$ | .02 | \$ | .01 | \$ |     |

See Notes to Consolidated Financial Statements.



Table of Contents

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

| Years Ended December 31,   | 2018     | 2017     | 2016       |
|--|----------|----------|------------|
| <b>Net income</b>  | \$ 629   | \$ 2,758 | \$ 167     |
| <b>Other comprehensive income (loss):</b>  |          |          |            |
| Net unrealized gain (loss) on available for sale securities  | (1,645)  | 127      | (3,345)    |
| Reclassification adjustment for realized gains on available for sale securities called or sold in current year |          | (134)    | (158)      |
| Gain (loss) from unfunded post-retirement benefit obligation   | 459      | (1,160)  | (42)       |
| <b>Total other comprehensive loss</b>  | (1,186)  | (1,167)  | (3,545)    |
| <b>Total comprehensive income (loss)</b>   | \$ (557) | \$ 1,591 | \$ (3,378) |

See Notes to Consolidated Financial Statements.

Table of Contents

## Peoples Financial Corporation and Subsidiaries

## Consolidated Statements of Changes in Shareholders' Equity

(in thousands except share and per share data)

|                                   | Number<br>of<br>Common<br>Shares | Common<br>Stock | Surplus   | Undivided<br>Profits | Accumulated<br>Other<br>Comprehensive<br>Income<br>(Loss) | Total     |
|-----------------------------------|----------------------------------|-----------------|-----------|----------------------|---|-----------|
| <b>Balance, January 1, 2017</b>   | 5,123,186                        | \$ 5,123        | \$ 65,780 | \$ 19,318            | \$ (1,760)  | \$ 88,461 |
| Net income                        |                                  |                 |           | 2,758                |   | 2,758     |
| Retirement of stock               | (40,000)                         | (40)            |           | (462)                |   | (502)     |
| Cash dividend (\$.01 per share)   |                                  |                 |           | (51)                 |   | (51)      |
| Other comprehensive loss          |                                  |                 |           |                      | (1,167)   | (1,167)   |
| <b>Balance, December 31, 2017</b> | 5,083,186                        | 5,083           | 65,780    | 21,563               | (2,927)   | 89,499    |
| Net income                        |                                  |                 |           | 629                  |   | 629       |
| Retirement of stock               | (140,000)                        | (140)           |           | (1,767)              |   | (1,907)   |
| Cash dividend (\$.02 per share)   |                                  |                 |           | (101)                |   | (101)     |
| Other comprehensive loss          |                                  |                 |           |                      | (1,186)   | (1,186)   |
| <b>Balance, December 31, 2018</b> | 4,943,186                        | \$ 4,943        | \$ 65,780 | \$ 20,324            | \$ (4,113)  | \$ 86,934 |

See Notes to Consolidated Financial Statements.

**Table of Contents****Peoples Financial Corporation and Subsidiaries****Consolidated Statements of Cash Flows****(in thousands)**

| <b>Years Ended December 31,</b>   | <b>2018</b>     | <b>2017</b>     | <b>2016</b>     |
|---|-----------------|-----------------|-----------------|
| <b>Cash flows from operating activities:</b>                                      |                 |                 |                 |
| <b>Net income</b>   | \$ 629          | \$ 2,758        | \$ 167          |
| Adjustments to reconcile net income to net cash provided by operating activities: |                 |                 |                 |
| Depreciation  | 1,964           | 1,914           | 1,823           |
| Provision for allowance for loan losses   | 122             | 116             | 568             |
| Writedown of other real estate  | 764             | 460             | 782             |
| (Gain) loss on sales of other real estate   | 21              | 101             | (251)           |
| (Income) loss from other investments  | 274             | (42)            | 51              |
| Gain on death benefits from life insurance  |                 | (429)           |                 |
| Amortization of available for sale securities                                     | 315             | 287             | 30              |
| Amortization of held to maturity securities                                       | 260             | 253             | 181             |
| Gain on liquidation, sales and calls of securities                                |                 | (134)           | (158)           |
| Gain on sales of other investments  | (17)            |                 |                 |
| Increase in cash surrender value of life insurance                                | (455)           | (458)           | (406)           |
| Change in accrued interest receivable   | (52)            | (49)            | (23)            |
| Change in other assets  | (57)            | (537)           | 191             |
| Change in other liabilities   | 506             | 717             | 189             |
| <b>Net cash provided by operating activities</b>                                  | <b>\$ 4,274</b> | <b>\$ 4,957</b> | <b>\$ 3,144</b> |

**Table of Contents****Peoples Financial Corporation and Subsidiaries****Consolidated Statements of Condition (continued)****(in thousands)**

| <b>Years Ended December 31,</b>   | <b>2018</b>      | <b>2017</b>      | <b>2016</b>      |
|---|------------------|------------------|------------------|
| <b>Cash flows from investing activities:</b>  |                  |                  |                  |
| Proceeds from maturities, liquidation, sales and calls of available for sale securities | \$ 60,222        | \$ 71,315        | \$ 149,715       |
| Purchases of available for sale securities  | (39,086)         | (83,561)         | (183,861)        |
| Proceeds from maturities of held to maturity securities                                 | 760              | 7,725            | 510              |
| Purchases of held to maturity securities  | (4,455)          | (10,991)         | (29,816)         |
| (Purchase) redemption of Federal Home Loan Bank Stock                                   | (699)            | (831)            | 1,098            |
| Proceeds from sales of other investments  | 125              |                  |                  |
| Proceeds from sales of other real estate  | 3,211            | 1,666            | 2,775            |
| Loans, net change   | 1,461            | 33,531           | 17,127           |
| Acquisition of premises and equipment   | (690)            | (423)            | (1,021)          |
| Investment in cash surrender value of life insurance                                    | (109)            | (94)             | (108)            |
| Redemption of life insurance  | 24               |                  |                  |
| Proceeds from death benefits from life insurance  |                  | 1,929            |                  |
| <b>Net cash provided by (used in) investing activities</b>                              | <b>20,764</b>    | <b>20,266</b>    | <b>(43,581)</b>  |
| <b>Cash flows from financing activities:</b>  |                  |                  |                  |
| Demand and savings deposits, net change   | (52,268)         | (51,804)         | 59,472           |
| Time deposits, net change   | (3,796)          | 6,358            | 2,837            |
| Cash dividends  | (101)            | (51)             |                  |
| Retirement of stock   | (1,907)          | (502)            |                  |
| Borrowings from Federal Home Loan Bank  | 1,428,700        | 131,500          | 98,920           |
| Repayments to Federal Home Loan Bank  | (1,403,756)      | (126,559)        | (111,072)        |
| <b>Net cash provided by (used in) financing activities</b>                              | <b>(33,128)</b>  | <b>(41,058)</b>  | <b>50,157</b>    |
| <b>Net increase (decrease) in cash and cash equivalents</b>                             | <b>(8,090)</b>   | <b>(15,835)</b>  | <b>9,720</b>     |
| <b>Cash and cash equivalents, beginning of year</b>                                     | <b>25,281</b>    | <b>41,116</b>    | <b>31,396</b>    |
| <b>Cash and cash equivalents, end of year</b>   | <b>\$ 17,191</b> | <b>\$ 25,281</b> | <b>\$ 41,116</b> |

See Notes to Consolidated Financial Statements.



**Table of Contents**

PEOPLES FINANCIAL CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE A BUSINESS AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES:

**Business of The Company**

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 Bank, 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).

**Principles of Consolidation**

The consolidated financial statements include the accounts of the Company and its wholly-owned subsidiaries. All significant intercompany transactions and balances have been eliminated in consolidation.

**Basis of Accounting**

The Company and its subsidiaries recognize assets and liabilities, and income and expense, on the accrual basis of accounting. 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. Actual results could differ from these 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, assumptions relating to employee and director benefit plan liabilities and valuation allowances associated with the realization of deferred tax assets, which are based on future taxable income.

**Revenue Recognition**

As of January 1, 2018, the Company adopted Accounting Standards Update (ASU) 2014-09, *Revenue from Contracts with Customers (Topic 606)*, using the modified retrospective method. Disclosures of revenue from contracts with customers for periods beginning after January 1, 2018 are presented under ASC Topic 606 and have not materially changed from the prior year amounts. This update prescribes the process related to the recognition of revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. ASU 2014-09 excludes revenue streams relating to loans and investment securities, which are the major source of revenue

## **Table of Contents**

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

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

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

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

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

## **New Accounting Pronouncements**

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

## **Table of Contents**

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

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

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

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

In November 2018, the FASB issued ASU 2018-19, *Codification Improvements to Topic 326, Financial Instruments Credit Losses*. ASU 2018-19 amends existing guidance to align the implementation date for nonpublic entities and clarifies that receivables arising from operating leases are not within the scope of Subtopic 326-20. The effective date and transition requirements of these amendments are the same as those in the credit losses standard, as amended by the new ASU. The adoption of this ASU is not expected to have a material effect on the Company's financial position, result of operations or cash flows.

ASU 2016-13, *Financial Instruments-Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments*, is intended to provide financial statement users with more decision-useful information related to expected credit losses on financial instruments and other commitments to extend credit by replacing the current incurred loss impairment methodology with a methodology that reflects expected credit losses and requires consideration of a broader range of reasonable and supportable information to determine credit loss estimates. ASU 2016-13 does not specify the method for measuring expected credit losses, and an entity is allowed to apply methods that reasonably reflect its expectations of the credit loss estimate. Additionally, the



## **Table of Contents**

amendments of ASU 2016-13 require that credit losses on available for sale debt securities be presented as an allowance rather than as a writedown. ASU 2016-13 is effective for the Company for interim and annual periods beginning after December 15, 2019 and the Company intends to adopt ASU 2016-13 during the first quarter of 2020. The Company has established a Current Expected Credit Loss (CECL) Committee which include the appropriate members of management, credit administration and accounting to evaluate the impact this ASU will have on the Company's financial position, results of operations and financial statement disclosures and determine the most appropriate method of implementing this ASU. The Company selected a third-party vendor to provide allowance for loan loss software as well as advisory services in developing a new methodology that would be compliant with ASU 2016-13, and is working with the approved third-party vendor to develop the CECL model and evaluate its impact. Management will continue to evaluate the impact this ASU will have on the Company's consolidated financial statements through its effective date.

## **Cash and Due from Banks**

The Company is required to maintain average reserve balances in its vault or on deposit with the Federal Reserve Bank. The average amount of these reserve requirements was approximately \$527,000 and \$564,000 for the years ending December 31, 2018 and 2017, respectively.

## **Securities**

The classification of securities is determined by Management at the time of purchase. Securities are classified as held to maturity when the Company has the positive intent and ability to hold the security until maturity. Securities held to maturity are stated at amortized cost. Securities not classified as held to maturity are classified as available for sale and are stated at fair value. Unrealized gains and losses, net of tax, on these securities are recorded in shareholders equity as accumulated other comprehensive income. The amortized cost of available for sale securities and held to maturity securities is adjusted for amortization of premiums and accretion of discounts to maturity, determined using the interest method. Such amortization and accretion is included in interest income on securities. A decline in the market value of any investment below cost that is deemed to be other-than-temporary is charged to earnings for the decline in value deemed to be credit related and a new cost basis in the security is established. The decline in value attributed to non-credit related factors is recognized in other comprehensive income. In estimating other-than-temporary losses, Management considers the length of time and the extent to which the fair value has been less than cost, the financial condition and nature of the issuer, the cause of the decline, especially if related to a change in interest rates, and the intent and ability of the Company to retain the investment in the issuer for a period of time sufficient to allow for any anticipated recovery in fair value. The specific identification method is used to determine realized gains and losses on sales of securities, which are reported as gain (loss) on sales and calls of securities in non-interest income.

## **Other Investments**

Other investments include a low income housing partnership in which the Company is a 99% limited partner. The partnership has qualified to receive annual low income housing federal tax credits that are recognized as a reduction of the current tax expense. The investment is accounted for using the equity method.

## **Table of Contents**

### **Federal Home Loan Bank Stock**

The Company is a member of the Federal Home Loan Bank of Dallas ( FHLB ) and as such is required to maintain a minimum investment in its stock that varies with the level of FHLB advances outstanding. The stock is bought from and sold to the FHLB based on its \$100 par value. The stock does not have a readily determinable fair value and as such is classified as restricted stock, carried at cost and evaluated for impairment in accordance with GAAP.

### **Loans**

The loan portfolio consists of commercial and industrial and real estate loans within the Company's trade area that we have the intent and ability to hold for the foreseeable future or until maturity. The loan policy establishes guidelines relating to pricing; repayment terms; collateral standards including loan to value limits, appraisal and environmental standards; lending authority; lending limits and documentation requirements.

Loans are stated at the amount of unpaid principal, reduced by unearned income and the allowance for loan losses. Interest on loans is recognized on a daily basis over the terms of each loan based on the unpaid principal balance. Loan origination fees are recognized as income when received. Revenue from these fees is not material to the financial statements.

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, land development, construction and commercial real estate loans, and their direct and indirect impact on its operations. Loan delinquencies and deposit overdrafts are monitored on a weekly basis in order to identify developing problems as early as possible. On a monthly basis, a watch list of credits based on our loan grading system is prepared. Grades are applied to individual loans based on factors including repayment ability, financial condition of the borrower and payment performance. Loans with lower grades are placed on the watch list of credits. The watch list is the primary tool for monitoring the credit quality of the loan portfolio. Once loans are determined to be past due, the loan officer and the special assets department work vigorously to return the loans to a current status.

The Company places loans on a nonaccrual status when, in the opinion of Management, they possess sufficient uncertainty as to timely collection of interest or principal so as to preclude the recognition in reported earnings of some or all of the contractual interest. Accrued interest on loans classified as nonaccrual is reversed at the time the loans are placed on nonaccrual. Interest received on nonaccrual loans is applied against principal. Loans are restored to accrual status when the obligation is brought current or has performed in accordance with the contractual terms for a reasonable period of time and the ultimate collectibility of the total contractual principal and interest is no longer in doubt. The placement of loans on and removal of loans from nonaccrual status must be approved by Management.

## **Table of Contents**

Loans which become 90 days delinquent are reviewed relative to collectability. Unless such loans are in the process of terms revision to bring them to a current status or foreclosure or in the process of collection, these loans are placed on nonaccrual and, if deemed uncollectible, are charged off against the allowance for loan losses. That portion of a loan which is deemed uncollectible will be charged off against the allowance as a partial charge off. All charge offs must be approved by Management and are reported to the Board of Directors.

### **Allowance for Loan Losses**

The allowance for loan losses ( ALL ) is a valuation account available to absorb losses on loans. The ALL is established through provisions for loan losses charged against earnings. Loans deemed to be uncollectible are charged against the ALL, and subsequent recoveries, if any, are credited to the allowance.

The ALL is based on Management's evaluation of the loan portfolio under current economic conditions and is an amount that Management believes will be adequate to absorb probable losses on loans existing at the reporting date. On a quarterly basis, the Company's problem asset committee meets to review the watch list of credits, which is formulated from the loan grading system. Members of this committee include loan officers, collection officers, the special assets director, the chief lending officer, the chief credit officer, the chief financial officer and the chief executive officer. The evaluation includes Management's assessment of several factors: review and evaluation of specific loans, changes in the nature and volume of the loan portfolio, current and anticipated economic conditions and the related impact on specific borrowers and industry groups, a study of loss experience, a review of classified, nonperforming and delinquent loans, the estimated value of any underlying collateral, an estimate of the possibility of loss based on the risk characteristics of the portfolio, adverse situations that may affect the borrower's ability to repay and the results of regulatory examinations. This evaluation is inherently subjective as it requires material estimates that may be susceptible to significant change.

The ALL consists of specific and general components. The specific component relates to loans that are classified as impaired. The general component of the allowance relates to loans that are not impaired. Changes to the components of the ALL are recorded as a component of the provision for the allowance for loan losses. Management must approve changes to the ALL and must report its actions to the Board of Directors. The Company believes that its allowance for loan losses is appropriate at December 31, 2018.

The Company considers a loan to be impaired when, based upon current information and events, it believes it is probable that the Company will be unable to collect all amounts due according to the contractual terms of the loan agreement. The Company's impaired loans include troubled debt restructurings and performing and non-performing major loans for which full payment of principal or interest is not expected. Payments received for impaired loans not on nonaccrual status are applied to principal and interest.

## **Table of Contents**

All impaired loans are reviewed, at a minimum, on a quarterly basis. The Company calculates the specific allowance required for impaired loans based on the present value of expected future cash flows discounted at the loan's effective interest rate, the loan's observable market price or the fair value of its collateral. Most of the Company's impaired loans are collateral-dependent.

The fair value of the collateral for collateral-dependent loans is based on appraisals performed by third-party valuation specialists, comparable sales and other estimates of fair value obtained principally from independent sources such as the Multiple Listing Service or county tax assessment valuations, adjusted for estimated selling costs. The Company has a Real Estate Appraisal Policy (the "Policy") which is in compliance with the guidelines set forth in the Interagency Appraisal and Evaluation Guidelines which implement Title XI of the Financial Institutions Reform, Recovery and Enforcement Act of 1989 (FIRREA) and the revised Interagency Appraisal and Evaluation Guidelines issued in 2010. The Policy further requires that appraisals be in writing and conform to the Uniform Standards of Professional Appraisal Practice (USPAP). An appraisal prepared by a state-licensed or state-certified appraiser is required on all new loans secured by real estate in excess of \$500,000. Loans secured by real estate in an amount of \$500,000 or less, or that qualify for an exemption under FIRREA, must have a summary appraisal report or in-house evaluation, depending on the facts and circumstances. Factors including the assumptions and techniques utilized by the appraiser, which could result in a downward adjustment to the collateral value estimates indicated in the appraisal, are considered by the Company.

When Management determines that a loan is impaired and the loan is collateral-dependent, an evaluation of the fair value of the collateral is performed. The Company maintains established criteria for assessing whether an existing appraisal continues to reflect the fair value of the property for collateral-dependent loans. Appraisals are generally considered to be valid for a period of at least twelve months. However, appraisals that are less than 12 months old may need to be adjusted. Management considers such factors as the property type, property condition, current use of the property, current market conditions and the passage of time when determining the relevance and validity of the most recent appraisal of the property. If Management determines that the most recent appraisal is no longer valid, a new appraisal is ordered from an independent and qualified appraiser.

During the interim period between ordering and receipt of the new appraisal, Management considers if the existing appraisal should be discounted to determine the estimated fair value of collateral. Discounts are applied to the existing appraisal and take into consideration the property type, condition of the property, external market data, internal data, reviews of recently obtained appraisals and evaluations of similar properties, comparable sales of similar properties and tax assessment valuations. When the new appraisal is received and approved by Management, the valuation stated in the appraisal is used as the fair value of the collateral in determining impairment, if any. If the recorded investment in the impaired loan exceeds the measure of fair value, a valuation allowance is required as a specific component of the allowance for loan losses. Any specific reserves recorded in the interim are adjusted accordingly.

## **Table of Contents**

The general component of the ALL is the loss estimated by applying historical loss percentages to non-classified loans which have been divided into segments. These segments include gaming; residential and land development; real estate, construction; real estate, mortgage; commercial and industrial and all other. The loss percentages are based on each segment's historical five year average loss experience which may be adjusted by qualitative factors such as changes in the general economy, or economy or real estate market in a particular geographic area or industry.

### **Bank Premises and Equipment**

Bank premises and equipment are stated at cost, less accumulated depreciation. Depreciation is computed by the straight-line method based on the estimated useful lives of the related assets.

### **Other Real Estate**

Other real estate ( ORE ) includes real estate acquired through foreclosure. Each other real estate property is carried at fair value, less estimated costs to sell. Fair value is principally based on appraisals performed by third-party valuation specialists. Any excess of the carrying value of the related loan over the fair value of the real estate at the date of foreclosure is charged against the ALL. Any expense incurred in connection with holding such real estate or resulting from any writedowns in value subsequent to foreclosure is included in non-interest expense. When the other real estate property is sold, a gain or loss is recognized on the sale for the difference, if any, between the sales proceeds and the carrying amount of the property. If the fair value of the ORE, less estimated costs to sell at the time of foreclosure, decreases during the holding period, the ORE is written down with a charge to non-interest expense. Generally, ORE properties are actively marketed for sale and Management is continuously monitoring these properties in order to minimize any losses.

### **Trust Department Income and Fees**

Corporate trust fees are accounted for on an accrual basis and personal trust fees are recorded when the underlying trust is serviced.

### **Income Taxes**

Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. Additionally, the recognition of future tax benefits, such as net operating loss carry forwards, is required to the extent that realization of such benefits is more likely than not. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which the assets and liabilities are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income tax expense in the period that includes the enactment date.

In the event the future tax consequences of differences between the financial reporting bases and the tax bases of the Company's assets and liabilities results in deferred tax assets, an evaluation of the probability of being able to realize the future benefits indicated by such asset is required. A valuation allowance is provided for the portion of the deferred tax asset when it is more likely than not that some portion or all of the deferred tax asset will not be realized. In assessing the

## **Table of Contents**

realizability of the deferred tax assets, Management considers the scheduled reversals of deferred tax liabilities, projected future taxable income and tax planning strategies. The Company currently evaluates income tax positions judged to be uncertain. A loss contingency reserve is accrued if it is probable that the tax position will be challenged, it is probable that the future resolution of the challenge will confirm that a loss has been incurred and the amount of such loss can be reasonably estimated.

## **Post-Retirement Benefit Plan**

The Company accounts for its post-retirement benefit plan under Accounting Standards Codification ( Codification or ASC ) Topic 715, Retirement Benefits ( ASC 715 ). The under or over funded status of the Company s post-retirement benefit plan is recognized as a liability or asset in the statement of condition. Changes in the plan s funded status are reflected in other comprehensive income. Net actuarial gains and losses and adjustments to prior service costs that are not recorded as components of the net periodic benefit cost are charged to other comprehensive income.

## **Earnings Per Share**

Basic and diluted earnings per share are computed on the basis of the weighted average number of common shares outstanding of 5,031,778 for 2018, 5,123,076 for 2017 and 5,123,186 for 2016.

## **Accumulated Other Comprehensive Income (Loss)**

At December 31, 2018, 2017 and 2016, accumulated other comprehensive loss consisted of net unrealized gains (losses) on available for sale securities and over (under) funded liabilities related to the Company s post-retirement benefit plan.

## **Statements of Cash Flows**

The Company has defined cash and cash equivalents to include cash and due from banks. The Company paid \$2,657,616, \$1,420,399 and \$1,020,177 in 2018, 2017 and 2016, respectively, for interest on deposits and borrowings. Income tax payments totaled \$78,435 in 2016. Loans transferred to other real estate amounted to \$4,706,732, \$1,946,045 and \$1,903,427 in 2018, 2017 and 2016, respectively.

## **Fair Value Measurement**

The Company reports certain assets and liabilities at their estimated fair value. These assets and liabilities are classified and disclosed in one of three categories based on the inputs used to develop the measurements. The categories establish a hierarchy for ranking the quality and reliability of the information used to determine fair value.

## **Reclassifications**

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

**Table of Contents**

## NOTE B SECURITIES:

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

| December 31, 2018                     | Amortized<br>Cost | Gross<br>Unrealized<br>Gains | Gross<br>Unrealized<br>Losses | Fair<br>Value |
|---------------------------------------|-------------------|------------------------------|-------------------------------|---------------|
| <b>Available for sale securities:</b> |                   |                              |                               |               |
| U.S. Treasuries                       | \$ 85,866         | \$                           | \$ (2,443)                    | \$ 83,423     |
| U.S. Government agencies              | 17,492            | 14                           | (259)                         | 17,247        |
| Mortgage-backed securities            | 112,391           | 231                          | (2,278)                       | 110,344       |
| States and political subdivisions     | 10,994            | 102                          |                               | 11,096        |
| Total available for sale securities   | \$ 226,743        | \$ 347                       | \$ (4,980)                    | \$ 222,110    |
| <b>Held to maturity securities:</b>   |                   |                              |                               |               |
| U.S. Government agencies              | \$ 8,185          | \$                           | \$ (371)                      | \$ 7,814      |
| States and political subdivisions     | 46,413            | 89                           | (857)                         | 45,645        |
| Total held to maturity securities     | \$ 54,598         | \$ 89                        | \$ (1,228)                    | \$ 53,459     |

**Table of Contents**

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

The amortized cost and fair value of debt securities at December 31, 2018, (in thousands) by contractual maturity, are shown below. Expected maturities will differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.



**Table of Contents**

|  | Amortized Cost    | Fair Value        |
|--|-------------------|-------------------|
| Available for sale securities:         |                   |                   |
| Due in one year or less                | \$ 28,177         | \$ 27,975         |
| Due after one year through five years  | 77,778            | 75,719            |
| Due after five years through ten years | 5,563             | 5,213             |
| Due after ten years                    | 2,834             | 2,859             |
| Mortgage-backed securities             | 112,391           | 110,344           |
| <b>Total</b>                           | <b>\$ 226,743</b> | <b>\$ 222,110</b> |

## Held to maturity securities:

|  |                  |                  |
|--|------------------|------------------|
| Due in one year or less                | \$ 2,523         | \$ 2,522         |
| Due after one year through five years  | 19,769           | 19,569           |
| Due after five years through ten years | 18,316           | 17,895           |
| Due after ten years                    | 13,990           | 13,473           |
| <b>Total</b>                           | <b>\$ 54,598</b> | <b>\$ 53,459</b> |

Available for sale and held to maturity securities with gross unrealized losses at December 31, 2018 and 2017, aggregated by investment category and length of time that individual securities have been in a continuous loss position, are as follows (in thousands):

**Table of Contents**

|                                   | Less Than Twelve Months |                         | Over Twelve Months |                         | Total             |                         |
|-----------------------------------|-------------------------|-------------------------|--------------------|-------------------------|-------------------|-------------------------|
|                                   | Fair Value              | Gross Unrealized Losses | Fair Value         | Gross Unrealized Losses | Fair Value        | Gross Unrealized Losses |
| <b>December 31, 2018:</b>         |                         |                         |                    |                         |                   |                         |
| U.S. Treasuries                   | \$ 999                  | \$ 1                    | \$ 82,424          | \$ 2,442                | \$ 83,423         | \$ 2,443                |
| U.S. Government agencies          | 4,939                   | 61                      | 17,608             | 569                     | 22,547            | 630                     |
| Mortgage-backed securities        | 24,834                  | 293                     | 55,649             | 1,985                   | 80,483            | 2,278                   |
| States and political subdivisions | 8,470                   | 122                     | 19,678             | 735                     | 28,148            | 857                     |
| <b>Total</b>                      | <b>\$ 39,242</b>        | <b>\$ 477</b>           | <b>\$ 175,359</b>  | <b>\$ 5,731</b>         | <b>\$ 214,601</b> | <b>\$ 6,208</b>         |
| <b>December 31, 2017:</b>         |                         |                         |                    |                         |                   |                         |
| U.S. Treasuries                   | \$ 49,586               | \$ 364                  | \$ 73,058          | \$ 1,812                | \$ 122,644        | \$ 2,176                |
| U.S. Government agencies          | 8,145                   | 37                      | 14,567             | 423                     | 22,712            | 460                     |
| Mortgage-backed securities        | 60,230                  | 415                     | 13,492             | 627                     | 73,722            | 1,042                   |
| States and political subdivisions | 11,552                  | 168                     | 7,010              | 382                     | 18,562            | 550                     |
| <b>Total</b>                      | <b>\$ 129,513</b>       | <b>\$ 984</b>           | <b>\$ 108,127</b>  | <b>\$ 3,244</b>         | <b>\$ 237,640</b> | <b>\$ 4,228</b>         |

At December 31, 2018, 18 of the 18 securities issued by the U.S. Treasury, 5 of the 6 securities issued by U.S. Government agencies, 35 of the 45 mortgage-backed securities and 61 of the 146 securities issued by states and political subdivisions contained unrealized losses.

Management evaluates securities for other-than-temporary impairment on a monthly basis. In performing this evaluation, the length of time and the extent to which the fair value has been less than cost, the fact that the Company's securities are primarily issued by U.S. Treasury and U.S. Government agencies and the cause of the decline in value are considered. In addition, the Company does not intend to sell and it is not more likely than not that we 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 this evaluation, the Company has determined that the declines summarized in the tables above are not deemed to be other-than-temporary.

**Table of Contents**

Proceeds from sales of available for sale debt securities were \$30,748,797 and \$29,641,206 during 2017 and 2016, respectively. Available for sale debt securities were sold and called for realized gains of \$133,986 and \$157,925 during 2017 and 2016, respectively. There were no sales or calls of available for sale securities in 2018. Proceeds from sales of other investments were \$125,145 for a realized gain of \$16,995 during 2018.

Securities with a fair value of \$206,017,056 and \$196,702,218 at December 31, 2018 and 2017, respectively, were pledged to secure public deposits, federal funds purchased and other balances required by law.

**NOTE C LOANS:**

The composition of the loan portfolio at December 31, 2018 and 2017 is as follows (in thousands):

| December 31,                     | 2018              | 2017              |
|----------------------------------|-------------------|-------------------|
| Gaming                           | \$ 25,767         | \$ 26,142         |
| Residential and land development | 298               | 263               |
| Real estate, construction        | 33,931            | 31,947            |
| Real estate, mortgage            | 178,917           | 189,201           |
| Commercial and industrial        | 27,505            | 26,360            |
| Other                            | 6,928             | 6,536             |
| <b>Total</b>                     | <b>\$ 273,346</b> | <b>\$ 280,449</b> |

In the ordinary course of business, the Company's bank subsidiary extends loans to certain officers and directors and their personal business interests at, in the opinion of Management, the same terms, including interest rates and collateral, as those prevailing at the time for comparable loans of similar credit risk with persons not related to the Company or its subsidiaries. These loans do not involve more than normal risk of collectability and do not include other unfavorable features. An analysis of the activity with respect to such loans to related parties is as follows (in thousands):

|  | 2018            | 2017            |
|--|-----------------|-----------------|
| Balance, January 1   | \$ 6,543        | \$ 6,658        |
| January 1 balances, loans of directors appointed during the year | 2,142           |                 |
| New loans and advances   | 2,272           | 907             |
| Repayments   | (1,800)         | (1,022)         |
| <b>Balance, December 31</b>                                      | <b>\$ 9,157</b> | <b>\$ 6,543</b> |



**Table of Contents**

As part of its evaluation of the quality of the loan portfolio, Management monitors the Company's credit concentrations on a monthly basis. Total outstanding concentrations were as follows (in thousands):

| December 31, | 2018      | 2017      |
|--------------|-----------|-----------|
| Gaming       | \$ 25,767 | \$ 26,142 |
| Hotel/motel  | 44,112    | 34,882    |
| Out of area  | 15,244    | 14,597    |

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

|  | Number of Days Past Due |          |                    |                   |            | Total<br>Loans | Loans Past<br>Due Greater<br>Than 90<br>Days and<br>Still Accruing |
|--|-------------------------|----------|--------------------|-------------------|------------|----------------|--|
|  | 30 -59                  | 60 -89   | Greater<br>Than 90 | Total<br>Past Due | Current    |                |  |
| December 31,<br>2018:                  |                         |          |                    |                   |            |                |  |
| Gaming                                 | \$                      | \$       | \$                 | \$                | \$ 25,767  | \$ 25,767      | \$   |
| Residential<br>and land<br>development |                         |          |                    |                   | 298        | 298            |  |
| Real estate,<br>construction           | 1,987                   | 340      | 860                | 3,187             | 30,744     | 33,931         |  |
| Real estate,<br>mortgage               | 2,866                   | 7,129    | 1,730              | 11,725            | 167,192    | 178,917        | 51   |
| Commercial<br>and industrial           | 9                       | 110      | 1,661              | 1,780             | 25,725     | 27,505         | 4  |
| Other                                  | 107                     | 3        |                    | 110               | 6,818      | 6,928          |  |
| Total                                  | \$ 4,969                | \$ 7,582 | \$ 4,251           | \$ 16,802         | \$ 256,544 | \$ 273,346     | \$ 55  |
| December 31,<br>2017:                  |                         |          |                    |                   |            |                |  |
| Gaming                                 | \$                      | \$       | \$                 | \$                | \$ 26,142  | \$ 26,142      | \$   |
| Residential<br>and land<br>development |                         |          |                    |                   | 263        | 263            |  |
| Real estate,<br>construction           | 747                     | 121      | 522                | 1,390             | 30,557     | 31,947         |  |
| Real estate,<br>mortgage               | 5,321                   | 790      | 4,884              | 10,995            | 178,206    | 189,201        |  |
| Commercial<br>and industrial           | 375                     | 2        | 2,344              | 2,721             | 23,639     | 26,360         |  |

|       |          |        |          |           |            |            |
|-------|----------|--------|----------|-----------|------------|------------|
| Other | 26       | 3      |          | 29        | 6,507      | 6,536      |
| Total | \$ 6,469 | \$ 916 | \$ 7,750 | \$ 15,135 | \$ 265,314 | \$ 280,449 |

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 based on factors including repayment ability, trends in net worth and/or financial condition of the borrower and guarantors, employment stability, management ability, loan to value fluctuations, the type and structure of the loan, conformity of the loan to bank policy and payment performance. Based on the total score, a loan grade of A, B, C, S, D, E or F is applied. A grade of A will generally be applied to loans for customers that are well known to the Company and that have excellent sources of repayment. A

**Table of Contents**

grade of B will generally be applied to loans for customers that have excellent sources of repayment which have no identifiable risk of collection. A grade of C will generally be applied to loans for customers that have adequate sources of repayment which have little identifiable risk of collection. A grade of S will generally be applied to loans for customers who meet the criteria for a grade of C but also warrant additional monitoring by placement on the watch list. A grade of D will generally be applied to loans for customers that are inadequately protected by current sound net worth, paying capacity of the borrower, or pledged collateral. Loans with a grade of D have unsatisfactory characteristics such as cash flow deficiencies, bankruptcy filing by the borrower or dependence on the sale of collateral for the primary source of repayment, causing more than acceptable levels of risk. Loans 60 to 89 days past due receive a grade of D. A grade of E will generally be applied to loans for customers with weaknesses inherent in the D classification and in which collection or liquidation in full is questionable. In addition, on a monthly basis the Company determines which loans are 90 days or more past due and assigns a grade of E to them. A grade of F is applied to loans which are considered uncollectible and of such little value that their continuance in an active bank is not warranted. Loans with this grade are charged off, even though partial or full recovery may be possible in the future.

**Table of Contents**

An analysis of the loan portfolio by loan grade, segregated by class of loans, as of December 31, 2018 and 2017 is as follows (in thousands):

|                                  | Loans With A Grade Of: |                  |                  |                  |           |           | Total          |
|----------------------------------|------------------------|------------------|------------------|------------------|-----------|-----------|----------------|
|                                  | A, B or C              | S                | D                | E                | F         |           |                |
| <b>December 31, 2018:</b>        |                        |                  |                  |                  |           |           |                |
| Gaming                           | \$ 21,080              | \$               | \$ 4,687         | \$               | \$        | \$        | 25,767         |
| Residential and land development | 65                     |                  |                  | 233              |           |           | 298            |
| Real estate, construction        | 32,497                 |                  | 217              | 1,217            |           |           | 33,931         |
| Real estate, mortgage            | 150,365                | 10,430           | 12,992           | 5,130            |           |           | 178,917        |
| Commercial and industrial        | 25,335                 |                  | 218              | 1,952            |           |           | 27,505         |
| Other                            | 6,904                  |                  | 20               | 4                |           |           | 6,928          |
| <b>Total</b>                     | <b>\$ 236,246</b>      | <b>\$ 10,430</b> | <b>\$ 18,134</b> | <b>\$ 8,536</b>  | <b>\$</b> | <b>\$</b> | <b>273,346</b> |
| <b>December 31, 2017:</b>        |                        |                  |                  |                  |           |           |                |
| Gaming                           | \$ 26,142              | \$               | \$               | \$               | \$        | \$        | 26,142         |
| Residential and land development |                        |                  |                  | 263              |           |           | 263            |
| Real estate, construction        | 30,412                 |                  | 358              | 1,177            |           |           | 31,947         |
| Real estate, mortgage            | 148,284                | 11,550           | 19,606           | 9,761            |           |           | 189,201        |
| Commercial and industrial        | 23,133                 |                  | 265              | 2,962            |           |           | 26,360         |
| Other                            | 6,516                  |                  | 16               | 4                |           |           | 6,536          |
| <b>Total</b>                     | <b>\$ 234,487</b>      | <b>\$ 11,550</b> | <b>\$ 20,245</b> | <b>\$ 14,167</b> | <b>\$</b> | <b>\$</b> | <b>280,449</b> |



**Table of Contents**

A loan may be impaired but not on nonaccrual status when the loan is well secured and in the process of collection. Total loans on nonaccrual as of December 31, 2018 and 2017 are as follows (in thousands):

| December 31,                     | 2018     | 2017      |
|----------------------------------|----------|-----------|
| Residential and land development | \$ 233   | \$ 263    |
| Real estate, construction        | 1,206    | 1,177     |
| Real estate, mortgage            | 4,954    | 9,548     |
| Commercial and industrial        | 1,855    | 2,818     |
| Other                            | 2        | 4         |
| Total                            | \$ 8,250 | \$ 13,810 |

Prior to 2017, certain loans were modified by granting interest rate concessions to these customers with such loans being classified as troubled debt restructurings. During 2018 and 2017, the Company did not restructure any additional loans. Specific reserves of \$69,000 and \$86,000 have been allocated to troubled debt restructurings as of December 31, 2018 and 2017, respectively. The Bank had no commitments to lend additional amounts to customers with outstanding loans classified as troubled debt restructurings as of December 31, 2018 and 2017.

**Table of Contents**

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

|                                     | Unpaid<br>Principal<br>Balance | Recorded<br>Investment | Related<br>Allowance | Average<br>Recorded<br>Investment | Interest<br>Income<br>Recognized |
|-------------------------------------|--------------------------------|------------------------|----------------------|-----------------------------------|----------------------------------|
| <b>December 31, 2018:</b>           |                                |                        |                      |                                   |                                  |
| With no related allowance recorded: |                                |                        |                      |                                   |                                  |
| Real estate, construction           | \$ 1,171                       | \$ 784                 | \$                   | \$ 785                            | \$                               |
| Real estate, mortgage               | 5,508                          | 5,474                  |                      | 5,826                             | 29                               |
| Commercial and industrial           | 2,083                          | 1,855                  |                      | 2,204                             |                                  |
| Other                               | 2                              | 2                      |                      | 3                                 |                                  |
| <b>Total</b>                        | <b>8,764</b>                   | <b>8,115</b>           |                      | <b>8,818</b>                      | <b>29</b>                        |
| With a related allowance recorded:  |                                |                        |                      |                                   |                                  |
| Residential and land development    | 233                            | 233                    | 20                   | 246                               |                                  |
| Real estate, construction           | 509                            | 422                    | 263                  | 387                               |                                  |
| Real estate, mortgage               | 574                            | 574                    | 101                  | 589                               | 25                               |
| <b>Total</b>                        | <b>1,316</b>                   | <b>1,229</b>           | <b>384</b>           | <b>1,222</b>                      | <b>25</b>                        |
| <b>Total by class of loans:</b>     |                                |                        |                      |                                   |                                  |
| Residential and land development    | 233                            | 233                    | 20                   | 246                               |                                  |
| Real estate, construction           | 1,680                          | 1,206                  | 263                  | 1,172                             |                                  |
| Real estate, mortgage               | 6,082                          | 6,048                  | 101                  | 6,415                             | 54                               |
| Commercial and industrial           | 2,083                          | 1,855                  |                      | 2,204                             |                                  |
| Other                               | 2                              | 2                      |                      | 3                                 |                                  |
| <b>Total</b>                        | <b>\$ 10,080</b>               | <b>\$ 9,344</b>        | <b>\$ 384</b>        | <b>\$ 10,040</b>                  | <b>\$ 54</b>                     |

**Table of Contents**

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

Transactions in the allowance for loan losses for the years ended December 31, 2018, 2017 and 2016, and the balances of loans, individually and collectively evaluated for impairment, as of December 31, 2018, 2017 and 2016 are as follows (in thousands):

**Table of Contents**

|   | Gaming    | Residential and<br>Land<br>Development | Real Estate,<br>Construction | Real Estate,<br>Mortgage | Commercial<br>and Industrial | Other    | Total      |
|---|-----------|--|------------------------------|--------------------------|------------------------------|----------|------------|
| <b>December 31, 2018:</b>                             |           |  |                              |                          |                              |          |            |
| Allowance for Loan Losses:                            |           |  |                              |                          |                              |          |            |
| Beginning Balance                                     | \$ 536    | \$ 40                                  | \$ 202                       | \$ 4,305                 | \$ 892                       | \$ 178   | \$ 6,153   |
| Charge-offs   |           |  |                              | (715)                    | (372)                        | (323)    | (1,410)    |
| Recoveries  |           |  | 17                           | 188                      | 112                          | 158      | 475        |
| Provision   | (120)     | (6)                                    | 176                          | 108                      | (156)                        | 120      | 122        |
| Ending Balance  | \$ 416    | \$ 34                                  | \$ 395                       | \$ 3,886                 | \$ 476                       | \$ 133   | \$ 5,340   |
| Allowance for Loan Losses:                            |           |  |                              |                          |                              |          |            |
| Ending balance: individually evaluated for impairment | \$        | \$ 20                                  | \$ 263                       | \$ 322                   | \$ 120                       | \$ 3     | \$ 728     |
| Ending balance: collectively evaluated for impairment | \$ 416    | \$ 14                                  | \$ 132                       | \$ 3,564                 | \$ 356                       | \$ 130   | \$ 4,612   |
| <b>Total Loans:</b>                                   |           |  |                              |                          |                              |          |            |
| Ending balance: individually evaluated for impairment | \$ 4,687  | \$ 233                                 | \$ 1,434                     | \$ 18,122                | \$ 2,170                     | \$ 24    | \$ 26,670  |
| Ending balance: collectively evaluated for impairment | \$ 21,080 | \$ 65                                  | \$ 32,497                    | \$ 160,795               | \$ 25,335                    | \$ 6,904 | \$ 246,676 |

December 31,  
2017:

| Allowance for Loan Losses: |    |     |    |       |    |      |    |       |    |      |    |       |    |       |
|----------------------------|----|-----|----|-------|----|------|----|-------|----|------|----|-------|----|-------|
| Beginning Balance          | \$ | 545 | \$ | 66    | \$ | 199  | \$ | 3,800 | \$ | 651  | \$ | 205   | \$ | 5,466 |
| Charge-offs                |    |     |    |       |    |      |    | (8)   |    | (36) |    | (235) |    | (279) |
| Recoveries                 |    |     |    | 686   |    | 32   |    | 29    |    | 11   |    | 92    |    | 850   |
| Provision                  |    | (9) |    | (712) |    | (29) |    | 484   |    | 266  |    | 116   |    | 116   |
| Ending Balance             | \$ | 536 | \$ | 40    | \$ | 202  | \$ | 4,305 | \$ | 892  | \$ | 178   | \$ | 6,153 |

| Allowance for Loan Losses:                            |    |  |    |    |    |     |    |       |    |     |    |   |    |       |
|---|----|--|----|----|----|-----|----|-------|----|-----|----|---|----|-------|
| Ending balance: individually evaluated for impairment | \$ |  | \$ | 40 | \$ | 105 | \$ | 1,082 | \$ | 636 | \$ | 6 | \$ | 1,869 |

|   |    |     |    |  |    |    |    |       |    |     |    |     |    |       |
|---|----|-----|----|--|----|----|----|-------|----|-----|----|-----|----|-------|
| Ending balance: collectively evaluated for impairment | \$ | 536 | \$ |  | \$ | 97 | \$ | 3,223 | \$ | 256 | \$ | 172 | \$ | 4,284 |
|---|----|-----|----|--|----|----|----|-------|----|-----|----|-----|----|-------|

| Total Loans:  |    |  |    |     |    |       |    |        |    |       |    |    |    |        |
|---|----|--|----|-----|----|-------|----|--------|----|-------|----|----|----|--------|
| Ending balance: individually evaluated for impairment | \$ |  | \$ | 263 | \$ | 1,536 | \$ | 29,367 | \$ | 3,228 | \$ | 18 | \$ | 34,412 |

|   |    |        |    |  |    |        |    |         |    |        |    |       |    |         |
|---|----|--------|----|--|----|--------|----|---------|----|--------|----|-------|----|---------|
| Ending balance: collectively evaluated for impairment | \$ | 26,142 | \$ |  | \$ | 30,411 | \$ | 159,834 | \$ | 23,132 | \$ | 6,518 | \$ | 246,037 |
|---|----|--------|----|--|----|--------|----|---------|----|--------|----|-------|----|---------|

**Table of Contents**

|   | Gaming    | Residential and<br>Land Development | Real Estate,<br>Construction | Real Estate,<br>Mortgage | Commercial<br>and Industrial | Other    | Total      |
|---|-----------|-------------------------------------|------------------------------|--------------------------|------------------------------|----------|------------|
| <b>December 31, 2016:</b>                             |           |                                     |                              |                          |                              |          |            |
| Allowance for Loan Losses:                            |           |                                     |                              |                          |                              |          |            |
| Beginning Balance                                     | \$ 582    | \$ 189                              | \$ 589                       | \$ 5,382                 | \$ 1,075                     | \$ 253   | \$ 8,070   |
| Charge-offs   |           |                                     | (260)                        | (2,499)                  | (509)                        | (254)    | (3,522)    |
| Recoveries  |           |                                     | 71                           | 107                      | 62                           | 110      | 350        |
| Provision   | (37)      | (123)                               | (201)                        | 810                      | 23                           | 96       | 568        |
| Ending Balance  | \$ 545    | \$ 66                               | \$ 199                       | \$ 3,800                 | \$ 651                       | \$ 205   | \$ 5,466   |
| Allowance for Loan Losses:                            |           |                                     |                              |                          |                              |          |            |
| Ending balance: individually evaluated for impairment | \$        | \$ 66                               | \$ 141                       | \$ 424                   | \$ 214                       | \$ 15    | \$ 860     |
| Ending balance: collectively evaluated for impairment | \$ 545    | \$                                  | \$ 58                        | \$ 3,376                 | \$ 437                       | \$ 190   | \$ 4,606   |
| <b>Total Loans:</b>                                   |           |                                     |                              |                          |                              |          |            |
| Ending balance: individually evaluated for impairment | \$        | \$ 291                              | \$ 2,114                     | \$ 32,850                | \$ 1,430                     | \$ 47    | \$ 36,732  |
| Ending balance: collectively evaluated for impairment | \$ 31,311 | \$                                  | \$ 30,389                    | \$ 173,322               | \$ 35,605                    | \$ 7,996 | \$ 278,623 |

NOTE D BANK PREMISES AND EQUIPMENT:

Bank premises and equipment are shown as follows (in thousands):

| December 31,                      | Estimated Useful Lives | 2018      | 2017      |
|-----------------------------------|------------------------|-----------|-----------|
| Land                              |                        | \$ 5,783  | \$ 5,783  |
| Building                          | 5 - 40 years           | 30,681    | 30,681    |
| Furniture, fixtures and equipment | 3 - 10 years           | 17,430    | 16,758    |
| Totals, at cost                   |                        | 53,894    | 53,222    |
| Less: Accumulated depreciation    |                        | 35,015    | 33,069    |
| Totals                            |                        | \$ 18,879 | \$ 20,153 |

NOTE E OTHER REAL ESTATE:

The Company's other real estate consisted of the following as of December 31, 2018 and 2017, respectively (in thousands except number of properties):

**Table of Contents**

| December 31,                                  |                         | 2018            |                         | 2017            |  |
|---|-------------------------|-----------------|-------------------------|-----------------|--|
|   | Number of<br>Properties | Balance         | Number of<br>Properties | Balance         |  |
| Construction, land development and other land | 12                      | \$ 6,007        | 14                      | \$ 6,670        |  |
| 1 - 4 family residential properties           | 3                       | 859             |                         |                 |  |
| Nonfarm nonresidential                        | 5                       | 1,725           | 5                       | 1,562           |  |
| Other   | 1                       | 352             |                         |                 |  |
| <b>Total</b>                                  | <b>21</b>               | <b>\$ 8,943</b> | <b>19</b>               | <b>\$ 8,232</b> |  |

**NOTE F DEPOSITS:**

At December 31, 2018, the scheduled maturities of time deposits are as follows (in thousands):

|              |                  |
|--------------|------------------|
| 2019         | \$ 54,902        |
| 2020         | 19,108           |
| 2021         | 1,607            |
| 2022         | 2,763            |
| 2023         | 1,842            |
| <b>Total</b> | <b>\$ 80,222</b> |

Time deposits of \$250,000 or more totaled approximately \$32,137,000 and \$30,457,000 at December 31, 2018 and 2017, respectively.

Deposits held for related parties amounted to \$3,676,971 and \$9,279,315 at December 31, 2018 and 2017, respectively.

Overdrafts totaling \$1,044,409 and \$466,812 were reclassified as loans at December 31, 2018 and 2017, respectively.

**NOTE G FEDERAL FUNDS PURCHASED:**

At December 31, 2018, the Company had facilities in place to purchase federal funds up to \$40,000,000 under established credit arrangements.

**NOTE H- BORROWINGS:**

At December 31, 2018, the Company was able to borrow up to \$17,638,095 from the Federal Reserve Bank Discount Window Primary Credit Program. The borrowing limit is based on the amount of collateral pledged, with certain loans from the Bank's portfolio serving as collateral. Borrowings bear interest at the primary credit rate, which is established periodically by the Federal



**Table of Contents**

Reserve Board and have a maturity of one day. The primary credit rate was 3.00% at December 31, 2018. There was no outstanding balance at December 31, 2018.

At December 31, 2018, the Company had \$36,141,790 outstanding in advances under a \$72,623,426 line of credit with the FHLB. One advance in the amount of \$35,000,000 bears interest at 2.65% at December 31, 2018 and matures in 2019. New advances may subsequently be obtained based on the liquidity needs of the bank subsidiary. The remaining balance consists of smaller advances bearing interest from 2.604% to 7.00% with maturity dates from 2030 to 2040. The advances are collateralized by specific loans, for which certain documents are held in custody by the FHLB, and, if needed, specific investment securities that are held in safekeeping at the FHLB.

At December 31, 2018, the Company had a \$500,000 unsecured revolving line of credit with First National Bankers Bank. The line has a term of one year and bears interest at Wall Street prime rate with interest due monthly. There was no outstanding balance at December 31, 2018.

**NOTE I INCOME TAXES:**

Deferred taxes (or deferred charges) as of December 31, 2018 and 2017, included in other assets, were as follows (in thousands):

| December 31,  | 2018     | 2017     |
|---|----------|----------|
| Deferred tax assets:  |          |          |
| Allowance for loan losses   | \$ 1,121 | \$ 1,292 |
| Employee benefit plans liabilities                                    | 3,117    | 3,048    |
| Unrealized loss on available for sale securities, charged from equity | 973      | 627      |
| Loss on credit impairment of securities                               | 356      | 356      |
| Earned retiree health benefits plan liability                         | 1,048    | 1,012    |
| General business and AMT credits                                      | 1,750    | 1,489    |
| Tax net operating loss carryforward                                   | 2,118    | 1,891    |
| Other   | 943      | 992      |
| Valuation allowance   | (8,642)  | (7,934)  |
| Deferred tax assets   | 2,784    | 2,773    |
| Deferred tax liabilities:   |          |          |
| Unearned retiree health benefits plan asset                           | 298      | 202      |
| Bank premises and equipment   | 2,235    | 2,359    |
| Other   | 251      | 212      |
| Deferred tax liabilities  | 2,784    | 2,773    |
| Net deferred taxes  | \$       | \$       |

**Table of Contents**

Income taxes consist of the following components (in thousands):

| Years Ended December 31,      | 2018    | 2017       | 2016  |
|-------------------------------|---------|------------|-------|
| Current                       | \$ (36) | \$ (1,080) | \$ 78 |
| Deferred:                     |         |            |       |
| Federal                       | (425)   | 4,023      | (247) |
| Change in valuation allowance | 425     | (4,023)    | 247   |
| <b>Total deferred</b>         |         |            |       |
| Totals                        | \$ (36) | \$ (1,080) | \$ 78 |

Income taxes amounted to less than the amounts computed by applying the U.S. Federal income tax rate of 21.0% for 2018 and 34.0% for 2017 and 2016 to income (loss) before income taxes. The reasons for these differences are shown below (in thousands):

|   | 2018    |      | 2017       |       | 2016  |       |
|---|---------|------|------------|-------|-------|-------|
|   | Tax     | Rate | Tax        | Rate  | Tax   | Rate  |
| Taxes computed at statutory rate                              | \$ 125  | 21   | \$ 571     | 34    | \$ 83 | 34    |
| Increase (decrease) resulting from:                           |         |      |            |       |       |       |
| Tax-exempt interest income                                    | (206)   | (35) | (362)      | (22)  | (417) | (170) |
| Income from BOLI  | (96)    | (16) | (302)      | (18)  | (144) | (59)  |
| Federal tax credits   | (298)   | (50) | (298)      | (18)  | (298) | (121) |
| Other   | 50      | 8    | (656)      | (39)  | 607   | 247   |
| Impact of tax rate change                                     |         |      | 3,990      | 238   |       |       |
| Change in valuation allowance for enacted change in tax rates |         |      | (3,990)    | (238) |       |       |
| Realization of AMT credit                                     | (36)    | (6)  | (742)      | (44)  |       |       |
| Other changes in valuation allowance                          | 425     | 72   | 709        | 42    | 247   | 101   |
| <b>Total income tax (benefit) expense</b>                     | \$ (36) | (6)  | \$ (1,080) | (65)  | \$ 78 | 32    |

During 2018 and 2017, the Company recorded an income tax benefit of \$36,000 and \$1,080,000, respectively. On December 22, 2017, the President signed into law The Tax Cuts and Jobs Act (the Act). In addition to reducing U.S. corporate income tax rates from 34% to 21%, the Act repealed the alternative minimum tax (AMT) regime for tax years beginning after December 31, 2017. For tax years beginning in 2018, 2019 and 2020, the AMT credit carryforward can be utilized to offset regular tax with any remaining AMT carryforwards eligible for a refund of 50%. Any remaining AMT credit carryforwards will become fully refundable beginning in the 2021 tax year. As a result, during 2018 and 2017, the Company reclassified the AMT credit carryforward to a tax receivable resulting in a deferred tax benefit of \$36,000 and \$742,000, respectively. In 2017, the Company also recorded a current tax benefit of \$338,000 to account for the carryback of general business tax credits to open tax years.

In 2017, the Company also remeasured the net deferred tax asset and corresponding valuation allowance as a result of the Act. The impact was to reduce the deferred tax asset and corresponding valuation allowance by \$3,990,000.

## **Table of Contents**

A valuation allowance is recognized against deferred tax assets when, based on the consideration of all available positive and negative evidence using a more likely than not criteria, it is determined that all or a portion of these tax benefits may not be realized. This assessment requires consideration of all sources of taxable income available to realize the deferred tax asset including taxable income in prior carry-back years, future reversals of existing temporary differences, tax planning strategies and future taxable income exclusive of reversing temporary differences and carryforwards. The Company incurred losses on a cumulative basis for the three-year period ended December 31, 2014, which is considered to be significant negative evidence. The positive evidence considered in support was insufficient to overcome this negative evidence. As a result, the Company established a full valuation allowance for its net deferred tax asset in the amount of \$8,140,000 as of December 31, 2014.

The Company intends to maintain this valuation allowance until it determines it is more likely than not that the asset can be realized through current and future taxable income. If not utilized, the Company's federal net operating loss of \$10,084,000 will begin to expire in 2034.

The Company has reviewed its income tax positions and specifically considered the recognition and measurement requirements of the benefits recorded in its financial statements for tax positions taken or expected to be taken in its tax returns. The Company currently has no unrecognized tax benefits that, if recognized, would favorably affect the income tax rate in future periods.

### **NOTE J - SHAREHOLDERS' EQUITY:**

Shareholders' equity of the Company includes the undistributed earnings of the bank subsidiary. Dividends to the Company's shareholders can generally be paid only from dividends paid to the Company by its bank subsidiary. Consequently, dividends are dependent upon the earnings, capital needs, regulatory policies and statutory limitations affecting the bank subsidiary. Dividends paid by the bank subsidiary are subject to the written approval of the Commissioner of Banking and Consumer Finance of the State of Mississippi and the Federal Deposit Insurance Corporation (the FDIC). At December 31, 2018, \$12,463,086 of undistributed earnings of the bank subsidiary included in consolidated surplus and retained earnings was available for future distribution to the Company as dividends. Dividends paid by the Company are subject to the written approval of the Federal Reserve Bank (FRB).

On December 8, 2017, the Board approved the repurchase of up to 110,000 of the outstanding shares of the Company's common stock. As a result of this repurchase plan, 110,000 shares have been repurchased for approximately \$1,477,000 and retired through December 31, 2018.

On September 26, 2018, the Board approved the repurchase of up to 70,000 of the outstanding shares of the Company's common stock. As a result of this repurchase plan, 70,000 shares have been repurchased for approximately \$933,000 and retired through December 31, 2018.

**Table of Contents**

On April 25, 2018, the Board declared a dividend of \$.01 per share payable May 10, 2018 to shareholders of record as of May 7, 2018. On September 26, 2018, the Board declared a dividend of \$.01 per share payable on October 15, 2018 to shareholders of record as of October 9, 2018.

The Company and the bank subsidiary are subject to various regulatory capital requirements administered by the federal banking agencies. Failure to meet minimum capital requirements can initiate certain mandatory and possibly additional discretionary actions by the regulators that, if undertaken, could have a direct material effect on the financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, specific capital guidelines must be met that involve quantitative measures of the assets, liabilities and certain off-balance sheet items as calculated under regulatory accounting practices. The capital amounts and classification of the bank subsidiary and the Company are also subject to qualitative judgments by the regulators about components, risk weightings and other factors.

New rules relating to risk-based capital requirements and the method for calculating components of capital and of computing risk-weighted assets to make them consistent with agreements that were reached by the Basel Committee on Banking Supervision and certain provisions of the Dodd-Frank Act became effective for the Company January 1, 2015. The rules establish a new Common equity tier 1 minimum capital requirement, increase the minimum capital ratios and assign a higher risk weight to certain assets based on the risk associated with these assets. Quantitative measures established by regulation to ensure capital adequacy require the bank subsidiary to maintain minimum amounts and ratios of Total, Common equity tier 1 and Tier 1 capital to risk-weighted assets, and Tier 1 capital to average assets. Beginning January 1, 2016, the Company must hold a capital conservation buffer composed of Common equity tier 1 capital above its minimum risk-based capital requirements in order to avoid limitations on capital distributions, including dividend payments and certain discretionary bonus payments to executive officers.

As of December 31, 2018, the most recent notification from the FDIC categorized the bank subsidiary as well capitalized under the regulatory framework for prompt corrective action. To be categorized as well capitalized, the bank subsidiary must have a Total risk-based capital ratio of 10.00% or greater, a Common equity tier 1 capital ratio of 6.50% or greater, a Tier 1 risk-based capital ratio of 8.00% or greater and a Leverage capital ratio of 5.00% or greater, with a capital conservation buffer above these requirements of 1.875% for 2018. The buffer will increase annually until it is fully phased-in to 2.50% at January 1, 2019. There are no conditions or events since that notification that Management believes have changed the bank subsidiary's category.

**Table of Contents**

The Company's actual capital amounts and ratios and required minimum capital amounts and ratios for 2018 and 2017, are as follows (in thousands):

|  | Actual    |        | For Capital Adequacy Purposes |       |
|--|-----------|--------|-------------------------------|-------|
|  | Amount    | Ratio  | Amount                        | Ratio |
| <b>December 31, 2018:</b>                              |           |        |                               |       |
| Total Capital (to Risk Weighted Assets)                | \$ 95,627 | 25.30% | \$ 30,240                     | 8.00% |
| Common Equity Tier 1 Capital (to Risk Weighted Assets) | 90,894    | 24.05% | 17,010                        | 4.50% |
| Tier 1 Capital (to Risk Weighted Assets)               | 90,894    | 24.05% | 22,680                        | 6.00% |
| Tier 1 Capital (to Average Assets)                     | 90,894    | 14.35% | 25,344                        | 4.00% |

**December 31, 2017:**

|  |           |        |           |       |
|--|-----------|--------|-----------|-------|
| Total Capital (to Risk Weighted Assets)                | \$ 97,122 | 25.12% | \$ 30,930 | 8.00% |
| Common Equity Tier 1 Capital (to Risk Weighted Assets) | 92,273    | 23.87% | 17,398    | 4.50% |
| Tier 1 Capital (to Risk Weighted Assets)               | 92,273    | 23.87% | 23,197    | 6.00% |
| Tier 1 Capital (to Average Assets)                     | 92,273    | 13.79% | 26,769    | 4.00% |

The bank subsidiary's actual capital amounts and ratios and required minimum capital amounts and ratios and capital amounts and ratios to be well capitalized for 2018 and 2017, are as follows (in thousands):

|  | Actual    |        | For Capital Adequacy Purposes |       | To Be Well Capitalized |        |
|--|-----------|--------|-------------------------------|-------|------------------------|--------|
|  | Amount    | Ratio  | Amount                        | Ratio | Amount                 | Ratio  |
| <b>December 31, 2018:</b>                              |           |        |                               |       |                        |        |
| Total Capital (to Risk Weighted Assets)                | \$ 92,485 | 24.61% | \$ 30,062                     | 8.00% | \$ 37,577              | 10.00% |
| Common Equity Tier 1 Capital (to Risk Weighted Assets) | 87,780    | 23.36% | 16,910                        | 4.50% | 24,425                 | 6.50%  |
| Tier 1 Capital (to Risk Weighted Assets)               | 87,780    | 23.36% | 22,546                        | 6.00% | 30,062                 | 8.00%  |
| Tier 1 Capital (to Average Assets)                     | 87,780    | 14.11% | 24,884                        | 4.00% | 31,105                 | 5.00%  |

**December 31, 2017:**

|  |           |        |           |       |           |        |
|--|-----------|--------|-----------|-------|-----------|--------|
| Total Capital (to Risk Weighted Assets)                | \$ 92,493 | 24.04% | \$ 30,778 | 8.00% | \$ 38,473 | 10.00% |
| Common Equity Tier 1 Capital (to Risk Weighted Assets) | 87,668    | 22.79% | 17,313    | 4.50% | 25,007    | 6.50%  |
| Tier 1 Capital (to Risk Weighted Assets)               | 87,668    | 22.79% | 23,084    | 6.00% | 30,778    | 8.00%  |
| Tier 1 Capital (to Average Assets)                     | 87,668    | 13.47% | 26,031    | 4.00% | 32,539    | 5.00%  |

**NOTE K - OTHER INCOME AND EXPENSES:**

Other income consisted of the following (in thousands):

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| Years Ended December 31,                    | 2018   | 2017   | 2016   |
|---|--------|--------|--------|
| Other service charges, commissions and fees | \$ 93  | \$ 99  | \$ 116 |
| Rentals                                     | 246    | 298    | 320    |
| Other                                       | 121    | 84     | 223    |
| Totals                                      | \$ 460 | \$ 481 | \$ 659 |

**Table of Contents**

Other expenses consisted of the following (in thousands):

| Years Ended December 31,           | 2018            | 2017            | 2016            |
|------------------------------------|-----------------|-----------------|-----------------|
| Advertising                        | \$ 557          | \$ 538          | \$ 544          |
| Data processing                    | 1,355           | 1,289           | 1,346           |
| FDIC and state banking assessments | 248             | 424             | 901             |
| Legal and accounting               | 449             | 422             | 566             |
| Other real estate                  | 1,254           | 740             | 868             |
| ATM expense                        | 585             | 582             | 555             |
| Trust expense                      | 304             | 307             | 370             |
| Other                              | 1,699           | 1,873           | 1,689           |
| <b>Totals</b>                      | <b>\$ 6,451</b> | <b>\$ 6,175</b> | <b>\$ 6,839</b> |

**NOTE L - FINANCIAL INSTRUMENTS WITH OFF-BALANCE-SHEET RISK:**

The Company is a party to financial instruments with off-balance-sheet risk in the normal course of business to meet the financing needs of its customers. These financial instruments include commitments to extend credit and irrevocable letters of credit. These instruments involve, to varying degrees, elements of credit and interest rate risk in excess of the amount recognized in the balance sheet. The contract amounts of those instruments reflect the extent of involvement the bank subsidiary has in particular classes of financial instruments. The Company's exposure to credit loss in the event of nonperformance by the other party to the financial instrument for commitments to extend credit and irrevocable letters of credit is represented by the contractual amount of those instruments. The Company uses the same credit policies in making commitments and conditional obligations as it does for on-balance-sheet instruments.

Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any conditions established in the agreement. Irrevocable letters of credit are conditional commitments issued by the Company to guarantee the performance of a customer to a third party. Commitments and irrevocable letters of credit generally have fixed expiration dates or other termination clauses and may require payment of a fee. Since some of the commitments and irrevocable letters of credit may expire without being drawn upon, the total amounts do not necessarily represent future cash requirements. The Company evaluated each customer's creditworthiness on a case-by-case basis. The amount of collateral obtained upon extension of credit is based on Management's credit evaluation of the customer. Collateral obtained varies but may include equipment, real property and inventory.

The Company generally grants loans to customers in its trade area.

At December 31, 2018 and 2017, the Company had outstanding irrevocable letters of credit aggregating \$235,141 and \$154,308, respectively. At December 31, 2018 and 2017, the Company had outstanding unused loan commitments aggregating \$31,885,422 and \$41,286,000, respectively. Approximately \$15,539,762 and \$19,691,000 of outstanding commitments were at fixed rates and the remainder were at variable rates at December 31, 2018 and 2017, respectively.



**Table of Contents**

## NOTE M - CONTINGENCIES:

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 are expected, in the opinion of Management, to have a material adverse effect upon the financial position or results of operations of the Company.

## NOTE N - CONDENSED PARENT COMPANY ONLY FINANCIAL INFORMATION:

Peoples Financial Corporation began its operations September 30, 1985, when it acquired all the outstanding stock of The Peoples Bank, Biloxi, Mississippi. A condensed summary of its financial information is shown below.

## CONDENSED BALANCE SHEETS (IN THOUSANDS):

| December 31,                                       | 2018             | 2017             |
|--|------------------|------------------|
| <b>Assets</b>                                      |                  |                  |
| Investments in subsidiaries, at underlying equity: |                  |                  |
| Bank subsidiary                                    | \$ 83,820        | \$ 84,893        |
| Nonbank subsidiary                                 | 1                | 1                |
| Cash in bank subsidiary                            | 283              | 1,392            |
| Other assets                                       | 2,830            | 3,213            |
| <b>Total assets</b>                                | <b>\$ 86,934</b> | <b>\$ 89,499</b> |
| <b>Liabilities and Shareholders Equity:</b>        |                  |                  |
| Other liabilities                                  | \$               | \$               |
| Total liabilities                                  |                  |                  |
| Shareholders equity                                | 86,934           | 89,499           |
| <b>Total liabilities and shareholders equity</b>   | <b>\$ 86,934</b> | <b>\$ 89,499</b> |

**Table of Contents**

## CONDENSED STATEMENTS OF INCOME (IN THOUSANDS):

| Years Ended December 31,                | 2018          | 2017            | 2016          |
|---|---------------|-----------------|---------------|
| <b>Income</b>                           |               |                 |               |
| Distributed income of bank subsidiary   | \$ 901        | \$ 1,900        | \$ 75         |
| Undistributed income of bank subsidiary | 112           | 942             | 247           |
| Other income (loss)                     | (252)         | 47              | (32)          |
| <b>Total income</b>                     | <b>761</b>    | <b>2,889</b>    | <b>290</b>    |
| <b>Expenses</b>                         |               |                 |               |
| Other                                   | 132           | 131             | 123           |
| <b>Total expenses</b>                   | <b>132</b>    | <b>131</b>      | <b>123</b>    |
| <b>Income before income taxes</b>       | <b>629</b>    | <b>2,758</b>    | <b>167</b>    |
| Income tax                              |               |                 |               |
| <b>Net income</b>                       | <b>\$ 629</b> | <b>\$ 2,758</b> | <b>\$ 167</b> |

**Table of Contents**

## CONDENSED STATEMENTS OF CASH FLOWS (IN THOUSANDS):

| Years Ended December 31,  | 2018           | 2017            | 2016          |
|---|----------------|-----------------|---------------|
| <b>Cash flows from operating activities:</b>  |                |                 |               |
| Net income  | \$ 629         | \$ 2,758        | \$ 167        |
| Adjustments to reconcile net income to net cash provided by (used in) operating activities: |                |                 |               |
| (Income) loss from other investments  | 274            | (42)            | 51            |
| Undistributed income of subsidiaries  | (112)          | (942)           | (247)         |
| Gain from sale of securities  | (17)           |                 |               |
| Other assets  |                | (20)            | (8)           |
| <b>Net cash provided by (used in) operating activities</b>                                  | <b>774</b>     | <b>1,754</b>    | <b>(37)</b>   |
| <b>Cash flows from investing activities:</b>  |                |                 |               |
| Proceeds from sale of other securities  | 125            |                 | 200           |
| <b>Net cash provided by investing activities</b>  | <b>125</b>     |                 | <b>200</b>    |
| <b>Cash flows from financing activities:</b>  |                |                 |               |
| Retirement of common stock  | (1,907)        | (502)           |               |
| Dividends paid  | (101)          | (51)            |               |
| <b>Net cash used in financing activities</b>  | <b>(2,008)</b> | <b>(553)</b>    |               |
| <b>Net increase (decrease) in cash</b>  | <b>(1,109)</b> | <b>1,201</b>    | <b>163</b>    |
| <b>Cash, beginning of year</b>  | <b>1,392</b>   | <b>191</b>      | <b>28</b>     |
| <b>Cash, end of year</b>  | <b>\$ 283</b>  | <b>\$ 1,392</b> | <b>\$ 191</b> |

## NOTE O - EMPLOYEE AND DIRECTOR BENEFIT PLANS:

The Company sponsors the Peoples Financial Corporation Employee Stock Ownership Plan ( ESOP ). Employees who are in a position requiring at least 1,000 hours of service during a plan year and who are 21 years of age are eligible to participate in the ESOP. The Plan included 401(k) provisions and the former Gulf National Bank Profit Sharing Plan. Effective January 1, 2001, the ESOP was amended to separate the 401(k) funds into the Peoples Financial Corporation 401(k) Profit Sharing Plan. The separation had no impact on the eligibility or benefits provided to participants of either plan. The 401(k) provides for a matching contribution of 75% of the amounts contributed by the employee (up to 6% of compensation). Contributions are determined by the Board of Directors and may be paid either in cash or Peoples Financial Corporation common stock. Total contributions to the plans charged to operating expense were

\$260,000, \$260,000 and \$276,000 in 2018, 2017 and 2016, respectively.

**Table of Contents**

Compensation expense of \$7,285,390, \$7,106,959 and \$7,804,295 was the basis for determining the ESOP contribution allocation to participants for 2018, 2017 and 2016, respectively. The ESOP held 247,627, 270,455 and 276,628 allocated shares at December 31, 2018, 2017 and 2016, respectively.

The Company established an Executive Supplemental Income Plan and a Directors' Deferred Income Plan, which provide for pre-retirement and post-retirement benefits to certain key executives and directors. Benefits under the Executive Supplemental Income Plan are based upon the position and salary of the officer at retirement or death. Normal retirement benefits under the plan are equal to 67% of salary for the president and chief executive officer, 58% of salary for the executive vice president and 50% of salary for all other executive officers and are payable monthly over a period of fifteen years. Under the Directors' Deferred Income Plan, the directors are given an opportunity to defer receipt of their annual directors' fees until retirement from the board. For those who choose to participate, benefits are payable monthly for ten years beginning the first day of the month following the director's normal retirement date. The normal retirement date is the later of the normal retirement age (65) or separation of service. Interest on deferred fees accrues at an annual rate of ten percent, compounded annually. The Company has acquired insurance policies, with the bank subsidiary as owner and beneficiary, which it may use as a source to pay potential benefits to the plan participants. These contracts are carried at their cash surrender value, which amounted to \$16,620,943 and \$16,222,847 at December 31, 2018 and 2017, respectively. The present value of accumulated benefits under these plans, using an interest rate of 4.00% and the interest ramp-up method has been accrued. The accrual amounted to \$12,919,127 and \$12,628,641 at December 31, 2018 and 2017, respectively, and is included in Employee and director benefit plans liabilities.

The Company also has additional plans for post-retirement benefits for certain key executives. The Company has acquired insurance policies, with the bank subsidiary as owner and beneficiary, which it may use as a source to pay potential benefits to the plan participants. These contracts are carried at their cash surrender value, which amounted to \$1,729,904 and \$1,605,421 at December 31, 2018 and 2017, respectively. The present value of accumulated benefits under these plans using an interest rate of 4.00% and the projected unit cost method has been accrued. The accrual amounted to \$1,613,326 and \$1,573,004 at December 31, 2018 and 2017, respectively, and is included in Employee and director benefit plans liabilities.

Additionally, there are two endorsement split dollar policies, with the bank subsidiary as owner and beneficiary, which provide a guaranteed death benefit to the participants' beneficiaries. These contracts are carried at their cash surrender value, which amounted to \$306,146 and \$299,242 at December 31, 2018 and 2017, respectively. The present value of accumulated benefits under these plans using an interest rate of 4.00% and the projected unit cost method has been accrued. The accrual amounted to \$97,587 and \$96,547 at December 31, 2018 and 2017, respectively, and is included in Employee and director benefit plans liabilities.

**Table of Contents**

The Company has additional plans for post-retirement benefits for directors. The Company has acquired insurance policies, with the bank subsidiary as owner and beneficiary, which it may use as a source to pay potential benefits to the plan participants. These contracts are carried at their cash surrender value, which amounted to \$184,070 and \$173,892 at December 31, 2018 and 2017, respectively. The present value of accumulated benefits under these plans using an interest rate of 4.00% and the projected unit cost method has been accrued. The accrual amounted to \$213,661 and \$214,968 at December 31, 2018 and 2017, respectively, and is included in Employee and director benefit plans liabilities.

The Company provides post-retirement health insurance to certain of its retired employees. Employees are eligible to participate in the retiree health plan if they retire from active service no earlier than age 60. In addition, the employee must have at least 25 continuous years of service with the Company immediately preceding retirement. However, any active employee who was at least age 65 as of January 1, 1995, does not have to meet the 25 years of service requirement. The Company reserves the right to modify, reduce or eliminate these health benefits. The Company has chosen to not offer this post-retirement benefit to individuals entering the employ of the Company after December 31, 2006. Employees who are eligible and enroll in the bank subsidiary's group medical and dental health care plans upon their retirement must enroll in Medicare Parts A, B and D when first eligible upon their retirement from the bank subsidiary. This results in the bank subsidiary's programs being secondary insurance coverage for retired employees and any dependent(s), if applicable, while Medicare Parts A and B will be their primary coverage, and Medicare Part D will be the sole and exclusive prescription drug benefit plan for retired employees.

The following is a summary of the components of the net periodic post-retirement benefit cost (credit) (in thousands):

| Years Ended December 31,                  | 2018   | 2017   | 2016  |
|---|--------|--------|-------|
| Service cost                              | \$ 171 | \$ 153 | \$ 93 |
| Interest cost                             | 136    | 135    | 101   |
| Amortization of net gain                  |        |        | (73)  |
| Amortization of prior service credit      | (81)   | (81)   | (81)  |
| Net periodic post-retirement benefit cost | \$ 226 | \$ 207 | \$ 40 |

The discount rate used in determining the accumulated post-retirement benefit obligation was 4.30% in 2018, 3.60% in 2017 and 4.00% in 2016. The assumed health care cost trend rate used in measuring the accumulated post-retirement benefit obligation was 6.00% in 2018. The rate was assumed to decrease gradually to 4.50% for 2024 and remain at that level thereafter. If the health care cost trend rate assumptions were increased 1.00%, the accumulated post-retirement benefit

**Table of Contents**

obligation as of December 31, 2018, would be increased by 18.73%, and the aggregate of the service and interest cost components of the net periodic post-retirement benefit cost for the year then ended would have increased by 23.45%. If the health care cost trend rate assumptions were decreased 1.00%, the accumulated post-retirement benefit obligation as of December 31, 2018, would be decreased by 14.93%, and the aggregate of the service and interest cost components of the net periodic post-retirement benefit cost for the year then ended would have decreased by 17.91%.

The following table presents the estimated benefit payments for each of the next five years and in the aggregate for the next five years (in thousands):

|           |    |       |
|-----------|----|-------|
| 2019      | \$ | 49    |
| 2020      |    | 68    |
| 2021      |    | 95    |
| 2022      |    | 106   |
| 2023      |    | 136   |
| 2024-2028 |    | 1,103 |

The following is a reconciliation of the accumulated post-retirement benefit obligation, which is included in Employee and director benefit plans liabilities (in thousands):

|  |    |       |
|--|----|-------|
| Accumulated post-retirement benefit obligation as of December 31, 2017 | \$ | 3,832 |
| Service cost   |    | 171   |
| Interest cost  |    | 136   |
| Actuarial gain   |    | (540) |
| Benefits paid  |    | (28)  |
| Accumulated post-retirement benefit obligation as of December 31, 2018 | \$ | 3,571 |

The following is a summary of the change in plan assets (in thousands):

|  | 2018 | 2017 | 2016 |
|--|------|------|------|
| Fair value of plan assets at beginning of year | \$   | \$   | \$   |
| Actual return on assets                        |      |      |      |
| Employer contribution                          | 28   | 48   | 75   |
| Benefits paid, net                             | (28) | (48) | (75) |
| Fair value of plan assets at end of year       | \$   | \$   | \$   |

**Table of Contents**

Amounts recognized in the Accumulated Other Comprehensive Income (Loss), net of tax, were (in thousands):

| For the year ended December 31,                     | 2018            | 2017          | 2016            |
|---|-----------------|---------------|-----------------|
| Net gain  | \$ 440          | \$ 11         | \$ 723          |
| Prior service charge                                | 680             | 622           | 676             |
| <b>Total accumulated other comprehensive income</b> | <b>\$ 1,120</b> | <b>\$ 633</b> | <b>\$ 1,399</b> |

Amounts recognized in the accumulated post-retirement benefit obligation and other comprehensive income (loss) were (in thousands):

| For the year ended December 31,                   | 2018          |
|---|---------------|
| Unrecognized actuarial loss                       | \$ 543        |
| Amortization of prior service cost                | 73            |
| <b>Total accumulated other comprehensive loss</b> | <b>\$ 616</b> |

The prior service credit and amortization of net gain that will be recognized in accumulated other comprehensive income during 2019 is \$81,381 and \$21,629, respectively.

**NOTE P - 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 the 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.





## **Table of Contents**

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 by asset class and include available trade, bid and other market information and whose methodology includes broker quotes, proprietary models and vast descriptive databases. Another source for determining fair value is matrix pricing, which is a mathematical technique used widely in the industry to value debt securities without relying exclusively on quoted prices for the specific securities but rather by relying on the securities' relationship to other benchmark securities. The Company's available for sale securities for which fair value is determined through the use of such pricing models and matrix pricing are classified as Level 2 assets. If the fair value of available for sale securities is generated through model-based techniques including the discounting of estimated cash flows, such securities are classified as Level 3 assets.

### **Held to Maturity Securities**

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

### **Other Investments**

The carrying amount shown as other investments approximates fair value.

### **Federal Home Loan Bank Stock**

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

### **Loans**

The fair value of fixed rate loans is estimated by discounting the future cash flows using the current rates at which similar loans would be made to borrowers with similar credit ratings for the remaining maturities. The cash flows considered in computing the fair value of such loans are segmented into categories relating to the nature of the contract and collateral based on contractual principal maturities. Appropriate adjustments are made to reflect probable credit losses. Cash flows have not been adjusted for such factors as prepayment risk or the effect of the maturity of balloon notes. The fair value of floating rate loans is estimated to be its carrying value. At each reporting period, the Company determines which loans are impaired. Accordingly, the Company's impaired loans are reported at their estimated fair value on a non-recurring basis. An allowance for each impaired loan, which are generally collateral-dependent, is calculated based on the fair value of its collateral. The fair value of the collateral is based on appraisals performed by third-party valuation specialists. Factors including the assumptions and techniques utilized by the appraiser are considered by Management. If the recorded investment in the impaired loan exceeds the measure of fair value of the collateral, a valuation allowance is recorded as a component of the allowance for loan losses. Impaired loans are non-recurring Level 3 assets.



**Table of Contents**

Other Real Estate

In the course of lending operations, Management may determine that it is necessary to foreclose on the related collateral. Other real estate acquired through foreclosure is carried at fair value, less estimated costs to sell. The fair value of the collateral is based on appraisals performed by third-party valuation specialists. Factors including the assumptions and techniques utilized by the appraiser are considered by Management. If the current appraisal is more than one year old and/or the loan balance is more than \$200,000, a new appraisal is obtained. Otherwise, the Bank's in-house property evaluator and Management will determine the fair value of the collateral, based on comparable sales, market conditions, Management's plans for disposition and other estimates of fair value obtained from principally independent sources, adjusted for estimated selling costs. Other real estate is a non-recurring Level 3 asset.

Cash Surrender Value of Life Insurance

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

Deposits

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

Borrowings from Federal Home Loan Bank

The fair value of FHLB fixed rate borrowings is estimated using discounted cash flows based on current incremental borrowing rates for similar types of borrowing arrangements. The fair value of FHLB variable rate borrowings is estimated to be its carrying value.

**Table of Contents**

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

|                                   | Total             | Fair Value Measurements Using |                   |           |
|-----------------------------------|-------------------|-------------------------------|-------------------|-----------|
|                                   |                   | Level 1                       | Level 2           | Level 3   |
| <b>December 31, 2018:</b>         |                   |                               |                   |           |
| U.S. Treasuries                   | \$ 83,423         | \$                            | \$ 83,423         | \$        |
| U.S. Government agencies          | 17,247            |                               | 17,247            |           |
| Mortgage-backed securities        | 110,344           |                               | 110,344           |           |
| States and political subdivisions | 11,096            |                               | 11,096            |           |
| <b>Total</b>                      | <b>\$ 222,110</b> | <b>\$</b>                     | <b>\$ 222,110</b> | <b>\$</b> |
| <b>December 31, 2017:</b>         |                   |                               |                   |           |
| U.S. Treasuries                   | \$ 122,644        | \$                            | \$ 122,644        | \$        |
| U.S. Government agencies          | 19,831            |                               | 19,831            |           |
| Mortgage-backed securities        | 88,261            |                               | 88,261            |           |
| States and political subdivisions | 14,470            |                               | 14,470            |           |
| <b>Total</b>                      | <b>\$ 245,206</b> | <b>\$</b>                     | <b>\$ 245,206</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 December 31, 2018 and 2017 were as follows (in thousands):

| December 31: | Total    | Fair Value Measurements Using |         |          |
|--------------|----------|-------------------------------|---------|----------|
|              |          | Level 1                       | Level 2 | Level 3  |
| 2018         | \$ 3,311 | \$                            | \$      | \$ 3,311 |
| 2017         | 6,511    | \$                            |         | \$ 6,511 |

Other real estate, which is measured at fair value on a non-recurring basis, by level within the fair value hierarchy as of December 31, 2018 and 2017 are as follows (in thousands):

| December 31: | Total    | Fair Value Measurements Using |         |          |
|--------------|----------|-------------------------------|---------|----------|
|              |          | Level 1                       | Level 2 | Level 3  |
| 2018         | \$ 8,943 | \$                            | \$      | \$ 8,943 |
| 2017         | 8,232    |                               |         | 8,232    |

**Table of Contents**

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

|                            | 2018     | 2017     |
|----------------------------|----------|----------|
| Balance, beginning of year | \$ 8,232 | \$ 8,513 |
| Loans transferred to ORE   | 4,707    | 1,946    |
| Sales                      | (3,232)  | (1,767)  |
| Writedowns                 | (764)    | (460)    |
| Balance, end of year       | \$ 8,943 | \$ 8,232 |

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

|   | Carrying<br>Amount | Fair Value Measurements Using |         |         | Total     |
|---|--------------------|-------------------------------|---------|---------|-----------|
|   |                    | Level 1                       | Level 2 | Level 3 |           |
| December 31, 2018:                        |                    |                               |         |         |           |
| Financial Assets:                         |                    |                               |         |         |           |
| Cash and due from banks                   | \$ 17,191          | \$ 17,191                     |         |         | \$ 17,191 |
| Available for sale securities             | 222,110            |                               | 222,110 |         | 222,110   |
| Held to maturity securities               | 54,598             |                               | 53,459  |         | 53,459    |
| Other investments                         | 2,811              | 2,811                         |         |         | 2,811     |
| Federal Home Loan Bank<br>stock           | 2,069              |                               | 2,069   |         | 2,069     |
| Loans, net                                | 268,006            |                               |         | 260,560 | 260,560   |
| Other real estate                         | 8,943              |                               |         | 8,943   | 8,943     |
| Cash surrender value of life<br>insurance | 18,841             |                               | 18,841  |         | 18,841    |
| Financial Liabilities:                    |                    |                               |         |         |           |
| Deposits:                                 |                    |                               |         |         |           |
| Non-interest bearing                      | 114,512            | 114,512                       |         |         | 114,512   |
| Interest bearing                          | 358,994            |                               |         | 359,386 | 359,386   |
| Borrowings from Federal<br>Home Loan Bank | 36,142             |                               | 36,211  |         | 36,211    |

**Table of Contents**

|  | Carrying<br>Amount | Fair Value Measurements Using |         |         | Total     |
|--|--------------------|-------------------------------|---------|---------|-----------|
|  |                    | Level 1                       | Level 2 | Level 3 |           |
| <b>December 31, 2017:</b>              |                    |                               |         |         |           |
| <b>Financial Assets:</b>               |                    |                               |         |         |           |
| Cash and due from banks                | \$ 25,281          | \$ 25,281                     | \$      | \$      | \$ 25,281 |
| Available for sale securities          | 245,206            |                               | 245,206 |         | 245,206   |
| Held to maturity securities            | 51,163             |                               | 50,538  |         | 50,538    |
| Other investments                      | 3,193              | 3,193                         |         |         | 3,193     |
| Federal Home Loan Bank stock           | 1,370              |                               | 1,370   |         | 1,370     |
| Loans, net                             | 274,296            |                               |         | 270,924 | 270,924   |
| Other real estate                      | 8,232              |                               |         | 8,232   | 8,232     |
| Cash surrender value of life insurance | 18,301             |                               | 18,301  |         | 18,301    |
| <b>Financial Liabilities:</b>          |                    |                               |         |         |           |
| <b>Deposits:</b>                       |                    |                               |         |         |           |
| Non-interest bearing                   | 127,274            | 127,274                       |         |         | 127,274   |
| Interest bearing                       | 402,296            |                               |         | 402,610 | 402,610   |
| Borrowings from Federal Home Loan Bank | 11,198             |                               | 11,389  |         | 11,389    |

**Table of Contents**

**REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

To the Shareholders and Board of Directors

Peoples Financial Corporation

Biloxi, Mississippi

**Opinion on the Financial Statements**

We have audited the accompanying consolidated statements of condition of Peoples Financial Corporation and subsidiaries (the Company) as of December 31, 2018 and 2017, the related consolidated statements of income, comprehensive income (loss), and cash flows for each of the three years in the period ended December 31, 2018, and changes in shareholder's equity for each of the two years in the period ended December 31, 2018, and the related notes to the financial statements (collectively, the financial statements). In our opinion, the financial statements present fairly, in all material respects, the financial position of the Company as of December 31, 2018 and 2017, and the results of its operations and its cash flows for each of the three years in the period ended December 31, 2018, in conformity with accounting principles generally accepted in the United States of America.

**Basis for Opinion**

These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on the Company's financial statements based on our audits. We are a public accounting firm registered with the Public Company Accounting Oversight Board (United States) (PCAOB) and are required to be independent with respect to the Company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audits in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement, whether due to error or fraud. The Company is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. As part of our audits we are required to obtain an understanding of internal control over financial reporting but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion.

Our audits included performing procedures to assess the risks of material misstatement of the financial statements, whether due to error or fraud, and performing procedures that respond to those risks. Such procedures included examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements. Our audits also included evaluating the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the financial statements. We believe that our audits provide a reasonable basis for our opinion.

/s/ Porter Keadle Moore, LLC

We have served as the Company's auditor since 2006.

Atlanta, Georgia



March 13, 2019

**Table of Contents**

**ITEM 9 - CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE**

None.

**ITEM 9a - CONTROLS AND PROCEDURES**

**Evaluation of Disclosure Controls and Procedures**

As of December 31, 2018 an evaluation was performed under the supervision and with the participation of the Chief Executive Officer and Chief Financial Officer of the effectiveness of the Company's disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e)). Based on that evaluation, the Chief Executive Officer and the Chief Financial Officer have concluded that the Company's disclosure controls and procedures are effective to ensure that the information required to be disclosed by the Company in the reports it files or submits under the Securities Exchange Act of 1934 is recorded, processed, summarized and reported, within the time periods specified in the SEC's rules and forms.

There were no changes in the Company's internal control over financial reporting that occurred during the period ended December 31, 2018 that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

**Management's Report on Internal Controls Over Financial Reporting**

The Company's management is responsible for establishing and maintaining adequate internal control over financial reporting, as defined in Rules 13(a)–15(f) of the Securities Exchange Act of 1934. In meeting its responsibility, management relies on its accounting and other related control systems. The internal control systems are designed to ensure that transactions are properly authorized and recorded in the Company's financial records and to safeguard the Company's assets from material loss or misappropriation.

Management of the Company, including its Chief Executive Officer and Chief Financial Officer, assessed the effectiveness of internal control over financial reporting as of December 31, 2018, using the criteria set forth in *Internal Control - Integrated Framework (2013)* issued by the Committee of Sponsoring Organizations of the Treadway Commission. Our assessment included a review of the documentation of controls, evaluations of the design of the internal control system and tests of operating effectiveness of the internal controls. Based on the assessment, management has concluded that the Company had effective internal control over financial reporting as of December 31, 2018.

Chevis C. Swetman  
Chairman, President and Chief Executive Officer  
March 13, 2019

Lauri A. Wood  
Chief Financial Officer  
March 13, 2019

**ITEM 9b - OTHER INFORMATION**

None.



**Table of Contents**

**PART III**

**ITEM 10 - DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE**

The information in Sections II, III, VIII and IX contained in the Proxy Statement in connection with the Annual Meeting of Shareholders to be held April 24, 2019, which was filed by the Company in definitive form with the Commission on March 13, 2019, is incorporated herein by reference.

The Company's Board of Directors has adopted a Code of Conduct that applies to not only the chief executive officer and the chief financial officer, but also all of the officers, directors and employees of the Company and its subsidiaries. A copy of this Code of Conduct can be found at the Company's internet website at [www.thepeoples.com](http://www.thepeoples.com). The Company intends to disclose any amendments to its Code of Conduct, and any waiver from a provision of the Code of Conduct granted to the Company's Chief Executive Officer or Chief Financial Officer on the Company's internet website within five business days following such amendment or waiver. The information contained on or connected to the Company's internet website is not incorporated by reference into this Annual Report on Form 10-K and should not be considered part of this or any other report that the Company may file with or furnish to the SEC.

**ITEM 11 - EXECUTIVE COMPENSATION**

The information in Section VI contained in the Proxy Statement in connection with the Annual Meeting of Shareholders to be held April 24, 2019, which was filed by the Company in definitive form with the Commission on March 13, 2019, is incorporated herein by reference.

**ITEM 12 - SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS**

The information in Sections IV and V contained in the Proxy Statement in connection with the Annual Meeting of Shareholders to be held April 24, 2019, which was filed by the Company in definitive form with the Commission on March 13, 2019, is incorporated herein by reference.

**ITEM 13 - CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS AND DIRECTOR INDEPENDENCE**

The information in Sections III and VII contained in the Proxy Statement in connection with the Annual Meeting of Shareholders to be held April 24, 2019, which was filed by the Company in definitive form with the Commission on March 13, 2019, is incorporated herein by reference.

**ITEM 14 - PRINCIPAL ACCOUNTING FEES AND SERVICES**

The information in Section XI contained in the Proxy Statement in connection with the Annual Meeting of Shareholders to be held April 24, 2019, which was filed by the Company in definitive form with the Commission on March 13, 2019, is incorporated herein by reference.

**Table of Contents**

**PART IV**

**ITEM 15 - EXHIBITS AND FINANCIAL STATEMENT SCHEDULES**

(a) 1. Index of Financial Statements:

See Item 8.

(a) 2. Index of Financial Statement Schedules:

All other schedules have been omitted as not applicable or not required or because the information has been included in the financial statements or applicable notes.

**Table of Contents**

## (a) 3. Index of Exhibits:

| Description  | Incorporated by Reference to<br>Registration or File Number | Form of<br>Report | Date of<br>Report | Exhibit Number<br>in Report |
|--|---|-------------------|-------------------|-----------------------------|
| (3.1) <u>Articles of Incorporation</u>   | 0-30050   | 10/a              | 6/21/1999         | 3.1                         |
| (3.2) <u>By-Laws</u>   | 0-30050   | 10/a              | 6/21/1999         | 3.2                         |
| (10.1) <u>Description of Automobile Plan</u>   | 0-30050   | 10-K              | 12/31/2003        | 10.1                        |
| (10.2) <u>Directors' Deferred Income Plan<br/>Agreements</u>   | 0-30050   | 10-K              | 12/31/2003        | 10.2                        |
| (10.3) <u>Executive Supplemental Income<br/>Plan Agreement - Chevis C.<br/>Swetman</u>   | 001-12103   | 10-Q              | 9/30/2007         | 10.2                        |
| (10.4) <u>Executive Supplemental Income<br/>Plan Agreement - A. Wes Fulmer</u>   | 001-12103   | 10-Q              | 9/30/2007         | 10.3                        |
| (10.5) <u>Executive Supplemental Income<br/>Plan Agreement - Lauri A. Wood</u>   | 001-12103   | 10-Q              | 9/30/2007         | 10.4                        |
| (10.6) <u>Split Dollar Agreements</u>  | 0-30050   | 10-K              | 12/31/2003        | 10.4                        |
| (10.7) <u>Deferred Compensation Plan</u>   | 001-12103   | 10-Q              | 9/30/2007         | 10.1                        |
| (10.8) <u>Description of Stock Incentive Plan</u>  | 33-15595  | 10-K              | 12/31/2001        | 10.6                        |
| (10.9) <u>Description of Bonus Plan</u>  | 001-12103   | 10-Q              | 9/30/2010         | 10.1                        |
| (21) Subsidiaries of the registrant (P)  | 33-15595  | 10-K              | 12/31/1988        | 22                          |
| (23.1) <u>Consent of Independent Registered<br/>Public Accounting Firm - Porter<br/>Keadle Moore, LLC*</u>   |   |                   |                   |                             |
| (31.1) <u>Certification of Principal Executive<br/>Officer Pursuant to Section 302 of<br/>the Sarbanes - Oxley Act of 2002 *</u>   |   |                   |                   |                             |
| (31.2) <u>Certification of Principal Financial<br/>Officer Pursuant to Section 302 of<br/>the Sarbanes - Oxley Act of 2002 *</u>   |   |                   |                   |                             |
| (32.1) <u>Certification of Principal Executive<br/>Officer Pursuant to 18 U.S.C. ss.<br/>1350*</u>   |   |                   |                   |                             |
| (32.2) <u>Certification of Principal Financial<br/>Officer Pursuant to 18 U.S.C. ss.<br/>1350*</u>   |   |                   |                   |                             |
| (101) The following materials from the Company's 2018 Annual Report to Shareholders, formatted in XBRL (Extensible Business Reporting Language): (i) Consolidated Statements of Condition at December 31, 2018 and 2017, (ii) Consolidated Statements of Income for the years ended December 31, 2018, 2017 and 2016, (iii) Consolidated Statements of Comprehensive Income (Loss) for the years ended December 31, 2018, 2017 and 2016, (iv) Consolidated Statements of Changes in Shareholders' Equity for the years ended December 31, 2018 and 2017, (v) Consolidated Statements of Cash Flows for the years ended December 31, 2018, 2017 and 2016 and (vi) Notes to the Consolidated Financial Statements for the years ended December 31, 2018, 2017 and 2016.* |   |                   |                   |                             |

\* Filed herewith.  
(P) Paper filing.

Table of Contents

SIGNATURES

Pursuant to the requirements 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: March 13, 2019

BY: /s/ Chevis C. Swetman

Chevis C. Swetman, Chairman of the Board

(principal executive officer)

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the Registrant and in the capacities and on the dates indicated.

BY: /s/ Chevis C. Swetman

Date: March 13, 2019

Chevis C. Swetman, Chairman, President and CEO

(principal executive officer)

BY: /s/ Drew Allen

Date: March 13, 2019

Drew Allen, Director

BY: /s/ Rex E. Kelly

Date: March 13, 2019

Rex E. Kelly, Director

BY: /s/ Dan Magruder

Date: March 13, 2019

Dan Magruder, Director

BY: /s/ Jeffrey H. O Keefe

Date: March 13, 2019

Jeffrey H. O Keefe, Director

BY: /s/ Lauri A. Wood

Date: March 13, 2019

Lauri A. Wood, Chief Financial Officer

(principal financial and accounting officer)