PEOPLES FINANCIAL CORP /MS/
Form 10-Q
November 07, 2008

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-Q

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

For the quarterly period ended September 30, 2008

or

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

Commission File Number 001-12103
PEOPLES FINANCIAL CORPORATION

(Exact name of registrant as specified in its charter)

Mississippi	64-0709834
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
Lameuse and Howard Avenues, Biloxi, Mississippi	39533
(Address of principal executive offices)	(Zip Code)

(228) 435-5511

(Registrant s telephone number, including area code)

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

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

Large accelerated filer o Accelerated filer þ Non-accelerated filer o (Do not check if a smaller reporting company) Smaller reporting company o

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

Indicate the number of shares outstanding of each of the issuer s classes of common stock, as of the last practicable date. Peoples Financial Corporation has only one class of common stock authorized. At October 31, 2008, there were 15,000,000 shares of $1 par value common stock authorized, and 5,294,883 shares issued and outstanding.

Part 1 Financial Information
Item 1: Financial Statements

Peoples Financial Corporation and Subsidiaries
Consolidated Statements of Condition

	September 30, 2008 (Unaudited)	December 31, 2007 (Audited)
Assets		
Cash and due from banks	$ 37,935,156	$ 34,665,370
Federal funds sold	25,760,000	270,000
Available for sale securities	293,385,286	387,028,925
Held to maturity securities, fair value of $3,424,632 at September 30, 2008; $4,676,471 at December 31, 2007	3,393,506	4,629,992
Other investments	3,160,000	
Federal Home Loan Bank Stock, at cost	936,000	936,200
Loans	462,554,828	450,992,074
Less: Allowance for loan losses	10,982,580	9,378,137
Loans, net	451,572,248	441,613,937
Bank premises and equipment, net of accumulated depreciation	34,236,961	34,410,789
Accrued interest receivable	5,090,902	7,371,216
Cash surrender value of life insurance	14,548,067	13,578,536
Other assets	4,682,239	2,851,608
Total assets	$874,700,365	$ 927,356,573

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

	September 30, 2008 (Unaudited)	December 31, 2007 (Audited)
Liabilities & Shareholders Equity		
Liabilities:		
Deposits:		
Demand, non-interest bearing	$124,360,867	$ 113,916,041
Savings and demand, interest bearing	257,188,216	231,435,685
Time, $100,000 or more	98,081,246	166,078,473
Other time deposits	57,906,928	57,700,280
Total deposits	537,537,257	569,130,479
Federal funds purchased and securities sold under agreements to repurchase	212,308,695	231,225,118
Borrowings from Federal Home Loan Bank	6,978,202	7,100,305
Other liabilities	12,634,428	13,359,047
Total liabilities	769,458,582	820,814,949
Shareholders Equity:		
Common stock, $1 par value, 15,000,000 shares authorized, 5,315,651 and 5,420,204 shares issued and outstanding at September 30, 2008 and December 31, 2007, respectively	5,315,651	5,420,204
Surplus	65,780,254	65,780,254
Undivided profits	33,868,806	34,458,291
Accumulated other comprehensive income, net of tax	277,072	882,875
Total shareholders equity	105,241,783	106,541,624
Total liabilities & shareholders equity	$874,700,365	$ 927,356,573

See selected notes to consolidated financial statements.

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2008	**2007**	**2008**	**2007**
Interest income:				
Interest and fees on loans	$ 6,603,096	$ 8,919,024	$20,711,343	$25,131,638
Interest and dividends on securities:				
U. S. Treasury	748,056	965,272	2,338,282	3,432,861
U.S. Government agencies	2,568,752	3,723,883	8,283,083	12,140,300
Mortgage-backed securities	421,063	313,705	1,317,989	647,302
States and politicial subdivisions	273,419	229,574	782,665	686,689
Other investments	42,475	76,568	143,455	182,739
Interest on federal funds sold	49,549	107,931	111,620	189,642
Total interest income	10,706,410	14,335,957	33,688,437	42,411,171
Interest expense:				
Deposits	2,273,965	3,862,267	8,111,706	11,093,430
Long-term borrowings	103,726	138,604	343,491	418,451
Federal funds purchased and securities sold under agreements to repurchase	1,111,474	2,474,717	3,731,166	8,044,886
Total interest expense	3,489,165	6,475,588	12,186,363	19,556,767
Net interest income	7,217,245	7,860,369	21,502,074	22,854,404
Provision for losses on loans	2,001,000	(1,197,000)	2,095,000	(1,097,000)
	$ 5,216,245	$ 9,057,369	$19,407,074	$23,951,404

Net interest income after provision for losses on loans

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2008	**2007**	**2008**	**2007**
Non-interest income:				
Trust department income and fees	$ 407,643	$ 495,172	$ 1,236,758	$ 1,393,417
Service charges on deposit accounts	1,717,985	1,710,913	5,139,820	5,014,671
Gain (loss) on sales, liquidation, or calls of securities	249,000	4,688	364,277	(614,327)
Other income	436,610	293,266	1,238,890	1,321,953
Total non-interest income	2,811,238	2,504,039	7,979,745	7,115,714
Non-interest expense:				
Salaries and employee benefits	3,564,471	3,743,041	10,641,717	10,608,272
Net occupancy	538,799	524,162	1,545,957	1,443,656
Rentals, depreciation and maintenance	950,180	810,879	2,744,481	2,429,454
Other expense	4,572,677	1,508,815	7,722,910	4,411,652
Total non-interest expense	9,626,127	6,586,897	22,655,065	18,893,034
Income before income taxes	(1,598,644)	4,974,511	4,731,754	12,174,084
Income taxes	(545,000)	1,580,000	1,518,000	4,078,000
Net Income	$ (1,053,644)	$ 3,394,511	$ 3,213,754	$ 8,096,084
Basic and diluted earnings per share	($ .20)	$ .62	$ .60	$ 1.47

See selected notes to consolidated financial statements.

Peoples Financial Corporation and Subsidiaries
Consolidated Statement of Shareholders Equity

	Number of Common Shares	Common Stock	Surplus	Undivided Profits	Accumulated Other Comprehensive Income	Comprehensive Income	Total
Balance, January 1, 2008	5,420,204	$ 5,420,204	$ 65,780,254	$ 34,458,291	$ 882,875		$ 106,541,624
Comprehensive Income:							
Net income				3,213,754		$ 3,213,754	3,213,754
Net unrealized loss on available for sale securities, net of tax					(1,060,961)	(1,060,961)	(1,060,961)
Reclassification adjustment for available for sale securities called or sold in current year, net of tax					(240,423)	(240,423)	(240,423)
Gain from unfunded post-retirement benefit obligation, net of tax					695,581	695,581	695,581
Total comprehensive income						$ 2,607,951	
Cumulative effect adjustment from adoption of EITF 06-04				(56,732)			(56,732)

Effect of stock retirement on accrued dividends				8,816			8,816
Dividend declared, ($ .29 per share)				(1,548,703)			(1,548,703)
Retirement of stock	(104,553)	(104,553)		(2,206,620)			(2,311,173)
Balance, September 30, 2008	5,315,651	$ 5,315,651	$ 65,780,254	$ 33,868,806	$ 277,072		$ 105,241,783

Note: Balances as of January 1, 2008 were audited.
See selected notes to consolidated financial statements.

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

	Nine Months Ended September 30, 2008	2007
Cash flows from operating activities:		
Net income	$ 3,213,754	$ 8,096,084
Adjustment to reconcile net income to net cash provided by operating activities:		
Depreciation	1,777,500	1,385,000
Provision for allowance for loan losses	2,095,000	(1,097,000)
Impairment loss on FHLMC preferred stock	2,964,000	
Gain on sale of bank premises	(142,607)	(192,200)
Gain on sale of other real estate		(10,470)
(Gain) loss on sales and calls of securities	(364,277)	614,327
Change in accrued interest receivable	2,280,314	1,306,371
Change in other assets	725,810	(764,856)
Change in other liabilities	(1,009,809)	(5,928,288)
Net cash provided by operating activities	11,539,685	3,408,968
Cash flows from investing activities:		
Proceeds from maturities, sales, liquidation and calls of available for sale securities	200,027,056	137,413,444
Investment in available for sale securities	(110,080,676)	(134,426,587)
Proceeds from maturities of held to maturity securities	1,240,000	82,460,000
Investment in held to maturity securities	(3,514)	(5,513,926)
Purchases of other investments	(3,160,000)	
Redemption of Federal Home Loan Bank Stock	200	207,400
Proceeds from sales of other real estate	19,500	55,000
Loans, net change	(12,424,936)	(49,108,938)
Proceeds from sale of bank premises	266,812	250,000
Acquisition of premises and equipment	(1,727,877)	(9,213,987)
Other assets	(990,201)	(564,215)
Net cash provided by investing activities	$ 73,166,364	$ 21,558,191

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

	Nine Months Ended September 30, 2008	2007
Cash flows from financing activities:		
Demand and savings deposits, net change	$ 36,197,357	$ (39,942,427)
Time deposits, net change	(67,790,579)	36,523,396
Cash dividends	(3,003,342)	(2,655,031)
Retirement of common stock	(2,311,173)	(2,817,784)
Borrowings from Federal Home Loan Bank	16,500,000	45,800,375
Repayments to Federal Home Loan Bank	(16,622,103)	(45,925,984)
Federal funds purchased and securities sold under agreements to repurchase, net change	(18,916,423)	(18,058,291)
Net cash used in financing activities	(55,946,263)	(27,075,746)
Net increase (decrease) in cash and cash equivalents	28,759,786	(2,108,587)
Cash and cash equivalents, beginning of period	34,935,370	44,193,493
Cash and cash equivalents, end of period	$ 63,695,156	$ 42,084,906

See selected notes to consolidated financial statements.

PEOPLES FINANCIAL CORPORATION AND SUBSIDIARIES
SELECTED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
For the Nine Months Ended September 30, 2008 and 2007

1. Basis of Presentation:

The accompanying unaudited consolidated financial statements and notes thereto contain all adjustments, consisting only of normal recurring adjustments, necessary to present fairly, in accordance with accounting principles generally accepted in the United States of America, the financial position of Peoples Financial Corporation and its subsidiaries (the Company) as of September 30, 2008 and the results of their operations and their cash flows for the periods presented. The interim financial information should be read in conjunction with the annual consolidated financial statements and the notes thereto included in the Company s 2007 Annual Report and Form 10-K.

The results of operations for the nine months ended September 30, 2008, are not necessarily indicative of the results to be expected for the full year.

Use of Estimates The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the reported period. Actual results could differ from those estimates.

Summary of Significant Accounting Policies The accounting and reporting policies of the Company conform with accounting principles generally accepted in the United States of America and general practices within the banking industry. With the exception of the adoption of new accounting pronouncements as discussed in Note 8, there have been no material changes or developments in the application of principles or in our evaluation of the accounting estimates and the underlying assumptions or methodologies that we believe to be Critical Accounting Policies as disclosed in our Form 10-K for the year ended December 31, 2007.

2. Earnings Per Share:

Per share data is based on the weighted average shares of common stock outstanding of 5,359,690 and 5,512,283 for the nine months ended September 30, 2008 and 2007, respectively, and 5,322,595 and 5,454,281 for the quarters ended September 30, 2008 and 2007, respectively.

3. Statements of Cash Flows:

The Company has defined cash and cash equivalents to include cash and due from banks and federal funds sold. The Company paid $13,051,262 and $19,279,163 for the nine months ended September 30, 2008 and 2007, respectively, for interest on deposits and borrowings. Income tax payments of $1,725,000 and $4,194,000 were made during the nine months ended September 30, 2008 and 2007, respectively. Loans in the amount of $371,626 and $19,500 were transferred to other real estate during the nine months ended September 30, 2008 and 2007, respectively.

4. Investments:

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

	Less Than Twelve Months		Over Twelve Months		Total	
	Fair Value	Gross Unrealized Loss	Fair Value	Gross Unrealized Loss	Fair Value	Gross Unrealized Loss
U.S. Government Agencies	$71,573,135	$1,189,793	$	$	$71,573,135	$1,189,793
States and political subdivisions	16,270,454	839,261	1,095,478	147,382	17,365,932	986,643
TOTAL	$87,843,589	$2,029,054	$1,095,478	$147,382	$88,939,067	$2,176,436

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

5. Past Due and Impaired Loans:

Loans past due ninety days or more and still accruing interest were $1,256,637 and $1,233,761 at September 30, 2008 and December 31, 2007, respectively.

Impaired loans include performing and non-performing loans for which full payment of principal or interest is not expected. At September 30, 2008 and December 31, 2007, performing loans which were classified as impaired loans totaled $7,944,393 and $11,654,527, respectively. At September 30, 2008 and December 31, 2007, non-performing loans which were classified as impaired loans included nonaccrual loans which amounted to $15,659,459 and $44,612, respectively. The total average recorded investment in impaired loans amounted to approximately $23,815,048 and $11,092,658 at September 30, 2008 and December 31, 2007, respectively. The Company had $7,178,851 and $5,642,719 of specific allowance related to impaired loans at September 30, 2008 and December 31, 2007, respectively. Interest income recognized on impaired loans was $563,802 and $621,290 during the nine months ended September 30, 2008 and the year ended December 31, 2007, respectively. Interest income recognized on impaired loans if the Company had used the cash-basis method of accounting would have been $442,462 and $669,971 during the nine months ended September 30, 2008 and the year ended December 31, 2007, respectively.

6. Allowance for Loan Losses:
Transactions in the allowance for loan losses were as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2008	2007	2008	2007
Balance, beginning of period	$ 9,327,780	$ 10,864,266	$ 9,378,137	$ 10,841,367
Recoveries	52,754	80,750	331,884	211,395
Loans charged off	(398,954)	(288,926)	(822,441)	(496,672)
Provision for allowance for loan losses	2,001,000	(1,197,000)	2,095,000	(1,097,000)
Balance, end of period	$ 10,982,580	$ 9,459,090	$ 10,982,580	$ 9,459,090

7. Other Comprehensive Income:
The income tax effect from the unrealized loss on available for sale securities on accumulated other comprehensive income was $670,410 at September 30, 2008. The income tax effect from the gain on unfunded post-retirement benefit obligation on accumulated other comprehensive income was $358,330 at September 30, 2008.
8. New Accounting Pronouncements:
The Company adopted Financial Accounting Standards Board Statement No. 157, Fair Value Measurement (SFAS 157) at January 1, 2008. There was no material impact to the financial statements presented herein as a result of this adoption. SFAS 157 applies to all assets and liabilities that are being measured and reported on a fair value basis. SFAS 157 requires new disclosure that establishes a framework for measuring fair value in accounting principles generally accepted in the United States of America, and expands disclosure about fair value measurements. This statement enables the reader of the financial statements to assess the inputs used to develop those measurements by establishing a hierarchy for ranking the quality and reliability of the information used to determine fair values.
The statement requires that assets and liabilities carried at fair value will be classified and disclosed in one of the following three categories: Level 1 Quoted market prices in active markets for identical assets or liabilities, Level 2 Observable market based inputs or unobservable inputs that are corroborated by market data, or Level 3 Unobservable inputs that are not corroborated by market data. In determining the appropriate levels, a detailed analysis of the assets and liabilities that are subject to SFAS 157 is performed. At each reporting period, all assets and liabilities for which the fair value measurement is based on significant unobservable inputs are classified as Level 3.
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 modes and vast

descriptive databases. The other source for determining fair value is matrix pricing, which is a mathematical technique used widely in the industry to value debt securities without relying exclusively on quoted prices for the specific securities but rather by relying on the securities relationship to other benchmark quoted securities.

The table below presents the balances of available for sale securities, which are the only assets measured at fair value on a recurring basis, by level within the hierarchy as of September 30, 2008. The Company did not measure liabilities at fair value on a recurring basis at September 30, 2008.

		Fair Value Measurement Using		
	September 30, 2008	Level 1	Level 2	Level 3
Available for sale securities	$ 293,385,286		$ 293,385,286	

In accordance with Statement No. 115, available for sale securities with an amortized cost of $292,915,403 were reported at September 30, 2008 at a fair value, net of unrealized gains and losses, of $293,385,286. The net change in unrealized gains and losses of $1,301,384 was included in comprehensive income during the first nine months of 2008.

At each reporting period, the Company determines which loans are impaired. Accordingly, the Company s impaired loans are reported at their estimated fair value on a non-recurring basis. An allowance for each impaired loan, which are generally collateral-dependent, is calculated based on the fair value of its collateral. The fair value of the collateral is based on appraisals performed by third-party valuation specialists. Factors including the assumptions and techniques utilized by the appraiser are considered by Management. If the recorded investment in the impaired loan exceeds the measure of fair value of the collateral, a valuation allowance is recorded as a component of the allowance for loan losses.

The table below presents the balances of impaired loans, which are the only assets measured at fair value on a non-recurring basis, by level within the hierarchy as of September 30, 2008. The Company did not measure liabilities at fair value on a non-recurring basis at September 30, 2008.

		Fair Value Measurement Using		
	September 30, 2008	Level 1	Level 2	Level 3
Impaired loans	$ 16,425,001		$ 16,425,001	

In accordance with the provisions of Statement No. 114, impaired loans with a carrying amount of $23,603,852 were written down to their fair value of $16,425,001 through a $7,178,851 charge to the provision for loan losses in prior periods.

The Company adopted Emerging Issue Task Force Issue No. 06-4, Accounting for Deferred Compensation and Postretirement Benefit Aspects of Endorsement Split-Dollar Life Insurance Arrangements, (EITF 06-4) at the beginning of our 2008 fiscal year. EITF 06-4 requires the accrual of the post-retirement benefit over the service period for deferred compensation plans funded through endorsement split-dollar life insurance. The Company is the owner and beneficiary of two endorsement split dollar policies which provide a guaranteed death benefit to the participants beneficiaries. As a result of adopting EITF 06-4 at January 1, 2008, a cumulative effect adjustment to retained earnings of $56,732 was recorded.

9. Reclassifications:

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

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

GENERAL

The Company is a one-bank holding company headquartered in Biloxi, Mississippi. It has two operating subsidiaries, PFC Service Corp. and The Peoples Bank, Biloxi, Mississippi (the Bank). The Bank provides a full range of banking, financial and trust services to state, county and local government entities and individuals and small and commercial businesses in Harrison, Hancock, Stone and Jackson counties in Mississippi.

The following presents Management s discussion and analysis of the consolidated financial condition and results of operations of Peoples Financial Corporation and Subsidiaries. These comments should be considered in combination with the Consolidated Financial Statements and Notes to Consolidated Financial Statements included in this report on Form 10-Q and the Consolidated Financial Statements, Notes to Consolidated Financial Statements and Management s Discussion and Analysis included in the Company s Form 10-K for the year ended December 31, 2007.

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.

Emergency Economic Stabilization Act

The Emergency Economic Stabilization Act of 2008 was enacted on October 3, 2008. The purpose of this law is to restore liquidity and stability to the financial system, while minimizing any potential long term negative impact on taxpayers. The law authorizes the United States Secretary of Treasury to spend up to $700 billion to purchase distressed assets, especially mortgage-backed securities, from the nation s banks. The program under which the asset purchase will be administered is referred to as the Troubled Asset Relief Program (TARP). The Company does not expect to participate in TARP.

The law also temporarily raises the basic limit on federal deposit insurance coverage from $100,000 to $250,000 per depositor. The higher insurance limits took effect immediately and will be in effect through December 31, 2009. Additionally, the Federal Deposit Insurance Corporation (FDIC) announced on October 14, 2008, a new program, the Temporary Liquidity Guarantee Program (TLGP), which guarantees newly issued senior unsecured debt of banks, thrifts, and certain holding companies, and provides full coverage of non-interest bearing deposit transaction accounts, regardless of dollar amount. The program provides a three year guarantee of newly issued debt and increased insurance coverage through December 31, 2009. This two-pronged program will be funded through special fees paid by the financial institutions participating. The Company must decide whether to participate in one, both or none of these phases of the program by December 5, 2008.

Critical Accounting Policies

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

OVERVIEW

For the third quarter of 2008, the Company realized a net loss of $1,053,644, while it realized net income of $3,394,511 for the third quarter of 2007. This significant change is directly attributable to asset impairment charges recorded during the current quarter. A loss of $2,964,000 from the other-than-temporary impairment of the Company s investment in Federal Home Loan Mortgage Corporation (FHLMC) preferred stock and a provision for loan losses of $2,001,000 were recorded during the third quarter of 2008. During the third quarter of 2007, the Company recorded a negative provision for loan losses of $1,197,000.

Net income for the first nine months 2008 was $3,213,754 compared with $8,096,084 for the first nine months of 2007. This decline was the result of the asset impairment charges discussed in the previous paragraph.

Total assets decreased to $874,700,365 at September 30, 2008 from $927,356,573 at December 31, 2007. This decrease was primarily attributable to the net decrease in available for sale securities of $93,643,639 during the first nine months of 2008. This significant decrease was the result of calls of available for sale securities of more than $155,000,000 since January 1, 2008. Proceeds from these calls funded loan demand and liquidity needs with excess funds being invested primarily in U.S. Agency securities.

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.

During the first nine months of 2008, the Federal Open Market Committee (the Committee) dropped the discount rate by a total of 225 basis points, which resulted in decreases in prime interest rates during this time. The Committee s actions were a part of the U.S. Government s larger plan to stabilize the national economy and address concerns of a looming recession. The impact of these rate reductions was significant to the Company s financial condition and results of operations.

Quarter Ended September 30, 2008 as Compared with Quarter Ended September 30, 2007

The Company s average interest earning assets decreased approximately $52,802,000, or 6%, from approximately $857,125,000 for the third quarter of 2007 to approximately $804,323,000 for the third quarter of 2008. As a direct result of the Committee s rate reductions, more than 20% of the Company s available for sale securities portfolio were called during 2008.

Also as a result of the Committee s actions, the average yield on earning assets decreased 136 basis points, from 6.75% for the third quarter of 2007 to 5.39% for the third quarter of 2008. The Company s loan portfolio generally has a 40%/60% blend of fixed/floating rate term. This results in the Company being more asset sensitive to market interest rates and generally is the cause of the decrease in interest income. In addition, the proceeds from the called securities that were reinvested in similar securities were at lower interest rates.

Average interest bearing liabilities decreased approximately $41,493,000, or 6%, from approximately $703,633,000 for the third quarter of 2007 to approximately $662,140,000 for the third quarter of 2008. The average rate paid on interest bearing liabilities decreased 157 basis points, from 3.68% for the third quarter of 2007 to 2.11% for the third quarter of 2008.

The Company s trade area generally experiences a very competitive interest rate environment for deposits. During the last two quarters of 2007, this competition ramped up significantly. In some cases, the Company chose to not match higher rates offered to our customers by a competitor. This strategy has resulted in a favorable improvement in the yield on interest-bearing liabilities as well as an overall reduction in total deposits.

The Company s net interest margin on a tax-equivalent basis, which is net interest income as a percentage of average earning assets, was 3.66% at September 30, 2008, up 60 basis points from 3.06% at September 30, 2007.

Nine Months Ended September 30, 2008 as Compared with Nine Months Ended September 30, 2007

The Company s average interest earning assets decreased approximately $67,755,000, or 8%, from approximately $880,711,000 for the first nine months of 2007 to approximately $812,956,000 for the first nine months of 2008. As a direct result of the Committee s rate reductions, more than 20% of the Company s available for sale securities portfolio were called during 2008.

Also as a result of the Committee s actions, the average yield on earning assets decreased 88 basis points, from 6.47% for the first nine months of 2007 to 5.59% for the first nine months of 2008. The Company s loan portfolio generally has a 40%/60% blend of fixed/floating rate term. This results in the Company being more asset sensitive to market interest rates and generally is the cause of the decrease in interest income. In addition, the proceeds from the called securities that were reinvested in similar securities were at lower interest rates.

Average interest bearing liabilities decreased approximately $50,114,000, or 7%, from approximately $720,333,000 for the first nine months of 2007 to approximately $670,219,000 for the first nine months of 2008. The average rate paid on interest bearing liabilities decreased 120 basis points, from 3.62% for the first nine months of 2007 to 2.42% for the first nine months of 2008.

The Company s trade area generally experiences a very competitive interest rate environment for deposits. During the last two quarters of 2007, this competition ramped up significantly. In some cases, the Company chose to not match higher rates offered to our customers by a competitor. This strategy has resulted in a favorable improvement in the yield on interest-bearing liabilities as well as an overall reduction in total deposits.

The Company s net interest margin on a tax-equivalent basis, which is net interest income as a percentage of average earning assets, was 3.59% at September 30, 2008, up 8 basis points from 3.51% at September 30, 2007.

The tables on the following pages analyze the changes in tax-equivalent net interest income for the quarters ended September 30, 2008 and 2007 and the nine months ended September 30, 2008 and 2007.

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

	Three Months Ended September 30, 2008			Three Months Ended September 30, 2007		
	Average Balance	Interest Earned/Paid	Rate	Average Balance	Interest Earned/Paid	Rate
Loans (2)(3)	$472,088	$ 6,603	5.59%	$433,657	$ 8,919	8.23%
Federal Funds Sold	11,397	50	1.75%	8,635	108	5.00%
HTM:						
Taxable				5,237	59	4.51%
Non taxable (1)	3,393	52	6.13%	4,629	72	6.22%
AFS:						
Taxable	285,869	3,738	5.23%	381,025	4,944	5.19%
Non taxable (1)	24,214	362	5.98%	18,661	276	5.92%
Other	7,362	42	2.82%	5,281	76	5.76%
Total	$804,323	$ 10,847	5.39%	$857,125	$ 14,454	6.75%
Savings & interest-bearing DDA	$254,513	$ 972	1.53%	$265,333	$ 1,441	2.17%
CD s	184,393	1,303	2.83%	215,774	2,421	4.49%
Federal funds purchased	215,548	1,111	2.06%	213,200	2,475	4.64%
FHLB advances	7,686	103	5.36%	9,326	139	5.96%
Total	$662,140	$ 3,489	2.11%	$703,633	$ 6,476	3.68%
Net tax-equivalent yield on earning assets			3.66%			3.06%

(1) All interest earned is reported on a taxable

equivalent basis using a tax rate of 34% in 2008 and 2007.

(2) Loan fees of $183,079 and $375,548 for 2008 and 2007, respectively, are included in these figures.

(3) Includes nonaccrual loans.

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

	Nine Months Ended September 30, 2008			Nine Months Ended September 30, 2007		
	Average Balance	Interest Earned/Paid	Rate	Average Balance	Interest Earned/Paid	Rate
Loans (2)(3)	$461,948	$ 20,711	5.98%	$421,795	$ 25,132	7.94%
Federal Funds Sold	7,024	112	2.12%	4,839	189	5.21%
HTM:						
Taxable				28,085	1,060	5.03%
Non taxable (1)	3,791	178	6.26%	4,830	229	6.32%
AFS:						
Taxable	309,603	11,939	5.14%	397,409	15,161	5.09%
Non taxable (1)	23,166	1,008	5.80%	18,382	811	5.89%
Other	7,424	143	2.57%	5,371	183	4.54%
Total	$812,956	$ 34,091	5.59%	$880,711	$ 42,765	6.47%
Savings & interest-bearing DDA	$253,197	$ 3,032	1.60%	$276,246	$ 4,225	2.04%
CD s	201,571	5,080	3.36%	206,536	6,869	4.43%
Federal funds purchased	207,612	3,731	2.40%	228,248	8,045	4.70%
FHLB advances	7,839	343	5.83%	9,303	418	5.99%
Total	$670,219	$ 12,186	2.42%	$720,333	$ 19,557	3.62%
Net tax-equivalent yield on earning assets			3.59%			3.51%

(1) All interest earned is reported on a taxable equivalent basis

using a tax rate of 34% in 2008 and 2007.

(2) Loan fees of $592,391 and $682,574 for 2008 and 2007, respectively, are included in these figures.

(3) Includes nonaccrual loans.

Provision for Loan Losses

In the normal course of business, the Company assumes risk in extending credit to its customers. This credit risk is managed through compliance with the loan policy (the policy), which is approved by the Board of Directors. The policy establishes guidelines relating to underwriting standards, including but not limited to financial analysis, collateral valuation, lending limits, pricing considerations and loan grading. A loan review process further assists with evaluating credit quality and assessing potential performance issues. Loan delinquencies and deposit overdrafts are closely monitored in order to identify developing problems as early as possible. In addition, the Company continuously monitors its relationships with its loan customers in concentrated industries such as gaming and hotel/motel, as well as the exposure for out of area loans, and their direct and indirect impact on its operations. A watch list of credits which pose a potential loss to the Company is prepared based on the loan grading system. This list forms the foundation of the Company s allowance for loan loss computation.

Since Hurricane Katrina hit the Mississippi Gulf Coast in August of 2005, the Company has modified its procedures to analyze its loan portfolio in light of the extraordinary impact of the storm on its trade area. Specific consideration of credits and their underlying collateral were conducted within weeks of the hurricane s landfall. Based on its evaluation, the Company recorded a provision for loan losses of $5,055,000 during the third quarter of 2005. The Company continued to closely monitor its portfolio during the quarters that followed, making note of the potential impact of federal assistance, insurance availability and affordability, the pace of recovery in the region and increasing construction costs. Another factor which was given serious consideration was the length of time which has passed since August of 2005, since research has proven that a window of approximately two years usually passes before potential losses from catastrophic events such as Hurricane Katrina become apparent. Based on these factors and its ongoing analysis, the Company recorded a negative provision of $1,250,000 during the third quarter of 2007, effectively reversing approximately 25% of the provision recorded in 2005.

The credit crisis our nation is now facing has affected the Bank s loan portfolio. The Company relies on its guidelines and existing methodology to monitor the performance of its loan portfolio and identify potential losses. For the quarter ended September 30, 2008, this on-going, systematic evaluation identified potential losses and resulted in the Company recording a provision of $2,001,000 for the third quarter of 2008, of which $1,180,000 relates to two residential development loans with a total outstanding balance of $10,594,320.

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

Non-interest income

Total non-interest income increased $307,199 for the third quarter of 2008 as compared with the third quarter of 2007. During the third quarter of 2008, the Company recorded a net gain on the sale, liquidation or call of securities of $249,000 as compared with a net gain of $4,688 during the third quarter of 2007.

Total non-interest income increased $864,031 for the first nine months of 2008 as compared with the first nine months of 2007. During the first nine months of 2008, the Company recorded a net gain on the sale, liquidation or call of securities of $364,277 as compared with a net loss of $614,327 during the first nine months of 2007.

Non-interest expense

Total non-interest expense increased $3,039,230 for the third quarter of 2008 as compared with the third quarter of 2007. During the third quarter of 2008, the Company recorded a charge to earnings for the impairment of its investment in FHLMC preferred stock of $2,964,000, which is included in Other Expense.

Total non-interest expense increased $3,762,031 for the first nine months of 2008 as compared with the first nine months of 2007 as equipment rentals, depreciation and maintenance expense and other expense increased.

Equipment rentals, depreciation and maintenance expenses increased $315,027 for the first nine months of 2008 compared with the first nine months of 2007. Contributing to this increase was an increase in depreciation expense of $347,500 on banking premises which were placed into service after March 31, 2007.

Included in the increase of $3,311,258 in other expense for the first nine months of 2008 as compared with the first nine months of 2007 are the impairment charge on the FHLMC preferred stock and increases in ATM and accounting and auditing costs. The increase in expense of $186,818 for offsite ATMs was caused by an increase in the number of such ATMs and in the number of transactions at such ATMs. The increase in accounting and auditing fees of $123,082 was due to the outsourcing of the I/T internal audit function and the increase in audit fees for 2008.

FINANCIAL CONDITION

Available for sale securities decreased $93,643,639 at September 30, 2008, compared with December 31, 2007. The Federal Reserve reduced interest rates by 225 basis points during 2008, which resulted in more than $155,00,000 of the Company s U.S. Agency securities being called during the first nine months of the year. Proceeds from these calls have provided funding for lending and liquidity requirements, and excess funds have been invested in U.S. Agency securities. The following schedule reflects the mix of available for sale securities at September 30, 2008 and December 31, 2007:

	September 30, 2008	December 31, 2007
Available for sale securities:		
U.S. Treasury	$ 66,392,175	$ 73,306,340
U.S. Government agencies and corp.	170,324,369	253,799,811
Mortgage-backed securities	29,917,772	33,383,897
States and political subdivisions	25,017,133	22,482,364
Equity securities	1,733,837	4,056,513
Total available for sale securities	$293,385,286	$387,028,925

The Company s held to maturity portfolio was invested solely in debt securities issued by state and political subdivisions at September 30, 2008 and December 31, 2007. The decrease in these securities of $1,236,486 since December 31, 2007 is the result of maturities.

The composition of the loan portfolio was as follows:

	September 30, 2008	December 31, 2007
Real estate, construction	$114,222,465	$ 93,739,256
Real estate, mortgage	290,467,377	265,463,768
Loans to finance agricultural production	3,094,971	2,545,169
Commercial and industrial loans	42,332,888	76,267,162
Loans to individuals for household, family and other consumer expenditures	11,027,296	11,173,054
Obligations of states and political subdivisions	1,408,852	1,747,293
All other loans	979	56,372
Total	$462,554,828	$450,992,074

Interest earning assets, particularly available for sale securities, have decreased since January 1, 2008 along with a decrease in interest rates earned on these assets. These trends directly impact accrued interest receivable, which decreased $2,280,314 during the first half of 2008.

Other assets increased $1,830,631 at September 30, 2008 as compared with December 31, 2007 as a result of increased deferred taxes of $1,997,645 on unrealized losses on available for sale securities and the impairment charge on the FHLMC preferred stock.

Total deposits decreased $31,593,222 at September 30, 2008, as compared with December 31, 2007. Fluctuations among the different types of deposits represent recurring activity for the Company. Since December 31, 2007, however, time deposits of $100,000 or more have decreased by $67,997,227. This significant decrease primarily resulted from the Company s decision to not match higher rates offered to our customers by competitors. The

Company anticipates that deposits will continue at or near their present level during the remainder of 2008.

Federal funds purchased and securities sold under agreements to repurchase primarily include the bank subsidiary s funds management account, which is a non-deposit product. Balances in the funds management accounts decreased $18,916,423 at September 30, 2008, as compared with December 31, 2007, as the result of the periodic reallocation of funds by certain customers between deposit products and non-deposit products.

SHAREHOLDERS EQUITY AND CAPITAL ADEQUACY

As a part of its on-going stock repurchase program, the Company repurchased and retired 104,553 shares of its common stock, at a total repurchase price of $2,311,173 during the first nine months of 2008. Management believes that the Company s stock is undervalued, and plans to continue its repurchase activities in future quarters.

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. One measure of capital adequacy is the primary capital ratio which was 12.76% at September 30, 2008, which is well above the regulatory minimum of 6.00%. Management continues to emphasize the importance of maintaining the appropriate capital levels of the Company and has established the goal of maintaining its primary capital ratio at 8.00%, which is the minimum requirement for classification as being well-capitalized by the banking regulatory authorities.

LIQUIDITY

Liquidity represents the Company s ability to adequately provide funds to satisfy demands from depositors, borrowers and other commitments by either converting assets to cash or accessing new or existing sources of funds. Management monitors these funds requirements in such a manner as to satisfy these demands and provide the maximum earnings on its earning assets. Deposits, payments of principal and interest on loans, proceeds from maturities of investment securities and earnings on investment securities are the principal sources of funds for the Company. Borrowings from the Federal Home Loan Bank, federal funds sold and federal funds purchased are utilized by the Company to manage its daily liquidity position.

FINANCIAL HIGHLIGHTS (in thousands except per share data)
EARNINGS SUMMARY

Three Months Ended September 30,	2008	2007
Net interest income	$ 7,217	$ 7,860
Provision for loan losses	2,001	(1,197)
Non-interest income	2,811	2,504
Non-interest expense	9,626	6,586
Income taxes	(545)	1,580
Net income	(1,054)	3,395
Earnings per share	(.20)	.62

Nine Months Ended September 30,	2008	2007
Net interest income	$21,502	$22,854
Provision for loan losses	2,095	(1,097)
Non-interest income	7,980	7,116
Non-interest expense	22,655	18,893
Income taxes	1,518	4,078
Net income	3,214	8,096
Earnings per share	.60	1.47

PERFORMANCE RATIOS (annualized)

September 30,	2008	2007
Return on average assets	.47%	1.12%
Return on average equity	3.69%	10.73%
Net interest margin	3.59%	3.51%
Efficiency ratio	83%	61%

Item 4: Controls and Procedures

As of September 30, 2008, an evaluation was performed under the supervision and with the participation of the Chief Executive Officer and Chief Financial Officer of the effectiveness of the Company s disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e)). Based on that evaluation, the Chief Executive Officer and the Chief Financial Officer have concluded that the Company s disclosure controls and procedures are effective to ensure that the information required to be disclosed by the Company in the reports it files or submits under the Securities Exchange Act of 1934 is recorded, processed, summarized and reported, within the time periods specified in the Securities and Exchange Commission s rules and forms.

There were no changes in the Company s internal control over financial reporting that occurred during the period ended September 30, 2008 that have materially affected, or are reasonably likely to materially affect, the Company s internal control over financial reporting.

PART II OTHER INFORMATION

Item 1: Legal Proceedings

The Company s bank subsidiary (the Bank) filed suit again USF&G in 1998 to recover damages for USF&G s bad faith failure to defend and indemnify the Bank in connection with a lawsuit filed against the Bank in 1996. The Bank obtained legal representation from a local plaintiff s attorney and customer (Attorney) on a contingent basis.

In December 2000, the case was transferred from the judge to whom it was originally assigned to a second judge (the Judge). The Judge had previously handled some discovery matters in the case.

The Bank had made a routine loan to the Judge in November 1998, which was guaranteed by the Attorney. The loan was repaid in February 2000 by someone other than the Judge, apparently at the request of the Attorney. Neither the Attorney nor the Judge disclosed the loan or the repayment to USF&G or its counsel.

During the course of the case, the Bank and USF&G filed competing motions for summary judgment. The Judge granted summary judgment in the Bank s favor on the issue of liability and subsequently presided over a settlement conference in which he expressed his opinion about the value of the case in monetary terms. The case was settled on December 24, 2001, for $1.5 million.

In 2003, the Attorney, the Judge and other parties were indicted for alleged fraud, bribery, etc. involving various events, including allegations concerning the Bank v. USF&G lawsuit. Neither the Bank nor any Bank employee was indicted. Following the indictments, USF&G filed a civil action against the Attorney, the Judge and the Bank alleging fraud in connection with the outcome of the Bank v. USF&G lawsuit. The complaint demands $2.5 million in compensatory damages and $10 million in punitive damages, prejudgment interest and attorneys fees, etc. The USF&G v. Bank suit was stayed until 30 days following the completion of the criminal case.

The criminal case against the Attorney, the Judge and other parties concluded on August 12, 2005. No guilty verdicts were returned. The defendants received not guilty verdicts on several counts and there was no verdict (mistrial) on a number of other counts, including the Bank v. USF&G matter. On September 16, 2005, the U. S. Attorney s office announced that it would retry the Attorney, the Judge and other parties on fraud and bribery charges related to the Bank v. USF&G matter. The new trial began on February 7, 2007. On March 31, 2007, guilty verdicts on counts of bribery, conspiracy, mail fraud/honest services fraud and racketeer influenced corrupt organizations (RICO) violations were returned against the Attorney, the Judge and other parties. The Attorney, the Judge and other parties have indicated that they plan to appeal the guilty verdicts. On October 30, 2007, the judge in the USF&G lawsuit lifted the stay order in that case.

On February 4, 2008, USF&G filed an amended complaint against the Bank, the Attorney and the Judge. In the amended complaint, USF&G seeks $2.5 million in compensatory damages, $10 million in punitive damages and prejudgment interest and attorneys fees, etc. In addition, USF&G seeks a declaratory judgment to set aside the settlement in the original lawsuit between USF&G and the Bank. On February 20, 2008, the Bank filed an answer to the amended complaint. The court granted the Bank s motion to transfer the case from Jackson, MS, to Gulfport, MS and set a trial date of February 9, 2009. Disclosure filings and discovery were initiated during the second quarter of 2008. The Attorney and the Judge appealed their convictions to the Fifth Circuit Court of Appeals. As a result of the appeals, the USF&G v. Bank suit has been stayed.

The Company understands that this litigation, as with any litigation, is inherently uncertain and it is reasonably possible that the Company may incur a loss in this matter. The Company has no reason to conclude, however, that the loss is probable and cannot reasonably estimate the amount of any possible loss. No liability for the USF&G lawsuit has been accrued. This conclusion is based on relevant legal advice, the fact that this lawsuit is in its very earliest stages and the Company s resolve to vigorously contest the case.

The bank is involved in various other legal matters and claims which are being defended and handled in the ordinary course of business. None of these matters is expected, in the opinion of Management, to have a material adverse effect upon the financial position or results of operations of the Company.

Item 6 Exhibits and Reports on Form 8-K

(a) Exhibits

Exhibit 31.1:	Certification of Chief Executive Officer Pursuant to Section 302 of the Sarbanes Oxley Act of 2002
Exhibit 31.2:	Certification of Chief Financial Officer Pursuant to Section 302 of the Sarbanes Oxley Act of 2002
Exhibit 32.1:	Certification of Chief Executive Officer Pursuant to 18 U.S.C. ss. 1350
Exhibit 32.2:	Certification of Chief Financial Officer Pursuant to 18 U.S.C. ss. 1350

(b) Reports on Form 8-K

A Form 8-K was filed on July 17, 2008, September 25, 2008, October 6, 2008 and October 14, 2008.

SIGNATURES

Pursuant to the requirement of Section 13 of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

PEOPLES FINANCIAL CORPORATION
(Registrant)

Date: November 7, 2008

By: /s/ Chevis C. Swetman

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

Date: November 7, 2008

By: /s/ Lauri A. Wood

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