PEOPLES FINANCIAL CORP /MS/
Form 10-Q
August 09, 2007

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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 June 30, 2007

or

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

Commission File Number 0-30050

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 or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act. (Check one:)

Large Accelerated filer o Accelerated filer þ Non-Accelerated filer 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 July 31, 2007, there were 15,000,000 shares of $1 par value common stock authorized, and 5,515,782 shares issued and outstanding.

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PART I
FINANCIAL INFORMATION
PEOPLES FINANCIAL CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CONDITION

June 30, December 31, and June 30,	(Unaudited) 2007	(Audited) 2006	(Unaudited) 2006
Assets			
Cash and due from banks	$ 82,045,189	$ 37,793,493	$ 59,876,184
Federal funds sold	7,525,000	6,400,000	1,680,000
Held to maturity securities, market value of $15,659,000 - June 30, 2007; $85,519,000 - December 31, 2006; $132,253,000 - June 30, 2006	15,692,746	85,574,260	132,596,937
Available for sale securities, at market value	411,750,551	397,207,489	249,120,369
Federal Home Loan Bank stock, at cost	1,158,100	1,128,500	1,101,700
Loans	429,853,383	401,194,010	401,010,495
Less: Allowance for loan losses	10,864,266	10,841,367	11,042,833
Loans, net	418,989,117	390,352,643	389,967,662
Bank premises and equipment, net of accumulated depreciation	24,242,019	19,658,585	18,340,033
Accrued interest receivable	8,413,007	8,142,230	6,062,262
Other assets	20,804,770	17,765,868	19,836,553
Total assets	$ 990,620,499	$ 964,023,068	$ 878,581,700

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PEOPLES FINANCIAL CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CONDITION (Continued)

June 30, December 31, and June 30,	(Unaudited) 2007	(Audited) 2006	(Unaudited) 2006
Liabilities & Shareholders Equity			
Liabilities:			
Deposits:			
Demand, non-interest bearing	$ 214,329,629	$ 148,455,754	$ 167,165,370
Savings and demand, interest bearing	250,239,717	271,331,272	296,176,398
Time, $100,000 or more	144,849,302	132,846,509	97,394,708
Other time deposits	59,289,641	60,536,259	62,255,783
Total deposits	668,708,289	613,169,794	622,992,259
Federal funds purchased and securities sold under agreements to repurchase	197,142,818	226,032,370	148,593,191
Borrowings from Federal Home Loan Bank	13,982,178	7,267,349	7,339,841
Other liabilities	12,322,587	19,320,860	9,436,224
Total liabilities	892,155,872	865,790,373	788,361,515
Shareholders Equity:			
Common Stock, $1 par value, 15,000,000 shares authorized, 5,515,782, 5,548,199 and 5,548,199 shares issued and outstanding at June 30, 2007, December 31, 2006 and June 30, 2006, respectively	5,515,782	5,548,199	5,548,199
Surplus	65,780,254	65,780,254	65,780,254
Undivided profits	31,792,995	29,253,825	22,851,882
Accumulated other comprehensive income, net of tax	(4,624,404)	(2,349,583)	(3,960,150)
Total shareholders equity	98,464,627	98,232,695	90,220,185

Total liabilities and shareholders equity	$ 990,620,499	$ 964,023,068	$ 878,581,700

See Selected Notes to Consolidated Financial Statements.

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PEOPLES FINANCIAL CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF INCOME
(Unaudited)

	For the Quarters Ended June 30,		For the Six Months Ended June 30,	
	2007	2006	2007	2006
Interest income:				
Interest and fees on loans	$ 8,422,725	$ 6,871,406	$ 16,212,614	$ 13,054,483
Interest and dividends on investments:				
U. S. Treasury	1,152,278	1,495,269	2,467,589	3,323,351
U. S. Government agencies and corporations	4,144,884	2,774,493	8,416,417	4,533,026
States and political subdivisions	233,953	208,790	457,115	417,391
Other investments	296,220	39,845	439,768	125,819
Interest on federal funds sold	30,602	98,866	81,711	539,356
Total interest income	14,280,662	11,488,669	28,075,214	21,993,426
Interest expense:				
Deposits	3,704,829	2,619,658	7,231,163	4,837,928
Borrowings from Federal Home Loan Bank	165,304	126,525	279,847	242,391
Federal funds purchased and securities sold under agreements to repurchase	2,845,117	1,237,760	5,570,169	1,901,005
Total interest expense	6,715,250	3,983,943	13,081,179	6,981,324
Net interest income	7,565,412	7,504,726	14,994,035	15,012,102
Provision for allowance for losses on loans	51,000	42,000	100,000	77,000
Net interest income after provision for allowance for losses on loans	$ 7,514,412	$ 7,462,726	$ 14,894,035	$ 14,935,102

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PEOPLES FINANCIAL CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF INCOME (Continued)
(Unaudited)

	For the Quarters Ended June 30,		For the Six Months Ended June 30,	
	2007	2006	2007	2006
Other operating income:				
Trust department income and fees	$ 449,625	$ 374,221	$ 898,245	$ 730,238
Service charges on deposit accounts	1,631,897	1,244,781	3,303,758	2,305,268
Other service charges, commissions and fees	60,423	76,367	117,953	150,874

See Selected Notes to Consolidated Financial Statements.

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PEOPLES FINANCIAL CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF SHAREHOLDERS EQUITY

# of Common Shares	Common Stock	Surplus	Undivided Profits	Accumulated Other Comprehensive Income	Comprehensive Income	Total

Note: Balances as of January 1, 2006 were audited.

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PEOPLES FINANCIAL CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF SHAREHOLDERS EQUITY (Continued)

	# of Common Shares	Common Stock	Surplus	Undivided Profits	Accumulated Other Compre-hensive Income	Comprehen-sive Income	Total
Balance, January 1, 2007	5,548,199	$ 5,548,199	$ 65,780,254	$ 29,253,825	$ (2,349,583)		$ 98,232,695
Comprehensive Income:							
Net income				4,701,573		$ 4,701,573	4,701,573
Net unrealized loss on available for sale securities, net of tax					(2,630,891)	(2,630,891)	(2,630,891)
Reclassification adjustment for available for sale securities called or sold in the current year, net of tax					356,070	356,070	356,070
Total comprehensive income						$ 2,426,752	
Retirement of common stock	(32,417)	(32,417)		(783,458)			(815,875)
Dividend declared ($ .25 per share)				(1,378,945)			(1,378,945)
Balance, June 30, 2007	5,515,782	$ 5,515,782	$ 65,780,254	$ 31,792,995	$ (4,624,404)		$ 98,464,627

Note: Balances as of January 1, 2007 were audited.
See Selected Notes to Consolidated Financial Statements.

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PEOPLES FINANCIAL CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited)

For the Six Months Ended June 30,	2007	2006
Cash flows from operating activities:		
Net income	$ 4,701,573	$ 5,089,871
Adjustments to reconcile net income to net cash provided by (used in) operating activities:		
Depreciation	910,000	758,000
Provision for loan losses	100,000	77,000
Gain on sale of bank premises	(192,200)	
Gain on sales of other real estate	(10,470)	(150,000)
Loss on sales of securities	619,015	
Changes in assets and liabilities:		
Accrued interest receivable	(270,777)	(1,746,904)
Other assets	(866,793)	(224,154)
Other liabilities	(7,810,083)	246,123
Net cash provided by (used in) operating activities	(2,819,735)	4,049,936
Cash flows from investing activities:		
Proceeds from maturities and calls of held to maturity securities	75,390,000	153,170,000
Proceeds from maturities, sales and calls of available for sale securities	105,881,327	8,110,292
Purchases of investments in held to maturity securities	(5,508,486)	(151,719,978)
Purchases of investments in available for sale securities	(124,481,485)	(80,634,652)
Purchases of investments in Federal Home Loan Bank	(29,600)	(25,100)
Proceeds from sales of other real estate	55,000	238,000

Loans, net increase	(28,736,474)	(51,705,744)
Proceeds from sale of bank premises	250,000	
Acquisition of premises and equipment	(5,551,234)	(1,210,126)
Other assets	(344,428)	(295,685)
Net cash provided by (used in) investing activities	16,924,620	(124,072,993)

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PEOPLES FINANCIAL CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS (Continued)
(Unaudited)

For the Six Months Ended June 30,	2007	2006
Cash flows from financing activities:		
Demand and savings deposits, net increase (decrease)	$ 44,782,320	$ (14,338,167)
Time deposits, net increase	10,756,175	45,113,084
Borrowings from Federal Home Loan Bank	35,850,030	10,607,443
Repayments to Federal Home Loan Bank	(29,135,201)	(10,619,607)
Retirement of common stock	(815,875)	(16,651)
Cash dividends	(1,276,086)	(1,109,826)
Federal funds purchased and securities sold under agreements to repurchase, net decrease	(28,889,552)	(674,559)
Net cash provided by financing activities	31,271,811	28,961,717
Net increase (decrease in) cash and cash equivalents	45,376,696	(91,061,340)
Cash and cash equivalents, beginning of period	44,193,493	152,617,524
Cash and cash equivalents, end of period	$ 89,570,189	$ 61,556,184

See Selected Notes to Consolidated Financial Statements.

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PEOPLES FINANCIAL CORPORATION AND SUBSIDIARIES
SELECTED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
For the Six Months Ended June 30, 2007 and 2006

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 the Company and its subsidiaries as of June 30, 2007 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 2006 Annual Report.

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.

The results of operations for the six months ended June 30, 2007, are not necessarily indicative of the results to be expected for the full year.

2. Earnings Per Share:

Per share data is based on the weighted average shares of common stock outstanding of 5,541,765 and 5,548,403 for the six months ended June 30, 2007 and 2006, respectively, and 5,535,402 and 5,548,199 for the quarter ended June 30, 2007 and 2006, 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 $13,081,000 and $6,873,000 for the six months ended June 30, 2007 and 2006, respectively, for interest on deposits and borrowings. Income tax payments of $3,444,000 and $2,855,000 were made during the six months ended June 30, 2007 and 2006, respectively. Loans transferred to other real estate amounted to $41,000 during the six months ended June 30, 2006.

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4. Investments:

Securities with gross unrealized losses at June 30, 2007, aggregated by investment category and length of time that individual securities have been in a continuous loss position are as follows (in 000 s):

	Less Than Twelve Months		Over Twelve Months		Total	
	Fair Value	Gross Unreal-ized Loss	Fair Value	Gross Unreal-ized Loss	Fair Value	Gross Unreal-ized Loss
U. S. Treasury	$ 58,659	$ 289	$ 28,790	$ 192	$ 87,449	$ 481
U. S. Govt. Agencies	183,094	2,182	88,952	1,534	272,046	3,716
States and political subdivisions	9,888	272	8,135	297	18,023	569
Mortgage backed securities	20,741	684			20,741	684
FHLMC preferred stock			2,459	616	2,459	616
Total	$ 272,382	$ 3,427	$ 128,336	$ 2,639	$ 400,718	$ 6,066

Management evaluates securities for other-than-temporary impairment on a monthly basis. In performing this evaluation, the length of time and the extent to which the fair value has been less than cost and the fact that the Company s securities are primarily issued by U. S. Treasury and U. S. Government Agencies are considered. In addition, the Company assesses the cause of the decline in value and the intent and ability of the Company to hold these securities until maturity. While 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 were $1,489,000 and $5,284,000 at June 30, 2007 and 2006, respectively. Nonaccrual loans amounted to approximately $3,803,000 and $451,000 at June 30, 2007 and 2006, respectively.

At June 30, 2007 and 2006, the Company s other individually evaluated impaired loans included performing loans and totaled $7,197,000 and $12,429,000. The average recorded investment in impaired loans amounted to approximately $11,008,000 and $13,139,000 at June 30, 2007 and 2006,

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respectively. The Company had $5,801,000 and $4,936,000 of specific allowance related to impaired loans at June 30, 2007 and 2006, respectively. Interest income recognized on impaired loans was $124,000 and $261,000 during the six months ended June 30, 2007 and 2006, respectively. Interest income recognized on impaired loans if the Company had used the cash-basis method of accounting would have approximated $125,000 and $321,000 during the six months ended June 30, 2007 and 2006, respectively.

6. Allowance for Loan Losses:

Transactions in the allowance for loan losses were as follows:

	For the Six Months Ended June 30, 2007	For the Year Ended December 31, 2006	For the Six Months Ended June 30, 2006
Balance, beginning of period	$ 10,841,367	$ 10,966,022	$ 10,966,022
Provision for loan losses	100,000	141,000	77,000
Recoveries	130,645	463,345	227,700
Loans charged off	(207,746)	(729,000)	(227,889)
Balance, end of period	$ 10,864,266	$ 10,841,367	$ 11,042,833

7. Other Comprehensive Income:

The income tax benefit on the accumulated other comprehensive income was $1,172,000 and $614,000 at June 30, 2007 and 2006, respectively.

8. Federal Funds Purchased and Securities Sold Under Agreements to Repurchase:

On June 27, 2007, the Board of Directors authorized the Company to establish an additional $10,000,000 unsecured line of credit. As a result, the Company now has facilities in place to purchase federal funds up to $111,000,000 under established credit arrangements in order to meet its liquidity needs.

9. Notes Payable:

On July 6, 2007, the Company opened a $5,000,000 unsecured line of credit with The Bankers Bank. The line draws interest at 1/2% under New York Prime and requires interest only payments quarterly with all principal and remaining accrued interest due at maturity, which is July 6, 2009.

10. Income Taxes:

The Financial Accounting Standards Board (the FASB) issued FASB Interpretation No. 48, Accounting for Uncertainty in Income Taxes An Interpretation of FASB Statement No. 109 (FIN 48). This interpretation clarifies the accounting and disclosure for uncertainty in income tax positions and is effective for the Company for the year beginning January 1, 2007. The Company has considered the recognition and measurement requirements of FIN 48 of the benefits recorded in its financial statements for tax positions taken or expected to be taken in its tax returns. Based on its

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evaluation of these tax positions for open tax years 2003 2006, the unrecognized tax benefit, including applicable interest and penalties, is not material to the financial position of the Company as of January 1, 2007.

11. Shareholders Equity:

As of July 25, 2007, the Company repurchased and retired 119,184 shares, including 55,974 shares repurchased and retired since July 1, 2007, under a stock repurchase plan originally approved on November 26, 2002 and extended on November 22, 2005. At July 25, 2007, the Company had the authorization to repurchase and retire an additional 20,290 shares under the plan approved on November 26, 2002 and extended November 22, 2005.

On July 25, 2007, the Board of Directors approved a stock repurchase plan under which 2.50%, or approximately 136,000, of the outstanding shares of Company stock may be repurchased and retired.

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

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

The following presents Management s discussion and analysis of the consolidated financial condition and results of operations of Peoples Financial Corporation and Subsidiaries (the Company) for the six months ended June 30, 2007 and 2006. These comments highlight the significant events and should be considered in combination with the Consolidated Financial Statements included in this report on Form 10-Q.

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.

Overview

During the first six months of 2007, net income was $4,702,000, as compared with $5,089,000 for the first six months of 2006. Earnings for the first six months of 2007 included a loss of $409,000, net of taxes, from the sale of securities. Proceeds from the sale of these securities funded liquidity needs of the bank subsidiary.

Total assets reached $991,000,000 at June 30, 2007, with investments increasing $46,000,000 and net loans increasing $29,000,000 at June 30, 2007 as compared with June 30, 2006. These increases were funded by the increase in total deposits of $46,000,000 and increase in non-deposit funds management accounts of $49,000,000 at June 30, 2007 as compared with June 30, 2006, continuing the trend since August of 2005 when Hurricane Katrina hit the Gulf Coast region.

The following compares financial highlights for the six months ended June 30, 2007 and 2006:

For the six months ended June 30,	2007	2006
Net income per share	$ .85	$ .92
Book value per share	$ 17.85	$ 16.26
Return on average total assets	.95%	1.17%
Allowance for loan losses as a % of loans, net of unearned discount	2.53%	2.75%

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Financial Condition

Held to Maturity Securities

Held to maturity securities decreased $116,904,000 at June 30, 2007, compared with June 30, 2006. The significant increase in the balances of deposits and non-deposit products after Hurricane Katrina in August 2005 has outpaced loan demand during the last twenty-four months. These funds were initially invested in short term U.S. Treasury securities and classified as held to maturity. Proceeds from the maturity of these investments are now primarily funding the purchase of U.S. Treasury and U.S. Agency securities with longer maturities and which are being classified as available for sale. The Company continues to monitor its investment in bonds issued by municipalities which have been affected by Hurricane Katrina. At June 30, 2007, Management has determined that no provision for loss on these investments is required.

Gross unrealized gains for held to maturity securities were $34,000 and $50,000 at June 30, 2007 and 2006, respectively. Gross unrealized losses were $68,000 and $394,000 at June 30, 2007 and 2006, respectively. The following schedule reflects the mix of the held to maturity investment portfolio at June 30, 2007 and 2006:

June 30,	2007		2006	
	Amount	%	Amount	%
U.S. Treasury	$ 8,994,614	57%	$ 58,607,734	44%
U.S. Government agencies	2,000,000	13%	68,000,000	51%
States & political subdivisions	4,698,132	30%	5,989,203	5%
Totals	$ 15,692,746	100%	$ 132,596,937	100%

Available for Sale Securities

Available for sale securities increased $162,630,000 at June 30, 2007, compared with June 30, 2006, as a result of managing the Company s liquidity position, as discussed above. The Company continues to monitor its investment in bonds issued by municipalities which have been affected by Hurricane Katrina. At June 30, 2007, Management has determined that no provision for loss on these investments is required.

Gross unrealized gains were $143,000 and $93,000 and gross unrealized losses were $5,999,000 and $6,087,000 at June 30, 2007 and 2006, respectively. The schedule on the following page reflects the mix of available for sale securities at June 30, 2007 and 2006:

June 30,	2007 Amount	%	2006 Amount	%
U.S. Treasury	$ 82,463,442	20%	$ 43,175,580	17%
U.S. Government agencies	285,493,317	69%	187,579,562	75%
Mortgage-backed securities	20,741,398	5%		
States and political subdivisions	18,777,682	5%	14,720,813	6%
Other securities	4,274,712	1%	3,644,414	2%
Totals	$ 411,750,551	100%	$ 249,120,369	100%

Loans

Loans increased $28,843,000 at June 30, 2007, as compared with June 30, 2006. Slower than expected recovery funding and increasing insurance costs have resulted in only minimal loan growth on the Mississippi Gulf Coast since Hurricane Katrina in August 2005. The Company has supplemented its loan portfolio with out of area and syndicated national casino credits as loan demand fluctuates in its trade area. With the large increase in deposits since Hurricane Katrina far exceeding local loan demand, out of area loans and syndicated national casino loans have been more aggressively pursued and such loans increased $3,100,000 and $14,000,000, respectively, at June 30, 2007 as compared with June 30, 2006.

Bank Premises and Equipment

Bank premises and equipment increased $5,902,000 at June 30, 2007, as compared with June 30, 2006, primarily as a result of construction projects including the expansion of the Main Office and renovations at our Orange Grove branch.

Accrued Interest Receivable

Accrued interest receivable increased $2,351,000 at June 30, 2007, as compared with June 30, 2006, due to an increase in interest earning assets and the rate earned on these assets.

Other Assets

Other assets increased $968,000 at June 30, 2007, as compared with June 30, 2006, primarily due to an increase in deferred taxes on unrealized losses on available for sale securities.

Deposits

Total deposits increased $45,716,000 at June 30, 2007, as compared with June 30, 2006. Typically, significant increases or decreases in total deposits and/or significant fluctuations among the different types of deposits from quarter to quarter are anticipated by Management as customers in the casino and construction industries and county and municipal areas reallocate their resources periodically. Since Hurricane Katrina in August 2005, the Company has realized a significant increase in demand and savings deposits and jumbo CD s as municipal customers receive federal and state funding and commercial and personal customers begin receiving insurance proceeds, block grants, SBA loans and other forms of assistance. Based on previous post-hurricane experience and expectations with respect to the time frame for reconstruction, the Company anticipates that deposits will continue at or near their present level throughout the remaining quarters of 2007.

The Company has managed its funds including structuring the maturity of investment securities and the classification of investments as well as utilizing other funding sources and structuring their maturity to manage the potential volatility of its deposits.

Federal Funds Purchased and Securities Sold Under Agreements to Repurchase

Federal funds purchased and securities sold under agreements to repurchase increased $48,550,000 at June 30, 2007, as compared with June 30, 2006, as a result of the reallocation of funds by certain commercial customers between deposit and non-deposit products.

Other Liabilities

Other liabilities increased $2,886,000 at June 30, 2007, as compared with June 30, 2006. This increase is primarily a result of an increase in the liability for the Company s retiree health plan of $1,158,000 due to the adoption of SFAS 158 at December 31, 2006 and to the increase in liabilities related to deferred compensation plans.

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. One measure of capital adequacy is the primary capital ratio which was 11.06% at June 30, 2007, as compared with 11.60% at June 30, 2006. These ratios are 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.

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.

The Company s net interest margin on a tax-equivalent basis, which is net income as a percentage of average earning assets, was 3.41% at June 30, 2007, down 53 basis points from 3.94% at June 30, 2006. The table that follows this discussion analyzes the changes in tax-equivalent net interest income for the six months ended June 30, 2007 and 2006.

Average earning assets increased $120,746,000, or 16%, from $772,012,000 in June 2006 to $892,758,000 in June 2007. The average yield on earning assets improved 59 basis points, from 5.75% at June 30, 2006 to 6.34% at June 30, 2007. The increase in the yield is attributable to increases in prime rate since January 1, 2006. The large increase in funds from deposit and funds management account growth during the last twenty-four months has funded the increase in loan demand and the remaining funds have been invested in U.S. Treasury and Agency securities and classified as held to maturity in 2006 and as available for sale in 2007. The loan portfolio generally has a 40%/60% blend of fixed/floating rate term. This fact, coupled with the relatively shorter term duration of investment maturities results in the Company being more asset sensitive to changes in market interest rates.

Average interest bearing liabilities increased $139,187,000, or 24%, from $589,827,000 in June 2006 to $729,014,000 in June 2007. The average rate paid on interest bearing liabilities increased 122 basis points, from 2.37% in June 2006 to 3.59% in June 2007. This significant increase, as well as the decrease in the net tax-equivalent yield on earning assets, is largely the result of rates paid on funds management accounts, a non-deposit product classified as federal funds purchased and securities sold under agreement to repurchase.

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

	For the Six Months Ended June 30, 2007			For the Six Months Ended June 30, 2006		
	Average Balance	Interest Earned/ Paid	Yield	Average Balance	Interest Earned/ Paid	Yield
INTEREST INCOME:						
Loans (2)(3)	$ 415,765	$ 16,213	7.80%	$ 356,898	$ 13,054	7.32%
Federal funds sold	2,967	82	5.53%	21,898	539	4.92%
Held to maturity:						
Taxable	39,698	1,001	5.04%	172,470	3,856	4.47%
Non-taxable (1)	4,933	155	6.28%	6,114	218	7.13%
Available for sale:						
Taxable	405,738	10,216	5.04%	195,958	3,999	4.08%
Non-taxable (1)	18,240	537	5.89%	14,158	414	5.85%
Other	5,417	106	3.91%	4,516	126	5.58%
Total	$ 892,758	$ 28,310	6.34%	$ 772,012	$ 22,206	5.75%
INTEREST EXPENSE:						
Savings and demand, interest bearing	$ 281,986	$ 2,784	1.97%	$ 311,466	$ 2,641	1.70%
Time deposits	201,840	4,447	4.41%	130,248	2,197	3.37%
Federal funds purchased and securities sold under agreements to repurchase	235,897	5,570	4.72%	139,925	1,901	2.72%
Borrowings from FHLB	9,291	280	6.03%	8,188	242	5.91%
Total	$ 729,014	$ 13,081	3.59%	$ 589,827	$ 6,981	2.37%

Net tax-equivalent yield on earning assets	3.41%	3.94%

(1) All interest earned is reported on a taxable equivalent basis using a tax rate of 34% in 2007 and 2006.

(2) Loan fees of $307and $308 for 2007 and 2006, respectively, are included in these figures.

(3) Includes nonaccrual loans.

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Provision for Loan Losses

Management continuously monitors the Company s relationships with its loan customers, especially those in concentrated industries such as gaming/casino and hotel/motel, as well as the exposure for out of area loans, and their direct and indirect impact on its operations. A thorough analysis of current economic conditions and the quality of the loan portfolio is conducted on a quarterly basis. Management utilized these analyses, with special emphasis on the impact of Hurricane Katrina on the loan portfolio and underlying collateral, in determining the adequacy of its allowance for loan losses at June 30, 2007. In determining potential loan losses as a result of Hurricane Katrina since August 2005, the Company has evaluated its commercial and residential loan portfolios separately.

Management continues its evaluation in recognition of the extraordinary impact of Katrina on its trade area, attempting to quantify potential losses in accordance with the Company s established methodology. Loan delinquencies and deposit overdrafts are closely monitored in order to identify developing problems as early as possible.

Additionally, Management has considered the historical data available from the impact of other natural disasters on the Mississippi Gulf Coast and other coastal communities, including the length of time between the storm s landfall and identification of all losses. Past bank experience with hurricanes and FDIC research have shown that the actual loss position may not be known until two years after the event.

Although almost two years has passed, uncertainty remains regarding the impact of federal assistance, settlement of insurance claims, the availability and affordability of windstorm insurance and the rate and pace of recovery in the Company s trade area. Commercial and personal customers are still assessing their resources and making decisions about the future plans. Meanwhile, construction costs continue to escalate, further impacting recovery efforts. The ability of customers to service their debt must be carefully considered.

During the last several months, we have started to realize the full impact of Hurricane Katrina on insurance coverage going forward. Several carriers have announced their intention to restrict coverage in our trade area. For those carriers continuing to write policies on the Gulf Coast, premiums are increasing significantly. Commercial development has already been negatively impacted by the ability to obtain insurance coverage. Ultimately, the effect of the insurance uncertainty may pose a potential risk to a large portion of our loan portfolio.

The Company has identified no additional significant potential losses as a result of Hurricane Katrina since its initial evaluation in September 2005. In fact, some loans which were thought to pose a potential loss during the initial evaluation have shown positive developments. It is also very possible that potential losses, despite the best efforts of the Company, have not yet been identified. Management believes that it is reasonably possible that the actual amount of potential loan losses as a result of Hurricane Katrina may be less than what was estimated in September 2005, but as a result of the factors discussed above, this amount cannot be reasonably estimated at this time and no provision or negative provision for losses on loans was recorded for the six months ended June 30, 2007 and 2006.

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The Company recorded a provision of $100,000 during the first six months of 2007 which relates to potential losses on overdrawn deposit accounts. This provision is included in the provision for allowance for losses on loans in the consolidated income statement.

Trust Department Income and Fees

Trust Department income and fees increased $168,000 for the first six months of 2007 as compared with the first six months of 2006, as a result of an increase in cash management accounts funded with insurance and other proceeds.

Service Charges on Deposit Accounts

Service charges on deposit accounts increased $998,000 for the six months ended June 30, 2007, as compared with the six months ended June 30, 2006. This increase is almost equally the result of an increase in ATM fee income as transactions at casino ATMs have significantly increased during this period and an increase in NSF fee income due to an increase in the fee charged.

Loss on Sale of Securities

The Company realized a loss from the sale of available for sale securities during the first six months of 2007 of $619,000. The proceeds of these sales were used to fund the liquidity needs of the bank subsidiary.

Other Income

Other income increased $279,000 for the six months ended June 30, 2007 as compared with the six months ended June 30, 2006, primarily as a result of the gain from the sale of bank premises of $192,000.

Salaries and Employee Benefits

Salaries and employee benefits increased $727,000 for the first six months of 2007 as compared with the first six months of 2006. The Company increased salaries to its employees in order to reward performance and retain personnel within the competitive local employment environment.

Net Occupancy

Net occupancy expense decreased $186,000 for the six months ended June 30, 2007 as compared with the six months ended June 30, 2006, as a result of the decrease in costs associated with insurance coverage as the Company has chosen to self fund a portion of its windstorm and fire coverage.

Equipment Rentals, Depreciation and Maintenance

Equipment rentals, depreciation and maintenance increased $268,000 for the six months ended June 30, 2007 as compared with the six months ended June 30, 2006 as a result of an increase in depreciation costs from banking premises acquired during 2006 and 2007.

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Other Expense

Other expense increased $543,000 for the six months ended June 30, 2007 as compared with the six months ended June 30, 2006, as a result of the increase in expenses related to offsite ATMs as transactions increase.

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. Since Hurricane Katrina, the Company s deposits and non-deposit accounts have increased significantly, as discussed previously. Management carefully monitors its liquidity needs, particularly relating to these potentially volatile deposits. The Company is currently investing in short-term U. S. Treasury and Agency Securities. It is anticipated that loan demand will be funded in future quarters from the maturity of these investments.

Item 4: Controls and Procedures

As of June 30, 2007, 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-15e). 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 June 30, 2007 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 against 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. There has been no discovery.

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 will 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. Despite the verdicts in the criminal case, the USF&G v. Bank suit remains subject to the stay order until the stay order is lifted by the judge in that case.

Item 4 Submission of Matters to a Vote of Security Holders

None.

Item 5 Other Information

None.

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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 April 16, 2007, June 27, 2007 and July 16, 2007.

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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: August 9, 2007

By: /s/ Chevis C. Swetman

Chevis C. Swetman
Chairman, President and Chief Executive Officer

Date: August 9, 2007

By: /s/ Lauri A. Wood

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

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