# 2018

## ANNUAL REPORT

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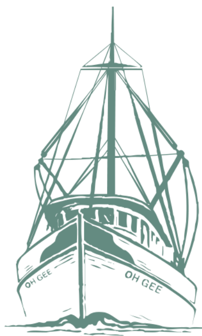


PEOPLES FINANCIAL CORPORATION
AND SUBSIDIARIES

To Our Shareholders,

We are pleased with our financial results for 2018, this is our third consecutive year of profitability.

During 2018, the company continued to expand initiatives designed to enhance service to our customers and further increase operational efficiencies. In addition to our semi-annual dividend, the bank stock repurchase of 180,000 shares was completed and was deemed a huge success.

In 2018, the board of directors of Peoples Financial Corporation appointed three new directors to the board of The Peoples Bank; Mr. Padrick Dennis has served as Vice President of Construction and Operations for Specialty Contractors and Associates, Inc., since 2010. Mr. Dennis earned a Juris Doctor from the University of Mississippi School of Law, graduating Summa Cum Laude and also holds a Bachelor of Arts degree (Politics) and Bachelor of Science degree (Accounting and Business Administration) from Washington & Lee University, graduating Summa Cum Laude.

Also appointed to the bank board was Mr. George Sliman, a Director and President of SunStates Holdings, Inc., a privately-held real estate investment company. Mr. Sliman's responsibilities include financial reporting, risk management, information technology and special projects. In addition, Mr. Sliman is a general partner and managing member of several privately-held investment entities. A retired Certified Public Accountant, Mr. Sliman graduated from Springhill College, Magna Cum Laude and earned a Masters of Business Administration from the Wharton School of Business at the University of Pennsylvania.

Likewise joining the bank board was Mr. Tanner Swetman, who joined the bank in 2005 and currently serves as Vice President of Corporate Affairs. Mr. Swetman has oversight responsibility for the Business Development, Investment, Branch Administration and Property Departments. Mr. Swetman also serves as Chairman of the Asset Liability Committee and is a member of the Investment and Trust committees. Mr. Swetman holds a Bachelor of Science in Business Administration with an emphasis in Management from the University of Southern Mississippi. Mr. Swetman also completed the Mississippi School of Banking at the University of Mississippi, the Graduate School of Banking at Louisiana State University and the University of Chicago Booth School of Business Executive Development Program

For over 122 years, our culture has focused on providing a variety of banking and financial services and exceptional service to our customers. Our board of directors and employees are devoted to continuing our legacy of service and contributing to the prosperity of the Mississippi Gulf Coast.

Sincerely yours,

Chevis C. Swetman
Chairman of the Board
President & Chief Executive Officer

# MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

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

## FORWARD-LOOKING INFORMATION

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

## NEW ACCOUNTING PRONOUNCEMENTS

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

## CRITICAL ACCOUNTING POLICIES

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

### Investments

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

### Allowance for Loan Losses

The Company's allowance for loan losses ("ALL") reflects the estimated losses resulting from the inability of its borrowers to make loan payments. The ALL is established and maintained at an amount sufficient to cover the estimated loss associated with the loan portfolio of the Company as of the date of the financial statements. Credit losses arise not only from credit risk, but also from other risks inherent in the lending process including, but not limited to, collateral risk, operation risk, concentration risk and economic risk. As such, all related risks of lending are considered when assessing the adequacy of the ALL. On a quarterly basis, Management estimates the probable level of losses to determine whether the allowance is adequate to absorb reasonably foreseeable, anticipated losses in the existing portfolio based on our past loan loss experience, known and inherent risk in the portfolio, adverse situations that may affect the borrowers' ability to repay and the estimated value of any underlying collateral and current economic conditions. Management believes that the ALL is adequate and appropriate for all periods presented in these financial statements. If there was a deterioration of any of the factors considered by Management in evaluating the ALL, the estimate of loss would be updated,

and additional provisions for loan losses may be required. The analysis divides the portfolio into two segments: a pool analysis of loans based upon a five year average loss history which is updated on a quarterly basis and which may be adjusted by qualitative factors by loan type and a specific reserve analysis for those loans considered impaired under GAAP. All credit relationships with an outstanding balance of $100,000 or greater that are included in Management's loan watch list are individually reviewed for impairment. All losses are charged to the ALL when the loss actually occurs or when a determination is made that a loss is likely to occur; recoveries are credited to the ALL at the time of receipt.

### Other Real Estate

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

### Employee Benefit Plans

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

### Income Taxes

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

### GAAP Reconciliation and Explanation

This report contains non-GAAP financial measures determined by methods other than in accordance with GAAP. Such non-GAAP financial measures include taxable equivalent interest income and taxable equivalent net interest income. Management uses these non-GAAP financial measures because it believes they are useful for evaluating our operations and performance over periods of time, as well as in managing and evaluating our business and in discussions about our operations and performance. Management believes these non-GAAP financial measures provide users of our financial information with a meaningful measure for assessing our financial results, as well as comparison to financial results for prior periods. These non-GAAP financial measures should not be considered as a substitute for operating results determined in accordance with GAAP and may not be comparable to other similarly titled financial measures used by other companies. A reconciliation of these operating performance measures to GAAP performance measures for the years ended December 31, 2018, 2017 and 2016 is included in the table below.

### RECONCILIATION OF NON-GAAP PERFORMANCE MEASURES (IN THOUSANDS)

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

## OVERVIEW

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

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

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

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

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

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

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

## RESULTS OF OPERATIONS

### Net Interest Income

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

<u>2018 as compared with 2017</u>

The Company's average interest-earning assets decreased approximately $30,425,000, or 5%, from approximately $600,369,000 for 2017 to approximately $569,944,000 for 2018. Average loans decreased approximately $16,605,000 due to principal payments, maturities, charge-offs and foreclosures on existing loans significantly exceeding new loans. Average balances due from depository institutions decreased approximately $18,321,000 based on the liquidity needs of the bank subsidiary. The average yield on interest-earning assets was 3.17% for 2017 compared with 3.51% for 2018. The yield on average loans increased from 4.47% for 2017 to 4.85% for 2018 as a result of the increase in prime rate during 2017 and 2018. The yield on taxable available for sale securities increased from 1.52% for 2017 to 1.98% for 2018 as the Company changed its investment strategy to improve yield while not compromising duration and credit risk.

Average interest-bearing liabilities decreased approximately $22,849,000, or 5%, from approximately $437,627,000 for 2017 to approximately $414,778,000 for 2018. Average savings and interest-bearing DDA balances decreased approximately $36,155,000 primarily as several large commercial customers relocated their funds to other institutions in the current year. Average borrowings from the Federal Home Loan Bank ("FHLB") increased approximately $11,161,000 due to the liquidity

needs of the bank subsidiary. The average rate paid on interest-bearing liabilities increased 31 basis points, from .33% for 2017 to .64% for 2018. This increase was the result of increased rates.

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

*2017 as compared with 2016*

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

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

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

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

## ANALYSIS OF AVERAGE BALANCES, INTEREST EARNED/PAID AND YIELD (IN THOUSANDS)

| | 2018 | | | 2017 | | | 2016 | | |
|---|---|---|---|---|---|---|---|---|---|
| | Average Balance | Interest Earned/Paid | Rate | Average Balance | Interest Earned/Paid | Rate | Average Balance | Interest Earned/Paid | Rate |
| Loans (1) (2) | $ 273,724 | $ 13,265 | 4.85% | $ 290,329 | $ 12,970 | 4.47% | $ 327,819 | $ 14,232 | 4.34% |
| Balances due from depository institutions | 9,498 | 205 | 2.16% | 27,819 | 420 | 1.51% | 31,559 | 277 | 0.88% |
| Held to maturity: | | | | | | | | | |
| Taxable | 33,864 | 970 | 2.86% | 29,389 | 753 | 2.56% | 8,562 | 184 | 2.15% |
| Non taxable (3) | 18,208 | 580 | 3.19% | 19,082 | 717 | 3.76% | 19,596 | 725 | 3.70% |
| Available for sale: | | | | | | | | | |
| Taxable | 220,076 | 4,349 | 1.98% | 217,059 | 3,298 | 1.52% | 188,512 | 2,558 | 1.36% |
| Non taxable (3) | 13,055 | 608 | 4.66% | 15,677 | 864 | 5.51% | 20,902 | 1,123 | 5.37% |
| Other | 1,519 | 22 | 1.45% | 1,014 | 26 | 2.56% | 1,732 | 22 | 1.27% |
| Total | $ 569,944 | $ 19,999 | 3.51% | $ 600,369 | $ 19,048 | 3.17% | $ 598,682 | $ 19,121 | 3.19% |
| Savings and interest-bearing DDA | $ 317,197 | $ 1,468 | 0.46% | $ 353,352 | $ 736 | 0.21% | $ 359,801 | $ 437 | 0.12% |
| Time deposits | 84,168 | 886 | 1.05% | 82,038 | 637 | 0.78% | 77,644 | 457 | 0.59% |
| Federal funds purchased and securities sold under agreements to repurchase | 369 | 10 | 2.71% | 354 | 3 | 0.85% | | | |
| Borrowings from FHLB | 13,044 | 294 | 2.25% | 1,883 | 47 | 2.50% | 8,240 | 131 | 1.59% |
| Total | $ 414,778 | $ 2,658 | 0.64% | $ 437,627 | $ 1,423 | 0.33% | $ 445,685 | $ 1,025 | 0.23% |
| Net tax-equivalent spread | | | 2.87% | | | 2.84% | | | 2.97% |
| Net tax-equivalent margin on earning assets | | | 3.04% | | | 2.94% | | | 3.02% |

*(1) Loan fees of $310, $338 and $389 for 2018, 2017 and 2016, respectively, are included in these figures.*

*(2) Includes nonaccrual loans.*

*(3) All interest earned is reported on a taxable equivalent basis using a tax rate of 21% in 2018 and 34% in 2017 and 2016. See disclosure of Non-GAAP financial measures on page 2.*

## ANALYSIS OF CHANGES IN INTEREST INCOME AND EXPENSE (IN THOUSANDS)

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

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

**Provision for Allowance for Loan Losses**

In the normal course of business, the Company assumes risk in extending credit to its customers. This credit risk is managed through compliance with the loan policy, which is approved by the Board of Directors. The policy establishes guidelines relating to underwriting standards, including but not limited to financial analysis, collateral valuation, lending limits, pricing considerations and loan grading. The Company's Loan Review and Special Assets Departments play key roles in monitoring the loan portfolio and managing problem loans. New loans and, on a periodic basis, existing loans are reviewed to evaluate compliance with the loan policy. Loan customers in concentrated industries such as gaming and hotel/motel, as well as the exposure for out of area; residential and land development; construction and commercial real estate loans, and their direct and indirect impact on the Company's operations are evaluated on a monthly basis. Loan delinquencies and deposit overdrafts are closely monitored in order to identify developing problems as early as possible. Lenders experienced in workout scenarios consult with loan officers and customers to address non-performing loans. A monthly watch list of credits which pose a potential loss to the Company is prepared based on the loan grading system. This list forms the foundation of the Company's allowance for loan loss computation.

Management relies on its guidelines and existing methodology to monitor the performance of its loan portfolio and to identify and estimate potential losses based on the best available information. The potential effect of declines in real estate values and actual losses incurred by the Company were key factors in our analysis. Much of the Company's loan portfolio is collateral-dependent, requiring careful consideration of changes in the value of the collateral. Note A to the Consolidated Financial Statements discloses a

summary of the accounting principles applicable to impaired and nonaccrual loans as well as the allowance for loan losses. Note C to the Consolidated Financial Statements presents additional analyses of the composition, aging, credit quality and performance of the loan portfolio as well as the transactions in the allowance for loan losses.

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

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

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

**Non-interest Income**

*2018 as compared with 2017*

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

*2017 as compared with 2016*

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

**Non-interest Expense**

*2018 as compared with 2017*

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

*2017 as compared with 2016*

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

**Income Taxes**

The Company recognized an income tax benefit of $36,000 and $1,080,000 in 2018 and 2017, respectively, and income tax expense of $78,000 in 2016. During 2014, Management established a valuation allowance against its net deferred tax asset of approximately

$8,140,000. As of December 31, 2018, the valuation allowance is still in place. The 2018 and 2017 benefits were the result of the impact of the elimination of the alternative minimum tax credit carryforwards from new tax legislation and the correction of refunds for prior years. Note I to the Consolidated Financial Statements presents a reconciliation of income taxes for these three years and further analysis of the valuation allowance.

**FINANCIAL CONDITION**

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

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

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

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

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

**SHAREHOLDERS' EQUITY AND CAPITAL ADEQUACY**

Strength, security and stability have been the hallmark of the Company since its founding in 1985 and of its bank subsidiary since its founding in 1896. A strong capital foundation is fundamental to the continuing prosperity of the Company and the security of its customers and shareholders. The primary and risk-based capital ratios are important indicators of the strength of a Company's capital. These figures are presented in the Five-Year Comparative Summary of Selected Financial Information. The Company has established the goal of being classified as "well-capitalized" by the banking regulatory authorities.

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

**LIQUIDITY**

Liquidity represents the Company's ability to adequately provide funds to satisfy demands from depositors, borrowers and other commitments by either converting assets to cash or accessing new or existing sources of funds. Note L to the Consolidated Financial Statements discloses information relating to financial instruments with off-balance-sheet risk, including letters of credit and outstanding unused loan commitments. The Company closely monitors the potential effects of funding these commitments on its liquidity position. Management monitors these funding requirements in such a manner as to satisfy these demands and to provide the maximum return on its earning assets.

The Company monitors and manages its liquidity position diligently through a number of methods, including through the computation of liquidity risk targets and the preparation of various analyses of its funding sources and utilization of those sources on a monthly basis. The Company also uses proforma liquidity projections which are updated on a continuous basis in the management of its liquidity needs and also conducts contingency testing on its liquidity plan. The Company has also been approved to participate in the Federal Reserve's Discount Window Primary Credit Program, which it intends to use only as a contingency. Management carefully monitors its liquidity needs, particularly relating to potentially volatile deposits, and the Company has encountered no problems with meeting its liquidity needs.

Deposits, payments of principal and interest on loans, proceeds from maturities of investment securities and earnings on investment securities are the principal sources of funds for the Company.

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

## REGULATORY MATTERS

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

## OFF-BALANCE SHEET ARRANGEMENTS

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

# CONSOLIDATED STATEMENTS OF CONDITION

*(In thousands except share data)*

| DECEMBER 31, | 2018 | 2017 |
|---|---|---|
| **Assets** | | |
| Cash and due from banks | $ 17,191 | $ 25,281 |
| Available for sale securities | 222,110 | 245,206 |
| Held to maturity securities, fair value of $53,459 - 2018; $50,538 - 2017 | 54,598 | 51,163 |
| Other investments | 2,811 | 3,193 |
| Federal Home Loan Bank Stock, at cost | 2,069 | 1,370 |
| Loans | 273,346 | 280,449 |
| Less: Allowance for loan losses | 5,340 | 6,153 |
| Loans, net | 268,006 | 274,296 |
| Bank premises and equipment, net of accumulated depreciation | 18,879 | 20,153 |
| Other real estate | 8,943 | 8,232 |
| Accrued interest receivable | 1,956 | 1,904 |
| Cash surrender value of life insurance | 18,841 | 18,301 |
| Other assets | 1,382 | 1,325 |
| **Total assets** | $ 616,786 | $ 650,424 |
| | | |
| **Liabilities and Shareholders' Equity** | | |
| **Liabilities:** | | |
| Deposits: | | |
| Demand, non-interest bearing | $ 114,512 | $ 127,274 |
| Savings and demand, interest bearing | 278,772 | 318,278 |
| Time, $100,000 or more | 52,787 | 43,991 |
| Other time deposits | 27,435 | 40,027 |
| Total deposits | 473,506 | 529,570 |
| Borrowings from Federal Home Loan Bank | 36,142 | 11,198 |
| Employee and director benefit plans liabilities | 18,415 | 18,370 |
| Other liabilities | 1,789 | 1,787 |
| **Total liabilities** | 529,852 | 560,925 |
| **Shareholders' Equity:** | | |
| Common Stock, $1 par value, 15,000,000 shares authorized, 4,943,186 shares issued and outstanding at December 31, 2018 and 5,083,186 shares issued and outstanding at December 31, 2017 | 4,943 | 5,083 |
| Surplus | 65,780 | 65,780 |
| Undivided profits | 20,324 | 21,563 |
| Accumulated other comprehensive loss | (4,113) | (2,927) |
| **Total shareholders' equity** | 86,934 | 89,499 |
| **Total liabilities and shareholders' equity** | $ 616,786 | $ 650,424 |

*See Notes to Consolidated Financial Statements.*

# CONSOLIDATED STATEMENTS OF INCOME

| *(In thousands except per share data)*<br>**YEARS ENDED DECEMBER 31,** | **2018** | **2017** | **2016** |
|---|---|---|---|
| **Interest income:** | | | |
| Interest and fees on loans | $ 13,265 | $ 12,970 | $ 14,232 |
| Interest and dividends on securities: | | | |
| U.S. Treasuries | 1,410 | 1,602 | 1,133 |
| U.S. Government agencies | 471 | 531 | 872 |
| Mortgage-backed securities | 2,633 | 1,320 | 600 |
| States and political subdivisions | 1,744 | 1,634 | 1,325 |
| Other investments | 22 | 26 | 53 |
| Interest on balances due from depository institutions | 205 | 420 | 278 |
| **Total interest income** | 19,750 | 18,503 | 18,493 |
| **Interest expense:** | | | |
| Deposits | 2,354 | 1,373 | 894 |
| Federal funds purchased and securities sold under agreements to repurchase | 10 | 3 | |
| Borrowings from Federal Home Loan Bank | 294 | 47 | 131 |
| **Total interest expense** | 2,658 | 1,423 | 1,025 |
| **Net interest income** | 17,092 | 17,080 | 17,468 |
| **Provision for allowance for loan losses** | 122 | 116 | 568 |
| **Net interest income after provision for allowance for loan losses** | 16,970 | 16,964 | 16,900 |
| **Non-interest income:** | | | |
| Trust department income and fees | 1,708 | 1,689 | 1,614 |
| Service charges on deposit accounts | 3,737 | 3,732 | 3,763 |
| Gain on liquidation, sales and calls of securities | | 134 | 158 |
| Gain on sale of other investments | 17 | | |
| Income (loss) on other investments | (274) | 42 | (51) |
| Increase in cash surrender value of life insurance | 455 | 458 | 406 |
| Gain from death benefits from life insurance | | 429 | |
| Other income | 460 | 481 | 659 |
| **Total non-interest income** | 6,103 | 6,965 | 6,549 |
| **Non-interest expense:** | | | |
| Salaries and employee benefits | 10,891 | 10,949 | 11,088 |
| Net occupancy | 2,004 | 2,121 | 2,323 |
| Equipment rentals, depreciation and maintenance | 3,134 | 3,006 | 2,954 |
| Other expense | 6,451 | 6,175 | 6,839 |
| **Total non-interest expense** | 22,480 | 22,251 | 23,204 |
| **Income before income taxes** | 593 | 1,678 | 245 |
| Income tax (benefit) expense | (36) | (1,080) | 78 |
| **Net income** | $ 629 | $ 2,758 | $ 167 |
| **Basic and diluted earnings per share** | $ .13 | $ .54 | $ .03 |
| **Dividends declared per share** | $ .02 | $ .01 | $ |

*See Notes to Consolidated Financial Statements.*

# CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)

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

*See Notes to Consolidated Financial Statements.*

# CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY

*(In thousands except share and per share data)*

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

*See Notes to Consolidated Financial Statements.*

# CONSOLIDATED STATEMENTS OF CASH FLOWS

*(In thousands)*

| YEARS ENDED DECEMBER 31, | 2018 | 2017 | 2016 |
|---|---|---|---|
| **Cash flows from operating activities:** | | | |
| **Net income** | $ 629 | $ 2,758 | $ 167 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | | |
| Depreciation | 1,964 | 1,914 | 1,823 |
| Provision for allowance for loan losses | 122 | 116 | 568 |
| Writedown of other real estate | 764 | 460 | 782 |
| (Gain) loss on sales of other real estate | 21 | 101 | (251) |
| (Income) loss from other investments | 274 | (42) | 51 |
| Gain from death benefits from life insurance | | (429) | |
| Amortization of available for sale securities | 315 | 287 | 30 |
| Amortization of held to maturity securities | 260 | 253 | 181 |
| Gain on liquidation, sales and calls of securities | | (134) | (158) |
| Gain on sales of other investments | (17) | | |
| Increase in cash surrender value of life insurance | (455) | (458) | (406) |
| Change in accrued interest receivable | (52) | (49) | (23) |
| Change in other assets | (57) | (537) | 191 |
| Change in other liabilities | 506 | 717 | 189 |
| **Net cash provided by operating activities** | 4,274 | 4,957 | 3,144 |
| | | | |
| **Cash flows from investing activities:** | | | |
| Proceeds from maturities, liquidation, sales and calls of available for sale securities | 60,222 | 71,315 | 149,715 |
| Purchases of available for sale securities | (39,086) | (83,561) | (183,861) |
| Proceeds from maturities of held to maturity securities | 760 | 7,725 | 510 |
| Purchases of held to maturity securities | (4,455) | (10,991) | (29,816) |
| (Purchase) redemption of Federal Home Loan Bank Stock | (699) | (831) | 1,098 |
| Proceeds from sales of other investments | 125 | | |
| Proceeds from sales of other real estate | 3,211 | 1,666 | 2,775 |
| Loans, net change | 1,461 | 33,531 | 17,127 |
| Acquisition of premises and equipment | (690) | (423) | (1,021) |
| Investment in cash surrender value of life insurance | (85) | (94) | (108) |
| Proceeds from death benefits from life insurance | | 1,929 | |
| **Net cash provided by (used in) investing activities** | 20,764 | 20,266 | (43,581) |
| | | | |
| **Cash flows from financing activities:** | | | |
| Demand and savings deposits, net change | (52,268) | (51,804) | 59,472 |
| Time deposits, net change | (3,796) | 6,358 | 2,837 |
| Cash dividends | (101) | (51) | |
| Retirement of stock | (1,907) | (502) | |
| Borrowings from Federal Home Loan Bank | 1,428,700 | 131,500 | 98,920 |
| Repayments to Federal Home Loan Bank | (1,403,756) | (126,559) | (111,072) |
| **Net cash provided by (used in) financing activities** | (33,128) | (41,058) | 50,157 |
| | | | |
| **Net increase (decrease) in cash and cash equivalents** | (8,090) | (15,835) | 9,720 |
| **Cash and cash equivalents, beginning of year** | 25,281 | 41,116 | 31,396 |
| **Cash and cash equivalents, end of year** | $ 17,191 | $ 25,281 | $ 41,116 |

*See Notes to Consolidated Financial Statements.*

# NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

## NOTE A – BUSINESS AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES:

**Business of The Company**
Peoples Financial Corporation (the "Company") is a one-bank holding company headquartered in Biloxi, Mississippi. Its two operating subsidiaries are The Peoples Bank, Biloxi, Mississippi (the "Bank"), and PFC Service Corp. Its principal subsidiary is the Bank, which provides a full range of banking, financial and trust services to state, county and local government entities and individuals and small and commercial businesses operating in those portions of Mississippi, Louisiana and Alabama which are within a fifty mile radius of the Waveland,Wiggins and Gautier branches, the Bank's three most outlying locations (the "trade area").

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

**Basis of Accounting**
The Company and its subsidiaries recognize assets and liabilities, and income and expense, on the accrual basis of accounting. The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America ("GAAP") requires Management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from these estimates. Material estimates common to the banking industry that are particularly susceptible to significant change in the near term include, but are not limited to, the determination of the allowance for loan losses, the valuation of other real estate acquired in connection with foreclosure or in satisfaction of loans, assumptions relating to employee and director benefit plan liabilities and valuation allowances associated with the realization of deferred tax assets, which are based on future taxable income.

**Revenue Recognition**
As of January 1, 2018, the Company adopted Accounting Standards Update ("ASU") 2014-09, *Revenue from Contracts with Customers (Topic 606)*, using the modified retrospective method. Disclosures of revenue from contracts with customers for periods beginning after January 1, 2018 are presented under ASC Topic 606 and have not materially changed from the prior year amounts. This update prescribes the process related to the recognition of revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. ASU 2014-09 excludes revenue streams relating to loans and investment securities, which are the major source of revenue for the Company, from its scope. As a result, the adoption of the guidance had no material impact on the measurement or recognition of revenue. Consistent with this guidance, the Company recognizes noninterest income within the scope of this guidance as services are transferred to its customers in an amount that reflects the consideration it expects to be entitled to in exchange for those services. Other types of revenue contracts, the income from which is included in non-interest income, that are within the scope of ASU 2014-09 are:

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

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

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

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

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

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

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

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

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

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

ASU 2016-13, *Financial Instruments-Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments*, is intended to provide financial statement users with more decision-useful information related to expected credit losses on financial instruments and other commitments to extend credit by replacing the current incurred loss impairment methodology with a methodology that reflects expected credit losses and requires consideration of a broader range of reasonable and supportable information to determine credit loss estimates. ASU 2016-13 does not specify the method for measuring expected credit losses, and an entity is allowed to apply methods that reasonably reflect its expectations of the credit loss estimate. Additionally, the amendments of ASU 2016-13 require that credit losses on available for sale debt securities be presented as an allowance rather than as a write-down. ASU 2016-13is effective for the Company for interim and annual periods beginning after December 15, 2019 and the Company intends to adopt ASU 2016-13 during the first quarter of 2020. The Company has established a Current Expected Credit Loss (CECL) Committee which include the appropriate members of management, credit administration and accounting to evaluate the impact this ASU will have on the Company's financial position, results of operations and financial statement disclosures and determine the most appropriate method of implementing this ASU. The Company selected a third-party vendor to provide allowance for loan loss software as well as advisory services in developing a new methodology that would be compliant with ASU 2016-13, and is working with the approved third-party vendor to develop the CECL model and evaluate its impact. Management will continue to evaluate the impact this ASU will have on the Company's consolidated financial statements through its effective date.

**Cash and Due from Banks**

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

**Securities**

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

**Other Investments**

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

**Trust Department Income and Fees**
Corporate trust fees are accounted for on an accrual basis and personal trust fees are recorded when the underlying trust is serviced.

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

In the event the future tax consequences of differences between the financial reporting bases and the tax bases of the Company's assets and liabilities results in deferred tax assets, an evaluation of the probability of being able to realize the future benefits indicated by such asset is required. A valuation allowance is provided for the portion of the deferred tax asset when it is more likely than not that some portion or all of the deferred tax asset will not be realized. In assessing the realizability of the deferred tax assets, Management considers the scheduled reversals of deferred tax liabilities, projected future taxable income and tax planning strategies. The Company currently evaluates income tax positions judged to be uncertain. A loss contingency reserve is accrued if it is probable that the tax position will be challenged, it is probable that the future resolution of the challenge will confirm that a loss has been incurred and the amount of such loss can be reasonably estimated.

**Post-Retirement Benefit Plan**

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

**Earnings Per Share**

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

**Accumulated Other Comprehensive Income (Loss)**

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

**Statements of Cash Flows**

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

**Fair Value Measurement**

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

**Reclassifications**

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

**NOTE B – SECURITIES:**

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

| | Amortized Cost | Gross Unrealized Gains | Gross Unrealized Losses | Fair Value |
|---|---|---|---|---|
| December 31, 2018: | | | | |
| Available for sale securities: | | | | |
| U.S. Treasuries | $ 85,866 | $ | $ (2,443) | $ 83,423 |
| U.S. Government agencies | 17,492 | 14 | (259) | 17,247 |
| Mortgage-backed securities | 112,391 | 231 | (2,278) | 110,344 |
| States and political subdivisions | 10,994 | 102 | | 11,096 |
| Total available for sale securities | $ 226,743 | $ 347 | $ (4,980) | $ 222,110 |
| Held to maturity securities: | | | | |
| U.S. Government agencies | $ 8,185 | $ | $ (371) | $ 7,814 |
| States and political subdivisions | 46,413 | 89 | (857) | 45,645 |
| Total held to maturity securities | $ 54,598 | $ 89 | $ (1,228) | $ 53,459 |
| December 31, 2017: | | | | |
| Available for sale securities: | | | | |
| U.S. Treasuries | $ 124,820 | $ | $ (2,176) | $ 122,644 |
| U.S. Government agencies | 19,989 | | (158) | 19,831 |
| Mortgage-backed securities | 89,207 | 96 | (1,042) | 88,261 |
| States and political subdivisions | 14,178 | 292 | | 14,470 |
| Total available for sale securities | $ 248,194 | $ 388 | $ (3,376) | $ 245,206 |
| Held to maturity securities: | | | | |
| U.S. Government agencies | $ 8,185 | $ | $ (302) | $ 7,883 |
| States and political subdivisions | 42,978 | 227 | (550) | 42,655 |
| Total held to maturity securities | $ 51,163 | $ 227 | $ (852) | $ 50,538 |

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

| | Amortized Cost | Fair Value |
|---|---|---|
| Available for sale securities: | | |
| Due in one year or less | $ 28,177 | $ 27,975 |
| Due after one year through five years | 77,778 | 75,719 |
| Due after five years through ten years | 5,563 | 5,213 |
| Due after ten years | 2,834 | 2,859 |
| Mortgage-backed securities | 112,391 | 110,344 |
| **Total** | $ 226,743 | $ 222,110 |
| Held to maturity securities: | | |
| Due in one year or less | $ 2,523 | $ 2,522 |
| Due after one year through five years | 19,769 | 19,569 |
| Due after five years through ten years | 18,316 | 17,895 |
| Due after ten years | 13,990 | 13,473 |
| **Total** | $ 54,598 | $ 53,459 |

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

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

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

Management evaluates securities for other-than-temporary impairment on a monthly basis. In performing this evaluation, the length of time and the extent to which the fair value has been less than cost, the fact that the Company's securities are primarily issued by U.S. Treasury and U.S. Government agencies and the cause of the decline in value are considered. In addition, the Company does not intend to sell and it is not more likely than not that we will be required to sell these securities before maturity. While some available for sale securities have been sold for liquidity purposes or for gains, the Company has traditionally held its securities, including those classified as available for sale, until maturity. As a result of this evaluation, the Company has determined that the declines summarized in the tables above are not deemed to be other-than temporary.

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

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

**NOTE C – LOANS:**

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

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

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

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

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

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

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

| | Number of Days Past Due | | | | | | Loans Past Due Greater Than 90 Days and Still |
|---|---|---|---|---|---|---|---|
| | 30-59 | 60-89 | Greater Than 90 | Total Past Due | Current | Total Loans | Accruing |
| December 31, 2018: | | | | | | | |
| Gaming | $ | $ | $ | $ | $ 25,767 | $ 25,767 | $ |
| Residential and land development | | | | | 298 | 298 | |
| Real estate, construction | 1,987 | 340 | 860 | 3,187 | 30,744 | 33,931 | |
| Real estate, mortgage | 2,866 | 7,129 | 1,730 | 11,725 | 167,192 | 178,917 | 51 |
| Commercial and industrial | 9 | 110 | 1,661 | 1,780 | 25,725 | 27,505 | 4 |
| Other | 107 | 3 | | 110 | 6,818 | 6,928 | |
| Total | $ 4,969 | $ 7,582 | $ 4,251 | $ 16,802 | $ 256,544 | $ 273,346 | $ 55 |
| December 31, 2017: | | | | | | | |
| Gaming | $ | $ | $ | $ | $ 26,142 | $ 26,142 | $ |
| Residential and land development | | | | | 263 | 263 | |
| Real estate, construction | 747 | 121 | 522 | 1,390 | 30,557 | 31,947 | |
| Real estate, mortgage | 5,321 | 790 | 4,884 | 10,995 | 178,206 | 189,201 | |
| Commercial and industrial | 375 | 2 | 2,344 | 2,721 | 23,639 | 26,360 | |
| Other | 26 | 3 | | 29 | 6,507 | 6,536 | |
| Total | $ 6,469 | $ 916 | $ 7,750 | $ 15,135 | $ 265,314 | $ 280,449 | $ |

The Company monitors the credit quality of its loan portfolio through the use of a loan grading system. A score of 1 – 5 is assigned to the loan based on factors including repayment ability, trends in net worth and/or financial condition of the borrower and guarantors, employment stability, management ability, loan to value fluctuations, the type and structure of the loan, conformity of the loan to bank policy and payment performance. Based on the total score, a loan grade of A, B, C, S, D, E or F is applied. A grade of A will generally be applied to loans for customers that are well known to the Company and that have excellent sources of repayment. A grade of B will generally be applied to loans for customers that have excellent sources of repayment which have no identifiable risk of collection. A grade of C will generally be applied to loans for customers that have adequate sources of repayment which have little identifiable risk of collection. A grade of S will generally be applied to loans for customers who meet the criteria for a grade of C but also warrant additional monitoring by placement on the watch list. A grade of D will generally be applied to loans for customers that are inadequately protected by current sound net worth, paying capacity of the borrower, or pledged collateral. Loans with a grade of D have unsatisfactory characteristics such as cash flow deficiencies, bankruptcy filing by the borrower or dependence on the sale of collateral for the primary source of repayment, causing more than acceptable levels of risk. Loans 60 to 89 days past due receive a grade of D. A grade of E will generally be applied to loans for customers with weaknesses inherent in the D classification and in which collection or liquidation in full is questionable. In addition, on a monthly basis the Company determines which loans are 90 days or more past due and assigns a grade of E to them. A grade of F is applied to loans which are considered uncollectible and of such little value that their continuance in an active bank is not warranted. Loans with this grade are charged off, even though partial or full recovery may be possible in the future.

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

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

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

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

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

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

| | Unpaid Principal Balance | Recorded Investment | Related Allowance | Average Recorded Investment | Interest Income Recognized |
|---|---|---|---|---|---|
| December 31, 2018: | | | | | |
| With no related allowance recorded: | | | | | |
| Real estate, construction | $ 1,171 | $ 784 | $ | $ 785 | $ |
| Real estate, mortgage | 5,508 | 5,474 | | 5,826 | 29 |
| Commercial and industrial | 2,083 | 1,855 | | 2,204 | |
| Other | 2 | 2 | | 3 | |
| Total | 8,764 | 8,115 | | 8,818 | 29 |
| With a related allowance recorded: | | | | | |
| Residential and land development | 233 | 233 | 20 | 246 | |
| Real estate, construction | 509 | 422 | 263 | 387 | |
| Real estate, mortgage | 574 | 574 | 101 | 589 | 25 |
| Total | 1,316 | 1,229 | 384 | 1,222 | 25 |
| Total by class of loans: | | | | | |
| Residential and land development | 233 | 233 | 20 | 246 | |
| Real estate, construction | 1,680 | 1,206 | 263 | 1,172 | |
| Real estate, mortgage | 6,082 | 6,048 | 101 | 6,415 | 54 |
| Commercial and industrial | 2,083 | 1,855 | | 2,204 | |
| Other | 2 | 2 | | 3 | |
| Total | $ 10,080 | $ 9,344 | $ 384 | $ 10,040 | $ 54 |
| December 31, 2017: | | | | | |
| With no related allowance recorded: | | | | | |
| Real estate, construction | $ 1,441 | $ 967 | $ | $ 1,024 | $ |
| Real estate, mortgage | 8,920 | 8,025 | | 8,654 | 31 |
| Commercial and industrial | 922 | 884 | | 916 | |
| Other | 4 | 4 | | 4 | |
| Total | 11,287 | 9,880 | | 10,598 | 31 |
| With a related allowance recorded: | | | | | |
| Residential and land development | 263 | 263 | 40 | 275 | |
| Real estate, construction | 210 | 210 | 105 | 226 | |
| Real estate, mortgage | 3,556 | 2,672 | 725 | 2,676 | 28 |
| Commercial and industrial | 1,934 | 1,934 | 342 | 1,923 | |
| Total | 5,963 | 5,079 | 1,212 | 5,100 | 28 |
| Total by class of loans: | | | | | |
| Residential and land development | 263 | 263 | 40 | 275 | |
| Real estate, construction | 1,651 | 1,177 | 105 | 1,250 | |
| Real estate, mortgage | 12,476 | 10,697 | 725 | 11,330 | 59 |
| Commercial and industrial | 2,856 | 2,818 | 342 | 2,839 | |
| Other | 4 | 4 | | 4 | |
| Total | $ 17,250 | $ 14,959 | $ 1,212 | $ 15,698 | $ 59 |

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

| | Gaming | Residential and Land Development | Real Estate, Construction | Real Estate, Mortgage | Commercial and Industrial | Other | Total |
|---|---|---|---|---|---|---|---|
| December 31, 2018: | | | | | | | |
| Allowance for Loan Losses: | | | | | | | |
| Beginning Balance | $ 536 | $ 40 | $ 202 | $ 4,305 | $ 892 | $ 178 | $ 6,153 |
| Charge-offs | | | | (715) | (372) | (323) | (1,410) |
| Recoveries | | | 17 | 188 | 112 | 158 | 475 |
| Provision | (120) | (6) | 176 | 108 | (156) | 120 | 122 |
| Ending Balance | $ 416 | $ 34 | $ 395 | $ 3,886 | $ 476 | $ 133 | $ 5,340 |
| Allowance for Loan Losses: | | | | | | | |
| Ending balance: individually evaluated for impairment | $ | $ 20 | $ 263 | $ 322 | $ 120 | $ 3 | $ 728 |
| Ending balance: collectively evaluated for impairment | $ 416 | $ 14 | $ 132 | $ 3,564 | $ 356 | $ 130 | $ 4,612 |
| Total Loans: | | | | | | | |
| Ending balance: individually evaluated for impairment | $ 4,687 | $ 233 | $ 1,434 | $ 18,122 | $ 2,170 | $ 24 | $ 26,670 |
| Ending balance: collectively evaluated for impairment | $ 21,080 | $ 65 | $ 32,497 | $ 160,795 | $ 25,335 | $ 6,904 | $ 246,676 |
| December 31, 2017: | | | | | | | |
| Allowance for Loan Losses: | | | | | | | |
| Beginning Balance | $ 545 | $ 66 | $ 199 | $ 3,800 | $ 651 | $ 205 | $ 5,466 |
| Charge-offs | | | | (8) | (36) | (235) | (279) |
| Recoveries | | 686 | 32 | 29 | 11 | 92 | 850 |
| Provision | (9) | (712) | (29) | 484 | 266 | 116 | 116 |
| Ending Balance | $ 536 | $ 40 | $ 202 | $ 4,305 | $ 892 | $ 178 | $ 6,153 |
| Allowance for Loan Losses: | | | | | | | |
| Ending balance: individually evaluated for impairment | $ | $ 40 | $ 105 | $ 1,082 | $ 636 | $ 6 | $ 1,869 |
| Ending balance: collectively evaluated for impairment | $ 536 | $ | $ 97 | $ 3,223 | $ 256 | $ 172 | $ 4,284 |
| Total Loans: | | | | | | | |
| Ending balance: individually evaluated for impairment | $ | $ 263 | $ 1,536 | $ 29,367 | $ 3,228 | $ 18 | $ 34,412 |
| Ending balance: collectively evaluated for impairment | $ 26,142 | $ | $ 30,411 | $ 159,834 | $ 23,132 | $ 6,518 | $ 246,037 |
| December 31, 2016: | | | | | | | |
| Allowance for Loan Losses: | | | | | | | |
| Beginning Balance | $ 582 | $ 189 | $ 589 | $ 5,382 | $ 1,075 | $ 253 | $ 8,070 |
| Charge-offs | | | (260) | (2,499) | (509) | (254) | (3,522) |
| Recoveries | | | 71 | 107 | 62 | 110 | 350 |
| Provision | (37) | (123) | (201) | 810 | 23 | 96 | 568 |
| Ending Balance | $ 545 | $ 66 | $ 199 | $ 3,800 | $ 651 | $ 205 | $ 5,466 |
| Allowance for Loan Losses: | | | | | | | |
| Ending balance: individually evaluated for impairment | $ | $ 66 | $ 141 | $ 424 | $ 214 | $ 15 | $ 860 |
| Ending balance: collectively evaluated for impairment | $ 545 | $ | $ 58 | $ 3,376 | $ 437 | $ 190 | $ 4,606 |
| Total Loans: | | | | | | | |
| Ending balance: individually evaluated for impairment | $ | $ 291 | $ 2,114 | $ 32,850 | $ 1,430 | $ 47 | $ 36,732 |
| Ending balance: collectively evaluated for impairment | $ 31,311 | $ | $ 30,389 | $ 173,322 | $ 35,605 | $ 7,996 | $ 278,623 |

## NOTE D – BANK PREMISES AND EQUIPMENT:

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

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

## NOTE E – OTHER REAL ESTATE:

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

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

## NOTE F – DEPOSITS:

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

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

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

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

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

## NOTE G – FEDERAL FUNDS PURCHASED:

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

## NOTE H – BORROWINGS:

At December 31, 2018, the Company was able to borrow up to $17,638,095 from the Federal Reserve Bank Discount Window Primary Credit Program. The borrowing limit is based on the amount of collateral pledged, with certain loans from the Bank's portfolio serving as collateral. Borrowings bear interest at the primary credit rate, which is established periodically by the Federal Reserve Board, and have a maturity of one day. The primary credit rate was 3.00% at December 31, 2018. There was no outstanding balance at December 31, 2018.

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

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

## NOTE I – INCOME TAXES:

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

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

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

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

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

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

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

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

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

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

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

## NOTE J – SHAREHOLDERS’ EQUITY:

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

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

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

On April 25, 2018, the Board declared a dividend of $.01 per share payable May 10, 2018 to shareholders of record as of May 7, 2018. On

September 26, 2018, the Board declared a dividend of $.01 per share payable on October 15, 2018 to shareholders of record as of October 9, 2018.

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

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

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

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

| | Actual | | For Capital Adequacy Purposes | |
|---|---|---|---|---|
| | Amount | Ratio | Amount | Ratio |
| December 31, 2018: | | | | |
| Total Capital (to Risk Weighted Assets) | $ 95,627 | 25.30% | $ 30,240 | 8.00% |
| Common Equity Tier 1 Capital (to Risk Weighted Assets) | 90,894 | 24.05% | 17,010 | 4.50% |
| Tier 1 Capital (to Risk Weighted Assets) | 90,894 | 24.05% | 22,680 | 6.00% |
| Tier 1 Capital (to Average Assets) | 90,894 | 14.35% | 25,344 | 4.00% |
| December 31, 2017: | | | | |
| Total Capital (to Risk Weighted Assets) | $ 97,122 | 25.12% | $ 30,930 | 8.00% |
| Common Equity Tier 1 Capital (to Risk Weighted Assets) | 92,273 | 23.87% | 17,398 | 4.50% |
| Tier 1 Capital (to Risk Weighted Assets) | 92,273 | 23.87% | 23,197 | 6.00% |
| Tier 1 Capital (to Average Assets) | 92,273 | 13.79% | 26,769 | 4.00% |

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

| | Actual | | For Capital Adequacy Purposes | | To Be Well Capitalized | |
|---|---|---|---|---|---|---|
| | Amount | Ratio | Amount | Ratio | Amount | Ratio |
| December 31, 2018: | | | | | | |
| Total Capital (to Risk Weighted Assets) | $ 92,485 | 24.61% | $ 30,062 | 8.00% | $ 37,577 | 10.00% |
| Common Equity Tier 1 Capital (to Risk Weighted Assets) | 87,780 | 23.36% | 16,910 | 4.50% | 24,425 | 6.50% |
| Tier 1 Capital (to Risk Weighted Assets) | 87,780 | 23.36% | 22,546 | 6.00% | 30,062 | 8.00% |
| Tier 1 Capital (to Average Assets) | 87,780 | 14.11% | 24,884 | 4.00% | 31,105 | 5.00% |
| December 31, 2017: | | | | | | |
| Total Capital (to Risk Weighted Assets) | $ 92,493 | 24.04% | $ 30,778 | 8.00% | $ 38,473 | 10.00% |
| Common Equity Tier 1 Capital (to Risk Weighted Assets) | 87,668 | 22.79% | 17,313 | 4.50% | 25,007 | 6.50% |
| Tier 1 Capital (to Risk Weighted Assets) | 87,668 | 22.79% | 23,084 | 6.00% | 30,778 | 8.00% |
| Tier 1 Capital (to Average Assets) | 87,668 | 13.47% | 26,031 | 4.00% | 32,539 | 5.00% |

## NOTE K – OTHER INCOME AND EXPENSES:

Other income consisted of the following (in thousands):

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

Other expenses consisted of the following (in thousands):

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

## NOTE L – FINANCIAL INSTRUMENTS WITH OFF-BALANCE-SHEET RISK:

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

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

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

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

## NOTE M – CONTINGENCIES:

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

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

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

### CONDENSED BALANCE SHEETS (IN THOUSANDS):

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

### CONDENSED STATEMENTS OF INCOME (IN THOUSANDS):

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

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

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

## NOTE O – EMPLOYEE AND DIRECTOR BENEFIT PLANS:

The Company sponsors the Peoples Financial Corporation Employee Stock Ownership Plan ("ESOP"). Employees who are in a position requiring at least 1,000 hours of service during a plan year and who are 21 years of age are eligible to participate in the ESOP. The Plan included 401(k) provisions and the former Gulf National Bank Profit Sharing Plan. Effective January 1, 2001, the ESOP was amended to separate the 401(k)

funds into the Peoples Financial Corporation 401(k) Profit Sharing Plan. The separation had no impact on the eligibility or benefits provided to participants of either plan. The 401(k) provides for a matching contribution of 75% of the amounts contributed by the employee (up to 6% of compensation). Contributions are determined by the Board of Directors and may be paid either in cash or Peoples Financial Corporation common stock. Total contributions to the plans charged to operating expense were $260,000, $260,000 and $276,000 in 2018, 2017 and 2016, respectively.

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

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

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

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

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

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

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

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

The discount rate used in determining the accumulated post-retirement benefit obligation was 4.30% in 2018, 3.60% in 2017 and 4.00% in 2016. The assumed health care cost trend rate used in measuring the accumulated post-retirement benefit obligation was 6.00% in 2018. The rate was assumed to decrease gradually to 4.50% for 2024 and remain at that level thereafter. If the health care cost trend rate assumptions were increased 1.00%, the accumulated post-retirement benefit obligation as of December 31, 2018, would be increased by 18.73%, and the aggregate of the service and interest cost components of the net periodic post-retirement benefit cost for the year then ended would have increased by 23.45%. If the health care cost trend rate assumptions were decreased 1.00%, the accumulated post-retirement benefit obligation as of December 31, 2018, would be decreased by 14.93%, and the aggregate of the service and interest cost components of the net periodic post-retirement benefit cost for the year then ended would have decreased by 17.91%.

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

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

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

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

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

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

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

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

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

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

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

## NOTE P – FAIR VALUE MEASUREMENTS AND DISCLOSURES:

The Company utilizes fair value measurements to record fair value adjustments to certain assets and liabilities and to determine fair value disclosures. Available for sale securities are recorded at fair value on a recurring basis. Additionally, from time to time, the Company may be required to record other assets at fair value on a non-recurring basis, such as impaired loans and ORE. These non-recurring fair value adjustments typically involve the application of lower of cost or market accounting or write-downs of individual assets. Additionally, the Company is required to disclose, but not record, the fair value of other financial instruments.

**Fair Value Hierarchy**

The Company groups assets and liabilities at fair value in three levels, based on the markets in which the assets and liabilities are traded and the reliability of the assumptions used to determine fair value. These levels are:

Level 1 - Valuation is based upon quoted prices for identical instruments traded in active markets.

Level 2 - Valuation is based upon quoted market prices for similar instruments in active markets, quoted prices for identical or similar instruments in markets that are not active and model-based valuation techniques for which all significant assumptions are observable in the market.

Level 3 - Valuation is generated from model-based techniques that use at least one significant assumption not observable in the market. These unobservable assumptions reflect estimates of assumptions that market participants would use in pricing the asset or liability. Valuation techniques include the use of option pricing models, discounted cash flow models and similar techniques.

Following is a description of valuation methodologies used to determine the fair value of financial assets and liabilities.

**Cash and Due from Banks**
The carrying amount shown as cash and due from banks approximates fair value.

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

**Held to Maturity Securities**
The fair value of held to maturity securities is based on quoted market prices.

**Other Investments**
The carrying amount shown as other investments approximates fair value.

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

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

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

**Cash Surrender Value of Life Insurance**
The carrying amount of cash surrender value of bank-owned life insurance approximates fair value.

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

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

The balances of available for sale securities, which are the only assets measured at fair value on a recurring basis, by level within the fair value hierarchy and by investment type, as of December 31, 2018 and 2017, were as follows (in thousands):

| | | Fair Value Measurements Using | | |
|---|---|---|---|---|
| | Total | Level 1 | Level 2 | Level 3 |
| December 31, 2018: | | | | |
| U.S. Treasuries | $ 83,423 | $ | $ 83,423 | $ |
| U.S. Government agencies | 17,247 | | 17,247 | |
| Mortgage-backed securities | 110,344 | | 110,344 | |
| States and political subdivisions | 11,096 | | 11,096 | |
| Total | $ 222,110 | $ | $ 222,110 | $ |

| December 31, 2017: | Total | Fair Value Measurements Using Level 1 | Level 2 | Level 3 |
|---|---|---|---|---|
| U.S. Treasuries | $ 122,644 | $ | $ 122,644 | $ |
| U.S. Government agencies | 19,831 | | 19,831 | |
| Mortgage-backed securities | 88,261 | | 88,261 | |
| States and political subdivisions | 14,470 | | 14,470 | |
| Total | $ 245,206 | $ | $ 245,206 | $ |

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

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

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

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

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

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

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

| | | Fair Value Measurements Using | | | |
|---|---|---|---|---|---|
| | Carrying Amount | Level 1 | Level 2 | Level 3 | Total |
| December 31, 2018: | | | | | |
| Financial Assets: | | | | | |
| Cash and due from banks | $ 17,191 | $ 17,191 | $ | $ | $ 17,191 |
| Available for sale securities | 222,110 | | 222,110 | | 222,110 |
| Held to maturity securities | 54,598 | | 53,459 | | 53,459 |
| Other investments | 2,811 | 2,811 | | | 2,811 |
| Federal Home Loan Bank stock | 2,069 | | 2,069 | | 2,069 |
| Loans, net | 268,006 | | | 260,560 | 260,560 |
| Other real estate | 8,943 | | | 8,943 | 8,943 |
| Cash surrender value of life insurance | 18,841 | | 18,841 | | 18,841 |
| Financial Liabilities: | | | | | |
| Deposits: | | | | | |
| Non-interest bearing | 114,512 | 114,512 | | | 114,512 |
| Interest bearing | 358,994 | | | 359,386 | 359,386 |
| Borrowings from | | | | | |
| Federal Home Loan Bank | 36,142 | | 36,211 | | 36,211 |
| | | | | | |
| December 31, 2017: | | | | | |
| Financial Assets: | | | | | |
| Cash and due from banks | $ 25,281 | $ 25,281 | $ | $ | $ 25,281 |
| Available for sale securities | 245,206 | | 245,206 | | 245,206 |
| Held to maturity securities | 51,163 | | 50,538 | | 50,538 |
| Other investments | 3,193 | 3,193 | | | 3,193 |
| Federal Home Loan Bank stock | 1,370 | | 1,370 | | 1,370 |
| Loans, net | 274,296 | | | 270,924 | 270,924 |
| Other real estate | 8,232 | | | 8,232 | 8,232 |
| Cash surrender value of life insurance | 18,301 | | 18,301 | | 18,301 |
| Financial Liabilities: | | | | | |
| Deposits: | | | | | |
| Non-interest bearing | 127,274 | 127,274 | | | 127,274 |
| Interest bearing | 402,296 | | | 402,610 | 402,610 |
| Borrowings from | | | | | |
| Federal Home Loan Bank | 11,198 | | 11,389 | | 11,389 |

## REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Shareholders and Board of Directors
Peoples Financial Corporation
Biloxi, Mississippi

**Opinion on the Financial Statements**

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

**Basis for Opinion**

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

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

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

Porter Keadle Moore, LLC

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

Atlanta, Georgia
March 13, 2019

# FIVE-YEAR COMPARATIVE SUMMARY OF SELECTED FINANCIAL INFORMATION

**(In thousands except per share data)**

| | 2018 | 2017 | 2016 | 2015 | 2014 |
|---|---|---|---|---|---|
| **Balance Sheet Summary** | | | | | |
| Total assets | $ 616,786 | $ 650,424 | $ 688,014 | $ 641,004 | $ 668,895 |
| Available for sale securities | 222,110 | 245,206 | 233,578 | 202,807 | 215,122 |
| Held to maturity securities | 54,598 | 51,163 | 48,150 | 19,025 | 17,784 |
| Loans, net of unearned discount | 273,346 | 280,449 | 315,355 | 337,557 | 362,407 |
| Deposits | 473,506 | 529,570 | 575,016 | 512,707 | 516,920 |
| Borrowings from FHLB | 36,142 | 11,198 | 6,257 | 18,409 | 38,708 |
| Shareholders' equity | 86,934 | 89,499 | 88,461 | 91,839 | 94,951 |
| **Summary of Operations** | | | | | |
| Interest income | $ 19,750 | $ 18,503 | $ 18,493 | $ 19,311 | $ 22,156 |
| Interest expense | 2,658 | 1,423 | 1,025 | 875 | 1,441 |
| Net interest income | 17,092 | 17,080 | 17,468 | 18,436 | 20,715 |
| Provision for loan losses | 122 | 116 | 568 | 2,582 | 7,404 |
| Net interest income after provision for loan losses | 16,970 | 16,964 | 16,900 | 15,854 | 13,311 |
| Non-interest income | 6,103 | 6,965 | 6,549 | 6,898 | 8,619 |
| Non-interest expense | 22,480 | 22,251 | 23,204 | 28,106 | 27,208 |
| Income (loss) before taxes | 593 | 1,678 | 245 | (5,354) | (5,278) |
| Income tax expense (benefit) | (36) | (1,080) | 78 | (762) | 4,726 |
| Net income (loss) | $ 629 | $ 2,758 | $ 167 | $ (4,592) | $ (10,004) |
| **Per Share Data** | | | | | |
| Basic and diluted earnings (loss) per share | $ .13 | $ .54 | $ .03 | $ (.90) | $ (1.95) |
| Dividends per share | .02 | .01 | | | .10 |
| Book value | 17.59 | 17.84 | 17.27 | 17.93 | 18.53 |
| Weighted average number of shares | 5,031,778 | 5,123,076 | 5,123,186 | 5,123,186 | 5,123,186 |
| **Selected Ratios** | | | | | |
| Return on average assets | 0.10% | 0.41% | 0.02% | (.69%) | (1.38%) |
| Return on average equity | 0.71% | 3.08% | 0.19% | (4.92%) | (10.31%) |
| Primary capital to average assets | 14.43% | 14.34% | 13.99% | 15.06% | 14.38% |
| Risk-based capital ratios: | | | | | |
| Tier 1 | 24.05% | 23.87% | 21.69% | 20.58% | 20.70% |
| Total | 25.30% | 25.12% | 22.94% | 21.83% | 21.95% |

# CORPORATE INFORMATION AND MARKET INFORMATION

## Corporate Information:

**Mailing Address**
P. O. Box 529
Biloxi, MS 39533-0529

**Physical Address**
152 Lameuse Street
Biloxi, MS 39530
(228) 435-8205

**Website**
www.thepeoples.com

**Corporate Stock**
The common stock of Peoples Financial Corporation is traded on the OTCQX Best Market under the symbol: PFBX.

**S.E.C. Form 10-K Requests**
A copy of the Annual Report on Form 10-K, as filed with the Securities and Exchange Commission, may be obtained without charge by directing a written request to:

Lauri A. Wood, Chief Financial Officer and Controller
Peoples Financial Corporation
P. O. Box 529, Biloxi, Mississippi 39533-0529
(228) 435-8412
e-mail: lwood@thepeoples.com

**Shareholder Information**
For investor relations and general information about Peoples Financial Corporation:

Paul D. Guichet, Vice-President
The Peoples Bank, Biloxi, Mississippi
P.O. Box 529, Biloxi, MS 39533-0529
(228) 435-8761
e-mail: investorrelations@thepeoples.com

For information about the common stock of Peoples Financial Corporation, including dividend reinvestment and other transfer agent inquiries:

Asset Management and Trust Services Department
The Peoples Bank, Biloxi, Mississippi
P.O. Box 1416, Biloxi, MS 39533-1416
(228) 435-8208
e-mail: investorrelations@thepeoples.com

**Independent Registered Public Accounting Firm**
Porter Keadle Moore, LLC
Atlanta, Georgia

## Market Information:

The Company's stock is traded under the symbol PFBX. Until December 15, 2017, the stock was traded on the NASDAQ Capital Market ("NASDAQ"). To reduce costs, the Company delisted from NASDAQ and began trading on the OTCQX Best Market ("OTCQX") on December 18, 2017. As of January 31, 2019, there were approximately 445 holders of the Company's common stock, which does not reflect persons or entities that hold our common stock in nominee or "street" name through various brokerage firms. At that date, the Company had 4,943,186 shares of common stock issued and outstanding.

The following is a summary of the high and low bid prices of our common stock for the periods indicated as reported by NASDAQ for all quarters in 2017 and by OCTQX for the fourth quarter of 2017 and for all quarters of 2018. The quotations reflect inter-dealer prices, without retail mark-up, mark-down or commission and may not necessarily represent actual transactions.

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

# BRANCH LOCATIONS

*The Peoples Bank, Biloxi, Mississippi*

**BILOXI BRANCHES**

**Main**
152 Lameuse Street, Biloxi, Mississippi 39530
(228) 435-5511

**Asset Management and Trust Department**
**Personal and Corporate Trust Services**
758 Vieux Marche, Biloxi, Mississippi 39530
(228) 435-8208

**Cedar Lake**
1740 Popps Ferry Road, Biloxi, Mississippi 39532
(228) 435-8688

**Keesler Air Force Base**
1507 Meadows Drive
Keesler AFB, MS 39534
(228) 435-8690

**West Biloxi**
2560 Pass Road, Biloxi, Mississippi 39531
(228) 435-8203

**GULFPORT BRANCHES**

**Armed Forces Retirement Home**
1800 Beach Drive, Gulfport, Mississippi 39507
(228) 897-8724

**Downtown Gulfport**
1105 30th Avenue, Gulfport, Mississippi 39501
(228) 897-8715

**Handsboro**
0412 E. Pass Road, Gulfport, Mississippi 39507
(228) 897-8717

**Orange Grove**
12020 Highway 49 North, Gulfport, Mississippi 39503
(228) 897-8718

**OTHER BRANCHES**

**Bay St. Louis**
408 Highway 90 East, Bay St. Louis, Mississippi 39520
(228) 897-8710

**Diamondhead**
5429 West Aloha Drive, Diamondhead, Mississippi 39525
(228) 897-8714

**D’Iberville - St. Martin**
10491 Lemoyne Boulevard, D’Iberville, Mississippi 39540
(228) 435-8202

**Gautier**
2609 Highway 90, Gautier, Mississippi 39553
(228) 497-1766

**Long Beach**
298 Jeff Davis Avenue, Long Beach, Mississippi 39560
(228) 897-8712

**Ocean Springs**
2015 Bienville Boulevard, Ocean Springs, Mississippi 39564
(228) 435-8204

**Pass Christian**
301 East Second Street, Pass Christian, Mississippi 39571
(228) 897-8719

**Saucier**
17689 Second Street, Saucier, Mississippi 39574
(228) 897-8716

**Waveland**
470 Highway 90, Waveland, Mississippi 39576
(228) 467-7257

**Wiggins**
1312 S. Magnolia Drive, Wiggins, Mississippi 39577
(228) 897-8722

# BOARD OF DIRECTORS AND EXECUTIVE OFFICERS

## BOARD OF DIRECTORS

**Peoples Financial Corporation**

Chevis C. Swetman, *Chairman; President and Chief Executive Officer, Peoples Financial Corporation and The Peoples Bank, Biloxi, Mississippi*

Dan Magruder, *Vice-Chairman; Retired Business Executive*

Drew Allen, *President, Allen Beverages, Inc*.

Rex E. Kelly, *Principal, Strategic Communications*

Jeffrey H. O'Keefe, *Chairman, Bradford-O'Keefe Funeral Homes, Inc.*

## OFFICERS

**Peoples Financial Corporation**

Chevis C. Swetman, *President and Chief Executive Officer*

A. Wes Fulmer, *Executive Vice-President*

Ann F. Guice, *First Vice-President*

J. Patrick Wild, *Second Vice-President*

Evelyn R. Herrington, *Vice-President and Secretary*

Lauri A. Wood, *Chief Financial Officer and Controller*

## BOARD OF DIRECTORS

**The Peoples Bank, Biloxi, Mississippi**

Chevis C. Swetman, *Chairman; President and Chief Executive Officer, Peoples Financial Corporation and The Peoples Bank, Biloxi, Mississippi*

Liz Corso Joachim, *Vice-Chairperson; President, Frank P. Corso, Inc.*

Drew Allen, *President, Allen Beverages, Inc.*

Ron Barnes, *President and CEO, Coast Electric Power Association*

Padrick D. Dennis, *Vice President, Specialty Contractors & Associates, Inc.*

A. Wes Fulmer, *Executive Vice-President, Peoples Financial Corporation and The Peoples Bank, Biloxi, Mississippi*

Rex E. Kelly, *Principal, Strategic Communications*

Dan Magruder, *Retired Business Executive*

Jeffrey H. O'Keefe, *Chairman, Bradford-O'Keefe Funeral Homes, Inc*.

Paige Reed Riley, *Owner, Hillyer House*

George J. Sliman, III, *President, SunStates Holdings, Inc.*

A. Tanner Swetman, *Vice President, The Peoples Bank, Biloxi, Mississippi*

## SENIOR MANAGEMENT

**The Peoples Bank, Biloxi, Mississippi**

Chevis C. Swetman, *President and Chief Executive Officer*

A. Wes Fulmer, *Executive Vice-President*

Lauri A. Wood, *Senior Vice-President and Cashier*

Ann F. Guice, *Senior Vice-President*

J. Patrick Wild, *Senior Vice-President*

Evelyn R. Herrington, *Senior Vice-President*