

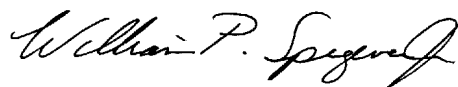
# THIRD QUARTER 2009

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## CERTIFICATION

The undersigned certify that we have reviewed the September 30, 2009 quarterly report of AgSouth Farm Credit, ACA, that the report has been prepared under the oversight of the Audit Committee of the Board of Directors and in accordance with all applicable statutory or regulatory requirements, and that the information contained herein is true, accurate, and complete to the best of our knowledge and belief.



William P. Spigener, Jr.  
Chief Executive Officer



Alisa D. Gunter  
Chief Financial Officer



Thomas H. Coward  
Chairman of the Board

October 27, 2009

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*AgSouth Farm Credit, ACA*

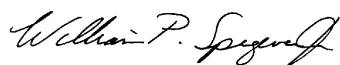
# Report on Internal Control Over Financial Reporting

The Association's principal executives and principal financial officers, or persons performing similar functions, are responsible for establishing and maintaining adequate internal control over financial reporting for the Association's Consolidated Financial Statements. For purposes of this report, "internal control over financial reporting" is defined as a process designed by, or under the supervision of the Association's principal executives and principal financial officers, or persons performing similar functions, and effected by its Board of Directors, management and other personnel. This process provides reasonable assurance regarding the reliability of financial reporting information and the preparation of the Consolidated Financial Statements for external purposes in accordance with accounting principles generally accepted in the United States of America.

Internal control over financial reporting includes those policies and procedures that: (1) pertain to the maintenance of records that in reasonable detail accurately and fairly reflect the transactions and dispositions of the assets of the Association, (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial information in accordance with accounting principles generally accepted in the United States of America, and that receipts and expenditures are being made only in accordance with authorizations of management and directors of the Association, and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of the Association's assets that could have a material effect on its Consolidated Financial Statements.

The Association's management has completed an assessment of the effectiveness of internal control over financial reporting as of September 30, 2009. In making the assessment, management used the framework in *Internal Control — Integrated Framework*, promulgated by the Committee of Sponsoring Organizations of the Treadway Commission, commonly referred to as the "COSO" criteria.

Based on the assessment performed, the Association concluded that as of September 30, 2009, the internal control over financial reporting was effective based upon the COSO criteria. Additionally, based on this assessment, the Association determined that there were no material weaknesses in the internal control over financial reporting as of September 30, 2009.



William P. Spigener  
Chief Executive Officer



Alisa D. Gunter  
Chief Financial Officer

October 27, 2009

# Management's Discussion and Analysis of Financial Condition and Results of Operations

*(dollars in thousands)*

The following commentary reviews the financial condition and results of operations of AgSouth Farm Credit, ACA (Association) for the period ended September 30, 2009. This information should be read in conjunction with the accompanying financial statements, notes to the financial statements, and the 2008 Annual Report of AgSouth Farm Credit. The accompanying consolidated financial statements were prepared under the oversight of the Audit Committee of the Board of Directors.

The Association is not immune to the current level of stress in the financial services industry. The following report reflects how the dynamics of the general economy have affected the Association's balance sheet and income statement. The news is not all negative. The Association's earnings are strong and significant and while they may fall below the 2008 level of profitability, the Board and management are proud of these financial results.

## **FORWARD LOOKING INFORMATION**

This quarterly report contains forward-looking statements. These statements are not guarantees of future performance and involve certain risks, uncertainties and assumptions that are difficult to predict. Words such as "anticipates," "believes," "could," "estimates," "may," "should," "will," or other variations of these terms are intended to identify the forward-looking statements. These statements are based on assumptions and analyses made in light of experience and other historical trends, current conditions, and expected future developments. However, actual results and developments may differ materially from our expectations and predictions due to a number of risks and uncertainties, many of which are beyond our control. These risks and uncertainties include, but are not limited to:

- political, legal, regulatory and economic conditions and developments in the United States and abroad;
- economic fluctuations in the agricultural, rural utility, international, and farm-related business sectors;
- weather-related, disease, and other adverse climatic or biological conditions that periodically occur that impact agricultural productivity and income;

- changes in United States government support of the agricultural industry; and
- actions taken by the Federal Reserve System in implementing monetary policy.

## **LOAN PORTFOLIO**

The Association provides funds to farmers, rural homeowners and farm-related businesses for financing of short and intermediate-term loans and long-term real estate mortgage loans. The Association's loan portfolio is diversified over a wide range of agricultural commodities produced in our region, including poultry (broilers, turkeys and eggs), timber, field crops and grains, horses, and beef cattle. Loans to producers of these commodities total \$1,139,289 or 76.30 percent of the Association's portfolio. Farm size varies, and many of the Association customers have diversified farming operations. These factors, along with the numerous opportunities for non-farm income in the area, reduce the level of income dependency on any given commodity.

During the third quarter of 2009 the Association originated \$48,186 in loans for the secondary home loan market. Originations at the same period 2008 were \$17,628. The 173.35 percent increase is due to the lower interest rate environment and the significant number of refinances processed by the secondary market unit. As of September 30, 2009, the Association held \$1,957 in qualifying home loans for sale.

## **Georgia Region**

August 2009 marked the first month in over a year that the unemployment percentage for the state actually showed improvement. Overall unemployment dropped from a high of 10.5 percent in July to 10.2 percent at August month end. This remains the highest unemployment rate seen in the state in the past 33 years. The number of total jobs available in the state also stopped its decline in August for the first time in the past 12 months holding steady at 3.87 million jobs, the same figure as July. This is down from 4.11 million jobs in August 2008. While the decrease in unemployment and the steady employment rate is encouraging, Georgia's economy remains in a fairly deep recession. Commercial banks throughout the state and particularly in the metro Atlanta area continue to experience significant stress. Georgia leads the nation in the number of failed banks in 2009 with twenty-six (26) through September, 2009. Stress in

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many bank's portfolios is shifting from residential loans to the commercial real estate sector and this is expected to create additional bank failures in those with weak capital positions.

There are some positive signs as expansion in Georgia's military installations increases. Fort Benning, Fort Stewart, Fort Gordon, and Robbins Air Force base represent four(4) of the top six(6) employers in the state with Wal-Mart and Delta Airlines completing the top six(6). Expansion is underway at several of these bases that are located within AgSouth territory. A new Kia auto plant is under construction near Columbus, Georgia and will employ 2,500 workers as well as create many affiliated supply businesses. The hospitality and convention industry around Atlanta is also showing signs of improvement.

Row crop conditions across the region are rated fair to good, with some excellent, by the most recent USDA reports. While commodity prices moderated from 2008 levels, recent increases should make most crops profitable for 2009, given good yield conditions. The corn and tobacco harvest are near completion. Peanuts, cotton, and soybeans are approaching maturity and yields are expected to be good. The blueberry crop saw mixed results with lower quality and high bush yields due to excessive rains in the spring; however, a larger percentage of the rabbit eye variety was sold on the fresh market at higher prices and made up for the reduction in early high bush yield. The sweet onion season was fairly good and most stored onions have now been shipped. Prices were slightly above average and repayment from onion sales has been good.

Milk prices have improved from second quarter lows decreasing negative margins and allowing some producers to move to positive margins. Some of the region's dairies were stressed during the low price period however all are expected to recover if prices continue their upward movement through the fall. The timber industry continues to be depressed. Some price improvement has been seen in the pine composite lumber price index since June which caused several sawmills that had announced shut downs to continue to operate. Most mills have cut production back to one shift and are operating still at slightly negative margins. The protracted recovery in the region's housing market is continuing to stress the timber industry. Pulp markets are one bright spot as pulpwood prices have improved over the past 12 months due to demand from paper as well as increased demand from alternative energy sources such as power generation and pellet mills.

The poultry industry has benefited from decreased feed cost and improved prices. Significant profitability has returned to all integrators. We still face the crisis of the closed Pilgrim's plant in Douglas, Georgia. There is hope and recent indications the plant may be reopened by Pilgrims Pride as they come out of bankruptcy however there is no conclusive evidence of this at this time. Failure of the plant to reopen will

stress the portfolio of grower loans we hold in that region. We are making an assessment of each individual loan at this time.

Loan demand has remained fairly strong overall; however, we have seen a drastic reduction in the number of land sale and purchase transactions. This decrease in activity in the land market is also having a downward effect on values particularly in those areas where values had previously been inflated due to higher and better use influences that have now diminished. We have scaled back loan to value ratios in most new transactions. Areas where land values were not heavily affected by non-farm influences have remained stable.

### **South Carolina Region**

When the recession hit in 2007, South Carolina was in the midst of an economic transition which had started years earlier, shifting from a high labor intensive manufacturing state with emphasis on textiles to a more knowledge and service based economy. The slowing economy just exacerbated the problem with unemployment growing to a high of 12.1 percent at second quarter end. During both July and August, South Carolina labor force data improved with unemployment down and reported at 11.5 percent as of August month end. September job data was not yet available at the time this commentary was being drafted, but signs indicate unemployment comparing closely to August month end results. In general, economists are reasonably confident the state's economy has bottomed out, but economists cannot fully agree as to when the South Carolina economy will actually begin to show improvement. More optimistic views indicate the second quarter of 2010 could be the time when real economic improvement will begin to be noted, while more pessimistic outlooks project that it could take as long as 36 months before the state will recognize unemployment rates equal to or better than the pre-recession levels.

There are many sectors of the South Carolina economy that actually held up reasonably well and even showed some improvement over the past two years. But the downfalls of the manufacturing and construction sectors have continued to erode the state's overall economy, especially as it relates to keeping the work force active. Some of the sectors that have held up best within the state have been engineering, information technology, and finance. To avoid lay-offs, businesses are deferring capital improvements, reducing work hours, utilizing paycuts and furloughs as they wait for the economy to improve.

Another factor to consider within the South Carolina region is that the largest commodity concentration financed is the timber industry, with the most significant portion of this financing represented by timberland. The involvement in financing the timber industry is important as housing starts have been significantly reduced during the recessionary

period and both stumpage and finished prices have been negatively impacted by this occurrence. Forest products and timberland loans, exclusive of timber processing and harvesting units, represent about 41 percent of the overall region financing, but less than 8 percent of loans in this commodity concentration are paid specifically from timber sales. Timber processing and harvesting represents less than 2 percent of the region's loan portfolio. Within the timber industry, a positive sign has been the stabilization of pulp and paper demand as quarter end approached. Should pulp and paper prices actually begin to improve, this could make a positive impact on both pine and hardwood pulpwood in the southeast.

Broiler loans within the region represent in excess of 16 percent of the region's portfolio. Loans with egg producers are about one half of one percent, and turkey financing in South Carolina totals just above 1%. These poultry products have all showed signs of improvement during the third quarter as feed costs have contracted slightly. Feed costs and the workforce needed to operate the processing units will be key factors in the near future as to the level of profitability observed by the various integrators. Demand for poultry products remains reasonably good, and some new poultry grow-out units are being constructed, primarily in the Batesburg-Leesville area of the state.

Row crop results within the region have, for the most part, been good in 2009 as most areas received reasonable rainfall from late spring until mid summer. Corn harvest is almost complete and early projections are that yields will improve dramatically compared to 2008. Cotton is now being harvested and early cotton yield projections for 2009 are about 700 to 750 pounds per acre. Likewise, peanut harvest is in the initial stages and early projections for peanuts indicate yields will be reduced some compared to 2008. Very little soybean harvest has been observed in the state thus far, but this will begin shortly. The soybean acreage is up from 2008 levels. Given the lack of rainfall during late summer in key soybean producing areas of the state, it is anticipated yields will be reduced somewhat compared to 2008.

Approximately 5 percent of the South Carolina region's portfolio consists of equine with the heaviest concentration of horses in the Aiken, Camden, and Anderson areas of the state. Most of the financing is to part-time farmers and is to purchase, improve, or refinance real estate. Very few of these loans are paid specifically from equine income.

A significant portion of the loans within South Carolina are tied to real estate, with the large majority repaid from non-farm salaries and non-farm business income. The movement of real estate within the region has slowed with the recession and there are fewer sales taking place than in preceding years. The lack of comparable sales used to value property has diminished significantly and created a more conservative approach to real estate financing in 2009 with lower loan to

appraised value ratios being utilized. Loan growth in the state or region has been very flat through the first three quarters of this year primarily due to the more conservative approach to financing rural real estate.

### **ASSOCIATION BALANCE SHEET**

The gross loan volume of the Association as of September 30, 2009, was \$1,490,792, an increase of \$45,591 or 3.15 percent as compared to \$1,445,201 at December 31, 2008. Net loans outstanding at September 30, 2009 were \$1,482,576 as compared to \$1,440,734 at December 31, 2008. Net loans accounted for 94.54 percent of total assets at September 30, 2009, as compared to 94.36 percent of total assets at December 31, 2008.

The increase in gross and net loan volume during the reporting period is attributed to draws on annual operating credits to farmer/borrowers during the planting season outpacing payments and payoffs. The Association is seeing increased demand for some credit needs as commercial banks back away from agricultural lending in the current economic environment. The Association will be challenged to seek and find new, high quality volume that will not add significant risk to the portfolio.

Included in the loan balance is \$8,084 of assets made under the Mission Related Investments initiative of the Farm Credit System. These assets were made as bonds, but because of certain characteristics, they were booked as loans. Separate reporting is provided to the Farm Credit Administration (FCA) on a quarterly basis on these Mission Related Investments.

The Association typically structures loans to meet the needs of the borrower. Many term loans are made for ten years or less allowing the borrower to build equity faster and thus reducing the risk in the loan portfolio.

There is an inherent risk in the extension of any type of credit. Portfolio credit quality continues to be maintained at an acceptable level and credit administration remains satisfactory. Nonaccrual loans increased from \$4,419 at December 31, 2008, to \$21,520 at September 30, 2009. This increase is the result of transfers to nonaccrual status exceeding payments and payoffs on existing nonaccrual accounts and includes several accounts in excess of \$1,000. The increase in nonaccrual loans can, in some instances, be tied to the general economy. Association staff is working diligently to work out these nonaccrual debt situations, which sometimes includes foreclosure action and/or taking a deed in lieu of foreclosure. The Association has three, tenured staff members dedicated full-time to the process of nonaccrual debt collection and work-outs.

Other property owned increased to \$4,425 at September 30, 2009 from \$216 at December 31, 2008. The increase in other property owned is the result of work-out situations with

troubled debts and includes several pieces of property taken as deed in lieu of foreclosure. The Association is actively marketing all properties for sale. For details, please visit our website at [www.agsouthfc.com/classifieds](http://www.agsouthfc.com/classifieds).

Association management maintains an allowance for loan losses in an amount considered sufficient to absorb possible losses in the loan portfolio based on current and expected future conditions. The allowance for loan losses at September 30, 2009, was \$8,216 compared to \$4,467 at December 31, 2008, and was considered by management to be adequate to cover possible losses. The increase in the allowance account came from an addition to the provision for loan losses and recoveries which exceeded charge-offs during the reporting period. The Asset/Liability Committee (ALCO) of the Association, which is comprised of members of senior management, corporate lenders, and staff assigned to special assets management, met in September to review the allowance account. The ALCO determined that an addition to the allowance account was needed. The Association has funded the allowance through the provision for loan loss in the amount of \$4,049 since January 1, 2009.

Premises and equipment, net increased \$1,555 from \$13,342 at December 31, 2008 to \$14,897 at September 30, 2009. The Association has new office facilities under construction in Douglas, Georgia and Rock Hill, South Carolina. Staff relocated to the Douglas office in September and will relocate to Rock Hill in late October. The Association also has an extensive remodeling project going on in Summerville, South Carolina. These new buildings and improvements will help the Association better meet the needs of the customer base.

## RESULTS OF OPERATIONS

### *For the three months ended September 30, 2009*

Net income for the three months ended September 30, 2009, totaled \$7,435 as compared to \$9,212 for the same period in 2008. Net interest income before the provision for loan loss increased \$875 for the three months ended September 30, 2009, as compared to the same period in 2008 due primarily to the increase in margin on new and existing loan volume. Net interest income after the provision for loan losses decreased \$409 in the quarter ending September 30, 2009. The Association's ALCO made the decision that a provision entry was needed after analyzing the risk in the current portfolio. The ALCO authorized a provision entry of \$1,533 in September. The analysis included reviewing historical trends, loan size, loan performance and credit quality reports.

At September 30, 2009, interest income on loans decreased \$2,183 compared to the same period in 2008. The decrease was due to the lower interest rate environment. At September 30, 2008, the weighted average rate of the accruing loan portfolio was 7.304 percent compared to 6.617 percent at September 30, 2009. Nonaccrual income, which is

included in interest income, was \$87 for the three months ended September 30, 2009, as compared to \$108 for the same period in 2008.

Interest expense decreased \$3,058 for the three months ended September 30, 2009. The decrease is attributable to the lower interest rate environment and the ability to fix a portion of the Association's lendable equity at favorable rates which resulted in lower interest expense.

Noninterest income increased \$328 over the same period last year. Loan fees increased \$307 or 76.18 percent. The increase in loan fees is due to late charges, servicing fees on loans sold to AgFirst Farm Credit Bank and other associations, and servicing fees on loans sold in the secondary mortgage market. Fees for financially related services increased \$53 from \$179 at September 30, 2008 compared to \$232 at September 30, 2009. The 29.61 percent increase in fees for financially related services is the result of income earned on sales of multi-peril insurance and fee appraisal services. The equity in earnings from other Farm Credit institutions decreased \$75 from \$3,130 at September 30, 2008 to \$3,055 at September 30, 2009.

Gains on the sale of rural home loans increased \$14 from \$181 at September 30, 2008 compared to \$195 at September 30, 2009. The increase in gains is the result of the activity in the housing market and originators being successful at getting these loans processed quickly and efficiently.

Losses on other property owned increased \$92 as a result of several write downs on property held for sale. Other noninterest income increased \$121 from a loss of \$31 at September 30, 2008 compared to income of \$90 at September 30, 2009. Other noninterest income includes gains recorded on the Association's investment in a long-term deferred compensation account maintained for certain key employees and previous retirees and other miscellaneous income.

Noninterest expense for the three months ended September 30, 2009, increased \$1,561 compared to the same period of 2008. Salaries and employee benefit expense increased \$1,509 between the two reporting periods. The 37.12 percent increase in salaries and employee benefits is tied to an increase in expense related to the Association's retirement plan. It also includes a slight increase in the number of full-time employees as the Association prepares for some upcoming retirements as well as normal annual salary adjustments.

Occupancy and equipment expense at September 30, 2009 was \$596 compared to \$497 for the same period in 2008. The Insurance Fund premium increased \$173 from \$442 at September 30, 2008 to \$615 at September 30, 2009. The increase in the premium expense is tied to a change in the

calculation of the expense by the insurance corporation as well as the increase in both accruing and nonaccruing loan volume. Other operating expenses decreased \$220 from September 30, 2008, \$1,275 compared to \$1,055 at September 30, 2009. The decrease is the result of cost saving measures implemented in the second quarter in an effort to control expenses and meet 2009 earnings goals. Some of the decrease may be timing related when compared to the prior year period.

### ***For the nine months ended September 30, 2009***

Net income for the nine months ended September 30, 2009, totaled \$21,050 as compared to \$27,131 for the same period in 2008. Net interest income before the provision for loan loss increased \$1,844 for the nine months ended September 30, 2009, as compared to the same period in 2008 due primarily to the increase in margin on new volume and focused repricing efforts on existing loan volume. Net interest income after the provision for loan losses decreased \$1,955 in the nine months ending September 30, 2009. The Association's ALCO made the decision that a provision entry was needed after analyzing the risk in the current portfolio. The ALCO authorized provision entries of \$643 in March, \$1,872 in June and \$1,533 in September. The analysis included reviewing historical trends, loan size, loan performance and credit quality reports.

At September 30, 2009, interest income on loans decreased \$7,036 compared to the same period in 2008. The decrease was due to the lower interest rate environment. Nonaccrual income, which is included in interest income, was \$136 for the nine months ended September 30, 2009, as compared to \$302 for the same period in 2008.

Interest expense decreased \$8,880 for the nine months ended September 30, 2009. The decrease is attributable to the lower interest rate environment and the ability to fix a portion of the Association's lendable equity at favorable rates which resulted in lower interest expense.

Noninterest income increased \$1,364 over the same period last year. Loan fees increased \$696 or 33.97 percent. The increase in loan fees is due to late charges, servicing fees on loans sold to AgFirst Farm Credit Bank and other associations and servicing fees on loans sold in the secondary mortgage market. Fees for financially related services increased \$102 from \$396 at September 30, 2008 compared to \$498 at September 30, 2009. The 25.76 percent increase in fees for financially related services is the result of increased income earned on sales of multi-peril insurance and fee appraisal services. The equity in earnings from other Farm Credit institutions increased \$213 from \$8,898 at September 30, 2008 to \$9,111 at September 30, 2009. The increase is the result of the higher average Notes Payable note balance and participations sold to other Associations.

Losses on other property owned increased to \$181. The additional losses were primarily from a write-down on several pieces of other property owned based upon more recent appraisals. Gains on the sale of rural home loans increased 49.55 percent from \$553 at September 30, 2008 compared to \$827 at September 30, 2009. The increase in gains is the result of the activity in the housing market. With the lower rate environment, refinance activity has been significant for the Association. Other noninterest income increased \$260 from \$99 at September 30, 2008 compared to \$359 at September 30, 2009. The Association booked income from premium refunds and savings related to the Farm Credit Captive Insurance fund.

Noninterest expense for the nine months ended September 30, 2009, increased \$5,343 compared to the same period of 2008. Salaries and employee benefit expense increased \$5,128 between the two reporting periods. The 41.20 percent increase in salaries and employee benefits is tied to an increase in expense related to the Association's retirement plan. Refer to Note 3 for specific details about the increase in retirement expense. It also increased due to the slight increase in the number of full-time employees as the Association prepares for some upcoming retirements as well as normal annual salary adjustments. Additionally, the Association evaluated the 2009 performance measures for incentive purposes and determined that some employees would earn incentive in 2009. Based upon this information, the Association accrued \$1,212 in incentive in June, 2009.

Occupancy and equipment expense at September 30, 2009 was \$1,625 compared to \$1,523 for the same period in 2008. The Insurance Fund premium increased from \$1,385 at September 30, 2008 to \$1,768 at September 30, 2009. The increase in the premium expense is tied to a change in the calculation of the expense by the insurance corporation as well as the increase in accruing and nonaccruing loan volume. Other operating expenses decreased \$270 from September 30, 2008, \$3,803 compared to \$3,533 at September 30, 2009. The decrease is the result of cost saving measures implemented in the second quarter in an effort to control expenses and meet 2009 earnings goals. Some of the decrease may be timing related when compared to the prior year period.

### **FUNDING SOURCES**

The principal source of funds for the Association is the borrowing relationship established with AgFirst Farm Credit Bank (the Bank) through a General Financing Agreement. The General Financing Agreement utilizes the Association's credit and fiscal performance as criteria for establishing a line of credit on which the Association may draw funds. The Bank advances the funds to the Association in the form of notes payable. The notes payable are segmented into variable rate and fixed rate sections. The variable rate note is utilized by the Association to fund variable rate loan

advances and operating funds requirements. The fixed rate note is used specifically to fund fixed rate loan advances made by the Association. The total notes payable to the Bank at September 30, 2009 was \$1,305,526 as compared to \$1,262,811 at December 31, 2008. The increase is related to the increase in loan volume between the two reporting periods.

As of September 30, 2009, the Association had invested \$138,900 of its lendable equity in fixed rate notes. These fixed rate notes will mature in 2010 through January 2013.

## **CAPITAL RESOURCES**

Total members' equity at September 30, 2009 increased to \$236,980 from the December 31, 2008 total of \$228,389. The increase is primarily attributed to the earnings of the Association offset by revolvment of allocated equities and the retirement of capital stock and participation certificates during the reporting period. At December 31, 2008, allocated retained earnings totaled \$109,795. At September 30, 2009, the allocated retained earnings had decreased to \$96,879.

Total capital stock and participation certificates were \$6,427 on September 30, 2009, compared to \$6,605 on December 31, 2008. The decrease is attributed to the retirement of protected stock and participation certificates on loans liquidated in the normal course of business, the retirement of excess stock, and new loans being capitalized at lower regulatory levels.

Farm Credit Administration (FCA) regulations require all Farm Credit institutions to maintain minimum permanent capital, total surplus, and core surplus ratios. These ratios are calculated by dividing the Association's permanent capital, total surplus, and core surplus, as defined in FCA regulations, by a risk-adjusted asset base. As of September 30, 2009, the Association's total surplus ratio and core surplus ratio were 13.99 percent and 10.19 percent, respectively, and the permanent capital ratio was 14.43 percent. All three ratios were well above the minimum regulatory ratios of 7.00 percent for permanent capital and total surplus ratios and 3.50 percent for the core surplus ratio.

The Association has a portion of the portfolio in an in-portfolio guarantee program with Farmer Mac. At September 30, 2009, the Association had loans totaling \$10,984 in this program. No additional placement of loans is scheduled at this time. The cost of the guarantees year to date was \$47. The use of the Farmer Mac in-portfolio guarantee has a positive effect on the Association's capital ratios.

At December 31, 2008, the Association's permanent capital ratio was 14.78 percent. The decrease to 14.43 percent permanent capital at September 30, 2009 is the result of the Association's growth outpacing additions to retained

earnings. Association management continues to discuss several options available to the Association to strengthen the capital position. These options include selling additional loans to AgFirst and others, placing pools of loans with Farmer Mac in the in-portfolio guarantee program, and participating with AgFirst in a capitalized participation pool. All options are being studied should management and the Board determine that steps are necessary to maintain the Association's strong capital position.

**NOTE:** Shareholder investment in the Association could be affected by the financial condition and results of operations of AgFirst Farm Credit Bank. Copies of AgFirst's annual and quarterly reports are available upon request free of charge by calling 1-800-845-1745, ext. 378, or writing Stephen Gilbert, AgFirst Farm Credit Bank, P.O. Box 1499, Columbia, SC 29202. Information concerning AgFirst Farm Credit Bank can also be obtained at their website, [www.agfirst.com](http://www.agfirst.com). Copies of the Association's annual and quarterly reports are also available upon request free of charge by calling 1-800-310-4805, ext 237, writing Alisa D. Gunter, CFO, AgSouth Farm Credit, ACA, PO Box 4966, Spartanburg, SC 29305, or accessing the website [www.agsouthfc.com](http://www.agsouthfc.com). The Association prepares a quarterly report within 40 days after the end of each fiscal quarter, except that no report need be prepared for the fiscal quarter that coincides with the end of the fiscal year of the institution.

# AgSouth Farm Credit, ACA

## Consolidated Balance Sheets

<i>(dollars in thousands)</i>	<b>September 30, 2009</b> <i>(unaudited)</i>	<b>December 31, 2008</b> <i>(audited)</i>
<b>Assets</b>		
Cash	\$ 1,046	\$ 2,772
Loans	1,490,792	1,445,201
Less: allowance for loan losses	8,216	4,467
Net loans	1,482,576	1,440,734
Loans held for sale	1,957	977
Accrued interest receivable	18,336	17,145
Investment in other Farm Credit institutions	23,341	23,316
Premises and equipment, net	14,897	13,342
Other property owned	4,425	216
Due from AgFirst Farm Credit Bank	8,621	11,225
Other assets	13,075	17,063
Total assets	<u>\$ 1,568,274</u>	<u>\$ 1,526,790</u>
<b>Liabilities</b>		
Notes payable to AgFirst Farm Credit Bank	\$ 1,305,526	\$ 1,262,811
Accrued interest payable	3,883	4,754
Patronage refund payable	216	9,952
Other liabilities	21,669	20,884
Total liabilities	<u>1,331,294</u>	<u>1,298,401</u>
Commitments and contingencies		
<b>Members' Equity</b>		
Protected borrower equity	236	335
Capital stock and participation certificates	6,191	6,270
Retained earnings		
Allocated	96,879	109,795
Unallocated	133,878	112,202
Accumulated other comprehensive income (loss)	(204)	(213)
Total members' equity	<u>236,980</u>	<u>228,389</u>
Total liabilities and members' equity	<u>\$ 1,568,274</u>	<u>\$ 1,526,790</u>

*The accompanying notes are an integral part of these financial statements.*

AgSouth Farm Credit, ACA

# Consolidated Statements of Income

*(unaudited)*

<i>(dollars in thousands)</i>	<b>For the three months ended September 30,</b>		<b>For the nine months ended September 30,</b>	
	<b>2009</b>	<b>2008</b>	<b>2009</b>	<b>2008</b>
<b>Interest Income</b>				
Loans	\$ 24,481	\$ 26,664	\$ 72,157	\$ 79,193
<b>Interest Expense</b>				
Notes payable to AgFirst Farm Credit Bank	11,850	14,886	35,799	44,584
Other	3	25	8	103
Total interest expense	<u>11,853</u>	<u>14,911</u>	<u>35,807</u>	<u>44,687</u>
Net interest income	12,628	11,753	36,350	34,506
Provision for (reversal of allowance for) loan losses	<u>1,534</u>	<u>250</u>	<u>4,049</u>	<u>250</u>
Net interest income after provision for (reversal of allowance for) loan losses	<u>11,094</u>	<u>11,503</u>	<u>32,301</u>	<u>34,256</u>
<b>Noninterest Income</b>				
Loan fees	710	403	2,745	2,049
Fees for financially related services	232	179	498	396
Equity in earnings of other Farm Credit institutions	3,055	3,130	9,111	8,898
Gains (losses) on other property owned, net	(81)	11	(149)	32
Gains (losses) on sale of rural home loans, net	195	181	827	553
Other noninterest income	90	(31)	359	99
Total noninterest income	<u>4,201</u>	<u>3,873</u>	<u>13,391</u>	<u>12,027</u>
<b>Noninterest Expense</b>				
Salaries and employee benefits	5,574	4,065	17,576	12,448
Occupancy and equipment	596	497	1,625	1,523
Insurance Fund premium	615	442	1,768	1,385
Other operating expenses	1,055	1,275	3,533	3,803
Total noninterest expense	<u>7,840</u>	<u>6,279</u>	<u>24,502</u>	<u>19,159</u>
Income before income taxes	7,455	9,097	21,190	27,124
Provision (benefit) for income taxes	<u>20</u>	<u>(115)</u>	<u>140</u>	<u>(7)</u>
Net income	<u>\$ 7,435</u>	<u>\$ 9,212</u>	<u>\$ 21,050</u>	<u>\$ 27,131</u>

*The accompanying notes are an integral part of these financial statements.*

AgSouth Farm Credit, ACA

# Consolidated Statements of Changes in Members' Equity

*(unaudited)*

*(dollars in thousands)*

	Protected Borrower Capital	Capital Stock and Participation Certificates	Retained Earnings		Accumulated Other Comprehensive Income	Total Members' Equity
			Allocated	Unallocated		
Balance at December 31, 2007	\$ 457	\$ 6,176	\$ 102,123	\$ 107,688	\$ (197)	\$ 216,247
Net income				27,131		27,131
Employee benefit plans adjustments				(30)	17	(13)
Total comprehensive income						27,118
Protected borrower equity retired	(107)					(107)
Capital stock/participation certificates issued/(retired), net		98				98
Retained earnings retired			(11,864)			(11,864)
Patronage distribution adjustment			158	(221)		(63)
Balance at September 30, 2008	\$ 350	\$ 6,274	\$ 90,417	\$ 134,568	\$ (180)	\$ 231,429
Balance at December 31, 2008	\$ 335	\$ 6,270	\$ 109,795	\$ 112,202	\$ (213)	\$ 228,389
Comprehensive income						
Net income				21,050		21,050
Employee benefit plans adjustments					9	9
Total comprehensive income						21,059
Protected borrower equity retired	(99)					(99)
Capital stock/participation certificates issued/(retired), net		(79)				(79)
Retained earnings retired			(13,450)			(13,450)
Patronage distribution adjustment			534	626		1,160
Balance at September 30, 2009	\$ 236	\$ 6,191	\$ 96,879	\$ 133,878	\$ (204)	\$ 236,980

*The accompanying notes are an integral part of these financial statements.*

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*AgSouth Farm Credit, ACA*

# Notes to the Consolidated Financial Statements

*(dollars in thousands, except as noted)  
(unaudited)*

## **NOTE 1 – ORGANIZATION, SIGNIFICANT ACCOUNTING POLICIES, AND RECENTLY ISSUED ACCOUNTING PRONOUNCEMENTS**

The accompanying financial statements include the accounts of AgSouth Farm Credit, ACA (the Association). A description of the organization and operations of the Association, the significant accounting policies followed, and the financial condition and results of operations as of and for the year ended December 31, 2008, are contained in the 2008 Annual Report to Shareholders. These unaudited third quarter 2009 consolidated financial statements should be read in conjunction with the 2008 Annual Report to Shareholders.

The accompanying consolidated financial statements contain all adjustments necessary for a fair presentation of the interim financial condition and results of operations and conform with generally accepted accounting principles (GAAP) and prevailing practices within the banking industry. The results for the nine months ended September 30, 2009, are not necessarily indicative of the results to be expected for the year ending December 31, 2009.

Certain amounts in the prior period's consolidated financial statements may have been reclassified to conform to the current period's consolidated financial statement presentation. Such reclassifications had no effect on the prior period net income or total capital as previously reported.

The Association maintains an allowance for loan losses in accordance with GAAP. The loan portfolio is reviewed quarterly to determine the adequacy of the allowance for losses. As of September 30, 2009, the allowance for losses is adequate in management's opinion to provide for possible losses on existing loans.

In addition to the recently issued accounting pronouncements discussed in the 2008 Annual Report to Shareholders, effective January 1, 2009, the Association adopted accounting guidance for fair value measurements of nonfinancial assets and nonfinancial liabilities. The impact of adoption resulted in additional fair value disclosures (see Note 4), primarily regarding other property owned, but does not have an impact on the Association's financial condition or results of operations.

In April 2009, the Financial Accounting Standards Board (FASB) issued guidance, "Interim Disclosures about Fair Value of Financial Instruments." This guidance requires disclosures about fair value of financial instruments for

interim reporting periods of publicly traded companies as well as in annual financial statements. The Association adopted this guidance effective June 30, 2009 (see Note 5).

In May 2009, the FASB issued guidance, "Subsequent Events," which sets forth general standards of accounting for and disclosure of events that occur after the balance sheet date but before financial statements are issued or are available to be issued. There are two types of subsequent events: the first type consists of events or transactions that provide additional evidence about conditions that existed at the balance sheet date (recognized subsequent events) and the second type consists of events that provide evidence about conditions that did not exist at the balance sheet date but arose after that date (nonrecognized subsequent events). Recognized subsequent events should be included in the financial statements since the conditions existed at the date of the balance sheet. Nonrecognized subsequent events are not included in the financial statements since the conditions arose after the balance sheet date but before the financial statements are issued or are available to be issued. This guidance, which includes a required disclosure of the date through which an entity has evaluated subsequent events, was adopted by the Association effective June 30, 2009 (see Note 6).

In June 2009, the FASB issued guidance, "The FASB Accounting Standards Codification and the Hierarchy of Generally Accepted Accounting Principles." This Codification will become the source of authoritative U.S. generally accepted accounting principles recognized by the FASB. This guidance was adopted by the Association effective July 1, 2009 and had no impact on the Association's financial condition or results of operations.

## **NOTE 2 – ALLOWANCE FOR LOAN LOSSES AND IMPAIRED LOANS**

An analysis of the allowance for loan losses follows:

	<b>For the nine months ended September 30,</b>	
	<b>2009</b>	<b>2008</b>
Balance at beginning of period	\$ 4,467	\$ 3,970
Provision for (reversal of) loan losses	4,049	250
Charge-offs	(492)	(160)
Recoveries	192	31
Balance at end of period	<u>\$ 8,216</u>	<u>\$ 4,091</u>

The following table presents information concerning impaired loans as of September 30,

	<u>2009</u>	<u>2008</u>
Impaired loans with related allowance	\$ 6,756	\$ 346
Impaired loans with no related allowance	15,290	2,915
Total impaired loans	<u>22,046</u>	<u>3,261</u>
Allowance on impaired loans	<u>\$ 1,596</u>	<u>\$ 122</u>

The following table summarizes impaired loan information for the nine months ended September 30,

	<u>2009</u>	<u>2008</u>
Average impaired loans	\$ 11,589	\$ 3,428
Interest income recognized on impaired loans	142	309

### NOTE 3 – EMPLOYEE BENEFIT PLANS

The following is a table of retirement and other postretirement benefit expenses for the Association:

	<u>For the nine months ended September 30,</u>	
	<u>2009</u>	<u>2008</u>
Pension	\$ 4,514	\$ 805
401(k)	359	330
Other postretirement benefits	712	623
Total	<u>\$ 5,585</u>	<u>\$1,758</u>

The following is a table of non-qualified retirement and other postretirement benefit contributions for the Association:

	<u>Actual YTD Through 9/30/09</u>	<u>Projected Contributions For Remainder of 2009</u>	<u>Projected Total Contributions 2009</u>
Pension	\$ 64	\$ 22	\$ 86
Other postretirement benefits	422	260	682
Total	<u>\$ 486</u>	<u>\$ 282</u>	<u>\$ 768</u>

As of September 30, 2009, no contributions have been made for 2009 by the Association to the qualified District pension plan in which the Association participates. Actuarial calculations as of the last plan measurement date (December 31, 2008) projected total contributions of \$52.0 million to the qualified District pension plan for all participating institutions for 2009. The funding policy for this plan is to fund the accumulated benefit obligation (ABO) service cost plus the seven year amortization of the unfunded ABO using the discount rate determined as of December 31st of the preceding year. This aggregate contribution will be allocated to the participating District institutions, including

the Association, based upon each institution's pro rata share of ABO service cost. Market conditions could impact discount rates and return on plan assets which could make additional contributions necessary before the next plan measurement date of December 31, 2009.

Further details regarding employee benefit plans are contained in the 2008 Annual Report to Shareholders.

### NOTE 4 – FAIR VALUE MEASUREMENT

Effective January 1, 2008, the Association adopted FASB guidance on, fair value measurements. This guidance defines fair value, establishes a framework for measuring fair value and expands disclosures about fair value measurements for certain assets and liabilities measured at fair value on a recurring and non-recurring basis. These assets and liabilities primarily consist of assets held in trust funds, standby letters of credit, impaired loans, and other property owned.

This guidance defines fair value as the exchange price that could be received for an asset or paid to transfer a liability in an orderly transaction between market participants in the principal or most advantageous market for the asset or liability.

This guidance establishes a fair value hierarchy for disclosure of fair value measurements to maximize the use of observable inputs, that is, inputs that reflect the assumptions market participants would use in pricing an asset or liability based on market data obtained from sources independent of the reporting entity. The valuation hierarchy is based upon the transparency of inputs to the valuation of an asset or liability as of the measurement date. A financial instrument's categorization within the valuation hierarchy is based upon the lowest level of input that is significant to the fair value measurement.

The three levels of inputs and the classification of the Association's financial instruments within the fair value hierarchy are as follows:

#### Level 1

Level 1 inputs to the valuation methodology are unadjusted quoted prices for identical assets or liabilities in active markets. The Association's Level 1 assets at September 30, 2009 consist of assets held in trust funds related to deferred compensation and supplemental retirement plans. The trust funds include investments in securities that are actively traded and have quoted net asset value prices that are directly observable in the marketplace.

#### Level 2

Level 2 inputs to the valuation methodology include quoted prices for similar assets and liabilities in active markets; quoted prices in markets that are not active; and inputs that are observable, or can be corroborated, for substantially the full

term of the asset or liability. The Association has no Level 2 assets and liabilities measured at fair value on a recurring basis at September 30, 2009.

### Level 3

Level 3 inputs to the valuation methodology are unobservable and supported by little or no market activity. Valuation is determined using pricing models, discounted cash flow methodologies, or similar techniques, and could include significant management judgment or estimation. Level 3 assets and liabilities also could include instruments whose price has been adjusted based on dealer quoted pricing that is different than the third-party valuation or internal model pricing.

Level 3 assets at September 30, 2009 include impaired loans which represent the fair value of certain loans that were evaluated for impairment under FASB guidance. The fair value was based upon the underlying collateral since these were collateral-dependent loans. The fair value measurement process uses independent appraisals and other market-based information, but in many cases it also requires significant input based on management's knowledge of and judgment about current market conditions, specific issues relating to the collateral and other matters. As a result, these fair value measurements fall within Level 3 of the hierarchy. When the value of the collateral, less estimated costs to sell, is less than the principal balance of the loan, a specific reserve is established. Other property owned is classified as a level 3 asset at September 30, 2009. The fair value for other property owned is based upon the collateral less estimated costs to sell. Level 3 liabilities at September 30, 2009 include standby letters of credit whose market value is internally calculated based on information that is not observable either directly or indirectly in the marketplace.

### Assets and Liabilities Measured at Fair Value on a Recurring Basis

The following table presents the assets and liabilities that are measured at fair value on a recurring basis at September 30, 2009 for each of the fair value hierarchy levels:

	September 30, 2009			
	Level 1	Level 2	Level 3	Total Fair Value
<b>Assets:</b>				
Assets held in trust funds	\$ 715	\$ -	\$ -	\$ 715
Total Assets	\$ 715	\$ -	\$ -	\$ 715
<b>Liabilities:</b>				
Standby letters of credit	\$ -	\$ -	\$ 137	\$ 137
Total Liabilities	\$ -	\$ -	\$ 137	\$ 137

The following table presents the changes in Level 3 assets and liabilities measured at fair value on a recurring basis:

	Standby Letters Of Credit
Balance at January 1, 2009	\$ 122
<b>Total gains or (losses) realized/unrealized:</b>	
Included in earnings	-
Included in other comprehensive loss	-
Purchases, sales, issuances and settlements, net	15
Transfers in and/or out of level 3	-
Balance at September 30, 2009	\$ 137

### Assets and Liabilities Measured at Fair Value on a Non-recurring Basis

Assets and liabilities measured at fair value on a non-recurring basis at September 30, 2009 for each of the fair value hierarchy values are summarized below:

	September 30, 2009				YTD Total
	Level 1	Level 2	Level 3	Total Fair Value	Gains (Losses)
<b>Assets:</b>					
Impaired loans	\$ -	\$ -	\$ 5,169	\$ 5,169	\$ (1,725)
Other property owned	\$ -	\$ -	\$ 4,849	\$ 4,849	\$ (94)

### NOTE 5 — DISCLOSURES ABOUT FAIR VALUE OF FINANCIAL INSTRUMENTS

The following table presents the carrying amounts and fair values of the Association's financial instruments at September 30, 2009.

Quoted market prices are generally not available for certain System financial instruments, as described below. Accordingly fair values are based on judgments regarding anticipated cash flows, future expected loss experience, current economic conditions, risk characteristics of various financial instruments, and other factors. These estimates involve uncertainties and matters of judgment, and therefore cannot be determined with precision. Changes in assumptions could significantly affect the estimates.

The estimated fair values of the Association's financial instruments are as follows:

	<b>September 30, 2009</b>	
	<b>Carrying Amount</b>	<b>Estimated Fair Value</b>
<b>Financial assets:</b>		
Cash	\$ 1,046	\$ 1,046
Loans, net of allowance	\$ 1,482,576	\$ 1,528,781
Assets held in trust funds	\$ 715	\$ 715
<b>Financial liabilities:</b>		
Notes payable to AgFirst Farm Credit Bank	\$ 1,305,526	\$ 1,325,971

A description of the methods and assumptions used to estimate the fair value of each class of the Association's financial instruments for which it is practicable to estimate that value follows:

- A. **Cash:** The carrying value is a reasonable estimate of fair value.
- B. **Loans:** Because no active market exists for the Association's loans, fair value is estimated by discounting the expected future cash flows using the Association's current interest rates at which similar loans would be made to borrowers with similar credit risk. As the discount rates are based on the Bank's loan rates, as well as management estimates, management has no basis to determine whether the fair values presented would be indicative of the value negotiated in an actual sale.

For purposes of determining fair value of accruing loans, the loan portfolio is segregated into pools of loans with homogeneous characteristics based upon repricing and credit risk. Expected future cash flows and interest rates reflecting appropriate credit risk are separately determined for each individual pool.

Fair value of loans in a nonaccrual status is estimated to be the carrying amount less specific reserves.

The carrying value of accrued interest approximates its fair value.

- C. **Investment in AgFirst Farm Credit Bank and Other Farm Credit Institutions:** Estimating the fair value of the Association's investment in the Bank and Other Farm Credit Institutions is not practicable because the stock is not traded. The net investment is a requirement of borrowing from the Bank and is carried at cost plus allocated equities in the accompanying Consolidated Balance Sheets. The Association owns 5.47 percent of the issued stock of the Bank as of September 30, 2009 net of any reciprocal investment. As of that date, the Bank's assets totaled \$30.08 billion and shareholders' equity totaled \$1.60 billion.

The Bank's earnings were \$194.0 million during the first nine months of 2009.

In addition, the Association has an investment of \$2,484 related to other Farm Credit institutions.

**D. Notes Payable to AgFirst Farm Credit Bank:**

The notes payable are segregated into pricing pools according to the types and terms of the loans (or other assets) which they fund. Fair value of the notes payable is estimated by discounting the anticipated cash flows of each pricing pool using the current rate that would be charged for additional borrowings. For purposes of this estimate it is assumed the cash flow on the notes is equal to the principal payments on the Association's loan receivables plus accrued interest on the notes payable. This assumption implies that earnings on the Association's interest margin are used to fund operating expenses and capital expenditures.

- E. **Commitments to Extend Credit:** The estimated market value of off-balance-sheet commitments is minimal since the committed rate approximates current rates offered for commitments with similar rate and maturity characteristics and since the related credit risk is not significant.

- F. **Assets Held in Trust Funds:** See Note 4 for discussion of estimation of fair value for this instrument.

**NOTE 6 – SUBSEQUENT EVENTS**

The Association has evaluated subsequent events and has determined there are none requiring disclosure through November 3, 2009, which is the date the financial statements were available to be issued.