

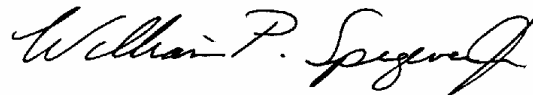
# THIRD QUARTER 2008

## TABLE OF CONTENTS

Management's Discussion and Analysis of Financial Condition and Results of Operations.....	2
Consolidated Financial Statements	
Consolidated Balance Sheets.....	8
Consolidated Statements of Income.....	9
Consolidated Statements of Changes in Members' Equity.....	10
Notes to the Consolidated Financial Statements.....	11

## CERTIFICATION

The undersigned certify that we have reviewed the September 30, 2008 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 22, 2008

# 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, 2008. This information should be read in conjunction with the accompanying financial statements, notes to the financial statements, and the 2007 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.

## 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, and beef cattle. Loans to producers of these commodities total \$1,039,430 or 71.38 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 to some degree the level of income dependency on any given commodity.

During the third quarter of 2008 the Association originated \$17,628 in loans for the secondary market. Originations at the same period 2007 were \$20,773. The 15.14 percent decline is due to the overall decline in housing activity. As of September 30, 2008, the Association held \$596 in qualifying loans for sale.

## Georgia Region

The third quarter began with most areas within the Georgia region receiving sufficient rainfall at critical times during crop maturation to reach a fair production level on most major crops. Rainfall began to subside in August with September becoming much dryer. The peanut crop appears to be in very good shape with harvest approximately 50 percent complete. Yield and quality are very good and production should generate a satisfactory profit. The cotton crop is rated mostly fair to good across the state by USDA and the same holds true within our region. Prices have dropped dramatically though, from 90 cents per pound to around 50 cents. This shortfall in price below the support price level will be made up by both direct and countercyclical payments on base acres bringing total receipts per pound back to near 72 cents. Soybeans have been hurt by the late summer drought and the continued dry conditions into September, however the majority of the crop is rated fair at this time by USDA. Two other significant crops in the region, blueberries and Vidalia onions, have completed the 2008 season with good results with respect to both price and yield. Most operating loans to blueberry and onion growers have been repaid in full.

The timber and forest products industry remains depressed. Lumber prices remain low due to the housing industry. Pulp prices have remained fairly stable to slightly increasing with fair demand for paper. Chip-n-saw and saw timber stumpage prices remain low. Many loggers and wood dealers have found it difficult to remain in business given the cost of fuel and product prices. Saw mills in our area have been operating slightly in the red but have not incurred significant

losses. It appears their losses will continue to build toward year-end.

Poultry integrators have had negative margins due primarily to high feed prices with some of the nation's largest poultry producers experiencing fairly significant losses. The Association does provide financing to some poultry growers supplied by these integrators. We are reassessing the risk associated with these integrators from a collateral standpoint as well as their ability to repay debt from other sources of income. Recent significant drops in corn and soybean prices will improve profitability.

Seasonal operating loan volume peaked in July and has begun to pay down. Most should be repaid by year-end with the exception of some that may be converted to commodity loans to allow borrowers to hold crops over into 2009. Input cost were significantly higher in 2008 and with the recent decline in commodity prices profit margins of farmers is going to be strained unless they were able to lock in high prices through forward contracts.

Loan demand remained strong during the quarter but given the volatile situation in the economy we are being very cautious in taking on new business. Many commercial banks have reduced availability of credit and there are opportunities to pick up good business but we are exercising extreme caution.

#### ***South Carolina Region***

As the spring ended, the South Carolina region encountered severe heat and dry conditions which affected some crops. The weather had a negative impact on corn and led to below average yields. Additionally, the very evident drought conditions in the Midlands and Piedmont area of the state led to minimal hay production and very poor grazing conditions for livestock. These two areas of the region have now received some rainfall but remain below normal moisture expectations. Despite the adverse growing conditions, mid-summer rain allowed the cotton, peanut and soybean crops to remain on track for average production. Cotton and peanut harvest is currently underway and soybean harvest is about to begin. Grain prices have been at historical highs during most of 2008 and many of the regions farmers have forward priced corn, wheat and soybeans taking advantage of the favorable markets. The South Carolina tomato crop was good and was not affected by salmonella issues in many other parts of the country. Based upon this fact, the South Carolina tomato producers received favorable prices for their product and enjoyed a good summer season. Peach production varied from farm to farm as some farms were affected by a late frost and scattered hail. With corn, peaches and pasture, the region has experienced a number of crop insurance claims.

Livestock and poultry producers have felt the effects of higher feed cost. Many beef cattle farmers, especially in the upper part of South Carolina, have reduced herd numbers

because of grain costs and the shortage of hay. The region's poultry integrators are encountering difficult times as increased feed costs have reduced liquidity built up during recent, profitable operating cycles. The Association has been prudent in requiring guarantees on most poultry grower accounts and over 50 percent of the outstanding volume loaned to broiler growers is guaranteed by the Farm Services Agency (FSA). Association staff is making every effort to stay abreast of the status of each integrator as this is a key factor affecting grower performance. Historically, South Carolina integrators have kept close communication with the lenders involved in the financing of poultry houses. The integrators continue to make some changes in growing cycles and size of birds produced, and these changes can adversely impact scheduled payments. Accordingly, the staff in areas handling broiler accounts have recently been evaluating each individual account to consider payment schedule modifications. As the third quarter ended, feed grain prices were receding some, and this should prove beneficial to the integrators if this trend continues. In South Carolina, there is one major egg integrator and the association is involved directly with this operation. The egg industry has enjoyed very profitable times recently.

Reduced housing starts and higher fuel costs have had a negative impact on the forestry industry. In most areas, timber prices have dropped since the end of the second quarter. The saw-mills and other timber processors within the area appear to be managing their cost closely given the difficult times. Loggers have experienced adversity primarily because of fuel cost and some have ceased their operations. Most remaining loggers now are closely associated with a given end-user or mill. The majority of the forest products and timber financing done by the Association is timberland financing with the bulk of these loans repaid from non-farm sources. A small percentage of these loans are guaranteed.

A significant portion of the region's loan volume is repaid through non-farm salaries and non-farm corporate income. With much of the region's loan volume including real estate financing in the form of cropland, pasture and timberland, the association makes every attempt to stay abreast of current real estate trends. Real estate sales started to slow in the second quarter and have remained at a slow pace through the end of the third quarter as compared to recent years. Real estate sales that are occurring are trading at values similar to 2007. Larger real estate loans within the region are typically retained with non-farm professionals and business owners. Most smaller and moderate size real estate loans include salaried individuals.

The present financial crisis in our country has negatively impacted South Carolina and the state is considered one of several states already in a recession as of quarter-end. A large contributing factor is the fact that South Carolina still has some older manufacturing companies which are being adversely affected by the economic environment. The South Carolina unemployment rate is now slightly above the

national rate. Eighteen counties in the state have unemployment in excess of 10%, and eleven of these are within the association's territory. Per capita income in the state also continues to fall below the national average. Overall, the state's economy is likely to remain slow barring unforeseen positive circumstances over the short term and no real significant improvement is anticipated well into 2009.

## **ASSOCIATION BALANCE SHEET**

The gross loan volume of the Association as of September 30, 2008, was \$1,455,797, an increase of \$131,957 or 9.97 percent as compared to \$1,323,840 at December 31, 2007. Net loans outstanding at September 30, 2008 were \$1,451,706 as compared to \$1,319,870 at December 31, 2007. Net loans accounted for 94.78 percent of total assets at September 30, 2008, as compared to 94.04 percent of total assets at December 31, 2007.

The increase in gross and net loan volume during the reporting period is primarily attributed to new loans and draws on annual operating credits to farmer/borrowers during the planting season. The Association continues to actively make large loans, some of which are participated with AgFirst Farm Credit bank and others. The Association is seeing increased demand for some credit needs as commercial banks back away from agricultural lending in the current economic environment. This has provided some opportunity for quality growth.

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 \$2,251 at December 31, 2007, to \$3,261 at September 30, 2008. This increase is the result of transfers to nonaccrual status exceeding payments and payoffs on existing nonaccrual accounts. There was one significant account transferred to nonaccrual status in January 2008 which totaled \$1,128. Association staff is working diligently to work out this and all other nonaccrual debt situations. Other property owned increased to \$216 at September 30, 2008 from \$40 at September 30, 2007. The increase in other property owned is one account with acreage and the Association is actively marketing this property for sale.

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, 2008, was \$4,091 compared to \$3,970 at December 31, 2007, and was considered by management to be adequate to cover possible losses. The slight 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 late September to review the allowance account. The ALCO determined that an addition to the allowance account was needed. The Association funded the allowance through the provision for loan loss by \$250.

Premises and equipment, net increased \$1,116 from \$11,681 at December 31, 2007 to \$12,797 at September 30, 2008. The Association recently completed a new office building in Sylvania, Georgia. The Association has purchased a lot in Douglas, Georgia and made a deposit on a lot in Rock Hill, South Carolina with plans to construct new buildings in both of these locations.

## **RESULTS OF OPERATIONS**

### ***For the three months ended September 30, 2008***

Net income for the three months ended September 30, 2008, totaled \$9,212 as compared to \$9,687 for the same period in 2007. Net interest income before the provision for loan loss increased \$575 for the three months ended September 30, 2008, as compared to the same period in 2007 due primarily to the increase in loan volume at higher margins and focused repricing activities. Net interest income after the provision for loan losses increased \$325 in the quarter ending September 30, 2008. 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 \$250 in September. The analysis included reviewing historical trends, loan size, loan performance and credit quality reports. The Board affirmed the action of the ALCO at the September board meeting.

At September 30, 2008, interest income on loans decreased \$1,636 compared to the same period in 2007. The decrease was due to the lower interest rate environment. Nonaccrual income, which is included in interest income, was \$108 for the three months ended September 30, 2008, as compared to \$227 for the same period in 2007.

Interest expense decreased \$2,211 for the three months ended September 30, 2008. 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 decreased \$992 over the same period last year. Loan fees decreased \$215 or 34.79 percent. The decrease in Loan fees is due to late charges, fees on loans sold and servicing fees on loans sold in the secondary mortgage market that were earned in 2007, but did not reoccur in this quarter of 2008. Fees for financially related services increased \$64 from \$115 at September 30, 2007 compared to

\$179 at September 30, 2008. The 55.65 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 \$236 from \$2,894 at September 30, 2007 to \$3,130 at September 30, 2008. The increase is the result of the higher average Notes Payable note balance and participations sold to other Associations.

Gains on the sale of rural homes loans decreased \$5 from \$186 at September 30, 2007 compared to \$181 at September 30, 2008. The decline in gains is the result of the general decline in the housing market. Other noninterest income decreased \$1,081 from \$1,050 at September 30, 2007 compared to a loss of \$31 at September 30, 2008. In the 2007 reporting period, the Association recorded a significant other gain. The gain was proceeds from a life insurance policy that was assigned to the Association in a troubled debt restructure. The loss recorded in the quarterly reporting period ending September 30, 2008 was from the necessary write-down to fair market value on the Association's deferred compensation plans that are maintained for current and retired employees.

Noninterest expense for the three months ended September 30, 2008, increased \$272 compared to the same period of 2007. Salaries and employee benefit expense increased \$246 between the two reporting periods. The 6.44 percent increase in Salaries and employee benefits is tied to 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, 2008 was \$497 compared to \$584 for the same period in 2007. A portion of the variance is the payment of annual maintenance agreements on phone and communication equipment in 2007 that has not yet been paid in 2008. It also includes furniture and equipment expensed in 2007 related to the occupancy of a new office building in Orangeburg, South Carolina. The Insurance Fund premium decreased \$21 from \$463 at September 30, 2007 to \$442 at September 30, 2008. The decrease in the premium expense is tied to change in the calculation of the expense by the insurance corporation. Other operating expenses increased \$134 from September 30, 2007, \$1,141, compared to \$1,275 at September 30, 2008. The increase is the result of higher gas and travel reimbursement rates for business travel and timing differences on expenditures booked to advertising and public & member relations and training between the two reporting periods.

#### ***For the nine months ended September 30, 2008***

Net income for the nine months ended September 30, 2008 totaled \$27,131 as compared to \$25,324 for the same period in 2007. Interest income decreased \$2,249 from \$81,442 at September 30, 2007 to \$79,193 at September 30, 2008. The variance was partially due to the lower interest rate environment during the comparative reporting periods. Nonaccrual income was \$302 for the nine months ended

September 30, 2008, as compared to \$419 for the same period in 2007.

Interest expense decreased \$4,144 from \$48,831 at September 30, 2007 to \$44,687 at September 30, 2008. The decrease in expense is tied to the lower interest rate environment. The Association was also able to lock-in a portion of its lendable equity at favorable rates further reducing interest expense.

Net interest income before the provision for loan loss increased \$1,895 when compared to the same period in 2007. During the nine month period ending September 30, 2008, 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 \$250 in September. The analysis included reviewing historical trends, loan size, loan performance and credit quality reports. The Board affirmed the action of the ALCO at the September board meeting. Net interest income after the provision for loan loss increased \$1,645. The increase in net interest income is the result of the increase in volume and increase in loan margins during the two reporting periods.

Noninterest income for the nine months ended September 30, 2008 totaled \$12,027 as compared to \$12,885 for the same period of 2007, a decrease of \$858. The decrease is primarily the result of other noninterest income not reoccurring in 2008 when compared to 2007. Other noninterest income at September 30, 2007 totaled \$1,349 compared to \$99 for the period ending September 30, 2008. The variance of \$1,250 includes the collection of proceeds from insurance proceeds assigned to the Association during a troubled debt restructure. Loan fee income decreased \$54 between the 2007 and 2008 reporting periods. Fees from financially related services increased \$69 between the reporting periods. Due to higher loans sold on a participation basis with AgFirst and other Farm Credit entities and a higher Notes Payable balance, the equity in earnings of other Farm Credit institutions increased \$466 from \$8,432 at September 30, 2007 to \$8,898 at September 30, 2008. Gains on other property owned increased from losses of \$12 to gains of \$32 between the two reporting periods. Gains on sale of rural home loans decreased \$133 from \$686 at September 30, 2007 to \$553 at September 30, 2008. The decline in gains is the result of lower activity in the secondary market.

Noninterest expense for the nine months ended September 30, 2008, decreased \$568 from \$19,727 at September 30, 2007 to \$19,159 at September 30, 2008. Salaries and employee benefits expense decreased \$652 between the two reporting periods. The decrease was primarily caused by increased deferrals of personnel expense related to the application of Financial Accounting Standards Bulletin (FASB) 91. The increase in deferrals is directly linked to loan activity in the first three quarters of 2008. The decrease was partially offset by the accrual of fifty percent (50%) of the estimated 2008 Incentive Plan payment in June. The accrual, which includes an estimate of benefit expense, totaled \$1,134. The Association's Incentive Plan is a

comprehensive plan that requires that a specific level of income and defined goals be achieved prior to participation. At June 30, 2008, Association management elected to book the accrual in anticipation of payout of the plan.

Occupancy and equipment expense decreased \$188 between the two reporting periods. This decrease is the result of the payment of property taxes in December 2007 rather than January 2008 and the payment of various expenses for furniture and equipment related to the new office building in Orangeburg, South Carolina. Insurance Fund premium expense was \$1,340 for the nine months ending September 30, 2007 compared to \$1,385 for the nine month period ending September 30, 2008. The increase in insurance fund expense is tied to the loan growth of the Association as well as a change in the basis for calculation of the premium expense by the insurance corporation. Other operating expenses includes communications, data processing, director expense, travel, training, advertising, public and member relations and all other expenses necessary to operate the Association. At September 30, 2007, these other expenses totaled \$3,576 compared to \$3,803 at September 30, 2008. The increase of \$227 is the result of timing differences in when expenses are incurred and additional higher travel expenses for business.

#### **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, 2008 was \$1,273,735 as compared to \$1,149,999 at December 31, 2007. The increase is related to the increase in loan volume between the two reporting periods.

As of September 30, 2008, the Association had invested \$138,900 of its lendable equity in fixed rate notes. These fixed rate notes will mature later in 2008 through October 2010.

#### **CAPITAL RESOURCES**

Total members' equity at September 30, 2008 increased to \$231,429 from the December 31, 2007 total of \$216,247. The increase is primarily attributed to the earnings of the Association offset by revolvement of allocated equities and the retirement of capital stock and participation certificates during the reporting period. At December 31, 2007, allocated

retained earnings totaled \$102,123. At September 30, 2008, the allocated retained earnings had decreased to \$90,417. In February 2008, the Association revolved \$11,839 in allocated surplus from the fiscal year 2002 series of equities. The checks and notices were mailed in late February to 12,558 customers. The revolvement is reflected in the change in allocated retained earnings during the two reporting periods.

Total capital stock and participation certificates were \$6,624 on September 30, 2008, compared to \$6,633 on December 31, 2007. 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, 2008, the Association's total surplus ratio and core surplus ratio were 14.34 percent and 10.92 percent, respectively, and the permanent capital ratio was 14.79 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, 2008, the Association had loans totaling \$14,952 in this program. No additional placement of loans is scheduled at this time. The cost of the guarantees year to date was \$69. The use of the Farmer Mac In-portfolio guarantee has a positive effect on the Association's capital ratios.

At December 31, 2007, the Association's permanent capital ratio was 15.52 percent. The decline to the 14.79 percent permanent capital at September 30, 2008 is the result of the growth in the Association's loan portfolio outpacing the addition to capital. Association management has discussed 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, 2008</b> <i>(unaudited)</i>	<b>December 31, 2007</b> <i>(audited)</i>
<b>Assets</b>		
Cash	\$ 1,291	\$ 4,429
Loans	1,455,797	1,323,840
Less: allowance for loan losses	4,091	3,970
Net loans	1,451,706	1,319,870
Loans held for sale	596	222
Accrued interest receivable	20,243	17,905
Investment in other Farm Credit institutions	21,904	21,790
Premises and equipment, net	12,797	11,681
Other property owned	216	40
Due from AgFirst Farm Credit Bank	8,308	12,178
Other assets	14,577	15,374
Total assets	<u>\$ 1,531,638</u>	<u>\$ 1,403,489</u>
<b>Liabilities</b>		
Notes payable to AgFirst Farm Credit Bank	\$ 1,273,735	\$ 1,149,999
Accrued interest payable	4,929	5,502
Patronage refund payable	207	9,946
Other liabilities	21,338	21,795
Total liabilities	<u>1,300,209</u>	<u>1,187,242</u>
Commitments and contingencies		
<b>Members' Equity</b>		
Protected borrower equity	350	457
Capital stock and participation certificates	6,274	6,176
Retained earnings		
Allocated	90,417	102,123
Unallocated	134,568	107,688
Accumulated other comprehensive income (loss)	(180)	(197)
Total members' equity	<u>231,429</u>	<u>216,247</u>
Total liabilities and members' equity	<u>\$ 1,531,638</u>	<u>\$ 1,403,489</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>	For the three months ended September 30,		For the nine months ended September 30,	
	2008	2007	2008	2007
<b>Interest Income</b>				
Loans	\$ 26,664	\$ 28,300	\$ 79,193	\$ 81,442
<b>Interest Expense</b>				
Notes payable to AgFirst Farm Credit Bank	14,886	17,082	44,584	48,689
Other	25	40	103	142
Total interest expense	14,911	17,122	44,687	48,831
Net interest income	11,753	11,178	34,506	32,611
Provision for (reversal of allowance for) loan losses	250	—	250	—
Net interest income after provision for (reversal of allowance for) loan losses	11,503	11,178	34,256	32,611
<b>Noninterest Income</b>				
Loan fees	403	618	2,049	2,103
Fees for financially related services	179	115	396	327
Equity in earnings of other Farm Credit institutions	3,130	2,894	8,898	8,432
Gains (losses) on other property owned, net	11	2	32	(12)
Gains (losses) on sale of rural home loans, net	181	186	553	686
Other noninterest income	(31)	1,050	99	1,349
Total noninterest income	3,873	4,865	12,027	12,885
<b>Noninterest Expense</b>				
Salaries and employee benefits	4,065	3,819	12,448	13,100
Occupancy and equipment	497	584	1,523	1,711
Insurance Fund premium	442	463	1,385	1,340
Other operating expenses	1,275	1,141	3,803	3,576
Total noninterest expense	6,279	6,007	19,159	19,727
Income before income taxes	9,097	10,036	27,124	25,769
Provision (benefit) for income taxes	(115)	349	(7)	445
Net income	\$ 9,212	\$ 9,687	\$ 27,131	\$ 25,324

*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, 2006	\$ 608	\$ 6,021	\$ 92,430	\$ 107,254	\$ —	\$ 206,313
Net income				25,324		25,324
Protected borrower equity retired	(136)					(136)
Capital stock/participation certificates issued/(retired), net		121				121
Retained earnings retired			(14,003)			(14,003)
Patronage distribution adjustment			944	(1,348)		(404)
Balance at September 30, 2007	\$ 472	\$ 6,142	\$ 79,371	\$ 131,230	\$ —	\$ 217,215
Balance at December 31, 2007	\$ 457	\$ 6,176	\$ 102,123	\$ 107,688	\$ (197)	\$ 216,247
Net income				27,131		27,131
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)
Employee benefit plans adjustments				(30)	17	(13)
Balance at September 30, 2008	\$ 350	\$ 6,274	\$ 90,417	\$ 134,568	\$ (180)	\$ 231,429

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

*AgSouth Farm Credit, ACA*

# Notes to the Consolidated Financial Statements

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

**NOTE 1 – ORGANIZATION AND SIGNIFICANT ACCOUNTING POLICIES**

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, 2007, are contained in the 2007 Annual Report to Shareholders. These unaudited third quarter 2008 consolidated financial statements should be read in conjunction with the 2007 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, 2008, are not necessarily indicative of the results to be expected for the year ending December 31, 2008.

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, 2008, the allowance for losses is adequate in management's opinion to provide for possible losses on existing loans.

In December 2007, the Financial Accounting Standards Board issued Statements of Financial Accounting Standards No. 141R, "Business Combinations" (SFAS 141R). SFAS 141R requires business combinations to be accounted for under the acquisition method of accounting (previously called the purchase method). The acquisition method requires (a) identifying the acquirer, (b) determining the acquisition date, (c) recognizing and measuring the identifiable assets acquired, the liabilities assumed, and any noncontrolling interest in the acquiree, at their acquisition date fair values, and (d) recognizing and measuring goodwill

or a gain from a bargain purchase. SFAS 141R should be applied prospectively to business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after December 15, 2008. Early application is prohibited. The Association is still evaluating the provisions of SFAS 141R, but believes that its adoption will significantly impact its accounting for combinations/acquisitions that may occur in 2009 and beyond.

**NOTE 2 – ALLOWANCE FOR LOAN LOSSES**

An analysis of the allowance for loan losses follows:

	<b>For the nine months ended September 30,</b>	
	<b>2008</b>	<b>2007</b>
Balance at beginning of period	\$ 3,970	\$ 3,806
Provision for (reversal of) loan losses	250	-
Loans (charged off), net of recoveries	(129)	116
<b>Balance at end of period</b>	<b>\$ 4,091</b>	<b>\$ 3,922</b>

**NOTE 3 – EMPLOYEE BENEFIT PLANS**

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

	<b>For the nine months ended September 30,</b>	
	<b>2008</b>	<b>2007</b>
Pension	\$ 805	\$ 1,257
401(k)	330	299
Other postretirement benefits	623	707
<b>Total</b>	<b>\$ 1,758</b>	<b>\$ 2,263</b>

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

	<b>Actual YTD Through 9/30/08</b>	<b>Projected Contributions For Remainder of 2008</b>	<b>Projected Total Contributions 2008</b>
Pension	\$ 64	\$ 22	\$ 86
Other postretirement benefits	438	152	590
<b>Total</b>	<b>\$ 502</b>	<b>\$ 174</b>	<b>\$ 676</b>

---

As of September 30, 2008, contributions of \$64 have been made to the pension plan for 2008. Actuarial projections as of the last plan measurement date (September 30, 2007) anticipated total contributions of \$86 for 2008. However, a new funding policy adopted during 2008 and a declining investment market, which has impacted the discount rate and the return on plan assets, will require an additional contribution to be made prior to the next plan measurement date at December 31, 2008. The additional contribution amount will be determined by the plan's Sponsor Committee.

In September 2006, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards No. 158, *Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans (SFAS 158)*, which required the recognition of the overfunded or underfunded status of pension and other postretirement benefit plans on the balance sheet. The balance sheet recognition provisions of SFAS 158 were adopted at December 31, 2007 by the Association.

SFAS 158 also requires that employers measure the benefit obligation and plan assets as of the fiscal year end for fiscal years ending after December 15, 2008. In fiscal 2007 and earlier, a September 30 measurement date was used for pension and other postretirement benefit plans. The Standard provides two approaches for an employer to transition to a fiscal year end measurement date. The approach applied by the Association allows for the use of the measurements determined for the prior year end. Under this alternative, pension and other postretirement benefit expense measured for the three-month period October 1, 2007 to December 31, 2007 (determined using the September 30, 2007 measurement date) is reflected as an adjustment to beginning 2008 unallocated retained earnings. As a result, the Association decreased unallocated retained earnings and increased the pension liability by \$30.

Upon adoption, SFAS 158 further required the determination of the fair value of plan assets and recognition of actuarial gains and losses, prior service costs or credits, and transition assets or obligations as a component of accumulated other comprehensive income (AOCI). These amounts are subsequently recognized as components of net periodic benefit costs. For the first nine months of 2008, \$17 has been recognized as a credit to AOCI and a debit to pension expense to reflect the amortization of the components previously recognized in AOCI.

Further details regarding employee benefit plans and adoption of SFAS 158 are contained in the 2007 Annual Report to Shareholders.