

AGSOUTH FARM CREDIT ANNUAL REPORT

2004



 **AgSouth**  
Farm Credit, ACA

AgSouth's Mission . . . . . 3

AgSouth's Leaders . . . . . 4

Products and Services . . . . . 5

Message to our Stockholders . . . . . 6

2004 Financial Results . . . . . 8

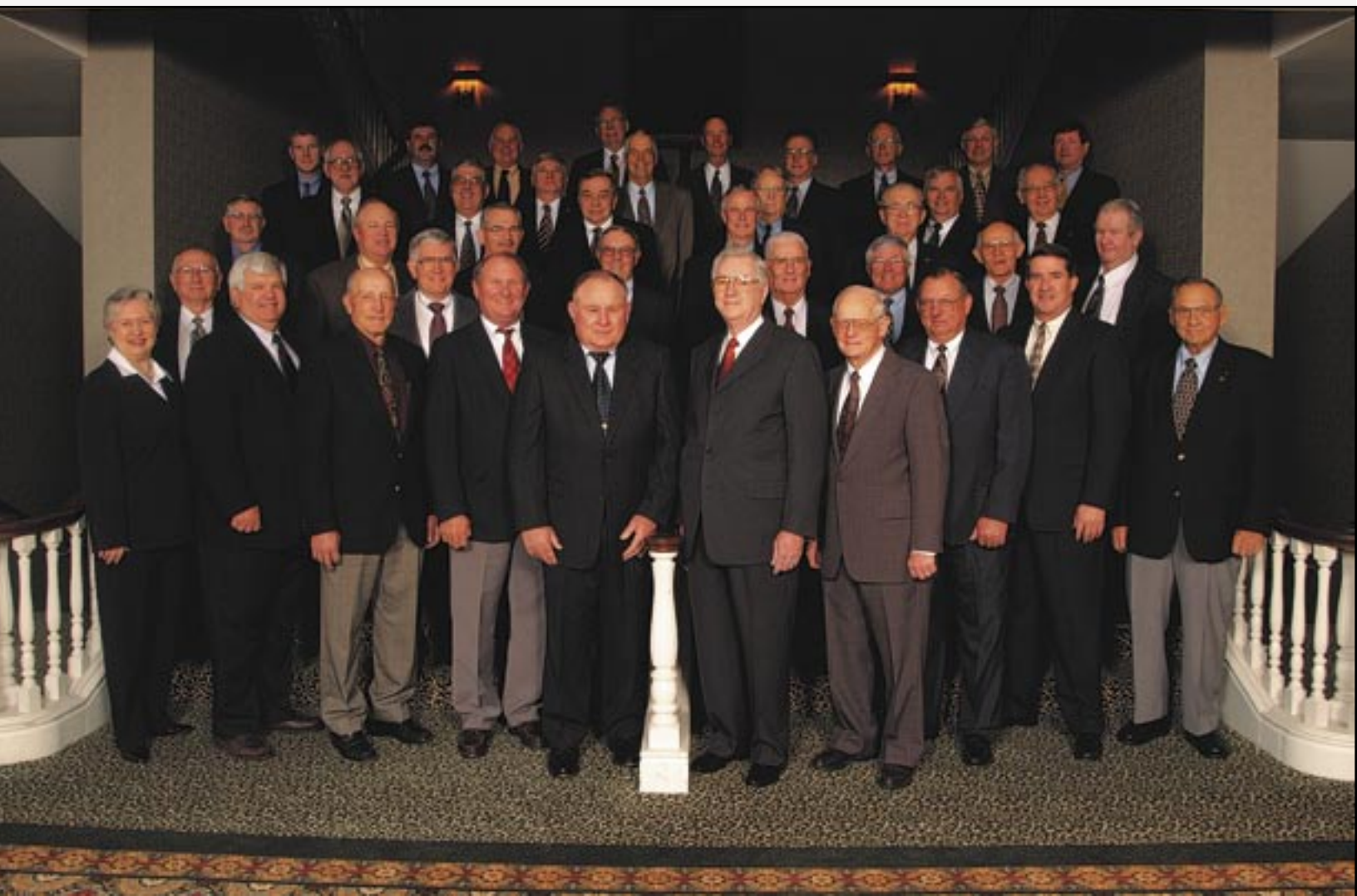


## AGSOUTH'S MISSION

*America's families enjoy high quality, affordable food and fiber thanks to the dedication of our nation's farm families and ag-related businesses. It is AgSouth's mission to support these families and businesses by being a source of reliable, cost-effective financial services.*



# AGSOUTH'S LEADERS



NOEL L. RIGGINS  
VICE CHAIRMAN

HARRY S. BELL  
CHAIRMAN

## BOARD OF DIRECTORS

GARY L. ALEXANDER  
JACK J. ARNOLD  
EARLE J. BEDENBAUGH  
KENNETH BENNETT  
ARTHUR Q. BLACK  
W. BAYNARD BOYKIN  
DOLAN E. BROWN  
CHARLES RAY BROWN  
T. W. BUZHARDT  
JAMES C. CARTER, JR.

THOMAS H. COWARD  
LOY D. COWART, JR.  
HERBERT A. DANIEL, SR.  
JACOB L. DAVIS, III  
LEE H. DELOACH  
W. LEWIS DUVALL  
DIANE H. EDWINS  
GEORGE A. HILLSMAN  
EUGENE T. JONES  
JEFFREY M. KNOWLES

A. HARVEY LEMMON  
EUGENE W. MERRITT, JR.  
JIMMY B. METTS  
SAMUEL A. MILFORD  
RICKY C. NORTH  
H. L. PAGE  
JEROME G. PARKER  
L. L. POST  
EDWARD M. RAST  
CHARLES C. RUCKS

JERRY A. SMOAK  
C. EARL THRAILKILL, JR.  
RAYMOND L. TUMBLESTON  
HUGH E. WEATHERS  
JOHN R. WELLS  
W. GORDON WELLS  
DAVID H. WOMACK  
ROBERT A. YOUMANS

*In addition to providing a variety of loans at competitive rates, AgSouth offers other products and services to better meet the needs of our members and rural America:*

### PATRONAGE PROGRAM

As a cooperative, AgSouth distributes profits to our members. Since 1991, AgSouth has distributed more than \$205 million to members through the patronage program, including more than \$141 million in cash. In 2004, AgSouth paid approximately \$29 in patronage for every \$100 in interest paid by users of the cooperative, proof that it *really* pays to do business with AgSouth!

### CROP INSURANCE PATRONAGE PROGRAM

In the summer of 2004, AgSouth introduced a patronage program for crop insurance. Similar to our loan patronage program, the crop insurance patronage program benefits those who purchase crop insurance through AgSouth by returning a portion of the association's crop insurance income to these patrons.

AgSouth has the same FCIC-subsidized rates offered by any other crop insurance agency, but by factoring in AgSouth's crop insurance patronage return, our patrons are able, in effect, to reduce their crop insurance premiums.

### HOME MORTGAGES

AgSouth Mortgages, a subsidiary of AgSouth Farm Credit, provides a variety of home loans at competitive rates, another way the association helps improve the quality of life in America.

### INSURANCE

AgSouth has licensed insurance agents on staff to help protect our patrons' livelihoods with crop and life insurance from reputable, distinguished companies.

### LEASES

AgSouth offers leasing programs for farms, ag-related businesses and commercial operations for everything from equipment to building structures. (Leases may be tax-exempt, but you should consult your financial advisor for advice regarding your particular situation.)

### ACCOUNTACCESS/LOANLINE

Check your account information and even make payments 24 hours a day, 7 days a week, through AccountAccess. Just sign up @ [www.agsouthfc.com](http://www.agsouthfc.com), and access your loan information even when you don't have access to your loan officer. No Internet access? No problem. Just dial 1-877-LoanLine and access the same information by phone.

### AUTODRAFT

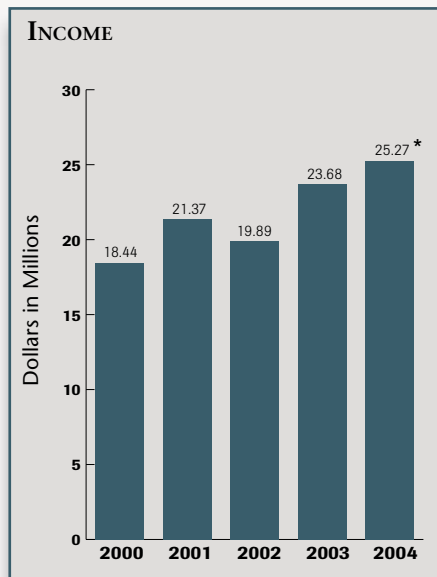
AutoDraft automatically deducts your payments from your bank account, whether they're monthly, quarterly or annually. With AutoDraft, there's no check to write, no stamp to lick and one less item on your "to do" list.

### FASTCASH

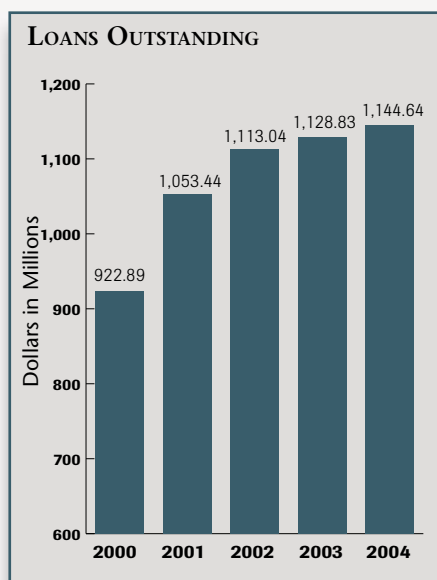
Use FastCash to withdraw funds from your line of credit with a simple phone call to your branch office. We'll electronically transfer funds from your line of credit to your checking or savings account, and the money will be in your account the next day.

## MESSAGE TO OUR STOCKHOLDERS

*This past year has presented many challenges as we merged Palmetto Farm Credit and AgSouth Farm Credit into the “new” AgSouth. However, along with challenges come new opportunities to build on our past achievements and create an even more profitable and responsive association for our members.*



\*ADJUSTED FOR ALLOWANCE REVERSAL OF \$21.03 MILLION



**I am pleased to report that our first year was very successful. In approving the merger, your board had three short-term goals:**

- To increase association earnings;
- To enhance and improve the patronage program; and
- To improve and expand our services.

In reviewing the association’s accomplishments during 2004, we can see that not only were these goals achieved, but also through careful management and strong leadership from your board, your association is now positioned for even greater success in the coming years.

Earnings for 2004 exceeded budget projections and record 2003 combined earnings of \$23.68 million. Loan fees, volume and spreads also exceeded expectations, as did our patronage return from AgFirst. Included in the 2004 earnings is the reversal of \$21.03 million in allowance for loan losses. This reversal was due to a directive of our regulator, the Farm Credit Administration. For more information on the allowance reversal, please see the notes to the financial statements. These significant earnings will allow the association to build capital faster than originally projected, as well as enable us to return a significant patronage distribution to our members – estimated to be 29 percent of total interest paid. The strong capital position allows all patrons to be on the same five-year revolvment cycle.

In addition to changes in the financial strength of your cooperative, the association went through other changes in 2004 that should prove to be beneficial to members. At the beginning of the year, the South Carolina credit staff was restructured to more effectively utilize their many talents to improve marketing efforts, provide better risk management and enhance customer service. We should continue to see further loan growth from this effort in 2005.

As part of the challenge to improve services, we continued to expand the secondary mortgage department, as well as crop insurance sales in South Carolina. During 2004 we hired or contracted with a number of originators. This expansion will enhance our secondary market operations and increase association income. Furthermore, late in 2004 we received approval to establish a patronage pool for our crop

insurance customers. This new program should help greatly expand our crop insurance sales in both Georgia and South Carolina. Crop insurance profits will be returned to those who purchase crop insurance from the association in much the same way as the general patronage program returns profits to those who borrow money from the cooperative.

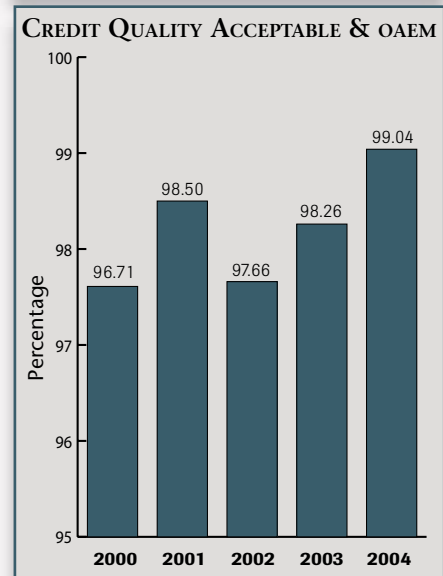
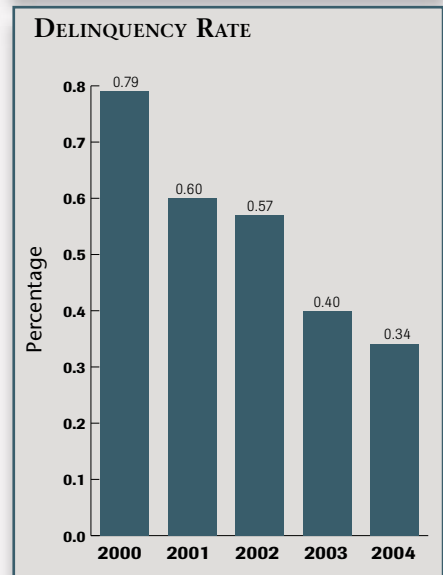
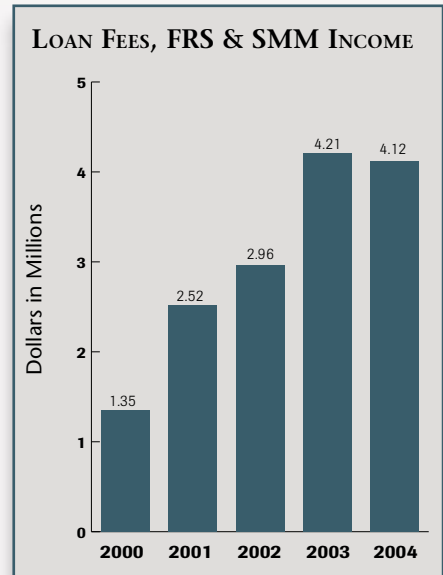
Long term, we believe the 2004 merger has given us the opportunity to continue to expand profits and services, while allowing for greater diversity and better risk management. I am very pleased that our portfolio continues to exhibit exceptional credit quality and, as you would expect, extremely low delinquencies. An association is only as good as its customers, and AgSouth is proud to be home to some of the best in the nation.

In preparing for the future of AgSouth, we completed or began facility upgrades in Baxley and Statesboro, Georgia, and in Laurens, Batesburg and Camden, South Carolina. Most of these upgrades will be completed in 2005. We are also looking at a more accessible location in the Aiken, South Carolina area. These new facilities will enhance our ability to deliver quality service to our members and the communities served by these branches.

Implementation of new technology continues to make our staff more efficient by enabling them to meet your growing financial needs and provide the personal service you expect from AgSouth employees. One benefit is through a new program called AccountAccess. This new program allows you to access your loan information online or by phone, and even make online payments 24 hours a day 7 days a week. You can sign up for AccountAccess through our informative web site at [www.agsouthfc.com](http://www.agsouthfc.com).

As we plan for 2005 and beyond, I am very proud of the extremely dedicated staff of AgSouth, whose primary focus continues to be to make you, our members, successful. It will be the objective of your board and management to deliver another record year, substantial patronage and significant revolvments of allocated surplus. It has always been our goal to operate in a safe and sound manner while delivering tangible benefits to you. If 2004 is any indication, the new AgSouth is better, stronger and more focused than ever on serving you, our members.

William P. Spigener, Jr., CEO



## CONTENTS

---

REPORT OF MANAGEMENT . . . . .	9
FIVE-YEAR SUMMARY . . . . .	10
MANAGEMENT'S DISCUSSION & ANALYSIS OF FINANCIAL CONDITION & RESULTS OF OPERATIONS . . . . .	11
DISCLOSURE REQUIRED BY FCA REGULATIONS . . . . .	17
AUDIT COMMITTEE REPORT . . . . .	22
REPORT OF INDEPENDENT AUDITORS . . . . .	23
CONSOLIDATED FINANCIAL STATEMENTS . . . . .	24
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS . . . . .	28

The accompanying consolidated financial statements and related financial information appearing throughout this annual report have been prepared by management of AgSouth Farm Credit, ACA (the Association) in accordance with generally accepted accounting principles appropriate in the circumstances. Amounts which must be based on estimates represent the best estimates and judgments of management. Management is responsible for the integrity, objectivity, consistency, and fair presentation of the consolidated financial statements and financial information contained in this report.

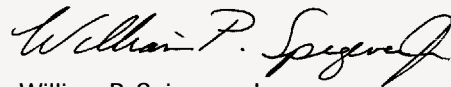
Management maintains and depends upon an internal accounting control system designed to provide reasonable assurance that transactions are properly authorized and recorded, that the financial records are reliable as the basis for the preparation of all financial statements, and that the assets of the Association are safeguarded. The design and implementation of all systems of internal control are based on judgments required to evaluate the costs of controls in relation to the expected benefits and to determine the appropriate balance between these costs and benefits. The Association maintains an internal audit program to monitor compliance with the systems of internal accounting control. Audits of the accounting records, accounting systems and internal controls are performed and internal audit reports including appropriate recommendations for improvement, are submitted to the Board of Directors.

The consolidated financial statements have been examined by independent public auditors, whose report appears elsewhere in this annual report. The Association is also subject to examination by the Farm Credit Administration.

The consolidated financial statements, in the opinion of management, fairly present the financial condition of the Association. The undersigned certify that the 2004 Annual Report has been prepared 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.



Harry S. Bell  
Chairman of the Board



William P. Spigener, Jr.  
Chief Executive Officer



Alisa D. Gunter  
Chief Financial Officer

March 3, 2005

# CONSOLIDATED FIVE-YEAR SUMMARY OF SELECTED FINANCIAL DATA

(UNAUDITED)

<i>(dollars in thousands)</i>	<b>December 31,</b>				
	<b>2004</b>	<b>2003</b>	<b>2002</b>	<b>2001</b>	<b>2000</b>
<b>Balance Sheet Data</b>					
Cash	\$ 6,048	\$ 4,654	\$ 5,404	\$ 5,490	\$ 5,939
Loans	1,144,637	1,128,828	1,113,040	1,053,437	922,895
Less: allowance for loan losses	4,021	25,253	25,446	26,306	25,384
Net loans	1,140,616	1,103,575	1,087,594	1,027,131	897,511
Investment in other Farm Credit institutions	15,492	16,207	19,271	22,497	24,527
Other property owned	403	1,030	1,825	1,828	1,790
Other assets	49,947	29,485	38,920	37,512	36,738
Total assets	\$ 1,212,506	\$ 1,154,951	\$ 1,153,014	\$ 1,094,458	\$ 966,505
Notes payable to AgFirst Farm Credit Bank *	\$ 996,763	\$ 968,284	\$ 980,076	\$ 920,363	\$ 801,905
Accrued interest payable and other liabilities with maturities of less than one year	26,988	34,789	29,218	22,492	17,388
Total liabilities	1,023,751	1,003,073	1,009,294	942,855	819,293
Protected borrower equity	1,197	1,530	2,021	2,808	3,590
Capital stock and participation certificates	6,010	6,304	6,468	6,579	6,497
Retained earnings					
Allocated	81,401	79,978	77,088	73,924	70,331
Unallocated	100,147	75,502	70,619	68,292	66,794
Accumulated other comprehensive income (loss)	—	(11,436)	(12,476)	—	—
Total members' equity	188,755	151,878	143,720	151,603	147,212
Total liabilities and members' equity	\$ 1,212,506	\$ 1,154,951	\$ 1,153,014	\$ 1,094,458	\$ 966,505
<b>Statement of Income Data</b>					
Net interest income	\$ 38,114	\$ 35,490	\$ 31,067	\$ 29,359	\$ 28,018
Provision for (reversal of) loan losses**	(21,033)	(396)	3,000	900	—
Noninterest income (expense), net	(12,842)	(12,210)	(8,179)	(7,087)	(9,577)
Net income	\$ 46,305	\$ 23,676	\$ 19,888	\$ 21,372	\$ 18,441
<b>Key Financial Ratios</b>					
Rate of return on average:					
Total assets	4.02%	2.06%	1.78%	2.11%	2.00%
Total members' equity	30.04%	15.89%	12.96%	14.26%	12.63%
Net interest income as a percentage of average earning assets					
	3.38%	3.19%	2.86%	3.02%	3.26%
Net chargeoffs (recoveries) to average loans					
	0.018%	(0.018)%	0.352%	(0.002)%	0.020%
Total members' equity to total assets					
	15.57%	13.15%	12.46%	13.85%	15.23%
Debt to members' equity (:1)					
	5.42	6.60	7.02	6.22	5.57
Allowance for loan losses to loans					
	0.35%	2.24%	2.29%	2.50%	2.75%
Permanent capital ratio					
	14.59%	14.36%	12.92%	12.97%	13.70%
Total surplus ratio					
	14.01%	13.82%	12.27%	12.30%	12.94%
Core surplus ratio					
	10.23%	9.61%	9.05%	9.12%	9.42%
<b>Net Income Distribution</b>					
Estimated patronage refunds:					
Cash dividend	\$ 6,392	\$ 5,671	\$ 5,131	\$ 5,891	\$ 5,103
Qualified allocated retained earnings	—	2,650	1,987	8,938	11,907
Nonqualified allocated retained earnings	14,915	10,582	9,985	4,806	—

\* General financing agreement is renewable on three-year cycles. The next renewal date is December 31, 2005.

\*\* A reversal of provision, shown in brackets, is an increase to net income.

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

DOLLARS IN THOUSANDS, EXCEPT AS NOTED

The following commentary summarizes the financial condition and results of operations of AgSouth Farm Credit, ACA, (Association) for the year ended December 31, 2004 with comparisons to the year ended December 31, 2003. This information should be read in conjunction with the Consolidated Financial Statements, Notes to the Consolidated Financial Statements and other sections in this Annual Report.

On July 15, 2003, the Association stockholders of AgSouth Farm Credit, ACA (AgSouth) and Palmetto Farm Credit, ACA (Palmetto), approved a plan of consolidation to form AgSouth Farm Credit, ACA (the Association). On August 28, 2003, the Farm Credit Administration gave its final approval for the consolidation, which was effective January 1, 2004. The consolidated association is called AgSouth Farm Credit, ACA (AgSouth), and is headquartered in Statesboro, Georgia.

The Association is an institution of the Farm Credit System, which was created by Congress in 1916 and has served agricultural producers for almost 90 years. The System mission is to maintain and improve the income and well-being of American farmers, ranchers, and producers or harvesters of aquatic products and farm-related businesses. The Farm Credit System is the largest agricultural lending organization in the United States. The Farm Credit System is regulated by the Farm Credit Administration, (FCA) which is an independent safety and soundness regulator.

The Association is a cooperative, which is owned by the members served. The territory of the Association extends across a diverse agricultural region of Georgia and South Carolina. Refer to Note 1 of the Notes to the Consolidated Financial Statements for counties in the Association's territory. The Association provides credit to farmers, ranchers, rural residents, and agribusinesses. Our success begins with our extensive agricultural experience and knowledge of the market.

The Association obtains funding from AgFirst Farm Credit Bank (the Bank). The Association is materially affected by the financial condition and results of operations of the Bank. Copies of the AgFirst Farm Credit Bank's Quarterly and Annual Reports are on the AgFirst website, [www.agfirst.com](http://www.agfirst.com), or may be obtained at no charge by calling 1-800-845-1745, extension 378. Copies of the Association's quarterly reports are available on the Association's website, [www.agsouthfc.com](http://www.agsouthfc.com), or may be obtained upon request free of charge by calling 1-800-310-4805, extension 237 or writing Alisa D. Gunter at PO BOX 4966, Spartanburg, SC 29305.

## ECONOMIC CONDITIONS

The Georgia economy continued its slow recovery during 2004 with an estimated Gross State Product increase of 3.8 percent. While this was the highest increase since 2000, it was the 5<sup>th</sup> straight year of sub par economic growth. 2005 should see improvements in sectors such as hospitality, manufacturing, and technology industries with air transportation continuing to experience trouble. A weakening in the value of the dollar has spurred export markets, reduced competition from imports for Georgia based manufacturers, and provided some stimulus for the manufacturing and agricultural sectors. Georgia's agriculture sector experienced average yields and relied heavily on price supports provided in the current farm bill for most major commodities as market conditions drove down most commodity prices from those in 2003. Poultry, cattle, and forest products

industries experienced relatively good market conditions. The unusual number of hurricanes, which bombarded the state through the growing season, hurt farm production but, given the number and intensity of those weather events, the AgSouth region of Georgia fared reasonably well. We also faced challenges presented by several new crop diseases in onions and soybeans, which if not eliminated will impact future production cost and yields.

During 2004, the South Carolina region of AgSouth, enjoyed very good crop results primarily attributed to the timely rainfall received during the growing cycle. Year-end results indicate cotton yields per acre set new state records even though harvested acres decreased slightly compared to 2003 and 2002. The state of South Carolina has experienced a substantial increase in peanut acreage over the past three years with the harvested acres in 2004 totaling 33,000 acres. Three new peanut buyers have located buying stations within the South Carolina service area since 2001. Corn production was also favorable with the total production increasing by 31 percent over the previous year to 29.5 million bushels. Growing conditions for wheat were average, and this crop yielded typical production when considering both the irrigated and non-irrigated crop. Even though South Carolina is not a significant producer of the crops noted in a national or global sense, the world supplies of these crops, excepting peanuts, have essentially led to depressed prices compared to the previous year. Peanuts, which are virtually all produced on a contract basis, provided South Carolina farmers' reasonable returns per unit in 2004 and were profitable. Turkey production in South Carolina and on a national basis has been going through a transition and one integrator in the state reduced production due to supply issues, which adversely affected growers. The integrator involved has noted a desire to improve production in late 2005 assuming the supply and demand circumstance has balanced out, which should lead to improved production and cash flows for the state's turkey farmers.

Dairy farmers throughout the Association continue to be strained by the volatility of the price received for their commodity even though the 2004 price did not reach the lower levels experienced in 2003. The broiler industry in the Association remains strong with the integrators enjoying profits and undertaking varying levels of expansion. Broiler grow-out and breeder units constructed during 2004 represent a significant portion of the new loan volume generated in the Association for the past operating year. Beef cattle remained a bright spot with stocker calves and cattle continuing to provide the cattle farmers' profits during 2004.

The timber industry continues to represent one of the largest commodity sectors financed by the Association. Timberland values have continued to increase primarily due to recreation and potential long-term returns. Pulpwood continues to be somewhat depressed due to large supplies, while returns received for pine and hardwood saw timber and poles have remained reasonably stable since 2003. Prices in this industry continue to depend upon harvest conditions dictated to a significant degree by weather patterns.

The potential for 2005 loan growth in the Association remains positive. Real estate, poultry, and financing of lifestyle operations represent primary targets for future financing. Even though the broiler expansion might slow down in some areas of the territory served in 2005, this industry continues to represent an opportunity for our association. Timberland continues to sell as some larger timber companies reduce their investment in land. The timberland being

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

DOLLARS IN THOUSANDS, EXCEPT AS NOTED (CONTINUED)

marketed should allow for the opportunity to finance both large and mid-size tracts for long-term real estate investors and lifestyle or part-time operators. Non-farm salaried investors and part-time farmers continue to focus on buying tracts of farmland and timberland of all sizes as this allows for living in desirable rural areas of the territory served and in some instances provides the opportunity to supplement off-farm income.

## 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 through numerous product types.

The gross loan volume of the Association as of December 31, 2004, was \$1,144,637, an increase of \$15,809 or 1.40 percent as compared to \$1,128,828 at December 31, 2003. Net loans outstanding (gross loans net of the allowance for loan losses) on December 31, 2004, were \$1,140,616 as compared to \$1,103,575 at December 31, 2003. Net loans accounted for 94.07 percent of total assets on December 31, 2004 as compared to 95.66 percent of total assets at December 31, 2003.

The geographic distribution of the loans by branch based on volume outstanding is as follows:

Branch	12/31/04	12/31/03
Aiken	2.58%	2.27%
Allendale	3.73	3.66
Anderson	5.90	5.77
Batesburg	6.16	6.01
Baxley	3.55	3.34
Blackshear	2.15	4.01
Brunswick	.01	—
Camden	4.52	3.85
Carrollton	1.66	2.20
Corporate Georgia	—	.27
Corporate South Carolina	.26	.87
Covington	2.03	1.85
Douglas	3.55	3.95
Greenville	3.47	3.62
Greenwood	2.27	2.70
Griffin	1.41	1.62
Jesup	1.68	—
Laurens	3.80	3.64
Madison	7.51	8.06
Orangeburg	3.89	4.18
Rock Hill	2.52	2.28
Spartanburg	4.10	4.26
St Matthews	1.95	1.88
Statesboro	6.30	6.60
Summerville	4.08	4.39
Sylvania	1.24	1.23
Thomaston	6.13	6.51
Vidalia	3.00	2.60
Walterboro	4.99	4.29
Participations	5.17	3.85
SAM	.39	.24
	<u>100.00%</u>	<u>100.00%</u>

The diversification of the Association loan volume by type is shown below:

Loan Type	12/31/04	12/31/03
Long-term farm mortgage	69.59%	67.35%
Production and intermediate-term	34.68	32.13
Rural home	4.82	5.99
Farm-related business	.94	.84
Aquatic	.07	.09
Processing & Marketing	1.47	2.68
Leases	—	.13
Sales contracts/purchase		
money mortgages	.25	.34
Nonaccrual	.53	.44
Participations purchased	2.04	3.45
Less: participations sold	<u>14.39</u>	<u>13.44</u>
	<u>100.00%</u>	<u>100.00%</u>

The Association's loan portfolio is diversified over a range of agricultural commodities in our region as shown in the table below. Predominant commodities in the portfolio are timber and related processing and harvesting, poultry, beef cattle, and feed grains, soybeans and hay that constitute over 69.61 percent of the entire portfolio.

Commodity Group	12/31/04	12/31/03
Timber	37%	35%
Broilers	13	12
Beef Cattle, Pasture	7	8
Feed/Grain/Soybeans/Hay	7	7
Cotton	5	5
Rural Home, Purchase Money Mortgage	5	7
Horses	4	4
Landlords	3	3
Timber Processing/Harvesting	3	3
Dairy	2	2
Eggs	2	2
Sod/Nursery	2	3
Fruit and Nut	1	2
Hogs	1	1
Turkeys	1	1
Vegetables	1	1
Other	6	4
	<u>100%</u>	<u>100%</u>

Repayment ability is closely related to the commodities produced by our borrowers, and increasingly, the off-farm income of borrowers. The Association's loan portfolio contains a concentration of poultry producers. Although a large percentage of the loan portfolio is concentrated in these enterprises, many of these operations are diversified within their enterprise and/or with crop production that reduces overall risk exposure. Demand for beef, prices of field grains, and international trade are some of the factors affecting the price of these commodities. Even though the concentration of large loans has increased over the past several years, the agricultural enterprise mix of these loans is diversified and similar to that of the overall portfolio. The risk in the portfolio associated with commodity concentration and large loans is reduced by the range of diversity of enterprises in the Association's territory.

Concentration of risk in the loan portfolio, whether by enterprise, individuals, or related parties, is managed through loan participations, underwriting standards, internal lending limits, and sound portfolio management and monitoring practices. As a part of these risk management strategies, the Association has entered into participation agreements with AgFirst and System entities. Please refer to Note 4 in the Notes to the Consolidated Financial Statements

section of this Annual Report for additional information concerning the loan types and loan portfolio. The Association continues to participate in the Farmer Mac Long-Term Standby Commitment (LTSB) program. Under this LTSB program, a loan is repurchased in the event the loan becomes 120 days or more past due, thus allowing the Association to effectively reduce its existing portfolio risk. At December 31, 2004, the Association had loans amounting to \$47,396 which were 100 percent guaranteed by Farmer Mac, compared to \$72,159 last year.

The increase in gross and net loan volume during the reporting period is primarily attributed to aggressive marketing efforts by the lending staff. The Association has been fortunate to regain several large, former accounts and has attracted some large real estate loans in addition to normal business.

The portfolio split between long-term volume and short and intermediate term volume has remained stable over the past several years. The short-term portfolio, which is heavily influenced by operating-type loans, normally reaches a peak balance in August and rapidly declines in the fall months as commodities are marketed and proceeds are applied to repay operating loans.

During 2004, the Association increased activity in the buying and selling of loan participations within and outside of the Farm Credit System (FCS). This provides a means for the Association to spread credit concentration risk and realize non-patronage sourced interest and fee income, which may strengthen the capital position.

#### Loan Participations:

	2004	2003
Participations Purchased		
– FCS Institutions	\$ 20,016	\$ 34,694
Participations Purchased		
– Non-FCS Institutions	3,297	4,259
Participations Sold	(164,600)	(151,725)
Total	\$ (141,287)	\$ (112,772)

The Association sells qualified long-term mortgage loans into the secondary market. For the year ended December 31, 2004, the Association originated loans for resale totaling \$107,835, which were sold into the secondary market, compared to \$115,263 the previous year.

The Association's loan portfolio is divided into performing and high-risk categories. As a part of a system to evaluate the success of a loan, the Association continues to review the credit quality of the loan portfolio on an ongoing basis. A Special Assets Management Department is responsible for servicing loans classified as high-risk. The high-risk assets, including accrued interest, are detailed below:

	12/31/04	12/31/03
<b>High-risk Assets</b>		
Nonaccrual loans	\$ 6,123	\$ 4,950
Restructured loans	–	48
Accruing loans 90 days past due	–	–
Total high-risk loans	6,123	4,998
Other property owned	403	1,030
Total high-risk assets	\$ 6,526	\$ 6,028

#### Ratios

Nonaccrual loans to total loans	.54%	.44%
High-risk assets to total assets	.54%	.52%

Nonaccrual loans represent all loans where there is a reasonable doubt as to the collection of principal and/or interest under the contractual terms of the loan. Nonaccrual loans increased \$1,173, or 23.70 percent in 2004. This increase resulted from transfers to

nonaccrual status exceeding payments and liquidations during 2004. Some decrease in the Association's nonaccrual balance is expected in early 2005. Of the \$6,123 in nonaccrual volume at December 31, 2004, \$615 or 10.04 percent, compared to 42.40 percent at December 31, 2003, was current as to scheduled principal and interest payments, but did not meet all regulatory requirements to be transferred into accrual status.

Loan restructuring is available to financially distressed borrowers. Restructuring of loans occurs when the Association grants a concession to a borrower based on either a court order or good faith in a borrower's ability to return to financial viability. The concessions can be in the form of a modification of terms or rates, a compromise of amounts owed, or deed in lieu of foreclosure. Other receipts of assets and/or equity to pay the loan in full or in part are also considered restructured loans. The type of alternative financing structure chosen is based on minimizing the loss incurred by both the Association and the borrower.

#### Credit Quality

We review the credit quality of the loan portfolio on an on-going basis as part of our risk management practices. During 2004 the Association converted from the Uniform Classification System to the Combined System Model, which is now used by all Farm Credit System institutions. Below are the classification definitions.

- *Acceptable* – Assets are expected to be fully collectible and represent the highest quality.
- *Other Assets Especially Mentioned (OAEM)* – Assets are currently collectible but exhibit some potential weakness.
- *Substandard* – Assets exhibit some serious weakness in repayment capacity, equity, and/or collateral pledged on the loan.
- *Doubtful* – Assets exhibit similar weaknesses to substandard assets. However, doubtful assets have additional weaknesses in existing facts, conditions and values that make collection in full highly questionable.
- *Loss* – Assets are considered uncollectible.

The following table presents selected statistics related to the credit quality of loans including accrued interest at December 31.

	2004	2003
Acceptable & OAEM	99.04%	98.26%
Substandard	.92	1.74
Doubtful	.04	–
Loss	–	–
Total	100.00%	100.00%

#### Allowance for Loan Losses

During 2004, the Association completed its study to further refine the allowance for loan losses methodology taking into account recently issued guidance by the FCA, the System's regulator, as well as the Securities and Exchange Commission (SEC) and Federal Financial Institutions Examination Council. As a result of this study and the resulting refinements in methodology, during the fourth quarter of 2004, the Association recorded a \$21,033 reversal of the allowance for loan losses.

The Association's allowance for loan losses methodology was adjusted and revised in the late 1980s to take into account the credit losses experienced in the mid-to-late 1980s, as a result of unusually adverse economic factors affecting American agriculture. Given the long cyclical nature of the agricultural economy, loss factors utilized to determine the allowance for loan losses subsequent to 1989 continued to reflect, to some extent, the loss history of the mid-to-late

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

DOLLARS IN THOUSANDS, EXCEPT AS NOTED (CONTINUED)

1980s, which resulted in conservative estimates of the allowance for loan losses. The Association's allowance for loan losses methodology utilized throughout the period was in accordance with generally accepted accounting principles and was consistently applied. While conservative in estimating the allowance for loan losses, the methodology used resulted in annual provisions for loan losses over the periods that reflected changes in credit quality and loss experience. Accordingly, the reserves provided in the mid-to-late 1980s have, in effect, remained part of the allowance for loan losses. The Association's allowance for loan losses methodology has consistently adhered to proper accounting policies, under the regulatory supervision of the FCA in its role as a "safety and soundness" regulator. It was the FCA's view that the allowance for loan losses should include among others, an assessment of: probable losses, historical loss experience and economic conditions.

In April 2004, the FCA issued an "Informational Memorandum" to System institutions regarding the criteria and methodologies that would be used in evaluating the adequacy of a System institution's allowance for loan losses. The Farm Credit Administration endorsed the direction provided by other bank regulators and the SEC and indicated the conceptual framework addressed in their guidance would be included as part of their examination process.

The refinement in methodology resulted in a calculated allowance for loan losses that was significantly less than the previously recorded balance due to revised loss factors that are more indicative of actual loss experience in recent years and current borrower analysis. The factors considered in determining the revised level of allowance for loan losses were generally based on recent historical charge-off experience adjusted for relevant environmental factors. The Association considered the following when adjusting the historical charge-offs experience:

- changes in credit risk classifications,
- changes in collateral values,
- changes in risk concentrations,
- changes in weather related conditions, and
- changes in economic conditions.

While the reversal had a significant impact on 2004 results of operations and the previously recorded allowance for loan losses, the refinement in methodology is not expected to have a significant impact on comparative results of operations in future periods. Additionally, the refinement in methodology did not have a significant impact on the level of the risk bearing capacity of the Association, generally referred to as "risk funds" (capital plus the allowance for loan losses), which totaled \$192,776 million at December 31, 2004 (16.84 percent of Association loans), as compared with \$177,131 million at December 31, 2003 (15.69 percent of Association loans).

The following table provides relevant information regarding the allowance for loan losses at December 31.

	2004	2003
Allowance for loan losses	\$ 25,253	\$ 25,446
Provision for (reversal of) loan losses	(21,033)	(396)
Net charge-offs/recoveries	(199)	203
Allowance for loan losses to loans	.35%	2.24%
Allowance for loan losses to nonaccrual loans	65.67%	510.16%
Allowance for loan losses to impaired loans	65.67%	505.26%
Net charge-offs/recoveries to average loans	.018%	(.018)%

Please refer to Note 4 in the Notes to the Consolidated Financial Statements of this Annual Report for further information concerning the allowance for loan losses.

## EMPLOYEE RETIREMENT PLANS

As of December 31, 2004, the Association had contributed \$13,697 to the Districtwide defined benefit retirement plan. The Districtwide funding brings the retirement plan's assets to an amount exceeding the Accumulated Benefit Obligation. The contributions eliminated the minimum pension liability with \$11,436 of the contributions being classified as prepaid retirement expense in other assets on the Consolidated Balance Sheets. Assuming that interest rates and returns on investments remain constant, benefits to the Association in subsequent periods should include improved net income due to lower retirement expense and the elimination of the pension-related charge to accumulated other comprehensive income in the shareholders' equity. See Note 10, Employee Benefit Plans, in the Notes to the Consolidated Financial Statements of this report for further information.

## RESULTS OF OPERATIONS

Net income for the year ended December 31, 2004, totaled \$46,305, an increase of \$22,629 or 95.58 percent, as compared to \$23,676 for the same period of 2003. Interest income for the year ended December 31, 2004, was \$73,052, an increase of \$263 or .36 percent as compared to \$72,789 for the same period of 2003. Interest income decreased by \$3,470 for the year ended December 31, 2003, compared to 2002. Major components of the changes in net income for the past two years are outlined in the following table.

### Changes in Net Income:

	2004-2003	2003-2002
<b>Net income (prior year)</b>	\$ 23,676	\$ 19,888
<b>Increase (decrease) in net income due to:</b>		
Interest income	263	(3,470)
Interest expense	(2,361)	(7,893)
Net interest income	2,624	4,423
Provision for loan losses	(20,637)	(3,396)
Noninterest income	2,188	1,170
Noninterest expense	3,048	4,896
Provision for income taxes	(228)	305
Total changes in income	22,629	3,788
<b>Net income</b>	<b>\$ 46,305</b>	<b>\$ 23,676</b>

Net interest income before the provision reversal increased by \$2,624 or 7.39 percent in 2004 compared to 2003. The primary reason for this increase was the increase in loan volume and an increased focus on loan pricing. The Association's net interest income as a percentage of average earning assets was 3.38 percent on December 31, 2004, compared to 3.19 percent on December 31, 2003. The increase is mainly attributed to aggressive marketing efforts to attract and obtain loans as well as increased efforts on loan pricing.

Interest income on nonaccrual loans for 2004, totaled \$1,155, an increase of \$155, compared to \$1,000 for 2003. Please refer to the Consolidated Five-Year Summary of Selected Financial Data in this Annual Report to review key financial ratios pertaining to earnings and net interest income. The sources of change in net interest income are illustrated, as follows:

### Change in Net Interest Income:

	Volume*	Rate	Nonaccrual Income	Total
<b>12/31/04 - 12/31/03</b>				
Interest income	\$ 1,087	\$ (978)	\$ 155	\$ 264
Interest expense	799	(3,159)	—	(2,360)
Change in net interest income	\$ 288	\$ 2,181	\$ 155	\$ 2,624
<b>12/31/03 - 12/31/02</b>				
Interest income	\$ 1,979	\$ (5,391)	\$ (59)	\$ (3,471)
Interest expense	805	(8,699)	—	(7,894)
Change in net interest income	\$ 1,174	\$ 3,308	\$ (59)	\$ 4,423

\* Volume variances can be the result of increased/decreased loan volume or from changes in the percentage composition of assets and liabilities between periods.

A reversal of the provision for loan losses at December 31, 2004 totaled \$21,033. The provision reversal at December 31, 2003 totaled \$396. The provision reversal in this 2004 fiscal year should be considered a nonrecurring event due to a refinement in the Allowance for Loan Loss methodology. Please refer to the Allowance for Loan Losses section discussed above.

Noninterest income for the year ended December 31, 2004, was \$16,433 as compared to \$14,245 the same period of 2003. The increase is primarily attributed to increase in loan fee income and fees for financially related services. The Association received \$7,987 in a patronage refund and \$3,677 in a special distribution from the Bank for the year ended December 31, 2004 as compared to \$8,466 and \$1,146 respectively for 2003.

Noninterest expense was \$29,383 for the year ending December 31, 2004, as compared to \$26,335 for the same period of 2003. Salaries and employee benefits made up 62.24 percent of noninterest expense in 2004, compared to 67.79 percent in 2003. The Association paid \$3,697 in merger and restructuring costs during 2004. Of this amount, \$3,672 was salaries and benefit provisions to employees terminated and retired as a result of the merger. Included in this amount is \$843, paid to Mr. Dantzler (former CEO) as a part of an employment agreement entered into in fiscal year 2002. Mr. Dantzler retired on April 30, 2004. The remainder of merger and restructuring costs, \$25, included printing, communications and other miscellaneous expenses. Noninterest expense was positively affected by the decrease in the Insurance Fund Premium from \$1,304 in 2003 to \$544 in 2004. The Farm Credit System Insurance Corporation sets the Insurance Fund premium.

The Association recorded a reduction in income taxes of \$108, for the year ended December 31, 2004, as compared to provision expense of \$120 for 2003. The decline in tax expense is due to the reduction in the Allowance for Loan Loss and its corresponding deferred tax asset.

A key factor in the growth of net income for future years will be continued improvement in net interest and noninterest income. Our goal is to generate earnings sufficient to fund operations, adequately capitalize the Association, and achieve an adequate rate of return for our members. To meet this goal, the agricultural economy must continue the improvement shown in recent years and the Association must meet certain objectives. These objectives are to attract and maintain high quality loan volume priced at competitive rates and to manage credit risk in our entire portfolio, while efficiently meeting the credit needs of our members.

## LIQUIDITY AND FUNDING SOURCES

### Liquidity

Liquidity management is the process whereby funds are made available to meet all financial commitments including the extension of credit, payment of operating expenses and payment of debt obligations. The Association receives access to funds through its borrowing relationship with the Bank and from income generated by operations. Sufficient liquid funds have been available to meet all financial obligations.

### Funding Sources

The principal source of funds for the Association is the borrowing relationship established with 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, creating notes payable to the Bank. The notes payable are segmented into variable rate and fixed rate components. 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 December 31, 2004, were \$996,763 as compared to \$968,284 at December 31, 2003. The increase of 3.07 percent during the period is attributable to the increase in loan volume.

In June 2004, the Association invested \$120,000 of its lendable equity (loanable funds) in fixed rate notes with maturities varying from 1 to 4 years. The investment generated additional income for the Association during that period of time. Income generated is included as a reduction to interest expense.

### Funds Management

The Bank and the Association manage assets and liabilities to provide a broad range of loan products and funding options, which will permit the Association to be competitive in all interest rate environments. The primary objective of the asset/liability management process is to provide stable and rising earnings, while maintaining adequate capital levels by managing exposure to credit and interest rate risks.

The majority of the interest rate risk in the Association balance sheet is transferred to the Bank through the notes payable structure. The Bank, in turn, actively utilizes funds management techniques to identify, quantify and control risk associated with the loan portfolio.

Demand for loan types is a driving force in establishing a funds management strategy. The Association offers fixed, adjustable and variable rate loan products that are marginally priced according to financial market rates. Variable rate loans may be indexed to either the Prime Rate or the 90-day London Interbank Offered Rate (LIBOR). Adjustable rate mortgages are indexed to U.S. Treasury Rates. Fixed rate loans are priced based on the current cost of Farm Credit debt of similar terms to maturity.

## CAPITAL RESOURCES

Total members' equity at December 31, 2004, increased 24.28 percent to \$188,755 from the December 31, 2003, total of \$151,878. The increase was primarily attributed to the increase in net income partially offset by cash patronage and revolvment of allocated equities. The additional earnings resulting from the reduction to the Allowance for Loan Loss, were not considered patronage source earnings and are included in Unallocated Retained Earnings.

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

DOLLARS IN THOUSANDS, EXCEPT AS NOTED (CONTINUED)

Total capital stock and participation certificates were \$7,207 on December 31, 2004, compared to \$7,834 on December 31, 2003. This 8.00 percent decrease is attributed to the retirement of protected and at risk stock and participation certificates on loans liquidated in the normal course of business and new loans being capitalized at lower regulatory levels.

The Association's capital ratios as of December 31 and the FCA minimum requirements follow:

	2004	2003	Regulatory Minimum
Permanent Capital	14.59%	14.36%	7.00%
Total Surplus	14.01%	13.82%	7.00%
Core Surplus	10.23%	9.61%	3.50%

At December 31, 2004, the Association's permanent capital ratio, average at-risk capital divided by average risk adjusted assets calculated in accordance with FCA regulations, exceeded the regulatory minimum of 7.00 percent. In addition to these regulatory requirements, the Association has established a five-year permanent capital goal in excess of the 7.00 percent FCA minimum requirement at 14.00 percent. As of December 31, 2004, the Association has exceeded the goal.

## PATRONAGE PROGRAM

Prior to the beginning of any fiscal year, the Association's Board of Directors, by adoption of a resolution, may obligate the Association to distribute to borrowers on a patronage basis all or any portion of available consolidated net earnings of the Association and its subsidiaries for such fiscal year or for that and subsequent fiscal years. Refer to Note 7 of the Notes to the Consolidated Financial Statements for more information concerning the patronage distributions. The Association declared patronage distributions of \$21,307 in 2004, and \$18,903 in 2003.

## YOUNG, BEGINNING, AND SMALL FARMERS AND RANCHERS PROGRAM

The Association's mission includes providing sound and constructive credit and related services to young, beginning and small (YBS) farmers and ranchers. Annual marketing goals are established to increase market share of loans to YBS farmers and ranchers. To facilitate credit, we have adopted financing programs and use government guaranteed loan programs. We are actively involved in developing and sponsoring educational opportunities, leadership training, business financial training and insurance services for YBS farmers and ranchers.

YBS farmers and ranchers are defined as:

*Young Farmer:* A farmer, rancher, or producer or harvester of aquatic products who is age 35 or younger as of the date the loan is originally made.

*Beginning Farmer:* A farmer, rancher, or producer or harvester of aquatic products who has 10 years or less farming or ranching experience as of the date loan is originally made.

*Small Farmer:* A farmer, rancher, or producer or harvester of aquatic products who normally generates less than \$250 in annual gross sales of agricultural or aquatic products at the date the loan is originally made.

The following table outlines the loan volume and number of YBS loans in the loan portfolio as of December 31 for the Association.

	December 31, 2004	
	Number of Loans	Amount of Loans
Young	1,341	\$ 124,108
Beginning	2,994	337,930
Small	6,932	629,218

The Association currently has a high penetration in the young, beginning, and small farmer market. As of December 31, 2004, the Association compared very favorably with the demographics of the service area according to the 2000 Ag Census. Young Farmers comprise 14.74 percent of the portfolio while beginning farmers account for 32.92 percent and small farmers make up 76.22 percent of the total portfolio. The 2000 Ag Census indicates that young farmers account for 4.39 percent of total farmers in our service area, beginning farmers 30.88 percent and small farmers account for 95.13 percent of total farmers in the AgSouth service area. The goal of the AgSouth Young, Beginning and Small Farmer program is to have this segment of our portfolio mirror or exceed the demographics. For purposes of the above table, a loan could be classified in more than one category depending upon the characteristics of the underlying borrower.

The following strategies and outreach programs have helped the Association achieve its goals and objectives relative to the young, beginning, and small farmer program.

- Provide current and pertinent farm management and financial training to YBS customers and prospects in group settings or one on one. This includes the hosting of an annual Agribusiness Leadership Institute where identified couples are brought together for a weekend training seminar.
- Inform customers and prospects of available services through advertising and public relations.
- Encourage young people to choose agriculture as a profession by supporting 4H and FFA.
- Support Young Farmers groups in the service area and at the state level.
- Make customers and prospects aware of farm related services and encourage them to take advantage of beneficial programs.
- Work closely with FSA personnel to meet the needs of YBS customers and prospects.

## FORWARD LOOKING INFORMATION

Certain information included in this discussion constitutes forward-looking statements and information that are based upon management's belief as well as certain assumptions made by and information currently available to management. When used in this discussion, the words "anticipate," "project," "expect," "believe," and similar expressions are intended to identify forward-looking statements. Although management of the Association believes that the expectations reflected in such forward-looking statements are reasonable, it can give no assurance that such expectations and projections will prove to have been correct. Such forward-looking statements are subject to certain risks, uncertainties and assumptions. Should one or more of these risks materialize, or should such underlying assumptions prove to be incorrect, actual results may vary materially from those anticipated, projected, or expected. Among key factors that may have a direct bearing on the Association's operating results are fluctuations in the economy, the relative strengths and weaknesses in the agricultural credit sectors and in the real estate market, the actions taken by the Federal Reserve for the purpose of managing the economy, and the continued growth of the agricultural market consistent with recent historical experience.

# DISCLOSURE REQUIRED BY FARM CREDIT ADMINISTRATION REGULATIONS

## Description of Business

Descriptions of the territory served, persons eligible to borrow, types of lending activities engaged in, financial services offered and related Farm Credit organizations are incorporated herein by reference to Note 1 to the consolidated financial statements, "Organization and Operations," included in this annual report to stockholders.

The description of significant developments that had or could have a material impact on earnings or interest rates to borrowers, acquisitions or dispositions of material assets, material changes in the manner of conducting the business, seasonal characteristics, and concentrations of assets, if any, is incorporated in "Management's Discussion and Analysis of Financial Condition and Results of Operations" included in this annual report to stockholders.

## Description of Property

The following table sets forth certain information regarding the properties of the reporting entity:

<u>Location</u>	<u>Description</u>	<u>Form of Ownership</u>
40 South Main Street Statesboro, GA	Branch & Administrative Headquarters	Owned
1880 Joe S. Jeffords Highway Orangeburg, SC	Branch & Administrative	Owned
101 Northtown Drive Spartanburg, SC	Administrative	Owned
2741 Whiskey Road South New Ellenton, SC	Branch	Owned
Barnwell Highway Allendale, SC	Branch	Owned
1325 Hwy 28 Bypass Anderson, SC	Branch	Owned
628 W. Columbia Avenue Batesburg, SC	Branch	Owned
64 Heritage Street Baxley, GA	Branch	Owned
111 Carter Avenue Blackshear, GA	Branch	Owned
1520 Newcastle Street Brunswick, GA	Branch	Leased*
15 Boulware Road Lugoff, SC	Branch	Owned
809 S. Park Street Carrollton, GA	Branch	Owned
7169 Hwy. 278 Covington, GA	Branch	Owned
196 Westside Drive Douglas, GA	Branch	Owned
596 S. Talbotton Street Greenville, GA	Branch	Owned
690 Bypass 72 Suite A Greenwood, SC	Branch	Leased**
1298 Enterprise Way Bypass South Griffin, GA	Branch	Owned

<u>Location</u>	<u>Description</u>	<u>Form of Ownership</u>
311 East Cherry Street Jesup, GA	Branch	Owned
306 Hillcrest Drive Laurens, SC	Branch	Owned
296 N. Main Street Madison, GA	Secondary Mortgage	Owned
2002 S. Main Street Madison, GA	Branch	Owned
1323 Kendall Road Newberry, SC	Branch	Owned
594 S. Columbia Avenue Rincon, GA	Branch	Leased***
305 W. Oakland Avenue Rock Hill, SC	Branch	Owned
1192 Asheville Highway Spartanburg, SC	Branch	Owned
Highway 601 North St. Matthews, SC	Branch	Owned
702 Kate Lane Summerville, SC	Branch	Owned
303 East Ogeechee Street Sylvania, GA	Branch	Leased****
620 N. Church Street Thomaston, GA	Branch	Owned
314 Commerce Way Vidalia, GA	Branch	Owned
800 S. Calhoun Street Bamberg, SC	Special Assets	Owned

\* *The term commenced on May 1, 2003 for a period of 12 months. Lessee agreed to pay lessor as rental for the premises the sum of \$850/month, payable in advance. The premises shall be used as office space and may not be sublet without prior consent from Lessor.*

\*\* *The term commenced on October 1, 1995 for a period of 24 months. The lease was renewed with the latest renewal covering the period October 4, 2003 through October 4, 2005. The lease payment is payable monthly in advance in the sum of \$1,458/month. The premises shall be used for office space. The lease holds an option to renew for an additional two year period at a mutually agreed upon lease rate.*

\*\*\* *The term commenced on March 1, 2002, and terminated on August 31, 2002 at the monthly rent or sum of \$300 payable one month in advance, on the 1st day of each month during said term. Since the termination of the lease-year (August 31, 2002), the lease has been extended month-to-month. The premises shall be used as office space and may not be sublet without prior consent from Lessor.*

\*\*\*\* *The term commenced on November 1, 1995, and terminated on October 31, 1996. The rent commencement date was November 1, 1995. Since the termination of the lease-year (October 31, 1996), the lease has been extended month-to-month. Either party upon 90 days written notice may cancel the lease. Lessee agreed to pay lessor as rental for the premises the sum of \$8,100/year, payable in advance at \$675/month. The premises shall be used as office space and may not be sublet without prior consent from Lessor.*

# DISCLOSURE REQUIRED BY FARM CREDIT ADMINISTRATION REGULATIONS (CONTINUED)

The Association also owns property at 929 Blackshear Highway, Baxley, GA. This property is currently listed for sale with a local realtor.

The Association has new facilities under construction in Statesboro and Batesburg. These offices are expected to be completed in early 2005. The Association owns a lot at 979 Highway 1 South, Lugoff, South Carolina, where construction will begin on a new Camden/Lugoff office in early 2005.

The Association holds a lease on vacant office space at 123 W. Public Square, Laurens, South Carolina. The current lease runs from May 1, 2001 to May 1, 2006. The lease payment of \$2,000/month is payable in advance. The Association is in negotiations with the landlord and may sublet the space.

## Legal Proceedings

Information, if any, to be disclosed in this section is incorporated herein by reference to Note 13 to the consolidated financial statements, "Commitments and Contingencies," included in this annual report to stockholders.

## Description of Capital Structure

Information to be disclosed in this section is incorporated herein by reference to Note 8 to the consolidated financial statements, "Members' Equity," included in this annual report to stockholders.

## Description of Liabilities

The description of liabilities, contingent liabilities and intrasystem financial assistance rights and obligations to be disclosed in this section is incorporated herein by reference to Notes 2, 7, 11 and 13 to the consolidated financial statements included in this annual report to stockholders.

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

"Management's Discussion and Analysis of Financial Condition and Results of Operations," which appears in this annual report to stockholders and is to be disclosed in this section, is incorporated herein by reference.

## Senior Officers

The following represents certain information regarding the senior officers of the Association:

Senior Officer	Position
William P. Spigener, Jr.	Chief Executive Officer
Alisa D. Gunter	Chief Financial Officer
R. H. Moore	Director of Risk Management
Phillip Craig Peebles	Regional President – Georgia
Ronald L. Summers	Regional President – South Carolina
Walter Van McCall	Regional Lending Manager – Georgia
A. Owen Smith	Regional Lending Manager – South Carolina

The business experience for the past five years for senior officers is with the Farm Credit System.

The total amount of compensation earned by all senior officers as a group during the years ended December 31, 2004, 2003 and 2002, is as follows:

Name of Individual or No. in Group	Year	Annual		Total
		Salary	Bonus	
William P. Spigener, Jr.	2004	\$253,990	\$ 62,225	\$316,215
William P. Spigener, Jr.	2003	\$210,980	\$ 42,194	\$253,174
William P. Spigener, Jr.	2002	\$199,038	\$ 40,206	\$239,244
Lynn Z. Dantzer*	2004	\$ 73,336	–	\$ 73,336
Lynn Z. Dantzer	2003	\$210,008	\$ 15,750	\$225,758
Lynn Z. Dantzer	2002	\$198,246	\$ 3,960	\$202,206
6	2004	\$719,075	\$183,668	\$902,743
6	2003	\$615,903	\$ 90,838	\$706,741
6	2002	\$583,848	\$ 56,016	\$639,864

\* Mr. Dantzer retired effective April 30, 2004.

In addition to a base salary, senior officers earn additional compensation under an annual incentive plan. The Association annual incentive plan is designed to motivate employees to exceed the business plan goals during the fiscal year. These goals typically include Association income, credit quality, credit administration, loan volume, delinquencies and other key ratios. Income to pay the incentive payments is derived from profits over and above those budgeted in the board-approved budget for 2004. All employees are covered by the annual incentive plan. The maximum any employee can earn under the plan is 25 percent of base salary. Partial payment of the incentive was in the fourth quarter of 2004 and final payment is in the first quarter of 2005. A copy of the incentive plan is available to stockholders upon request. Certain additional bonuses have been approved by the board based on either the overall performance of the Association, or particular ideas or performance leading to sustained increases in profits to the stockholders. Bonuses are shown in the year earned, which may be different than the year of payment.

Also, all employees are eligible to receive awards based on years of service on five year, or multiple of five year, anniversaries. A copy of this plan is available to stockholders upon request.

Disclosure of the total compensation earned in 2004 by any senior officer, or to any other individual included in the total whose compensation exceeds \$50,000, is available to stockholders upon request.

## Directors

Directors and senior officers are reimbursed on an actual cost basis for all expenses incurred in the performance of official duties. Such expenses may include transportation, lodging, meals, tips, tolls, parking of cars, laundry, registration fees, and other expenses associated with travel on official business. A copy of the policy is available to stockholders of the Association upon request.

The aggregate amount of reimbursement for travel, subsistence and other related expenses for all directors as a group was \$264,887 for 2004, \$216,208 for 2003, and \$150,330 for 2002.

Subject to approval by the board, the Association may allow directors honoraria of \$250 for attendance at meetings, committee meetings, or special assignments. Directors are also allowed travel honorarium of \$125 depending upon meeting location relative to their headquarters. Directors are paid a monthly retainer fee of \$250 each. Total compensation paid to directors as a group was \$359,250.

The following represents certain information regarding the directors of the Association. Unless specifically listed, the principal occupation of the board member for the past five years has been as a self-employed farmer.

**Harry S. Bell, Chairman**, is a row-crop farmer and the former president of the South Carolina Farm Bureau. He also serves on the boards of the Ridge Mutual Ginnery (cotton ginning), the Ridge Farmers Mutual (farm supply business), and the Southeastern Cotton Ginners (industry associations). Mr. Bell served 10 days at Association board meetings and 18 days at other official activities and was paid \$12,125 in 2004.

**Noel L. Riggins, Vice-Chairman**, is a broiler producer, cattle farmer, and retired airline pilot (effective 7-1-99). His principal occupation for the past five years was a self-employed poultry producer and cattle farmer and Delta Airlines pilot. He serves on the board of Lamar County Farm Bureau (insurance). During 2004, he served 9 days at Association board meetings and 19 days in other official activities and was paid \$10,875.

**Gary L. Alexander** is a poultry farmer who also owns and operates a landscape supply business. Mr. Alexander is an honorary board member of the South Carolina Poultry Federation (poultry promotion) as well as a board member of Blue Ridge Electric Cooperative (electric cooperative). During 2004, he served 10 days at Association board meetings and 10 days at other official activities and was paid \$8,500.

**Jack J. Arnold** is a poultry farmer. During 2004, he served 10 days at Association board meetings and 13 days at other official activities and was paid \$9,250.

**Earle J. Bedenbaugh**, retired USDA administrator, is an appointed outside director. During 2004, he served 10 days at Association board meetings and 12 days at other official activities and was paid \$9,875.

**Kenneth Bennett** is a farmer. He also owns and operates two corporations. His principal occupation and employment for the past five years was farming and operating the two corporations listed below. He serves as Chairman on the Satilla River Soil and Water Conservation District Board (conservation), is Supervisor of the Pierce County Soil and Water Conservation Service (conservation), serves on the board of the Okefenokee Area Development Authority for Ware and Pierce Counties (county development) and serves on the Satilla River Basin Local Advisory Committee (conservation). He also owns and operates the following two corporations: Waga Parts, Inc. (distributor of parts, tires, oils, batteries and accessories) and Wilbur James Wholesale, Inc. (jobber of parts, tires, oils, batteries and accessories). During 2004, he served 10 days at Association board meetings and 13 days in other official activities and was paid \$10,125.

**Arthur Q. Black** is a peach and strawberry farmer. He serves on the boards of the South Carolina and the York County Farm Bureaus (agricultural federations) and the board of Farmers Mutual Insurance (insurance). During 2004, Mr. Black served 10 days at Association board meetings and 7 days at other official activities and was paid \$9,000.

**W. Baynard Boykin** is a row-crop and timber farmer. Dr. Boykin is a board member of the South Carolina and the Kershaw County Farm Bureaus (agricultural federations), South Carolina Farm Bureau Marketing Association (grain marketing), Kershaw County Forest Land Owners Association (forest management), associate commissioner Kershaw County Soil and Water Conservation Service (conservation), and the advisory board of the Kershaw County Clemson Extension Service. He is also Director Emeritus of the South Carolina Peanut Board. During 2004, he served 10 days at Association board meetings and 13 days at other official activities and was paid \$10,000.

**Charles Ray Brown** is self-employed at Springfield Grain (agribusiness) and grows cotton and peanuts. He currently serves on the advisory council of the Orangeburg County Extension Service (extension service), the board of Orangeburg County Farm Bureau

(agricultural federation), South Carolina Peanut Advisory Board, and the Western Orangeburg County Industrial Park Commission (industrial recruitment). During 2004, he served 10 days at Association board meetings and 10 days in other official capacities and was paid \$9,750.

**Dolan E. Brown** is a farmer. His principal occupation and employment for the past five years was farming. He serves on the board of Georgia Farm Bureau (insurance). During 2004, he served 6 days at Association board meetings and 1 day in other official activities and was paid \$6,125.

**T. W. Buzhardt** is a beef cattle farmer and an employee of Ridge Lumber, Inc. During 2004, he served 10 days at Association board meetings and 6 days at other official activities and was paid \$8,375.

**Jimmy C. Carter, Jr.** is a beef cattle and hay farmer. He also operates a feed business and provides artificial insemination services for cattle. His principal occupation for the past five years was a self-employed farmer and farm service provider. Mr. Carter serves on the boards of the Henry County Farm Bureau (insurance), the Henry County Water and Sewage Authority, and the Henry County Cattleman's Association (beef cattle production). During 2004, he served 10 days at Association board meetings and 14 days in other official activities and was paid \$10,750.

**Thomas H. Coward** is a horse farmer and real estate developer. Mr. Coward also serves on the board of directors of the South Carolina Foundation Seed Association (certified seed association). During 2004, he served 10 days at Association board meetings and 11 days at other official activities and was paid \$10,375.

**Loy D. Cowart, Jr.** is a farmer. His principal occupation and employment for the past five years was farming. He serves on the boards of Durden Banking Company (banking), Pineland Telephone Cooperative (telephone service), Emanuel County Development Authority (county development), Emanuel County Board of Education (education) and serves as President of Emanuel County Farm Bureau (insurance). During 2004, he served 9 days at Association board meetings and 11 days in other official activities and was paid \$8,750.

**Herbert A. Daniel, Sr.** is a farmer. His principal occupation and employment for the past five years was farming. He serves on the board of the Claxton Bank (banking). During 2004, he served 6 days at Association board meetings and 3 days in other official activities and was paid \$6,125.

**Jacob L. Davis, III**, is a tobacco farmer and co-partner/owner of a tobacco warehouse. He also produces row crops and vegetables. His principal occupation and employment for the past five years was farming and with the tobacco warehouse business. He serves on the board of the Pierce County Farm Bureau (insurance). During 2004, he served 10 days at Association board meetings and 12 days in other official activities and was paid \$9,625.

**Lee H. DeLoach** serves as Bulloch County, Georgia Probate Judge. He is also a timber farmer and landlord. His principal occupation and employment for the past five years was his service as probate judge and managing his timber farm and rental property. Mr. DeLoach serves on the Bulloch County Keep America Beautiful Board (public education and code enforcement). During 2004, he served 9 days at Association board meetings and 7 days in other official activities and was paid \$7,625.

**W. Lewis Duvall** is a beef cattle and timber farmer. His principal occupation for the past five years was a self-employed farmer. He serves on the board of BankSouth Bank (banking). During 2004, he served 10 days at Association board meetings and 7 days in other official activities and was paid \$9,000.

# DISCLOSURE REQUIRED BY FARM CREDIT ADMINISTRATION REGULATIONS (CONTINUED)

**Diane H. Edwins** is a beef cattle, row crop, and timber farmer and part-time bookkeeper. Mrs. Edwins also serves on the board of the Berkeley Soil and Water Conservation District (conservation) and the Lord Berkeley Conservation Trust (conservation). In 2004, she served 10 days at Association board meetings and 13 days at other official activities and was paid \$9,750.

**George A. Hillsman** is a beef cattle, hay, and broiler farmer. His principal occupation for the past five years was a self-employed farmer. He serves on the board of Oconee River Soil and Water Conservation District (conservation of natural resources). During 2004, he served 10 days at Association board meetings and 7 days in other official activities and was paid \$8,750.

**Eugene T. Jones** is a cattle farmer and he also grows timber. His principal occupation and employment for the past five years was farming. He serves as supervisor to the District Soil and Water Conservation Service (conservation). During 2004, he served 10 days at Association board meetings and 11 days in other official activities and was paid \$9,625.

**Jeffrey M. Knowles** is a dairy farmer. His principal occupation for the past five years was a self-employed dairy farmer. During 2004, he served 8 days at Association board meetings and 2 days in other official activities and was paid \$6,625.

**A. Harvey Lemmon** is a purebred cattle producer. His principal occupation for the past five years was a self-employed cattle farmer. He serves on the boards of Georgia Beef Board (promote beef and research), Georgia Angus Association (Angus cattle promotion) and the Cattlemen's Beef Promotion and Research Board (national beef promotion and research). During 2004, he served 10 days at Association board meetings and 9 days in other official activities and was paid \$8,875.

**Eugene W. Merritt, Jr.** is an ornamental tree farmer and landscape contractor. Mr. Merritt also serves on the boards of AgFirst Farm Credit Bank (agricultural lending), Peoples National Bank (banking), Peoples BankCorp (bank holding company), Ocean Lake's Resort (recreational), and Pickens County YMCA (recreational). During 2004, he served 9 days at Association board meetings and was paid \$6,250.

**Jimmy B. Metts** is a cattle and row-crop farmer. He owns a timber procurement business and a restaurant as well. His principal occupation and employment for the past five years was farming, timber procurement and the operation of his restaurant. During 2004, he served 10 days at Association board meetings and 11 days in other official activities and was paid \$10,375.

**Samuel A. Milford** is a beef cattle and hay farmer. During 2004, he served 10 days at Association board meetings and 6 days at other official activities and was paid \$8,125.

**Ricky C. North** is a poultry farmer. Mr. North also serves on the board of Rich & Creamy, Incorporated (ice cream sales) and operates a Bruster's Real Ice Cream franchise. His principal occupation for the past five years was a self-employed farmer. During 2004, he served 10 days at Association board or board committee meetings and 12 days in other official activities and was paid \$10,125.

**H. L. Page** is a farmer. His principal occupation and employment for the past five years was farming. He serves on the board of Bryan County Farm Services Agency (agriculture programs) and also serves as president of the Bryan County Farm Bureau (insurance). During 2004, he served 7 days at Association board meetings and 1 day in other official activities and was paid \$6,125.

**Jerome G. Parker** is a farmer. He also owns a heating and air conditioning business. His principal occupation and employment for the past five years was farming and operating his heating and air conditioning business. He serves on the board of the Tattnall County Farm Bureau (insurance). During 2004, he served 10 days at Association board meetings and 7 days in other official activities and was paid \$8,625.

**L. L. Post** is a cattle, hay and timber farmer. He serves on the boards of Jeff Davis County Farm Bureau (insurance), the Southeast Georgia Cattlemen's Association (agriculture related) and serves on the Credentials and Election Committee for the Satilla Rural Membership Cooperative (utility). During 2004, he served 10 days at Association board meetings and 18 days in other official activities and was paid \$11,125.

**Edward M. Rast** is a cotton gin operator and cotton farmer. Mr. Rast also serves on the board of O. L. Hughes Cotton Gin (cotton ginning). During 2004, he served 9 days at Association board meetings and 4 days in other official capacities and was paid \$6,625.

**Charles C. Rucks** is a dairy farmer. He also produces hay and beef cattle. His principal occupation for the past five years was a self-employed dairy farmer. He serves on the boards of American Dairy Association (dairy industry) and the Spalding County Farm Bureau (insurance). During 2004, he served 10 days at Association board meetings and 16 days in other official activities and was paid \$10,500.

**Jerry A. Smoak**, is a retired vegetable grower and processor. (Too Goo Doo Farms in 2003.) He also serves on the board of the Charleston County Farm Bureau (agricultural federation) and the Agricultural Society of South Carolina (agricultural promotion). During 2004, he served 8 days at Association board meetings and 17 days in other official capacities and was paid \$10,000.

**C. Earl Thrailkill, Jr.** is a turkey and beef cattle farmer, and he also serves on the board of the Chester County Farm Bureau (agricultural federation). During 2004, he served 9 days at Association board meetings and 4 day at other official activities and was paid \$7,250.

**Raymond L. Tumbleston** is a retired tomato farmer and real estate developer who also owns a tomato-packing shed. He serves on the board of the Charleston County Farm Bureau (agricultural federation), the S.C. Migrant Commission (state commission), the Charleston Soil and Water Conservation District (conservation), and the S.C. Tomato Growers Association (tomato promotion). During 2004, he served 8 days at Association board meetings and 12 days in other official capacities and was paid \$8,500.

**Hugh E. Weathers** is a dairy farmer. Mr. Weathers is currently serving as Commissioner of Agriculture for the state of South Carolina. He serves on the board of the American Dairy Association of South Carolina (dairy promotion). During 2004, he served 10 days at Association board meetings and 19 days in other official capacities and was paid \$10,875.

**John R. Wells** is an Assistant Dean in the College of Business at the State University of West Georgia. His principal occupation for the past five years was with the State University of West Georgia (formerly West Georgia College). Mr. Wells is serving as outside director. During 2004, he served 10 days at Association board meetings and 7 days in other official activities and was paid \$8,500.

**W. Gordon Wells** is a timber farmer and plantation manager. Mr. Wells owns and operates Wells Supply Company (farm supplies). He currently serves on the board of the Lowcountry Rural Conservation and Development Council (rural conservation and development), Jasper County Farm Bureau (agricultural federation), and the Jasper

County Soil and Water Conservation Service (conservation). During 2004, he served 7 days at Association board meetings and 4 days in other official capacities and was paid \$5,750.

**David H. Womack** is a Certified Public Accountant in the firm of David H. Womack, PC & CPA. His principal occupation and employment for the past five years has been as a CPA. He serves on the boards of Evans Memorial Hospital Authority (health care), Brewton Cemetery, Inc. (perpetual care, non-profit) and Pinewood Christian Academy (education, non-profit). During 2004, he served 10 days at Association board meetings and 13 days in other official activities and was paid \$9,250. Mr. Womack serves on the board as an outside director.

**Robert A. Youmans** is a row crop and turfgrass farmer. He serves as a director on the Hampton County Farm Bureau (insurance). During 2004, he served 3 days at Association board meetings and was paid \$4,250.

The following chart details the year the director began serving on the board, the current term of expiration, and current committee assignments:

DIRECTOR	ORIGINAL YEAR OF ELECTION OR APPOINTMENT	CURRENT TERM EXPIRATION	COMMITTEE ASSIGNMENTS
Harry S. Bell <b>Chairman</b>	1967	2005	Executive, Audit, Governance, Policy
Noel L. Riggins <b>Vice Chairman</b>	1994	2006	Executive, Audit, Governance, Policy
Gary L. Alexander	1997	2006	Audit
Jack J. Arnold	1981	2005	Policy
Earle J. Bedenbaugh <i>Outside Director</i>	1990	2007	Audit
Kenneth Bennett	1987	2007	Policy
Arthur Q. Black	1995	2007	Governance
W. Baynard Boykin	1976	2007	Audit
Dolan E. Brown	1966	2005	
Charles Ray Brown	1976	2006	
T. W. Buzhardt	1988	2006	
Jimmy C. Carter, Jr.	1979	2007	Executive, Audit
Thomas H. Coward	1986	2006	
Loy D. Cowart	1968	2005	Executive, Governance
Herbert A. Daniel, Sr.	1969	2005	
Jacob L. Davis, III	1985	2005	Executive
Lee H. DeLoach	2002	2005	
W. Lewis Duvall	1967	2005	
Diane H. Edwins	2002	2005	Policy
George A. Hillsman	1996	2005	
Eugene T. Jones	1979	2007	Governance
Jeffrey M. Knowles	1972	2006	
A. Harvey Lemmon	1979	2005	Audit
Eugene W. Merritt, Jr.	1970	2006	
Jimmy B. Metts	1978	2005	
Samuel A. Milford	1992	2007	
Ricky C. North	1995	2007	Governance
H. L. Page	1972	2006	
Jerome G. Parker	1987	2006	
L. L. Post	1986	2007	Policy
Edward M. Rast	1964	2006	Governance
Charles C. Rucks	1988	2007	Executive, Policy
Jerry A. Smoak	1983	2006	Executive
C. Earl Thrailkill, Jr.	1990	2005	
Raymond L. Tumbleston	1987	2006	Policy
Hugh E. Weathers	1998	2006	
W. Gordon Wells	1982	2007	
John R. Wells <i>Outside Director</i>	1990	2005	
David H. Womack <i>Outside Director</i>	1991	2006	Audit
Robert A. Youmans	1996	2005	Governance

## Transactions with Senior Officers and Directors

The reporting entity's policies on loans to and transactions with its officers and directors, to be disclosed in this section are incorporated herein by reference to Note 12 to the consolidated financial statements, "Related Party Transactions," included in this annual report to stockholders.

## Involvement in Certain Legal Proceedings

There were no matters which came to the attention of management or the board of directors regarding involvement of current directors or senior officers in specified legal proceedings which should be disclosed in this section.

## Relationship with Independent Public Accountants

There were no material disagreements with our independent public accountants on any matter of accounting principles or financial statement disclosure during this period.

## Consolidated Financial Statements

The consolidated financial statements, together with the report thereon of PricewaterhouseCoopers LLP dated March 3, 2005, and the report of management, which appear in this annual report to stockholders are incorporated herein by reference.

Copies of the Association's quarterly reports are available upon request free of charge by calling 800-310-4805 or writing Alisa D. Gunter at PO Box 4966, Spartanburg, SC 29305-4966.

## Borrower Information Regulations

Since 1972, Farm Credit Administration (FCA) regulations have required that borrower information be held in strict confidence by Farm Credit System (FCS) institutions, their directors, officers and employees. These regulations provide Farm Credit institutions clear guidelines for protecting their borrowers' nonpublic personal information.

On November 10, 1999, the FCA Board adopted a policy that requires FCS institutions to formally inform new borrowers at loan closing of the FCA regulations on releasing borrower information and to address this information in the annual report to shareholders. The implementation of these measures ensures that new and existing borrowers are aware of the privacy protections afforded them through FCA regulations and Farm Credit System institution efforts.

## Stockholder Investment

Stockholder investment in the Association could be affected by the financial condition and results of operations of AgFirst Farm Credit Bank. Copies of the District annual and quarterly reports are available upon request free of charge by calling 1-800-845-1745, ext. 378, or writing Jay Wise, AgFirst Farm Credit Bank, P. O. Box 1499, Columbia, SC 29202. Information concerning AgFirst Farm Credit Bank can also be obtained by going to AgFirst's website at [www.agfirst.com](http://www.agfirst.com).

# AUDIT COMMITTEE REPORT

The Audit Committee of the Board of Directors (the Committee) is comprised of the directors named below. None of the directors who serve on the Audit Committee is an employee of AgSouth Farm Credit, ACA (the Association) and in the opinion of the Board of Directors, each is free of any relationship with the Association or management that would interfere with the director's independent judgment on the Committee.

The Committee has adopted a written charter that has been approved by the Board of Directors. The Committee has reviewed and discussed the Association's audited financial statements with management, which has primary responsibility for the financial statements.

PricewaterhouseCoopers LLP (PwC), the Association's independent auditor for 2004, is responsible for expressing an opinion on the conformity of the Association's audited financial statements with generally accepted accounting principles. The Committee has discussed with PwC the matters that are required to be discussed by Statement on Auditing Standards No. 61 (*Communication With Audit Committees*). PwC has provided to the Committee the written disclosures and the letter required by Independence Standards Board Standard No. 1 (*Independence Discussions with Audit Committees*), and the Committee has discussed with PwC that firm's independence.

The Committee has also concluded that PwC's provision of non-audit services, if any, to the Association is compatible with PwC's independence.

Based on the considerations referred to above, the Committee recommended to the Board of Directors that the audited financial statements be included in the Association's Annual Report for 2004. The foregoing report is provided by the following independent directors, who constitute the Audit Committee:



James C. Carter Jr.  
Chairman of the Audit Committee

## **Members of Audit Committee**

Gary Alexander  
Earle Bedenbaugh  
Harry Bell  
Dr. Baynard Boykin  
Harvey Lemmon  
Noel Riggins  
David Womack



**PricewaterhouseCoopers LLP**  
10 Tenth Street, Suite 1400  
Atlanta, GA 30309  
Telephone (678) 419 1000

## Report of Independent Auditors

March 3, 2005

To the Board of Directors and Stockholders  
of AgSouth Farm Credit, ACA

In our opinion, the accompanying consolidated balance sheets and the related consolidated statements of income, of changes in members' equity and of cash flows present fairly, in all material respects, the financial position of AgSouth Farm Credit, ACA and its subsidiaries at December 31, 2004, 2003 and 2002, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2004 in conformity with accounting principles generally accepted in the United States of America. These financial statements are the responsibility of the Association's management. Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits of these statements in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

As discussed in Note 14 to the financial statements, Palmetto Farm Credit, ACA and AgSouth Farm Credit, ACA merged effective January 1, 2004 to form AgSouth Farm Credit, ACA.

*PricewaterhouseCoopers* LLP

# CONSOLIDATED BALANCE SHEETS

<i>(dollars in thousands)</i>	<b>December 31, 2004</b>	<b>December 31, 2003</b>	<b>December 31 2002</b>
<b>Assets</b>			
Cash	\$ 6,048	\$ 4,654	\$ 5,404
Loans	1,144,637	1,128,828	1,113,040
Less: allowance for loan losses	4,021	25,253	25,446
Net loans	1,140,616	1,103,575	1,087,594
Accrued interest receivable	11,023	10,283	11,410
Investment in other Farm Credit institutions	15,492	16,207	19,271
Premises and equipment, net	8,543	6,810	6,324
Other property owned	403	1,030	1,825
Prepaid retirement expense	14,862	—	—
Due from AgFirst	11,666	8,980	8,959
Other assets	3,853	3,412	12,227
Total assets	<u>\$ 1,212,506</u>	<u>\$ 1,154,951</u>	<u>\$ 1,153,014</u>
<b>Liabilities</b>			
Notes payable to AgFirst Farm Credit Bank	\$ 996,763	968,284	980,076
Accrued interest payable	3,154	2,981	3,476
Patronage refund payable	7,091	6,212	5,320
Postretirement benefits other than pensions	9,444	7,609	6,230
Minimum pension liability	—	6,445	6,946
Other liabilities	7,299	11,542	7,246
Total liabilities	<u>1,023,751</u>	<u>1,003,073</u>	<u>1,009,294</u>
Commitments and contingencies			
<b>Members' Equity</b>			
Protected borrower equity	1,197	1,530	2,021
Capital stock and participation certificates	6,010	6,304	6,468
Retained earnings			
Allocated	81,401	79,978	77,088
Unallocated	100,147	75,502	70,619
Accumulated other comprehensive income (loss)	—	(11,436)	(12,476)
Total members' equity	<u>188,755</u>	<u>151,878</u>	<u>143,720</u>
Total liabilities and members' equity	<u>\$ 1,212,506</u>	<u>\$ 1,154,951</u>	<u>\$ 1,153,014</u>

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

# CONSOLIDATED STATEMENTS OF INCOME

<i>(dollars in thousands)</i>	<b>For the year ended December 31,</b>		
	<b>2004</b>	<b>2003</b>	<b>2002</b>
<b>Interest Income</b>			
Loans	\$ 73,052	\$ 72,789	\$ 76,259
<b>Interest Expense</b>			
Notes payable to AgFirst Farm Credit Bank	34,918	37,294	45,185
Other	20	5	7
	34,938	37,299	45,192
Total interest expense			
Net interest income	38,114	35,490	31,067
Provision for (reversal of) loan losses*	(21,033)	(396)	3,000
	59,147	35,886	28,067
Net interest income after provision for (reversal of) loan losses			
<b>Noninterest Income</b>			
Loan fees	2,697	2,532	1,880
Fees for financially related services	297	244	344
Patronage refund from AgFirst Farm Credit Bank	12,052	9,612	9,485
Gain (loss) on sale of rural home loans	933	1,436	739
Other noninterest income	454	421	627
	16,433	14,245	13,075
Total noninterest income			
<b>Noninterest Expense</b>			
Salaries and employee benefits	18,288	17,853	15,037
Occupancy and equipment	1,740	1,699	1,664
Insurance Fund premium	544	1,304	330
Other operating expenses	5,024	4,673	4,354
Losses on other property owned, net	90	425	54
Merger-implementation and restructuring costs	3,697	381	—
	29,383	26,335	21,439
Total noninterest expense			
Income before income taxes	46,197	23,796	19,703
Provision (benefit) for income taxes	(108)	120	(185)
	46,305	23,676	19,888
Net income	\$ 46,305	\$ 23,676	\$ 19,888

\* A reversal of provision, shown in brackets, is an increase to net income.  
The accompanying notes are an integral part of these financial statements.

# CONSOLIDATED STATEMENTS OF CHANGES IN MEMBERS EQUITY

<i>(dollars in thousands)</i>	Protected Borrower Equity	Capital Stock and Participation Certificates	Retained Earnings		Accumulated Other Comprehensive Income	Total Members' Equity
			Allocated	Unallocated		
Balance at December 31, 2001	\$ 2,808	\$ 6,579	\$ 73,924	\$ 68,292	\$ —	\$ 151,603
Comprehensive income						
Net income				19,888		19,888
Minimum pension liability adjustment					(12,476)	(12,476)
Total comprehensive income						7,412
Protected borrower equity retired	(787)					(787)
Capital stock/participation certificates issued		672				672
Capital stock/participation certificates retired		(783)				(783)
Patronage distribution						
Cash				(5,131)		(5,131)
Qualified allocated retained earnings			1,987	(1,987)		—
Nonqualified allocated retained earnings			9,985	(9,985)		—
Nonqualified retained earnings						—
Retained earnings retired			(9,216)			(9,216)
Distribution adjustment			408	(458)		(50)
Balance at December 31, 2002	2,021	6,468	77,088	70,619	(12,476)	143,720
Comprehensive income						
Net income				23,676		23,676
Minimum pension liability adjustment					1,040	1,040
Total comprehensive income						24,716
Protected borrower equity retired	(491)					(491)
Capital stock/participation certificates issued		693				693
Capital stock/participation certificates retired		(857)				(857)
Patronage distribution						
Cash				(5,671)		(5,671)
Qualified allocated retained earnings			2,650	(2,650)		—
Nonqualified allocated retained earnings			10,582	(10,582)		—
Nonqualified retained earnings						—
Retained earnings retired			(10,271)			(10,271)
Distribution adjustment			(71)	110		39
Balance at December 31, 2003	1,530	6,304	79,978	75,502	(11,436)	151,878
Comprehensive income						
Net income				46,305		46,305
Minimum pension liability adjustment					11,436	11,436
Total comprehensive income						57,741
Protected borrower equity retired	(333)					(333)
Capital stock/participation certificates issued		657				657
Capital stock/participation certificates retired		(951)				(951)
Patronage distribution						
Cash				(6,392)		(6,392)
Nonqualified allocated retained earnings			14,915	(14,915)		—
Retained earnings retired			(13,738)			(13,738)
Distribution adjustment			246	(353)		(107)
Balance at December 31, 2004	\$ 1,197	\$ 6,010	\$ 81,401	\$ 100,147	\$ —	\$ 188,755

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

# CONSOLIDATED STATEMENTS OF CASH FLOWS

<i>(dollars in thousands)</i>	<b>For the year ended December 31,</b>		
	<b>2004</b>	<b>2003</b>	<b>2002</b>
<b>Cash flows from operating activities:</b>			
Net income	\$ 46,305	\$ 23,676	\$ 19,888
Adjustments to reconcile net income to net cash provided by (used in) operating activities:			
Depreciation on premises and equipment	792	715	704
Provision for (reversal of) loan losses	(21,033)	(396)	3,000
(Gains) losses on other property owned, net	90	425	54
(Gains) losses on rural home loans	(933)	(1,436)	(739)
Originations of rural home loans held for sale	(107,451)	(115,263)	(81,246)
Proceeds from sale of rural home loans held for sale	108,834	125,633	75,335
Changes in operating assets and liabilities:			
(Increase) decrease in accrued interest receivable	(740)	1,127	1,211
(Increase) decrease in prepaid retirement expense	(3,426)	—	5,619
(Increase) decrease in due from AgFirst	(2,686)	(21)	(1,999)
(Increase) decrease in other assets	(891)	(119)	630
Increase (decrease) in accrued interest payable	173	(495)	(466)
Increase (decrease) in postretirement benefits other than pensions	1,835	1,379	819
Increase (decrease) in minimum pension liability	(6,445)	(501)	6,946
Increase (decrease) in other liabilities	(4,272)	5,352	(12,348)
Total adjustments	(36,153)	16,400	(2,480)
Net cash provided by (used in) operating activities	10,152	40,076	17,408
<b>Cash flows from investing activities:</b>			
Net (increase) decrease in loans	(16,309)	(15,842)	(64,017)
(Increase) decrease in investment in AgFirst Farm Credit Bank	715	3,064	3,226
Purchase of premises and equipment, net	(2,525)	(1,201)	(923)
Proceeds from sale of other property owned	867	611	471
Net cash provided by (used in) investing activities	(17,252)	(13,368)	(61,243)
<b>Cash flows from financing activities:</b>			
Advances on (repayment of) notes payable to AgFirst Farm Credit Bank, net	28,479	(11,792)	59,713
Protected borrower equity retired	(333)	(491)	(787)
Capital stock and participation certificates issued	657	693	672
Capital stock and participation certificates retired	(951)	(857)	(783)
Patronage refunds paid	(5,620)	(4,740)	(5,850)
Retained earnings retired	(13,738)	(10,271)	(9,216)
Net cash provided by (used in) financing activities	8,494	(27,458)	43,749
Net increase (decrease) in cash	1,394	(750)	(86)
Cash, beginning of period	4,654	5,404	5,490
Cash, end of period	\$ 6,048	\$ 4,654	\$ 5,404
<b>Supplemental schedule of non-cash activities:</b>			
Financed sales of other property owned	\$ —	\$ —	\$ 932
Loans transferred to other property owned	301	257	1,486
Cash dividends or patronage distributions declared or payable	6,392	5,671	5,131
Decrease (increase) in accumulated other comprehensive income related to minimum pension liability	11,436	1,040	(12,476)
<b>Supplemental information:</b>			
Interest paid	\$ 34,765	\$ 37,794	\$ 45,658
Taxes paid, net	42	65	241

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

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

DOLLARS IN THOUSANDS, EXCEPT AS NOTED

## Note 1 – Organization and Operations

- A. **Organization:** AgSouth Farm Credit, ACA (the Association) is a member-owned cooperative which provides credit and credit-related services to or for the benefit of eligible borrowers/stockholders for qualified purposes in the states of Georgia and South Carolina in the following counties:

*Georgia:* Counties of Appling, Atkinson, Bacon, Brantley, Bryan, Bulloch, Butts, Camden, Candler, Carroll, Charlton, Chatham, Clayton, Clinch, Coffee, Coweta, DeKalb, Douglas, Effingham, Emanuel, Evans, Fayette, Fulton, Glynn, Greene, Gwinnett, Haralson, Harris, Heard, Henry, Jasper, Jeff Davis, Jenkins, Lamar, Liberty, Long, McIntosh, Meriwether, Monroe, Montgomery, Morgan, Muscogee, Newton, Oconee, Pierce, Pike, Putnam, Rockdale, Screven, Spalding, Talbot, Tattall, Toombs, Troup, Upson, Walton, Ware, Wayne and Wheeler.

*South Carolina:* Counties of Abbeville, Aiken, Allendale, Anderson, Bamberg, Barnwell, Beaufort, Berkeley, Calhoun, Charleston, Cherokee, Chester, Colleton, Dorchester, Edgefield, Fairfield, Greenville, Greenwood, Hampton, Jasper, Kershaw, Lancaster, Laurens, Lexington, McCormick, Newberry, Oconee, Orangeburg, Pickens, Richland, Saluda, Spartanburg, Union, and York.

The Association is a lending institution of the Farm Credit System (the System), a nationwide system of cooperatively owned Banks and Associations, which was established by Acts of Congress to meet the credit needs of American agriculture and is subject to the provisions of the Farm Credit Act of 1971, as amended (the Farm Credit Act). The most recent significant amendment to the Farm Credit Act was the Agricultural Credit Act of 1987. At December 31, 2004, the System was comprised of four Farm Credit Banks and one Agricultural Credit Bank and numerous Associations.

AgFirst Farm Credit Bank (Bank) and its related Associations are collectively referred to as the "District." The Bank provides funding to all associations within the District and is responsible for supervising certain activities of the District Associations. The District consists of the Bank and twenty-three ACAs, twenty-one of which have reorganized as ACA parent-companies, which have two wholly owned subsidiaries, a FLCA (Federal Land Credit Association) and a PCA (Production Credit Association). Effective January 1, 2005, the two remaining Associations have reorganized as ACA holding companies.

ACA parent-companies provide financing and related services through its FLCA and PCA subsidiaries. The FLCA makes secured long-term agricultural real estate and rural home mortgage loans. The PCA makes short-and intermediate-term loans for agricultural production or operating purposes.

The Farm Credit Administration (FCA) is delegated authority by Congress to regulate the System banks and associations. The activities of the associations are examined by the FCA

and certain actions by the associations are subject to the prior approval of the FCA and the supervising Bank.

The Farm Credit Act established the Farm Credit System Insurance Corporation (Insurance Corporation) to administer the Farm Credit Insurance Fund (Insurance Fund). The Insurance Fund is required to be used (1) to ensure the timely payment of principal and interest on Systemwide debt obligations (Insured debt), (2) to ensure the retirement of protected borrower capital at par or stated value, and (3) for other specified purposes. The Insurance Fund is also available for discretionary uses by the Insurance Corporation of providing assistance to certain troubled System institutions and to cover the operating expenses of the Insurance Corporation. Each System bank is required to pay premiums into the Insurance Fund, based on its annual average loan principal outstanding until the monies in the Insurance Fund reach the "secure base amount," which is defined in the Farm Credit Act as 2.0 percent of the aggregate insured obligations (Systemwide debt obligations). When the amount in the Insurance Fund exceeds the secure base amount, the Insurance Corporation is required to reduce premiums, but it still must ensure that reduced premiums are sufficient to maintain the level of the Insurance Fund at the secure base amount.

- B. **Consolidation:** On July 15, 2003, the Association stockholders of AgSouth Farm Credit, ACA (AgSouth) and Palmetto Farm Credit, ACA (Palmetto), approved a plan of consolidation to form AgSouth Farm Credit, ACA (the Association). On August 28, 2003, the Farm Credit Administration gave its final approval for the consolidation, which was effective January 1, 2004. The consolidated association is called AgSouth Farm Credit, ACA (AgSouth), and is headquartered in Statesboro, Georgia.

The consolidation was accounted for at historical cost in a manner similar to that used in a pooling of interests. Accordingly, the financial statements for all periods presented have been restated to include the accounts of AgSouth and Palmetto. The Association succeeded to all rights and obligations of the two former associations pursuant to the plan of the consolidation. At December 31, 2003, the accounting practices used by the two associations were consistent in all material respects. Certain reclassifications were made to conform financial statement presentation. Intercompany transactions between the former associations were immaterial.

See Note 14 for additional information related to the consolidation.

- C. **Operations:** The Farm Credit Act sets forth the types of authorized lending activity, persons eligible to borrow, and financial services which can be offered by the Association. The Association is authorized to provide, either directly or in participation with other lenders, credit, credit commitments and related services to eligible borrowers. Eligible borrowers include farmers, ranchers, producers or harvesters of aquatic products, rural residents, and farm-related businesses.

The Association may sell to any Farm Credit borrowing member, on an optional basis, credit or term life insurance appropriate to protect the loan commitment in the event of death of the debtor(s). The sale of other insurance necessary to protect a member's farm or aquatic unit is permitted, but limited to hail and multi-peril crop insurance, and insurance necessary to protect the facilities and equipment of aquatic borrowers.

Upon request, stockholders of the Association will be provided with an AgFirst Farm Credit Bank Annual Report to Stockholders, which includes the combined financial statements of the Bank and its related Associations. The Association's financial condition may be impacted by factors that affect the Bank. The AgFirst Annual Report discusses the material aspects of the District's financial condition, changes in financial condition, and results of operations. In addition, the AgFirst Annual Report identifies favorable and unfavorable trends, significant events, uncertainties and the impact of activities of the Financial Assistance Corporation Assistance Board (Assistance Board) and Insurance Corporation.

The lending and financial services offered by the Bank are described in Note 1 of the District's Annual Report to Stockholders.

## Note 2 – Summary of Significant Accounting Policies

The accounting and reporting policies of the Association conform with accounting principles generally accepted in the United States of America (GAAP) and prevailing practices within the banking industry. The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the amounts reported in the consolidated financial statements and accompanying notes. Significant estimates are discussed in these footnotes, as applicable. Actual results may differ from these estimates.

Certain amounts in prior years' financial statements have been reclassified to conform to current consolidated financial statement presentation. Such reclassifications had no effect on net income or total members' equity of prior years. The consolidated financial statements include the accounts of the FLCA and the PCA. All significant inter-company transactions have been eliminated in consolidation.

- A. **Cash:** Cash, as included in the statement of cash flows, represents cash on hand and on deposit at banks.
- B. **Loans and Allowance for Loan Losses:** Long-term real estate mortgage loans generally have maturities ranging up to 30 years. Substantially all short- and intermediate-term loans for agricultural production or operating purposes have maturities of 10 years or less.

Loans are carried at their principal amount outstanding less unearned income. Interest on loans is accrued and credited to interest income based upon the principal amount outstanding. Loans are generally placed in nonaccrual status when principal or interest is delinquent for 90 days or more (unless adequately secured and in the process of collection) or circumstances indicate that collection of

principal and/or interest is in doubt. When a loan is placed in nonaccrual status, accrued interest deemed uncollectible is reversed (if accrued in the current year) or charged against the allowance for loan losses (if accrued in prior years).

When loans are in nonaccrual status, the interest portion of payments received in cash is generally recognized as interest income if collection of the recorded investment in the loan is fully expected and the loan does not have a remaining unrecovered prior charge-off associated with it. Otherwise, loan payments are applied against the recorded investment in the loan asset. Nonaccrual loans may be transferred to accrual status when principal and interest are current, prior charge-offs have been recovered, the ability of the borrower to fulfill the contractual repayment terms is fully expected and the loan is not classified "doubtful" or "loss."

In cases where a borrower experiences financial difficulties and the Association makes certain monetary concessions to the borrower through modifications to the contractual terms of the loan, the loan is classified as a restructured loan. If the borrower's ability to meet the revised payment schedule is uncertain, the loan is classified as a nonaccrual loan.

Loan origination fees and direct loan origination costs are deferred as part of the carrying amount of the loan and the net fee or cost is amortized over the life of the related loan as an adjustment to yield.

The allowance for loan losses is a valuation account used to reasonably estimate loan and lease losses existing as of the financial statement date. Determining the appropriate allowance for loan losses balance involves significant judgment about when a loss has been incurred and the amount of that loss. The determination of the allowance for loan losses is based on management's current judgments about the credit quality of its loan and lease portfolio. A specific allowance may be established for impaired loans under SFAS No. 114. Impairment of these loans is measured based on the present value of expected future cash flows discounted at the loan's effective interest rate or, as practically expedient, at the loan's observable market price or fair value of the collateral if the loan is collateral dependent. See Note 3 for a discussion on the refinement of the allowance for loan losses methodology.

The allowance for loan losses is maintained at a level considered adequate by management to provide for probable and estimable losses inherent in the loan portfolio. The allowance is increased through provisions for loan losses and loan recoveries and is decreased through reversals of provisions for loan losses and loan charge-offs.

The allowance is based on a periodic evaluation of the loan portfolio by management in which numerous factors are considered, including economic conditions, loan portfolio composition and prior loan loss experience. It is based on estimates, appraisals and evaluations of loans which, by their nature, contain elements of uncertainty and imprecision. The possibility exists that changes in the economy and its impact on borrower repayment capacity will cause these estimates, appraisals and evaluations to change.

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

DOLLARS IN THOUSANDS, EXCEPT AS NOTED (CONTINUED)

The level of allowance for loan losses is generally based on recent charge-off experience adjusted for relevant environmental factors. The Association considers the following factors when adjusting the historical charge-offs experience:

- Changes in credit risk classifications,
- Changes in collateral values,
- Changes in risk concentrations,
- Changes in weather related conditions, and
- Changes in economic conditions.

- C. **Gains/(Losses) on Loans Held for Sale:** Certain rural home loans originated by the Association are sold on a servicing released basis primarily to the Bank or into the secondary market to unrelated third parties. For loans sold to the Bank, the Association locks into a selling price with the Bank at the time that the Association enters into a commitment to lend to the potential borrower. Gains or losses on sales of mortgage loans are recognized based on the difference between the selling price and the carrying value of the related mortgage loans sold.
- D. **Investment in AgFirst Farm Credit Bank and Other Farm Credit Institutions:** The Association is required to maintain ownership in the Bank in the form of Class B and Class C stock. Accounting for this investment is on the cost plus allocated equities basis. Patronage refunds from the Bank are accrued as earned. The receivable for such patronage refunds is included in other assets.
- E. **Other Property Owned:** Other property owned, consisting of real and personal property acquired through a collection action, is recorded at fair value less estimated selling costs upon acquisition. Revised estimates to the fair value less cost to sell are reported as adjustments to the carrying amount of the asset, provided that such adjusted value is not in excess of the carrying amount at acquisition. Income and expenses from operations and carrying value adjustments are included in gains (losses) on other property owned.
- F. **Premises and Equipment:** Premises and equipment are carried at cost less accumulated depreciation. Depreciation is provided on the straight-line method over the estimated useful lives of the assets. Gains and losses on dispositions are reflected in current operations. Maintenance and repairs are charged to operating expense and improvements are capitalized.
- G. **Advanced Conditional Payments:** The Association is authorized under the Farm Credit Act to accept advance payments from borrowers. To the extent the borrower's access to such advance payments is restricted, the advanced conditional payments are netted against the borrower's related loan balance. Amounts in excess of the related loan balance and amounts to which the borrower has unrestricted access are presented as interest-bearing liabilities in the accompanying Balance Sheet. Advanced conditional payments are not insured. Interest is generally paid by the Association on such accounts.

- H. **Employee Benefit Plans:** The employees of the Association participate in the Retirement Plan (the Plan) of the AgFirst District, which is a defined benefit plan. The District utilizes the "Projected Unit Credit" actuarial method for financial reporting purposes and for funding purposes. As a result of the funded status at the Plan's measurement date (September 30) of the underlying Plan, the Association may record a minimum liability, an intangible asset relating to unrecognized prior service cost and other comprehensive income (loss). The adjustment to other comprehensive income (loss) would be net of deferred taxes, if significant. For participants hired before January 1, 2003, benefits are determined based on a final average pay formula. For those participants hired on or after January 1, 2003, benefits are determined using a cash balance formula.

The employees of the Association are eligible to participate in the District's thrift plan (Thrift Plan), which qualifies as a 401(k) plan as defined by the Internal Revenue Code. For employees hired on or prior to December 31, 2002, the Association will contribute \$.50 for each \$1.00 of the maximum employee contribution of 6 percent of total compensation. For employees hired after January 1, 2003, the Association will contribute \$1.00 for each \$1.00 of the maximum employee contribution of 6 percent of total compensation. Employee deferrals are not to exceed the maximum deferral as adjusted by the Internal Revenue Service. Thrift Plan costs are expensed as funded.

The Association provides certain health care and life insurance benefits to eligible retired employees. Substantially all employees may become eligible for these benefits if they reach early retirement age while working for the Association. Expenses of \$2,274, \$1,835 and \$1,358 for the years ended December 31, 2004, 2003 and 2002, respectively, were classified as salaries and employee benefits.

- I. **Income Taxes:** The Association is generally subject to Federal and certain other income taxes. The Association is eligible to operate as a cooperative that qualifies for tax treatment under Subchapter T of the Internal Revenue Code. Accordingly, under specified conditions, the Association can exclude from taxable income amounts distributed as qualified patronage refunds in the form of cash, stock or allocated surplus. Provisions for income taxes are made only on those taxable earnings that will not be distributed as qualified patronage refunds. The Association distributes patronage on the basis of book income. The Association recognizes deferred tax assets and liabilities for the expected future tax consequences of the temporary differences between the carrying amounts and tax bases of assets and liabilities. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be realized or settled.
- J. **Patronage Refund from AgFirst:** The Association records patronage refunds from the Bank and certain District Associations on an accrual basis. The patronage receivable from AgFirst is a component of other assets on the balance sheet at the end of each fiscal year.

**Note 3 – Refinement of the Allowance for Loan Losses Methodology**

During 2004, the Association conducted a study to further refine its allowance for loan losses methodology taking into account recently issued guidance by FCA, the System’s regulator, as well as the Securities and Exchange Commission (SEC) and Federal Financial Institutions Examination Council guidelines.

The Association’s allowance for loan losses methodology was adjusted and revised in the late 1980s to take into account credit losses in that period. Given the long cyclical nature of the agricultural economy, loss factors utilized to determine the allowance for loan losses subsequent to 1989 continued to reflect, to some extent, the loss history of the mid-to-late 1980s, which resulted in conservative estimates of the allowance for loan losses. The Association’s allowance for loan losses methodology utilized throughout the period was in accordance with generally accepted accounting principles and was consistently applied.

While conservative in estimating the allowance for loan losses, the methodology used resulted in annual provisions for loan losses over the periods that reflected changes in credit quality and loss experience. Accordingly, the reserves provided in the mid-to-late 1980s have, in effect, remained part of the allowance for loan losses. The Association’s allowance for loan losses methodology has consistently adhered to proper accounting policies, under the regulatory supervision of FCA in its role as a “safety and soundness” regulator. It was FCA’s view that the allowance for loan losses should include among others, an assessment of: probable losses, historical loss experience and economic conditions.

In April 2004, FCA issued an "Informational Memorandum" to System institutions regarding the criteria and methodologies that would be used in evaluating the adequacy of a System institution’s allowance for loan losses. FCA endorsed the direction provided by other bank regulators and the SEC and indicated the conceptual framework addressed in their guidance would be included as part of their examination process.

During the fourth quarter of 2004, the Association completed its study and refined its methodology to be in compliance with the guidance discussed in the previous paragraph. The refinement in methodology resulted in a calculated allowance for loan losses that was significantly less than the previously recorded balance due to revised loss factors that are more indicative of actual loss experience in recent years and current borrower analysis.

While the \$21,033 reversal had a significant impact on 2004 results of operations and the previously recorded allowance for loan losses, the refinement in methodology is not expected to have a significant impact on comparative results of operations in future periods. Additionally, the refinement in methodology did not have a significant impact on the level of the risk bearing capacity of the Association, generally referred to as “risk funds” (capital plus the allowance for loan losses), which totaled \$192,776 at December 31, 2004 (16.84 percent of Association loans), as compared with \$177,131 at December 31, 2003 (15.69 percent of Association loans).

**Note 4 – Loans and Allowance for Loan Losses**

A summary of loans follows:

	2004	December 31, 2003	2002
Long-term farm mortgage	\$ 796,551	\$ 760,245	\$ 652,895
Production and intermediate-term	396,938	362,712	419,953
Rural home	55,142	67,604	83,312
Farm related business	10,751	9,500	12,575
Aquatic	802	1,049	1,073
Processing and marketing	16,804	30,254	29,088
Leases	—	1,412	324
Sales contracts	2,813	3,874	4,485
Nonaccruals	6,123	4,950	10,385
Plus: participations purchased	23,313	38,953	43,750
Less: participations sold	(164,600)	(151,725)	(144,800)
<b>Total</b>	<b>\$ 1,144,637</b>	<b>\$ 1,128,828</b>	<b>\$ 1,113,040</b>

The Association’s concentration of credit risk in various agricultural commodities is shown in the following table. While the amounts represent the Association’s maximum potential credit risk as it relates to recorded loan principal, a substantial portion of the Association’s lending activities is collateralized and the Association’s exposure to credit loss associated with lending activities is reduced accordingly. An estimate of the Association’s credit risk exposure is considered in the determination of the allowance for loan losses.

Total loans at December 31, 2004 and 2003 consisted of the following commodity types:

Commodity Type	2004	December 31, 2003
Timber	37%	35%
Broilers	13	12
Beef Cattle, Pasture	7	8
Feed/Grain/Soybeans/Hay	7	7
Cotton	5	5
RHL, PMM	5	7
Horses	4	4
Landlords	3	3
Timber Processing/Harvesting	3	3
Dairy	2	2
Eggs	2	2
Sod/Nursery	2	3
Fruit and Nut	1	2
Hogs	1	1
Turkeys	1	1
Vegetables	1	1
Other	6	4
<b>Total</b>	<b>100%</b>	<b>100%</b>

The amount of collateral obtained, if deemed necessary upon extension of credit, is based on management’s credit evaluation of the borrower. Collateral held varies, but typically includes farmland and income-producing property, such as crops and livestock, as well as receivables. Long-term real estate loans are secured by the first liens on the underlying real property. Federal regulations state that long-term real estate loans are not to exceed 85 percent (97 percent if guaranteed by a government agency) of the property’s appraised value. However, a decline in a property’s market value subsequent to loan origination or advances, or other actions necessary to protect the financial interest of the Association in the collateral, may result in the loan to value ratios in excess of the regulatory maximum.

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

DOLLARS IN THOUSANDS, EXCEPT AS NOTED (CONTINUED)

Impaired loans are loans for which it is probable that not all principal and interest will be collected according to the contractual terms.

The following table presents information relating to impaired loans.

	December 31,		
	2004	2003	2002
<b>Nonaccrual loans:</b>			
Current as to principal and interest	\$ 615	\$ 2,099	\$ 456
Past due	5,508	2,851	9,929
<b>Total nonaccrual loans</b>	<b>6,123</b>	<b>4,950</b>	<b>10,385</b>
<b>Impaired accrual loans:</b>			
Restructured accrual loans	-	48	199
Accrual loans 90 days or more past due	-	-	77
<b>Total impaired accrual loans</b>	<b>-</b>	<b>48</b>	<b>276</b>
<b>Total impaired loans</b>	<b>\$ 6,123</b>	<b>\$ 4,998</b>	<b>\$ 10,661</b>

There were no material commitments to lend additional funds to debtors whose loans were classified as impaired at December 31, 2004.

Interest income is recognized and cash payments are applied on nonaccrual impaired loans as described in Note 2. The following table presents interest income recognized on impaired loans.

	Year Ended December 31,		
	2004	2003	2002
Interest income recognized on nonaccrual loans	\$ 1,155	\$ 1,000	\$ 1,059
Interest income on impaired accrual loans	71	66	45
<b>Interest income recognized on impaired loans</b>	<b>\$ 1,226</b>	<b>\$ 1,066</b>	<b>\$ 1,104</b>

The following table presents information concerning impaired loans as of December 31,

	2004	2003	2002
	Impaired loans with related allowance	\$ 471	\$ 712
Impaired loans with no related allowance	5,652	4,286	9,220
<b>Total impaired loans</b>	<b>\$ 6,123</b>	<b>\$ 4,998</b>	<b>\$ 10,661</b>
<b>Allowance on impaired loans</b>	<b>\$ 376</b>	<b>\$ 324</b>	<b>\$ 267</b>

The following table summarizes impaired loan information for the year ended December 31,

	2004	2003	2002
Average impaired loans	\$ 6,101	\$ 8,691	\$ 10,773

Interest income on nonaccrual and accruing restructured loans that would have been recognized under the original terms of the loans for the year ended December 31, 2004 were as follows:

Interest income which would have been recognized under the original loan terms	\$ 1,754
Less: interest income recognized	1,155
<b>Foregone interest income</b>	<b>\$ 599</b>

A summary of the changes in the allowance for loan losses follows:

	Year Ended December 31,		
	2004	2003	2002
Balance at beginning of year	\$ 25,253	\$ 25,446	\$ 26,306
Provision for loan losses	-	(396)	3,000
Nonrecurring provision for loan losses reversal*	(21,033)	-	-
Loans charged off	(311)	(322)	(3,984)
Recoveries	112	525	124
<b>Balance at end of year</b>	<b>\$ 4,021</b>	<b>\$ 25,253</b>	<b>\$ 25,446</b>

\* Represents the amount of provision reversal due to the change in methodology.

Ratio of net charge-offs during the period to average loans outstanding during the period	0.018%	(0.018)%	0.352%
---	--------	----------	--------

As previously discussed in Note 3, the nonrecurring provision for loan losses reversal resulted from the refinement of the Association's allowance for loan losses methodology.

To mitigate the risk of loan losses, the Association may enter into long-term standby commitments to purchase agreements with the Federal Agricultural Mortgage Corporation (Farmer Mac). The agreements, which are effectively credit guarantees that will remain in place until the loans are paid in full, give the Association the right to sell the loans identified in the agreements to Farmer Mac in the event of default, subject to certain conditions. The balance of loans under long-term standby commitments was \$47,396, \$72,159 and \$82,479 at December 31, 2004, 2003 and 2002, respectively. Fees paid to Farmer Mac for such commitments totaled \$313, \$405 and \$227 for the years ended December 31, 2004, 2003 and 2002, respectively. These amounts are classified as noninterest expense.

## Note 5 – Investment in AgFirst Farm Credit Bank

The Association is required to maintain ownership in the Bank of Class B and Class C stock as determined by the Bank. The Bank may require additional capital contributions to maintain its capital requirements.

## Note 6 – Premises and Equipment

Premises and equipment consisted of the following:

	December 31,		
	2004	2003	2002
Land	\$ 1,932	\$ 1,354	\$ 1,253
Buildings and improvements	8,293	7,286	6,925
Furniture and equipment	4,961	4,707	4,584
	15,186	13,347	12,762
Less: accumulated depreciation	6,643	6,537	6,438
<b>Total</b>	<b>\$ 8,543</b>	<b>\$ 6,810</b>	<b>\$ 6,324</b>

**Note 7 – Notes Payable to AgFirst Farm Credit Bank**

The Association’s indebtedness to the Bank represents borrowings by the Association to fund its loan portfolio. This indebtedness is collateralized by a pledge of substantially all of the Association’s assets and the terms of the revolving lines of credit are governed by a general financing agreement. Interest rates on both variable and fixed rate notes payable are generally established loan-by-loan based on the Bank’s marginal cost of funds, capital position, operating costs and return objectives. The interest rate is periodically adjusted by the Bank based upon agreement between the Bank and Association. The weighted average interest rates on the variable rate notes were 3.39 percent for LIBOR-based loans, 3.17 percent for Prime-based loans, and the weighted average remaining maturities were 5.1 years and 4.0 years, respectively, at December 31, 2004. The weighted average interest rate on the fixed rate and adjustable rate mortgage (ARM) notes payable which are match funded by the Bank was 4.17 percent and the weighted average remaining maturity was 7.9 years at December 31, 2004. The weighted average interest rate on all interest-bearing notes payable was 3.82 percent and the weighted average remaining maturity was 6.5 years at December 31, 2004.

Variable rate and fixed rate notes payable represent approximately 40.12 percent and 59.88 percent, respectively, of total notes payable at December 31, 2004.

The Bank, consistent with FCA regulations, has established limitations on the Association’s ability to borrow funds based on specified factors or formulas relating primarily to credit quality and financial condition. At December 31, 2004, the Association’s notes payable were within the specified limitations.

**Note 8 – Members’ Equity**

A description of the Association’s capitalization requirements, protection mechanisms, regulatory capitalization requirements and restrictions, and equities are provided below.

**A. Protected Borrower Equity**

Protection of certain borrower equity is provided under the Farm Credit Act which requires the Association, when retiring protected borrower equity, to retire such equity at par or stated value regardless of its book value. Protected borrower equity includes capital stock, participation certificates and allocated equities which were outstanding as of January 6, 1988, or were issued or allocated prior to October 6, 1988. If an Association is unable to retire protected borrower equity at par value or stated value, amounts required to retire this equity would be obtained from the Insurance Fund.

**B. Capital Stock and Participation Certificates**

In accordance with the Farm Credit Act and the Association’s capitalization bylaws, each borrower is required to invest in Class C stock for agricultural loans, or participation certificates in the case of rural home and farm related business loans, as a condition of borrowing. The initial borrower investment, through either purchase or transfer, must be in an amount equal to the lesser of \$1,000 or 2 percent of the amount of the loan. The Board of Directors may increase the amount of investment if necessary to meet the Association’s capital needs. Loans designated for sale or sold into the Secondary

Market on or after April 16, 1996 will have no voting stock or participation certificate purchase requirement if sold within 180 days following the date of designation.

The borrower acquires ownership of the capital stock or participation certificates at the time the loan is made, but usually does not make a cash investment. The aggregate par value is generally added to the principal amount of the related loan obligation. The Association retains a first lien on the stock or participation certificates owned by borrowers. Retirement of such equities will generally be at the lower of par or book value, and repayment of a loan does not automatically result in retirement of the corresponding stock or participation certificates.

**C. Regulatory Capitalization Requirements and Restrictions**

FCA’s capital adequacy regulations require the Association to achieve permanent capital of seven percent of risk-adjusted assets and off-balance-sheet commitments. Failure to meet the seven percent capital requirement can initiate certain mandatory and possibly additional discretionary actions by FCA that, if undertaken, could have a direct material effect on the Association’s financial statements. The Association is prohibited from reducing permanent capital by retiring stock or making certain other distributions to shareholders unless prescribed capital standards are met. FCA regulations also require that additional minimum standards for capital be achieved. These standards require all System institutions to achieve and maintain ratios as defined by FCA regulations. These required ratios are total surplus as a percentage of risk-adjusted assets of seven percent and of core surplus as a percentage of risk-adjusted assets of three and one-half percent. The Association’s permanent capital, total surplus and core surplus ratios at December 31, 2004 were 14.59 percent, 14.01 percent and 10.23 percent, respectively.

An FCA regulation empowers it to direct a transfer of funds or equities by one or more System institutions to another System institution under specified circumstances. The Association has not been called upon to initiate any transfers and is not aware of any proposed action under this regulation.

**D. Description of Equities**

The Association is authorized to issue or have outstanding Classes A and D Preferred Stock, Classes A, B, and C Common Stock, Classes B and C Participation Certificates, Stock and such other classes of equity as may be provided for in amendments to the bylaws in such amounts as may be necessary to conduct the Association’s business. All stock and participation certificates have a par or face value of five dollars (\$5.00) per share.

The Association had the following shares outstanding at December 31, 2004:

Class	Protected	Shares Outstanding	
		Number	Aggregate Par Value
B Common/Nonvoting	Yes	205,010	\$ 1,025
C Common/Voting	No	1,031,950	5,160
B Participation Certificates/Nonvoting	Yes	34,461	172
C Participation Certificates/Nonvoting	No	169,976	850
Total Capital Stock and Participation Certificates		1,441,397	\$ 7,207

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

DOLLARS IN THOUSANDS, EXCEPT AS NOTED (CONTINUED)

Protected common stock and participation certificates are retired at par or face value in the normal course of business. At-risk common stock and participation certificates are retired at the sole discretion of the Board at book value not to exceed par or face amounts, provided the minimum capital adequacy standards established by the Board are met.

## *Retained Earnings*

The Association maintains an unallocated retained earnings account and an allocated retained earnings account. The minimum aggregate amount of these two accounts is determined by the Board. At the end of any fiscal year, if the retained earnings accounts otherwise would be less than the minimum amount determined by the Board as necessary to maintain adequate capital reserves to meet the commitments of the Association, the Association shall apply earnings for the year to the unallocated retained earnings account in such amounts as may be determined necessary by the Board. Unallocated retained earnings are maintained for each borrower to permit liquidation on a patronage basis.

The Association maintains an allocated retained earnings account consisting of earnings held and allocated to borrowers on a patronage basis. In the event of a net loss for any fiscal year, such allocated retained earnings account will be subject to full impairment in the order specified in the bylaws beginning with the most recent allocation.

The Association has a first lien and security interest on all retained earnings account allocations owned by any borrowers, and all distributions thereof, as additional collateral for their indebtedness to the Association. When the debt of a borrower is in default or is in the process of final liquidation by payment or otherwise, the Association, upon approval of the Board, may order any and all retained earnings account allocations owned by such borrower to be applied on the indebtedness.

Allocated equities shall be retired solely at the discretion of the Board; provided, however, that minimum capital standards established by the FCA and the Board are met. Nonqualified retained surplus is considered to be permanently invested in the Association and as such, there is no plan to revolve or retire this surplus. All nonqualified distributions are tax deductible only when redeemed.

At December 31, 2004, allocated members' equity consisted of \$38,167 of qualified surplus, \$41,268 of nonqualified allocated surplus and \$1,966 of nonqualified retained surplus.

## *Patronage Distributions*

Prior to the beginning of any fiscal year, the Board, by adoption of a resolution, may obligate the Association to distribute to borrowers on a patronage basis all or any portion of available net earnings for such fiscal year or for that and subsequent fiscal years. Patronage distributions are based on the proportion of the borrower's interest to the amount of interest earned by the Association on its total loans unless another proportionate patronage basis is approved by the Board.

If the Association meets its capital adequacy standards after making the patronage distributions, the patronage distributions may be in cash, authorized stock of the Association, allocations of earnings retained in an allocated members' equity account, or any one or more of such forms of distribution. Patronage distributions of the Association's earnings may be paid on either a qualified or nonqualified basis, or a combination of both, as determined by the Board. A minimum of 20 percent of the total qualified patronage distribution to any borrower for any fiscal year shall always be paid in cash.

## *Dividends*

The Association may declare noncumulative dividends on its capital stock and participation certificates provided the dividend rate does not exceed 20 percent of the par value of the respective capital stock and participation certificates. Such dividends may be paid solely on Classes A and D Preferred Stock, or on all classes of stock and participation certificates.

The rate of dividends paid on Class A Preferred Stock for any fiscal year may not be less than the rate of dividends paid on Classes A, B, or C Common Stock or participation certificates for such year. The rate of dividends on Classes A, B, or C Common Stock and participation certificates shall be at the same rate per share.

Dividends may not be declared if, after recording the liability, the Association would not meet its capital adequacy standards. No dividends were declared by the Association for any of the periods included in these financial statements.

## *Transfer*

Classes A and D Preferred, Classes A, B, and C Common Stock, and Classes B and C Participation Certificates may be transferred to persons or entities eligible to purchase or hold such equities.

## *Impairment*

Any net losses recorded by the Association shall first be applied against unallocated members' equity. To the extent that such losses would exceed unallocated members' equity, such losses would be applied consistent with the Association's bylaws and distributed pro rata to each share and/or unit outstanding in the class, in the following order:

1. Allocated Surplus
2. Class C Common Stock and Class C Participation Certificates
3. Classes A and B Common Stock and Class B Participation Certificates
4. Classes A and D Preferred Stock

## *Liquidation*

In the event of liquidation or dissolution of the Association, any assets of the Association remaining after payment or retirement of all liabilities should be distributed to the holders of the outstanding stock and participation certificates in the following order:

1. Classes A and D Preferred Stock
2. Classes A and B Common Stock and Class B Participation Certificates
3. Class C Common Stock and Class C Participation Certificates
4. Allocated Surplus
5. Unallocated Surplus issued after January 1, 1996 shall be distributed to all holders of Class C Common Stock and Class C Participation Certificates from January 1, 1996
6. Remaining Assets shall be distributed ratably to the holders of all classes of Stock and Participation Certificates

#### E. Other Comprehensive Income (Loss)

The Association reports other comprehensive income (loss) in its Statement of Changes in Members' Equity. For the years ended December 31, 2003 and 2002, other comprehensive income (loss) is related to the minimum pension liability recorded as a result of the funded status of the underlying plan. During 2004, the District Associations funded the pension plans sufficiently to eliminate the pension-related charge to other comprehensive income (loss) at December 31, 2004. See Note 10 for further information.

#### Note 9 – Income Taxes

The provision (benefit) for income taxes follows:

	<b>Year Ended December 31,</b>		
	<b>2004</b>	<b>2003</b>	<b>2002</b>
Current:			
Federal	\$ 3	\$ 50	\$ (45)
State	–	15	(91)
Federal refunds related to long-term lending	–	–	(112)
State refunds	–	–	(251)
	<u>3</u>	<u>65</u>	<u>(499)</u>
Deferred:			
Federal	(88)	48	(94)
State	(23)	7	42
Deferred tax write-off	–	–	366
	<u>(111)</u>	<u>55</u>	<u>314</u>
Total provision (benefit) for income taxes	<u>\$ (108)</u>	<u>\$ 120</u>	<u>\$ (185)</u>

The provision (benefit) for income tax differs from the amount of income tax determined by applying the applicable U.S. statutory federal income tax rate to pretax income as follows:

	<b>December 31,</b>		
	<b>2004</b>	<b>2003</b>	<b>2002</b>
Federal tax at statutory rate	\$ 15,707	\$ 8,090	\$ 6,750
State tax, net	(15)	15	(198)
Patronage distributions	(1,847)	(870)	(1,538)
Tax-exempt FLCA earnings	(8,880)	(7,214)	(5,200)
Long-term lending related refunds	–	–	(112)
Deferred tax asset adjustment	–	–	366
Allowance for Loan Loss adjustment	(4,967)	–	–
Other	(106)	99	(253)
Provision (benefit) for income taxes	<u>\$ (108)</u>	<u>\$ 120</u>	<u>\$ (185)</u>

Deferred tax assets and liabilities result from the following at:

	<b>December 31,</b>		
	<b>2004</b>	<b>2003</b>	<b>2002</b>
Allowance for loan losses	\$ 43	\$ 267	\$ 267
Annual leave	42	41	47
Nonaccrual loan interest	27	27	27
Postretirement benefits other than pensions	78	71	53
Nonqualified patronage distributions	746	746	746
Depreciation (reclassified)	4	4	3
Gross deferred tax assets	<u>940</u>	<u>1,156</u>	<u>1,143</u>
Future Bank equity redemption	(262)	(588)	(540)
Loan fees	(18)	(18)	(18)
Pensions	(96)	(96)	(76)
Gross deferred tax liability	<u>(376)</u>	<u>(702)</u>	<u>(634)</u>
Net deferred tax asset (liability)	<u>\$ 564</u>	<u>\$ 454</u>	<u>\$ 509</u>

At December 31, 2004, deferred income taxes have not been provided by the Association on approximately \$7.4 million of patronage refunds received from the Bank prior to January 1, 1993. Such refunds, distributed in the form of stock, are subject to tax only upon conversion to cash. The tax liability related to future conversions is not expected to be material.

#### Note 10 – Employee Benefit Plans

The Association participates in a Districtwide defined benefit retirement plan. This plan is noncontributory and covers substantially all Association employees. Benefits are based on salary and years of service. The assets, liabilities and costs of the plan are not segregated by participating entities but are allocated among the participating entities. Pension costs are allocated by multiplying the District's net pension expense times the Association's salary expense as a percentage of the District's salary expense.

At December 31, 2004, the fair value of the plan assets of the District's defined benefit plan exceeded the Accumulated Benefit Obligation (ABO), while at December 31, 2003 and 2002, the Accumulated Benefit Obligation (ABO) of the District's defined benefit plan exceeded the fair value of plan assets. The fair value of the plan assets and the ABO were measured as of September 30, 2004. At December 31, 2003 and 2002, the Association's allocated amount of the minimum pension liability was recorded in the Consolidated Balance Sheets in the amount of the excess of the ABO over the fair value of plan assets. In conjunction with the minimum pension liability, accumulated other comprehensive loss was \$11,436 and \$12,476 at December 31, 2003 and 2002, respectively. The impact on deferred taxes was not significant.

In addition, supplemental retirement benefits are provided to certain key employees under a supplemental defined benefit executive plan, which is not qualified under the Internal Revenue Code. As a nonqualified plan, assets have been allocated and separately invested for this plan but are not isolated from the general creditors of the Association.

The Association participates in a Districtwide Thrift Plan. For employees hired on or prior to December 31, 2002, the Association will contribute \$.50 for each \$1.00 of the maximum employee contribution of 6 percent of total compensation. For employees hired after January 1, 2003, the Association will contribute \$1.00 for each \$1.00 of the maximum employee

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

DOLLARS IN THOUSANDS, EXCEPT AS NOTED (CONTINUED)

contribution of 6 percent of total compensation. Employee deferrals are not to exceed the maximum deferral as adjusted by the Internal Revenue Service.

The District sponsors a plan providing certain benefits (primarily health care) to its retirees. Certain Association charges related to this plan are an allocation of District charges based on the Association's proportional share of the plan liability.

On December 8, 2003, the Medicare Prescription Drug, Improvement and Modernization Act of 2003 (Medicare Act) was signed into law. This act introduces a prescription drug benefit under Medicare (Medicare Part D) as well as a federal subsidy to sponsors of retiree health care benefit plans that provide a benefit that is at least actuarially equivalent to Medicare Part D. In May 2004, the FASB issued FASB Staff Position ("FSP") 106-2, "Accounting and Disclosure Requirements Related to the Medicare Prescription Drug, Improvement and Modernization Act of 2003" (the "Act"). This Staff Position provides guidance on the accounting for the effects of the Act for employers that sponsor postretirement health care plans that provide prescription drug benefits. The District sponsored plan adopted FSP 106-2 effective July 1, 2004 (measured as of March 31, 2004), and, accordingly, the benefit obligation valuation as of December 31, 2004 reflects the impact of the Medicare Act. For Medicare-eligible participants receiving actuarially equivalent drug benefits, the expected per capita claims cost are estimated to be reduced by 12% beginning in 2006 due to a government reimbursement of a portion of prescription drug benefits. Subsidies under the Medicare Act will reduce the current period measurements of benefits expected to be provided in future periods. Due to the status of the plan and the assumptions used in the remeasurement upon adoption of FSP 106-2, there was no effect on expense for 2004.

The following is a table of retirement and postretirement benefits expenses (credits):

	2004	2003	2002
Pension	\$4,357	\$2,545	\$1,484
Thrift/deferred compensation	347	324	277
Other postretirement benefits	2,274	1,835	1,358
Total	<u>\$6,978</u>	<u>\$4,704</u>	<u>\$3,119</u>

As of December 31, 2004, the Association had contributed \$13,697 to the Districtwide defined benefit retirement plan, which was sufficient to meet its accumulated benefit obligation. The contributions eliminated the minimum pension liability and the pension-related charge to accumulated other comprehensive income (OCI) in shareholders' equity. As a result of the funding and the reclassification of the OCI, the Association ended 2004 with \$14,862 in prepaid retirement expense in other assets on the consolidated balance sheets.

## Note 11 – Intra-System Financial Assistance

The Farm Credit System Financial Assistance Corporation (Financial Assistance Corporation) was established in 1988 primarily to provide capital to institutions of the System experiencing financial difficulty. Such assistance was funded through the Financial Assistance Corporation's issuance of \$1.261 billion of 15-year U.S. Treasury-guaranteed debt. The interest rates on these issuances range from 8.80 percent to 9.45 percent. The repayment of this debt and related interest is the

responsibility of System banks. At December 31, 2004, \$325 million of Financial Assistance Corporation debt remains outstanding and will mature in June 2005. All other debt has either matured or was called and redeemed.

Each System bank may be required to pay premiums into the Insurance Fund based on its annual average loan principal outstanding. The Bank, in turn, may also assess the Association for insurance premiums based on the average principal outstanding of accrual and nonaccrual loans of the Association for each year. At December 31, 2004, the assets in the Insurance Fund aggregated \$2.164 billion. However, due to the authorized uses of the Insurance Fund, there is no assurance that Fund assets will be available or sufficient to ensure the payment of principal of, or interest on, insured debt securities in the event of a default by any System bank having primary liability thereon.

## Note 12 – Related Party Transactions

In the ordinary course of business, the Association enters into loan transactions with officers and directors of the Association, their immediate families and other organizations with which such persons may be associated. Such loans are subject to special approval requirements contained in the FCA regulations and are made on the same terms, including interest rates and collateral, as those prevailing at the time for comparable transactions with unrelated borrowers.

Total loans to such persons at December 31, 2004 amounted to \$17,546. During 2004, \$9,725 of new loans were made and repayments totaled \$7,666. In the opinion of management, none of these loans outstanding at December 31, 2004 involved more than a normal risk of collectibility.

## Note 13 – Commitments and Contingencies

The Association has various commitments outstanding and contingent liabilities.

The Association may participate in financial instruments with off-balance-sheet risk to satisfy the financing needs of its borrowers and to manage their exposure to interest-rate risk. These financial instruments include commitments to extend credit and/or commercial letters of credit. The instruments involve, to varying degrees, elements of credit risk in excess of the amount recognized in the financial statements. Commitments to extend credit are agreements to lend to a borrower as long as there is not a violation of any condition established in the contract. Commercial letters of credit are agreements to pay a beneficiary under conditions specified in the letter of credit. Commitments and letters of credit generally have fixed expiration dates or other termination clauses and may require payment of a fee. At December 31, 2004, \$107,850 of commitments to extend credit and \$433 of standby letters of credit were outstanding.

Since many of these commitments are expected to expire without being drawn upon, the total commitments do not necessarily represent future cash requirements. However, these credit-related financial instruments have off-balance-sheet credit risk because their amounts are not reflected on the Balance Sheet until funded or drawn upon. The credit risk associated with issuing commitments and letters of credit is substantially the same as that involved in extending loans to borrowers and

management applies the same credit policies to these commitments. Upon fully funding a commitment, the credit risk amounts are equal to the contract amounts, assuming that borrowers fail completely to meet their obligations and the collateral or other security is of no value. The amount of collateral obtained, if deemed necessary upon extension of credit, is based on management's credit evaluation of the borrower.

The Association also participates in standby letters of credit to satisfy the financing needs of its borrowers. These letters of credit are irrevocable agreements to guarantee payments of specified financial obligations. Outstanding standby letters of credit have expiration dates ranging from August 6, 2008 to October 29, 2010.

#### Note 14 – Consolidation of AgSouth Farm Credit, ACA and Palmetto Farm Credit ACA

As described in Note 1(B), effective January 1, 2004, AgSouth Farm Credit, ACA (AgSouth) and Palmetto Farm Credit, ACA (Palmetto) consolidated to form AgSouth Farm Credit, ACA (the Association). This consolidation was accounted for in a manner similar to a pooling of interests, and accordingly, the Association's combined financial statements have been restated to include the accounts and operations of both associations for all periods prior to the consolidation.

Separate results of operations of AgSouth and Palmetto for the periods prior to the consolidation are presented in the following table:

	<u>AgSouth</u>	<u>Palmetto</u>	<u>Combined</u>
<b>Year ended December 31, 2003</b>			
Net interest income	\$18,623	\$16,867	\$35,490
Net income	13,993	9,683	23,676
<b>Year ended December 31, 2002</b>			
Net interest income	\$16,689	\$14,378	\$31,067
Net income	13,584	6,304	19,888

Costs incurred related to the consolidation during 2004 were \$3,697.

#### Note 15 – Disclosures About Fair Value of Financial Instruments

The following table presents the carrying amounts and fair values of the Association's financial instruments at December 31, 2004, 2003 and 2002. The fair value of a financial instrument is generally defined as the amount at which the instrument could be exchanged in a current transaction between willing parties, other than in a forced or liquidation sale.

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:

	<u>December 31, 2004</u>		<u>December 31, 2003</u>	
	<u>Carrying Amount</u>	<u>Estimated Fair Value</u>	<u>Carrying Amount</u>	<u>Estimated Fair Value</u>
<b>Financial assets:</b>				
Cash	\$ 6,048	\$ 6,048	\$ 4,654	\$ 4,654
Loans	\$ 1,144,637	\$ 1,158,162	\$ 1,128,828	\$ 1,145,239
Allowance for loan losses	4,021	—	25,253	—
Loans, net	\$ 1,140,616	\$ 1,158,162	\$ 1,103,575	\$ 1,145,239

<b>Financial liabilities:</b>				
Notes payable to AgFirst Farm Credit Bank	\$ 996,763	\$ 984,444	\$ 968,284	\$ 956,620

	<u>December 31, 2002</u>	
	<u>Carrying Amount</u>	<u>Estimated Fair Value</u>
<b>Financial assets:</b>		
Cash	\$ 5,404	\$ 5,404
Loans	\$ 1,113,040	\$ 1,143,967
Allowance for loan losses	25,446	—
Loans, net	\$ 1,087,594	\$ 1,143,967

<b>Financial liabilities:</b>		
Notes payable to AgFirst Farm Credit Bank	\$ 980,076	\$ 986,587

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.

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

DOLLARS IN THOUSANDS, EXCEPT AS NOTED (CONTINUED)

- C. **Investment in AgFirst Farm Credit Bank and Other Farm Credit Institutions:** Estimating the fair value of the Association's investment in the Bank is not practicable because the stock is not traded. As described in Note 5, the net investment is a requirement of borrowing from the Bank and is carried at cost plus allocated equities in the accompanying balance sheet. The Association owns 8.56 percent of the issued stock of the Bank as of December 31, 2004 net of any reciprocal investment. As of that date, the Bank's assets totaled \$16.9 billion and shareholders' equity totaled \$1,024 million. The Bank's earnings were \$180 million during 2004.

In addition, the Association has an investment of \$1,126 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 and Standby Letters of 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.

## Note 16 – Quarterly Financial Information (Unaudited)

Quarterly results of operations for the years ended December 31, 2004, 2003 and 2002 follow:

	2004				
	First	Second	Third	Fourth	Total
Net interest income	\$ 9,187	\$ 9,179	\$ 9,955	\$ 9,793	\$ 38,114
Provision for (reversal of) loan losses	—	—	—	(21,033)	(21,033)
Noninterest income (expense), net	(3,418)	(6,179)	(2,619)	(626)	(12,842)
Net income (loss)	\$ 5,769	\$ 3,000	\$ 7,336	\$ 30,200	\$ 46,305

	2003				
	First	Second	Third	Fourth	Total
Net interest income	\$ 8,253	\$ 8,843	\$ 9,394	\$ 9,000	\$ 35,490
Provision for (reversal of) loan losses	125	—	—	(521)	(396)
Noninterest income (expense), net	(2,458)	(2,764)	(3,044)	(3,944)	(12,210)
Net income (loss)	\$ 5,670	\$ 6,079	\$ 6,350	\$ 5,577	\$ 23,676

	2002				
	First	Second	Third	Fourth	Total
Net interest income	\$ 7,430	\$ 7,446	\$ 7,906	\$ 8,285	\$ 31,067
Provision for (reversal of) loan losses	250	1,500	1,000	250	3,000
Noninterest income (expense), net	(1,984)	(1,840)	(1,913)	(2,442)	(8,179)
Net income (loss)	\$ 5,196	\$ 4,106	\$ 4,993	\$ 5,593	\$ 19,888

# SHOES NOT REQUIRED.

*(You can also wear boots.)*

Want to live your life by your own rules? Do what you want with your property?  
How about a place where nature is your closest neighbor?

Live the life you want with a little help from AgSouth. We've been making loans to  
keep rural America growing for more than 85 years, and we're the experts in the field.

***We Offer Loans For:***

- \* Real Estate & Lots*
- \* Home Purchase, Construction & Refinance*
- \* Farm & Home Improvements*
- \* Equipment & Livestock*

Call AgSouth to finance your dream today because there's more to life than work,  
and we finance it all.



 **AgSouth**  
Farm Credit, ACA

*Financial Services for Rural America.*

[www.agsouthfc.com](http://www.agsouthfc.com) | 866.585.6234





 **AgSouth**  
Farm Credit, ACA



AgSouth Farm Credit  
P.O. Box 718  
Statesboro, GA 30459

PRSR STD  
U.S. POSTAGE  
**PAID**  
COLUMBIA S.C.  
PERMIT 785