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*Pee Dee Farm Credit, ACA*

# **SECOND QUARTER 2005**

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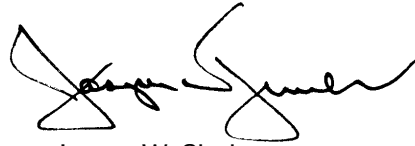
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Jasper W. Shuler  
Chief Executive Officer



Dale W. Player  
Chairman of the Board

July 29, 2005

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

*(dollars in thousands)*

The following commentary reviews the financial condition and results of operations of Pee Dee Farm Credit, ACA (Association) for the period ended June 30, 2005. These comments should be read in conjunction with the accompanying consolidated financial statements, notes to the consolidated financial statements and the 2004 Annual Report of the Association.

## **LOAN PORTFOLIO**

The Association provides funds to farmers, rural homeowners and farm-related businesses for financing of short and intermediate-term loans and long-term real estate mortgage loans. The Association's loan portfolio is diversified over a range of agricultural commodities in our region, including tobacco, poultry, swine and forestry. Farm size varies and many of the borrowers in the region have diversified farming operations. This factor, along with the numerous opportunities for non-farm income in the area, somewhat impacts the level of dependency on a given commodity. Approximately one third of the portfolio has significant outside income to diversify dependence on agriculture, consisting of lifestyle loans and loans to less than full-time farmers with retirement income, salaried income and non-agricultural business income. Further, approximately twenty-one percent of the assets carry federal guarantees as a risk management tool.

The gross loan volume of the Association as of June 30, 2005, was \$291,781, an increase of \$46,741 as compared to \$245,040 at December 31, 2004. Net loans outstanding at June 30, 2005, were \$290,780 as compared to \$244,040 at December 31, 2004. The Association has investment securities that are classified as held to maturity in the amount of \$14,808 at June 30, 2005 compared to \$12,553 at December 31, 2004. Net loans and security investments accounted for 96.22 percent of total assets at June 30, 2005, as compared to 95.39 percent of total assets at December 31, 2004.

The increase in gross and net loan volume during the reporting period is attributed primarily to the seasonal lending upswing. The Association continues to review and engage in participation opportunities, as well as customer opportunities within the territory.

There is an inherent risk in the extension of any type of credit. Portfolio credit quality continues to be maintained at an acceptable level, however, and credit administration remains satisfactory. Nonaccrual loans decreased from \$469 at December 31, 2004, to \$323 at June 30, 2005. This decrease is primarily the result of diligence on the part of Association staff and because of the higher than normal percentage of guaranteed loans.

Association management maintains an allowance for loan losses in an amount considered sufficient to absorb possible losses in the loan portfolio based on current and expected future conditions. The allowance for loan losses at June 30, 2005, was \$1,001, compared to \$1,000 at December 31, 2004, and was considered by management to be adequate to cover possible losses.

### ***Geographic Distribution of Loans by State at June 30, 2005:***

	<b>Percentage</b>
South Carolina	66.12 %
Alaska	.09
Arizona	.28
Arkansas	.09
California	.82
Colorado	.23
Florida	13.18
Georgia	11.65
Kansas	.14
Kentucky	.22
Maryland	.06
New York	.20
North Carolina	2.73
Oregon	.23
Pennsylvania	.90
Tennessee	1.08
Texas	1.78
Virginia	.14
Wisconsin	.06
	<u>100.00 %</u>

**Distribution of Loans by Loan Type at June 30, 2005:**

	<u>Percentage</u>	
Agricultural Production:		
Cash grains	1.90%	
Tobacco	12.10	
Livestock	5.84	
Cotton	5.37	
Poultry	8.37	
General row crops	1.35	
Forestry	7.95	
Other commodities	<u>1.10</u>	43.98%
Agricultural real estate mortgage	21.40	
Rural home	3.32	
Notes receivable sales contracts/PMMs	1.49	
Basic processing	9.07	
Farm-related business	3.59	
Nonaccruals	.11	
Participations purchased	41.92	
Participations sold	<u>(24.88)</u>	
	<u>100.00%</u>	

**RESULTS OF OPERATIONS****For the three months ended June 30, 2005**

Net income for the three months ended June 30, 2005, totaled \$1,811, as compared to \$1,321 for the same period in 2004. Net interest income increased \$248, for the three months ended June 30, 2005, as compared to the same period in 2004. Increased loan volume along with rising interest rates, are the primary reasons for the increase in net interest income.

At June 30, 2005, interest income on accruing loans increased \$1,125 compared to \$3,358 at June 30, 2004. Nonaccrual income was \$17 for the three months ended June 30, 2005, as compared to \$41 for the same period in 2004. Interest income on investment securities was \$195 for the three months ended June 30, 2005 while there was not any for the same period in 2004. Interest expense increased \$1,048 for the three months ended June 30, 2005, as compared to the comparable period of 2004.

Noninterest income for the three months ended June 30, 2005, totaled \$1,251, as compared to \$958 for the same period of 2004, an increase of \$293. The increase is primarily the result of increased patronage income, fees for financially related services, and other income. Noninterest expense for the three months ended June 30, 2005, increased \$46 compared to the same period of 2004. Increases in occupancy and equipment expenses and other operating expenses were the main cause for the increase.

**For the six months ended June 30, 2005**

Net income for the six months ended June 30, 2005, totaled \$3,291, as compared to \$2,278 for the same period in 2004. At June 30, 2005, net interest income increased by \$601 or 19.12 percent compared to June 30, 2004. Interest income on loans and investment securities increased by \$2,248 and interest expense increased by \$1,647. This change in net interest income is the result of both increased loan volume and interest rates.

Nonaccrual income was \$166 for the six months ended June 30, 2005, as compared to \$63 for the same period in 2004. The Association did not record a provision for loan loss for the six months ended June 30, 2005, nor for the same period in 2004. Growth in the portfolio has been coupled with continued geographic diversification and expanded scale with the capital markets portfolio while keeping the average individual size of those relationships relatively constant. As discussed in the 2004 Annual Report, the Association recorded a loan loss reversal of \$4,413 in the fourth quarter of 2004 that resulted in a significant decrease in the allowance for loan losses. Please refer to the 2004 Annual Report of the Association for a more detailed explanation of this change in accounting estimate.

Noninterest income for the six months ended June 30, 2005, totaled \$2,125, as compared to \$1,673 for the same period of 2004, an increase of \$452. The increase is primarily the result of increases in patronage income by \$146, FRS income by \$15, and other income by \$348. However, the increases were offset by a decrease in fees of \$57. Noninterest expense for the six months ended June 30, 2005, increased \$29 compared to the same period of 2004. This increase is attributed to a rise in occupancy and equipment expenses of \$35 and other operating expenses of \$170. However, salaries and employee benefits decreased by \$117 and insurance fund premium decreased by \$59. The Association recorded a provision for income taxes of \$23 for the six months ended June 30, 2005, an increase of \$11 as compared to the same period in 2004.

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## FUNDING SOURCES

The principal source of funds for the Association is the borrowing relationship established with AgFirst Farm Credit Bank (the Bank) through a General Financing Agreement. The General Financing Agreement utilizes the Association's credit and fiscal performance as criteria for establishing a line of credit on which the Association may draw funds. The funds are advanced by the Bank to the Association in the form of notes payable. The notes payable are segmented into variable rate and fixed rate sections. The variable rate note is utilized by the Association to fund variable rate loan advances and operating funds requirements. The fixed rate note is used specifically to fund fixed rate loan advances made by the Association. The total notes payable to the Bank at June 30, 2005, was \$269,573 as compared to \$222,656 at December 31, 2004. The increase during the period is primarily attributed to increased loan volume and interest rates.

## CAPITAL RESOURCES

Total members' equity at June 30, 2005, increased to \$42,273 from the December 31, 2004, total of \$39,114. The increase is primarily attributed to the increase in retained earnings in excess of the reduction of capital stock, participation certificates and revolved equities.

Total capital stock and participation certificates were \$1,651 on June 30, 2005, compared to \$1,756 on December 31, 2004. This decrease is attributed to the retirement of protected stock and participation certificates on loans liquidated in the normal course of business, new loans being capitalized at new lower regulatory levels, and the annual retirement of B stock.

Farm Credit Administration (FCA) regulations require all Farm Credit institutions to maintain minimum permanent capital, total surplus and core surplus ratios. These ratios are calculated by dividing the Association's permanent capital, total surplus and core surplus as defined in FCA regulations, by a risk-adjusted asset base. As of June 30, 2005, the Association's total surplus ratio and core surplus ratio were 13.69 percent and 11.15 percent, respectively, and the permanent capital ratio was 14.12 percent. All three ratios were well above the minimum regulatory ratios of 7.00 percent for permanent capital and total surplus ratios and 3.50 percent for the core surplus ratio.

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**NOTE:** Shareholder investment in the Association could be affected by the financial condition and results of operations of AgFirst Farm Credit Bank. Copies of AgFirst's annual and quarterly reports are available upon request free of charge by calling 1-800-845-1745, ext. 378, or writing Jay Wise, AgFirst Farm Credit Bank, P.O. Box 1499, Columbia, SC 29202. Information concerning AgFirst Farm Credit Bank can also be obtained at their website, [www.agfirst.com](http://www.agfirst.com). Copies of the Association's annual and quarterly reports are also available upon request free of charge by calling 1-800-741-7332, writing Joan Boice, Corporate Secretary, Pee Dee Farm Credit, ACA, P.O. Box 13209, Florence, SC 29504, or accessing the website, [www.peedeefarmcredit.com](http://www.peedeefarmcredit.com). The Association prepares a quarterly report within 45 days after the end of each fiscal quarter, except that no report need be prepared for the fiscal quarter that coincides with the end of the fiscal year of the institution.

*Pee Dee Farm Credit, ACA*  
**Consolidated Balance Sheets**

<i>(dollars in thousands)</i>	<b>June 30, 2005</b> <i>(unaudited)</i>	<b>December 31, 2004</b> <i>(audited)</i>
<b>Assets</b>		
Cash	\$ 7	\$ 7
Investment securities	14,808	12,553
Loans	291,781	245,040
Less: allowance for loan losses	1,001	1,000
Net loans	290,780	244,040
Accrued interest receivable	3,857	2,438
Investment in other Farm Credit institutions	3,695	3,645
Premises and equipment, net	458	610
Other assets	3,991	5,698
Total assets	\$ 317,596	\$ 268,991
<b>Liabilities</b>		
Notes payable to AgFirst Farm Credit Bank	\$ 269,573	\$ 222,656
Accrued interest payable	975	723
Patronage refund payable	95	1,675
Other liabilities	4,680	4,823
Total liabilities	275,323	229,877
Commitments and contingencies		
<b>Members' Equity</b>		
Protected borrower equity	527	584
Capital stock and participation certificates	1,124	1,172
Retained earnings		
Allocated	22,452	22,225
Unallocated	18,170	15,133
Total members' equity	42,273	39,114
Total liabilities and members' equity	\$ 317,596	\$ 268,991

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

*Pee Dee Farm Credit, ACA*

# Consolidated Statements of Income

*(unaudited)*

<i>(dollars in thousands)</i>	For the three months ended June 30,		For the six months ended June 30,	
	2005	2004	2005	2004
<b>Interest Income</b>				
Loans	\$ 4,500	\$ 3,399	\$ 8,414	\$ 6,544
Other	195	—	378	—
Total Interest Income	4,695	3,399	8,792	6,544
<b>Interest Expense</b>				
Notes payable to AgFirst Farm Credit Bank	2,793	1,745	5,047	3,400
Net interest income	1,902	1,654	3,745	3,144
Provision for (reversal of) loan losses	—	—	—	—
Net interest income after provision for (reversal of) loan losses	1,902	1,654	3,745	3,144
<b>Noninterest Income</b>				
Loan fees	271	396	579	636
Fees for financially related services	21	2	30	15
Equity in earnings of other Farm Credit institutions	534	453	1,009	863
Other noninterest income	425	107	507	159
Total noninterest income	1,251	958	2,125	1,673
<b>Noninterest Expense</b>				
Salaries and employee benefits	843	892	1,643	1,760
Occupancy and equipment	90	70	173	138
Insurance Fund premium	26	54	50	109
Other operating expenses	372	269	690	520
Total noninterest expense	1,331	1,285	2,556	2,527
Income before income taxes	1,822	1,327	3,314	2,290
Provision (benefit) for income taxes	11	6	23	12
Net income	\$ 1,811	\$ 1,321	\$ 3,291	\$ 2,278

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

*Pee Dee Farm Credit, ACA*

# Consolidated Statements of Changes in Members' Equity

*(unaudited)*

*(dollars in thousands)*

	Protected Borrower Capital	Capital Stock and Participation Certificates	Retained Earnings		Accumulated Other Comprehensive Income	Total Members' Equity
			Allocated	Unallocated		
Balance at December 31, 2003	\$ 701	\$ 1,155	\$ 16,653	\$ 14,618	\$ (2,480)	\$ 30,647
Net income				2,278		2,278
Protected borrower equity retired	(80)					(80)
Capital stock/participation certificates issued		41				41
Capital stock/participation certificates retired		(45)				(45)
Retained earnings retired			(3)			(3)
Distribution adjustment			82	(133)		(51)
Balance at June 30, 2004	\$ 621	\$ 1,151	\$ 16,732	\$ 16,763	\$ (2,480)	\$ 32,787
Balance at December 31, 2004	\$ 584	\$ 1,172	\$ 22,225	\$ 15,133	\$ —	\$ 39,114
Net income				3,291		3,291
Protected borrower equity retired	(57)					(57)
Capital stock/participation certificates issued		103				103
Capital stock/participation certificates retired		(151)				(151)
Retained earnings retired			(7)			(7)
Distribution adjustment			234	(254)		(20)
Balance at June 30, 2005	\$ 527	\$ 1,124	\$ 22,452	\$ 18,170	\$ —	\$ 42,273

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

# Notes to the Consolidated Financial Statements

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

## NOTE 1 – ORGANIZATION AND SIGNIFICANT ACCOUNTING POLICIES

A description of the organization and operations of Pee Dee Farm Credit, ACA (the Association), the significant accounting policies followed, and the financial condition and results of operations as of and for the year ended December 31, 2004, are contained in the 2004 Annual Report to Shareholders. These unaudited second quarter 2005 consolidated financial statements should be read in conjunction with the 2004 Annual Report to Shareholders.

The accompanying consolidated financial statements contain all adjustments necessary for a fair presentation of the interim financial condition and results of operations and conform with generally accepted accounting principles. The results for the six months ended June 30, 2005, are not necessarily indicative of the results to be expected for the year ending December 31, 2005.

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

The Association maintains an allowance for loan losses in accordance with generally accepted accounting principles. The loan portfolio is reviewed quarterly to determine the adequacy of the allowance for losses. As of June 30, 2005, the allowance for losses is adequate in management's opinion to provide for possible losses on existing loans.

*Investment Securities:* The Association, as permitted under the FCA regulations, holds investments for purposes of maintaining a liquidity reserve, managing short-term surplus funds and managing interest rate risk. The Association's investments are classified as held to maturity and accordingly have been reported at amortized cost.

The Association reviews all investments that are in a loss position in order to determine whether the unrealized loss, which is considered an impairment, is temporary or permanent. In the event of permanent impairment, the cost basis of the investment would be written down to its fair value, and the realized loss would be included in current earnings.

## NOTE 2 – ALLOWANCE FOR LOAN LOSSES

An analysis of the allowance for loan losses follows:

Balance at 12-31-03	\$ 5,446
(Reversal of) provision for loan losses	—
Loans (charged off), net of recoveries	<u>(2)</u>
Balance at 6-30-04	<u>\$ 5,444</u>
Balance at 12-31-04	\$ 1,000
(Reversal of) provision for loan losses	—
Recoveries, net of loans charged off	<u>1</u>
Balance at 6-30-05	<u>\$ 1,001</u>

As discussed in the 2004 Annual Report, the Association recorded a loan loss reversal of \$4,413 in the fourth quarter of 2004 that resulted in a decrease in the allowance for loan losses.

## NOTE 3 – EMPLOYEE BENEFIT PLANS

The Association participates in a Districtwide defined benefit retirement plan. The 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 each institution's salary expense as a percentage of the District's salary expense. The Association also participates in Districtwide Thrift and other postretirement benefit plans.

The following is a table of retirement and postretirement benefit expense for the six months ended June 30, 2005:

	<b>For the six months ended June 30,</b>	
	<b>2005</b>	<b>2004</b>
Pension	\$ 193	\$ 226
Thrift/deferred compensation	29	28
Other postretirement benefits	<u>238</u>	<u>287</u>
Total	<u>\$ 460</u>	<u>\$ 541</u>

As of June 30, 2005, no contributions have been made to the pension plan for 2005. Actuarial projections as of the last plan measurement date (September 30, 2004) did not anticipate any contributions for 2005; however, market conditions could impact discount rates and return on plan assets which could change this expectation, making contributions necessary before the next plan measurement date.