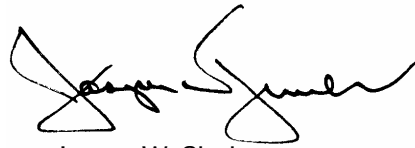


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*Pee Dee Farm Credit, ACA*

# **SECOND QUARTER 2006**

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Jasper W. Shuler  
Chief Executive Officer



James M. Ward  
Chairman of the Board

July 31, 2006

# 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, 2006. These comments should be read in conjunction with the accompanying consolidated financial statements, notes to the consolidated financial statements and the 2005 Annual Report of the Association. The accompanying consolidated financial statements were prepared under the oversight of the Audit Committee of the Board of Directors.

## 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 nineteen percent of the assets carry federal guarantees as a risk management tool.

The gross loan volume of the Association as of June 30, 2006, was \$321,983, an increase of \$34,609 as compared to \$287,374 at December 31, 2005. Net loans outstanding at June 30, 2006, were \$321,237 as compared to \$286,363 at December 31, 2005. The Association has investment securities that are classified as held to maturity in the amount of \$10,649 at June 30, 2006 compared to \$12,538 at December 31, 2005. The Association has entered into commitments to acquire Successor-in-Interest Contracts (SIIC), beginning in the fourth quarter of 2005. As of June 30, 2006, the Association had \$124,043 in other investments for SIIC, compared to \$73,189 at December 31, 2005. Net loans and investments accounted for 96.97 percent of total assets at June 30, 2006, as compared to 96.23 percent of total assets at December 31, 2005.

The increase in gross and net loan volume during the reporting period is attributed primarily to the seasonal lending upswing, participation loans, along with SIIC investments. 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 increased from \$263 at December 31, 2005, to \$569 at June 30, 2006. Several loans including both farm and home loans became more than ninety days delinquent and were moved to nonaccrual status during the six months ending June 30, 2006.

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, 2006, was \$746, compared to \$1,011 at December 31, 2005, and was considered by management to be adequate to cover possible losses. There were recoveries of \$38 and charge-offs of \$92 at June 30, 2006. The Association recognized a reversal of loan losses of \$211 during the six month period.

## Geographic Distribution of Loans by State at June 30, 2006:

	<u>Percentage</u>
South Carolina	65.03%
Arizona	.25
Arkansas	.06
California	1.61
Colorado	.26
Delaware	.02
Florida	12.57
Georgia	10.30
Kansas	.09
Louisiana	.07
Maine	.02
Maryland	.05
New Jersey	.13
New York	.67
North Carolina	5.11
Texas	2.41
Virginia	.30
Washington	.67
West Virginia	.01
Wisconsin	.37
	<u>100.00%</u>

**Distribution of Loans by Loan Type at June 30, 2006:**

	<u>Percentage</u>	
Agricultural Production:		
Cash grains	2.11%	
Tobacco	11.04	
Livestock	5.07	
Cotton	4.92	
Poultry	10.18	
General row crops	1.05	
Forestry	13.01	
Other commodities	2.31	
		49.69%
Agricultural real estate mortgage	20.09	
Aquatics	.08	
Rural home	3.04	
Notes receivable sales contracts/PMMs	1.27	
Basic processing	13.46	
Farm-related business	2.91	
Nonaccruals	.18	
Participations purchased	52.58	
Participations sold	<u>(43.30)</u>	
		<u>100.00%</u>

**RESULTS OF OPERATIONS*****For the three months ended June 30, 2006***

Net income for the three months ended June 30, 2006, totaled \$2,148, as compared to \$1,811 for the same period in 2005. Net interest income increased \$291, for the three months ended June 30, 2006, as compared to the same period in 2005. Increased loan and investment volume along with rising interest rates, are the primary reasons for the increase in net interest income.

At June 30, 2006, interest income on accruing loans increased \$1,483 compared to \$4,483 at June 30, 2005. Nonaccrual income was \$48 for the three months ended June 30, 2006, as compared to \$17 for the same period in 2005. Interest income on investment securities decreased to \$11 from the March 31, 2005 amount of \$195. Interest income was \$1,795 on other investments (SIIC) for the three months ended June 30, 2006, while there was not any during the same period in 2005. Interest expense increased \$3,007 for the three months ended June 30, 2006, as compared to the comparable period of 2005. This was a result of increased volume and rising interest rates.

Noninterest income for the three months ended June 30, 2006, totaled \$1,466, as compared to \$1,251 for the same period of 2005, an increase of \$215. The increase is primarily the result of increased patronage income, loan fees, and fees for financially related services. Noninterest expense for the three months ended June 30, 2006, increased \$178 compared to the same period of 2005. Increases in salaries and employee benefits and insurance fund premiums were the main causes for the increase.

***For the six months ended June 30, 2006***

Net income for the six months ended June 30, 2006, totaled \$4,089, as compared to \$3,291 for the same period in 2005. At June 30, 2006, net interest income increased by \$474 or 12.66 percent compared to June 30, 2005. Interest income on loans and investment securities increased by \$6,278 and interest expense increased by \$5,804. This change in net interest income is the result of both increased volume and interest rates.

Nonaccrual income was \$70 for the six months ended June 30, 2006, as compared to \$166 for the same period in 2005. The Association recorded a provision for loan loss of \$211 for the six months ended June 30, 2006, but did not record any for the same period in 2005. 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 2005 Annual Report, the Association recorded a loan loss reversal of \$4,413 in the fourth quarter of 2005 that resulted in a significant decrease in the allowance for loan losses. Please refer to the 2005 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, 2006, totaled \$2,693, as compared to \$2,125 for the same period of 2005, an increase of \$568. The increase is primarily the result of increases in patronage income by \$624, FRS income by \$25, and fees by \$186. However, the increases were offset by a decrease in other income of \$268. Noninterest expense for the six months ended June 30, 2006, increased \$475 compared to the same period of 2005. This increase is attributed to a rise in salaries and employee benefits of \$149, occupancy and equipment expenses of \$6, insurance fund premium of \$157 and other operating expenses of \$163. The Association recorded a provision for income taxes of \$3 for the six months ended June 30, 2006, a decrease of \$20 as compared to the same period in 2005.

**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, 2006, was \$418,823 as compared to \$334,915 at December 31, 2005. The increase during the period is

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primarily attributed to increased loan and investment volume and interest rates.

## **CAPITAL RESOURCES**

Total members' equity at June 30, 2006, increased to \$45,703 from the December 31, 2005, total of \$41,666. 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 \$1,642 on June 30, 2006, compared to \$1,693 on December 31, 2005. 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, 2006, the Association's total surplus ratio and core surplus ratio were 13.95 percent and 11.25 percent, respectively, and the permanent capital ratio was 14.38 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. 316, or writing Wanda Martin, 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.peedefarmcredit.com](http://www.peedefarmcredit.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, 2006</b> <i>(unaudited)</i>	<b>December 31, 2005</b> <i>(audited)</i>
<b>Assets</b>		
Cash	\$ 2	\$ —
Investment securities, held to maturity	10,649	12,538
Loans	321,983	287,374
Less: allowance for loan losses	746	1,011
Net loans	321,237	286,363
Other investments	124,043	73,189
Accrued interest receivable	4,949	3,687
Investment in other Farm Credit institutions	4,170	4,080
Premises and equipment, net	436	444
Other property owned	—	49
Prepaid retirement expense	2,886	3,082
Due from AgFirst Farm Credit Bank	1,483	2,859
Other assets	310	390
Total assets	<u>\$ 470,165</u>	<u>\$ 386,681</u>
<b>Liabilities</b>		
Notes payable to AgFirst Farm Credit Bank	\$ 418,823	\$ 334,915
Accrued interest payable	1,995	1,383
Patronage refund payable	149	1,975
Other liabilities	3,495	6,742
Total liabilities	<u>424,462</u>	<u>345,015</u>
Commitments and contingencies		
<b>Members' Equity</b>		
Protected borrower equity	459	522
Capital stock and participation certificates	1,183	1,171
Retained earnings		
Allocated	23,543	23,977
Unallocated	20,518	15,996
Total members' equity	<u>45,703</u>	<u>41,666</u>
Total liabilities and members' equity	<u>\$ 470,165</u>	<u>\$ 386,681</u>

*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,	
	2006	2005	2006	2005
<b>Interest Income</b>				
Loans	\$ 6,014	\$ 4,500	\$ 11,285	\$ 8,414
Investment securities	184	195	362	378
Other	1,795	—	3,423	—
Total Interest Income	7,993	4,695	15,070	8,792
<b>Interest Expense</b>				
Notes payable to AgFirst Farm Credit Bank	5,800	2,793	10,851	5,047
Net interest income	2,193	1,902	4,219	3,745
Provision for (reversal of allowance for) loan losses	—	—	(211)	—
Net interest income after provision for (reversal of allowance for) loan losses	2,193	1,902	4,430	3,745
<b>Noninterest Income</b>				
Loan fees	437	271	765	579
Fees for financially related services	48	21	55	30
Equity in earnings of other Farm Credit institutions	850	534	1,633	1,009
Gains (losses) on other property owned, net	—	—	1	—
Other noninterest income	131	425	239	507
Total noninterest income	1,466	1,251	2,693	2,125
<b>Noninterest Expense</b>				
Salaries and employee benefits	912	843	1,792	1,643
Occupancy and equipment	93	90	179	173
Insurance Fund premium	108	26	207	50
Other operating expenses	396	372	853	690
Total noninterest expense	1,509	1,331	3,031	2,556
Income before income taxes	2,150	1,822	4,092	3,314
Provision (benefit) for income taxes	2	11	3	23
Net income	\$ 2,148	\$ 1,811	\$ 4,089	\$ 3,291

*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		Total Members' Equity
			Allocated	Unallocated	
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
Balance at December 31, 2005	\$ 522	\$ 1,171	\$ 23,977	\$ 15,996	\$ 41,666
Net income				4,089	4,089
Protected borrower equity retired	(63)				(63)
Capital stock/participation certificates issued		71			71
Capital stock/participation certificates retired		(59)			(59)
Distribution adjustment			(434)	433	(1)
Balance at June 30, 2006	\$ 459	\$ 1,183	\$ 23,543	\$ 20,518	\$ 45,703

*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, 2005, are contained in the 2005 Annual Report to Shareholders. These unaudited second quarter 2006 consolidated financial statements should be read in conjunction with the 2005 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, 2006, are not necessarily indicative of the results to be expected for the year ending December 31, 2006.

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, 2006, 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. Purchased premiums and discounts are amortized or accreted using the effective interest method over the term of the respective security.

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 12-31-04	\$ 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>
Balance at 12-31-05	\$ 1,011
(Reversal of) provision for loan losses	(211)
Loans (charged off), net of recoveries	<u>(54)</u>
Balance at 6-30-06	<u>\$ 746</u>

## 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, 2006:

	<b>For the six months ended June 30,</b>	
	<b>2006</b>	<b>2005</b>
Pension	\$ 197	\$ 193
Thrift/deferred compensation	39	29
Other postretirement benefits	<u>140</u>	<u>238</u>
Total	<u>\$ 376</u>	<u>\$ 460</u>

As of June 30, 2006, no contributions have been made to the pension plan for 2006. Actuarial projections as of the last plan measurement date (September 30, 2005) did not anticipate any contributions for 2006; 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.