

SECOND QUARTER 2004

Management's Discussion and Analysis of
Financial Condition and Results of Operations.....2

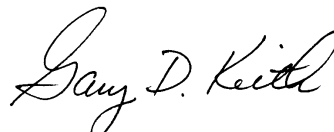
Consolidated Financial Statements

Consolidated Balance Sheets.....4

Consolidated Statements of Income.....5

Consolidated Statements of Changes in Members' Equity.....6

Notes to the Consolidated Financial Statements.....7



Gary D. Keith
Chief Executive Officer



Howard Moore
Chairman of the Board

July 29, 2004

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 Chattanooga Agricultural Credit Association (Association) for the period ended June 30, 2004. These comments should be read in conjunction with the accompanying financial statements, notes to the financial statements and the 2003 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 beef cattle, poultry, dairy, field crops, tobacco and vegetables. 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.

The gross loan volume of the Association as of June 30, 2004, was \$98,581, a decrease of \$3,410 as compared to \$101,991 at December 31, 2003. Net loans outstanding at June 30, 2004, were \$96,342 as compared to \$99,755 at December 31, 2003. Net loans accounted for 95.25 percent of total assets at June 30, 2004, as compared to 95.01 percent of total assets at December 31, 2003.

The decrease in gross and net loan volume during the reporting period is attributed primarily to expected payoffs on large accounts and normal payments scheduled.

There is an inherent risk in the extension of any type of credit. Portfolio credit quality continues to be maintained at an acceptable level, credit administration remains satisfactory. Nonaccrual loans decreased from \$969 at December 31, 2003, to \$392 at June 30, 2004. This decrease is primarily the result of \$1,144 of additional accounts transferred to nonaccrual, offset by \$1,721 of normal liquidations and payments.

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, 2004 was \$2,239 compared to \$2,236 at December 31, 2003, and was considered by management to be adequate to cover possible losses.

In June 2003, the American Institute of Certified Public Accountants' (AICPA) Accounting Standards Executive Committee (AcSEC) issued a proposed Statement of Position – Allowance for Credit Losses, which was intended to clarify the methodology for estimating the allowance for credit losses and to enhance financial statement disclosures related to the allowance for credit losses. In January 2004, AcSEC abandoned its proposed Statement of Position and announced that it would focus instead on improving financial statement disclosures regarding the allowance for loan losses.

System institutions have initiated studies to further refine their methodologies for calculating their respective allowances for loan losses, taking into account generally accepted accounting principles and applicable Farm Credit Administration requirements, as well as the Securities and Exchange Commission and Federal Financial Institutions Examination Council guidelines. These studies are likely to be completed by the fourth quarter of 2004 with any appropriate reductions to the allowance for loan losses implemented at that time. The resulting reductions in the allowance for loan losses may be significant.

In April 2004, the Farm Credit Administration, the System's regulator, issued an "Informational Memorandum" to System institutions regarding the allowance for loan losses. The memorandum addresses the status of the AICPA's project and the Securities and Exchange Commission and the Federal Financial Institutions Examination Council guidance on the subject. The objective of the Farm Credit Administration's memorandum was to clarify its expectations regarding the analysis and related documentation for the allowance for loan losses. The Farm Credit Administration endorsed the

direction provided by these other regulatory agencies and will include the conceptual framework addressed in this guidance in their examination process.

RESULTS OF OPERATIONS

For the three months ended June 30, 2004

Net income for the three months ended June 30, 2004, totaled \$314, as compared to \$341 for the same period in 2003. Net interest income decreased \$25, for the three months ended June 30, 2004, as compared to the same period in 2003.

At June 30, 2004, interest income on accruing loans decreased \$114 compared to the same time period of 2003. Nonaccrual interest income was \$2 for the three months ended June 30, 2004, as compared to \$3 for the same period in 2003. Interest expense decreased \$90 for the three months ended June 30, 2004, as compared to the comparable period of 2003. Noninterest income for the three months ended June 30, 2004, totaled \$261, as compared to \$238 for the same period of 2003. Noninterest expense for the three months ended June 30, 2004, increased \$60 compared to the same period of 2003.

For the six months ended June 30, 2004

Net income for the six months ended June 30, 2004, totaled \$647, as compared to \$649 for the same period in 2003. This decrease of \$2, or .31 percent, is primarily attributed to a decrease in net interest income and increase in noninterest expense.

At June 30, 2004, as a result of a lower interest environment and loan volume, interest income on accruing loans decreased by \$214 compared to 2003. Nonaccrual interest income was \$49 for the six months ended June 30, 2004, as compared to \$8 for the same period of 2003. Interest expense decreased \$171 for the six months ended June 30, 2004, as compared to the same period of 2003 due to the lower interest rate environment and loan volume. Noninterest income for the six months ended June 30, 2004, totaled \$486 as compared to \$479 for the same period of 2003, an increase of \$7. This increase is attributed to increases of \$25 in other noninterest income and \$1 in gains on other property owned, offset by decreases of \$11 in loan fees, \$6 in equity earnings from AgFirst Farm Credit Bank (the Bank) and \$2 in financially related services fee.

Noninterest expense for the six months ended June 30, 2004, increased \$89 compared to the same period of 2003. This increase is attributed to increases of \$42 in salaries

and employee benefits, \$6 in occupancy and equipment, \$51 other operating expenses offset by a decrease of \$10 in insurance fund premium. The Association recorded \$0 for income taxes for the six months ended June 30, 2004 and June 30, 2003.

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 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, 2004, was \$81,025 as compared to \$84,678 at December 31, 2003. The decrease during the period is primarily attributed to the decrease in loan volume.

CAPITAL RESOURCES

Total members' equity at June 30, 2004 increased to \$18,680 from the December 31, 2003 total of \$18,013. The increase is primarily attributed to an increase in member owned stock and retention of earnings.

Total capital stock and participation certificates were \$3,985 on June 30, 2004, compared to \$3,970 December 31, 2003. This increase is primarily attributed to more stock being issued to new borrowing entities than was retired on existing entities. The initial borrower investment, through either purchase or transfer, must be in an amount equal to the lesser of two percent of the total loan amount or \$5.

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, 2004, the Association's total surplus ratio and core surplus ratio were 13.74 percent and 11.36 percent, respectively, and the permanent capital ratio was 16.37 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.

Chattanooga Agricultural Credit Association
Consolidated Balance Sheets

| <i>(dollars in thousands)</i> | June 30, 2004 | December 31, 2003 |
|--|--------------------------|------------------------------|
| | <i>(unaudited)</i> | |
| Assets | | |
| Cash | \$ 83 | \$ 40 |
| Loans | 98,581 | 101,991 |
| Less: allowance for loan losses | 2,239 | 2,236 |
| Net loans | 96,342 | 99,755 |
| Accrued interest receivable | 903 | 738 |
| Investment in other Farm Credit institutions | 2,848 | 2,846 |
| Premises and equipment, net | 497 | 444 |
| Other assets | 478 | 1,172 |
| Total assets | <u>\$ 101,151</u> | <u>\$ 104,995</u> |
| Liabilities | | |
| Notes payable to AgFirst Farm Credit Bank | \$ 81,025 | \$ 84,678 |
| Accrued interest payable | 255 | 269 |
| Patronage refund payable | 18 | 423 |
| Other liabilities | 1,173 | 1,612 |
| Total liabilities | <u>82,471</u> | <u>86,982</u> |
| Commitments and contingencies | | |
| Members' Equity | | |
| Capital stock and participation certificates | 3,985 | 3,970 |
| Retained earnings | | |
| Allocated | 5,928 | 5,944 |
| Unallocated | 8,767 | 8,099 |
| Total members' equity | <u>18,680</u> | <u>18,013</u> |
| Total liabilities and members' equity | <u>\$ 101,151</u> | <u>\$ 104,995</u> |

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

Chattanooga Agricultural Credit Association
Consolidated Statements of Income

(unaudited)

| <i>(dollars in thousands)</i> | For the three months ended June 30, | | For the six months ended June 30, | |
|--|--|-------------|--|-------------|
| | 2004 | 2003 | 2004 | 2003 |
| Interest Income | | | | |
| Loans | \$ 1,410 | \$ 1,525 | \$ 2,881 | \$ 3,054 |
| Interest Expense | | | | |
| Notes payable to AgFirst Farm Credit Bank | 769 | 859 | 1,551 | 1,722 |
| Net interest income | 641 | 666 | 1,330 | 1,332 |
| Provision for (reversal of) loan losses | — | 35 | — | 82 |
| Net interest income after provision for (reversal of) loan losses | 641 | 631 | 1,330 | 1,250 |
| Noninterest Income | | | | |
| Loan fees | 74 | 49 | 104 | 115 |
| Fees for financially related services | 24 | 24 | 29 | 31 |
| Equity in earnings of other Farm Credit institutions | 159 | 164 | 314 | 320 |
| Gains (losses) on other property owned, net | — | (1) | — | (1) |
| Other noninterest income | 4 | 2 | 39 | 14 |
| Total noninterest income | 261 | 238 | 486 | 479 |
| Noninterest Expense | | | | |
| Salaries and employee benefits | 381 | 367 | 787 | 745 |
| Occupancy and equipment | 38 | 34 | 74 | 68 |
| Insurance Fund premium | 24 | 29 | 48 | 58 |
| Other operating expenses | 145 | 98 | 260 | 209 |
| Total noninterest expense | 588 | 528 | 1,169 | 1,080 |
| Income before income taxes | 314 | 341 | 647 | 649 |
| Provision (benefit) for income taxes | — | — | — | — |
| Net income | \$ 314 | \$ 341 | \$ 647 | \$ 649 |

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

Chattanooga Agricultural Credit Association
**Consolidated Statements of Changes in
Members' Equity**

(unaudited)

| <i>(dollars in thousands)</i> | Capital Stock and Participation Certificates | Retained Earnings | | Total Members' Equity |
|--|---|--------------------------|--------------------|--------------------------------------|
| | | Allocated | Unallocated | |
| Balance at December 31, 2002 | \$ 3,926 | \$ 5,122 | \$ 8,547 | \$ 17,595 |
| Net income | | | 649 | 649 |
| Capital stock/participation certificates issued | 143 | | | 143 |
| Capital stock/participation certificates retired | (135) | | | (135) |
| Retained earnings retired | | (1) | | (1) |
| Distribution adjustment | | 138 | (181) | (43) |
| Balance at June 30, 2003 | <u>\$ 3,934</u> | <u>\$ 5,259</u> | <u>\$ 9,015</u> | <u>\$ 18,208</u> |
| Balance at December 31, 2003 | \$ 3,970 | \$ 5,944 | \$ 8,099 | \$ 18,013 |
| Net income | | | 647 | 647 |
| Capital stock/participation certificates issued | 121 | | | 121 |
| Capital stock/participation certificates retired | (106) | | | (106) |
| Distribution adjustment | | (16) | 21 | 5 |
| Balance at June 30, 2004 | <u>\$ 3,985</u> | <u>\$ 5,928</u> | <u>\$ 8,767</u> | <u>\$ 18,680</u> |

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

Chattanooga Agricultural Credit Association

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 Chattanooga Agricultural Credit Association (the Association), the significant accounting policies followed, and the financial condition and results of operations as of and for the year ended December 31, 2003, are contained in the 2003 Annual Report to Stockholders. These unaudited second quarter 2004 consolidated financial statements should be read in conjunction with the 2003 Annual Report to Stockholders.

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, 2004, are not necessarily indicative of the results to be expected for the year ending December 31, 2004.

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, 2004, the allowance for losses is adequate in management's opinion to provide for possible losses on existing loans.

NOTE 2 – ALLOWANCE FOR LOAN LOSSES

An analysis of the allowance for loan losses follows:

| | |
|---|-----------------|
| Balance at 12-31-02 | \$ 2,227 |
| (Reversal of) provision for loan losses | 82 |
| Loans (Charged off), net of recoveries | <u>(36)</u> |
| Balance at 6-30-03 | <u>\$ 2,273</u> |
| Balance at 12-31-03 | \$ 2,236 |
| (Reversal of) provision for loan losses | – |
| Recoveries, net of loans charged off | <u>3</u> |
| Balance at 6-30-04 | <u>\$ 2,239</u> |

NOTE 3 – EMPLOYEE BENEFIT PLANS

The Association participates in a defined benefit retirement plan with three other District associations. Pension costs were determined by an actuary on a separate entity basis.

The following is a table of the components of net periodic benefit (income) cost for the defined benefit retirement plan for the six months ended June 30, 2004:

| | For the six months ended June 30, | |
|--------------------------------------|--|--------------|
| | 2004 | 2003 |
| Service cost | \$ 53 | \$ 41 |
| Interest cost | 60 | 50 |
| Expected return on plan assets | (72) | (56) |
| Amortization of prior service cost | 9 | 9 |
| Recognized net actuarial (gain) loss | 7 | 4 |
| Other | – | 1 |
| Net periodic benefit (income) cost | <u>\$ 57</u> | <u>\$ 49</u> |

The Association previously disclosed in its financial statements for the quarter ended March 31, 2004, that it expected to contribute \$110 to its pension plan in 2004. As of June 30, 2004 the Association had contributed \$74 to the pension plan. The Association does not anticipate contributing additional funds to its pension plan for the remainder of 2004.

The Association also participates in Districtwide thrift and other postretirement benefit plans. The other postretirement benefit plan provides certain benefits (primarily health care) to its retirees.

The following is a table of retirement and postretirement benefit expense for the six months ended June 30, 2004:

| | For the six months ended June 30, | |
|-------------------------------|--|---------------|
| | 2004 | 2003 |
| Pension | \$ 57 | \$ 49 |
| Thrift/deferred compensation | 29 | 28 |
| Other postretirement benefits | 75 | 72 |
| Total | <u>\$ 161</u> | <u>\$ 149</u> |