

# **FIRST QUARTER 2006**

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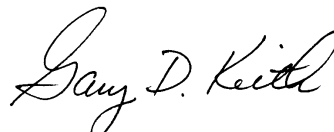
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Gary D. Keith  
Chief Executive Officer



Howard Moore  
Chairman of the Board

April 28, 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 Chattanooga Agricultural Credit Association (the Association) for the period ended March 31, 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.

## **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 including poultry, dairy, livestock and produce. 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 reduces the level of dependency on any single commodity.

The gross loan volume of the Association as of March 31, 2006, was \$133,876, an increase of \$8,297, as compared to \$125,579 at December 31, 2005. Net loans outstanding at March 31, 2006, were \$133,244 as compared to \$124,963 at December 31, 2005. Net loans accounted for 95.25 percent of total assets at March 31, 2006, as compared to 95.03 percent of total assets at December 31, 2005. The increase in gross and net loan volume during the reporting period is partly attributable to an increase in the purchase of loans from other financial institutions and new borrowers financing real estate.

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 \$228 at December 31, 2005, to \$296 at March 31, 2006. This increase is primarily the result of the addition of one account and payments received in the normal course of business.

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 March 31, 2006, was \$632 compared to \$616 at December 31, 2005, and was considered by management to be adequate to cover probable losses.

## **RESULTS OF OPERATIONS**

### ***For the three months ended March 31, 2006***

Net income for the three months ended March 31, 2006, totaled \$519, as compared to \$388 for the same period in 2005. Net interest income increased \$187 for the three months ended March 31, 2006, as compared to the same period in 2005. Increased loan volume is the primary reason for the increase in net interest income.

Noninterest income for the three months ended March 31, 2006, totaled \$296, as compared to \$226 for the same period of 2005, an increase of \$70. The increase is primarily the result of increases in equity earnings from other Farm Credit institutions and loan fees.

Noninterest expense for the three months ended March 31, 2006, increased \$112 compared to the same period of 2005. The primary reasons for the increase in noninterest expense were increases in salaries and employee benefits, and insurance fund premium.

## **FUNDING SOURCES**

The principal source of funds for the Association is the borrowing relationship established with AgFirst Farm Credit Bank (the Bank) through a General Financing Agreement. The General Financing Agreement utilizes the Association's credit and fiscal performance as criteria for establishing a line of credit on which the Association may draw funds. The Bank advances funds to the Association in the form of notes payable. The notes payable are segmented into variable rate and fixed rate sections. The variable rate note is utilized by the Association to fund variable rate loan advances and operating funds requirements. The fixed rate note is used specifically to fund fixed rate loan advances made by the Association. The total notes payable to the Bank at March 31, 2006, was \$115,573 as compared to \$108,023 at December 31, 2005.

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## CAPITAL RESOURCES

Total members' equity at March 31, 2006, increased to \$21,659 from the December 31, 2005 total of \$21,187. The increase is primarily attributed to the retention of earnings offset by a reduction in member owned stock.

Total capital stock and participation certificates were \$3,862 on March 31, 2006, compared to \$3,881 on December 31, 2005. This decrease is attributed to reduction in the maximum stock requirement of \$5 to \$2. 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 \$2.

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 March 31, 2006, the Association's total surplus ratio and core surplus ratio were 12.99 percent and 10.84 percent, respectively, and the permanent capital ratio was 14.89 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 423-624-2169 ext. 18 or writing Sue J. Maiser, Vice President/Finance, Chattanooga, ACA, P.O. Box 5220, Chattanooga, TN 37406, or accessing the website, [www.chattanoogaagcredit.com](http://www.chattanoogaagcredit.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.

*Chattanooga Agricultural Credit Association*  
**Consolidated Balance Sheets**

<i>(dollars in thousands)</i>	<b>March 31, 2006</b> <i>(unaudited)</i>	<b>December 31, 2005</b> <i>(audited)</i>
<b>Assets</b>		
Cash	\$ 1,145	\$ 751
Loans	133,876	125,579
Less: allowance for loan losses	632	616
Net loans	133,244	124,963
Other investments	113	86
Accrued interest receivable	1,707	1,172
Investment in other Farm Credit institutions	2,727	2,727
Premises and equipment, net	425	435
Prepaid retirement expense	145	180
Due from AgFirst Farm Credit Bank	—	1,011
Other assets	389	179
Total assets	<u>\$ 139,895</u>	<u>\$ 131,504</u>
<b>Liabilities</b>		
Notes payable to AgFirst Farm Credit Bank	\$ 115,573	\$ 108,023
Accrued interest payable	488	443
Patronage refund payable	21	454
Other liabilities	2,154	1,397
Total liabilities	<u>118,236</u>	<u>110,317</u>
Commitments and contingencies		
<b>Members' Equity</b>		
Capital stock and participation certificates	3,862	3,881
Retained earnings		
Allocated	7,250	7,177
Unallocated	10,547	10,129
Total members' equity	<u>21,659</u>	<u>21,187</u>
Total liabilities and members' equity	<u>\$ 139,895</u>	<u>\$ 131,504</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>	<b>For the three months ended March 31,</b>	
	<b>2006</b>	<b>2005</b>
<b>Interest Income</b>		
Loans	\$ 2,285	\$ 1,580
Other	2	—
	2,287	1,580
<b>Interest Expense</b>		
Notes payable to AgFirst Farm Credit Bank	1,387	867
Net interest income	900	713
Provision for (reversal of allowance for) loan losses	14	—
	886	713
<b>Noninterest Income</b>		
Loan fees	76	52
Fees for financially related services	5	5
Equity in earnings of other Farm Credit institutions	204	160
Gains (losses) on other property owned, net	—	(2)
Other noninterest income	11	11
	296	226
<b>Noninterest Expense</b>		
Salaries and employee benefits	448	368
Occupancy and equipment	40	42
Insurance Fund premium	45	9
Other operating expenses	130	132
	663	551
Income before income taxes	519	388
Provision (benefit) for income taxes	—	—
	519	388
Net income	\$ 519	\$ 388

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

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

*(unaudited)*

*(dollars in thousands)*

	Capital Stock and Participation Certificates	Retained Earnings		Total Members' Equity
		Allocated	Unallocated	
Balance at December 31, 2004	\$ 4,053	\$ 6,456	\$ 9,906	\$ 20,415
Net income			388	388
Capital stock/participation certificates issued	88			88
Capital stock/participation certificates retired	(64)			(64)
Distribution adjustment		16	(25)	(9)
Balance at March 31, 2005	\$ 4,077	\$ 6,472	\$ 10,269	\$ 20,818
Balance at December 31, 2005	\$ 3,881	\$ 7,177	\$ 10,129	\$ 21,187
Net income			519	519
Capital stock/participation certificates issued	64			64
Capital stock/participation certificates retired	(83)			(83)
Distribution adjustment		73	(101)	(28)
Balance at March 31, 2006	\$ 3,862	\$ 7,250	\$ 10,547	\$ 21,659

*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, 2005, are contained in the 2005 Annual Report to Shareholders. These unaudited first 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 three months ended March 31, 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 March 31, 2006, 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 12-31-04	\$ 450
(Reversal of) provision for loan losses	—
Recoveries, net of loans charged off	<u>2</u>
Balance at 3-31-05	<u>\$ 452</u>
Balance at 12-31-05	\$ 616
(Reversal of) provision for loan losses	14
Recoveries, net of loans charged off	<u>2</u>
Balance at 3-31-06	<u>\$ 632</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 three months ended March 31, 2006:

	<b>For the three months ended March 31,</b>	
	<b>2006</b>	<b>2005</b>
Service cost	\$ 31	\$ 27
Interest cost	38	38
Expected return on plan assets	(48)	(44)
Amortization of prior service cost	5	5
Recognized net actuarial (gain) loss	<u>9</u>	<u>11</u>
Net periodic benefit (income) cost	<u>\$ 35</u>	<u>\$ 37</u>

As of March 31, 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.

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 three months ended March 31, 2006:

	<b>For the three months ended March 31,</b>	
	<b>2006</b>	<b>2005</b>
Pension	\$ 35	\$ 37
Thrift/deferred compensation	17	14
Other postretirement benefits	<u>22</u>	<u>34</u>
Total	<u>\$ 74</u>	<u>\$ 85</u>