

FIRST QUARTER 2004

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Robert N. Carpenter
Chief Executive Officer



Charles W. Kackley
Chairman of the Board

April 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 the consolidated operations of Valley Farm Credit, ACA, Valley Farm Credit, FLCA and Valley Farm Credit, PCA (Association) for the period ended March 31, 2004. These comments should be read in conjunction with the accompanying consolidated financial statements, notes to the consolidated 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 livestock, poultry, beef, orchards, dairy and rural home loans. Those major farm commodities totaled approximately \$116,301 or 71.65 percent of the loan volume as of March 31, 2004. 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 March 31, 2004 was \$157,476, an increase of \$4,065 as compared to \$153,411 at December 31, 2003. Net loans outstanding at March 31, 2004 were \$154,650 as compared to \$150,585 at December 31, 2003. Net loans accounted for 95.58 percent of total assets at March 31, 2004 as compared to 95.53 percent of total assets at December 31, 2003.

The increase in gross and net loan volume during the reporting period is attributed primarily to new loans to several different sectors of the Association's agricultural portfolio, new loans to the residential portion of the portfolio and participation loans purchased.

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 were \$0 at March 31, 2004 and December 31, 2003. Association management maintains an allowance for loan losses in an amount sufficient to absorb losses inherent in the loan portfolio at the balance sheet date based on current conditions. The allowance for loan losses was \$2,826 at March 31, 2004 and at December 31, 2003.

In June, 2003, the American Institute of Certified Public Accountants' Accounting Standards Executive Committee (AcSEC) issued a proposed Statement of Position (SOP) – 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 SOP and announced that it would focus instead on improving financial statement disclosures regarding the allowance for loan losses.

We plan to conduct a study to further refine our methodology for calculating the allowance 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. The study is likely to be completed by the fourth quarter of 2004 with any appropriate reduction, which may be significant, to the allowance for loan losses implemented at that time.

RESULTS OF OPERATIONS

For the three months ended March 31, 2004

Net income for the three months ended March 31, 2004 totaled \$222, as compared to \$417 for the same period in 2003. Net interest income increased \$125 for the three months ended March 31, 2004 as compared to the same period in 2003.

At March 31, 2004, interest income on loans increased \$37 as compared to the same period in 2003. Nonaccrual income was \$0 for the three months ended March 31, 2004 compared to \$5 for the same period in 2003. Interest expense decreased \$88 for the three months ended March 31, 2004 as compared to the comparable period of 2003. Noninterest income for the three months ended March 31, 2004 totaled \$546 as compared to \$774 for the same period of 2003, a decrease of \$228. Noninterest expense for the three months ended March 31, 2004 increased \$92 compared to the same period of 2003. There was no provision (benefit) for income taxes at March 31, 2004 or the same period in 2003.

FUNDING SOURCES

The principal source of funds for the Association is the borrowing relationship established with the 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 March 31, 2004 was \$139,900 as compared to \$137,021 at December 31, 2003. The increase during the period is primarily attributed to an increase in loan volume.

CAPITAL RESOURCES

Total members' equity at March 31, 2004 decreased to \$16,659 from the December 31, 2003 total of \$16,976. The decrease is primarily attributed to the Association's patronage revolvment of allocated surplus and reduction of capital stock and participation certificates.

Total capital stock and participation certificates were \$3,854 on March 31, 2004 compared to \$3,872 on December 31, 2003. This decrease is attributed to the retirement of stock and participation certificates on loans liquidated in the normal course of business and new loans being capitalized at lower stock levels.

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, 2004, the Association's total surplus ratio and core surplus ratio were 9.67 percent and 8.05 percent, respectively, and the permanent capital ratio was 12.50 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.

Valley Farm Credit, ACA
Consolidated Balance Sheets

<i>(dollars in thousands)</i>	March 31, 2004	December 31, 2003
	<i>(unaudited)</i>	
Assets		
Cash	\$ 6	\$ 6
Loans	157,476	153,411
Less: allowance for loan losses	2,826	2,826
Net loans	154,650	150,585
Accrued interest receivable	1,304	935
Investment in AgFirst Farm Credit Bank	1,393	1,393
Premises and equipment, net	3,506	3,458
Other assets	937	1,246
Total assets	<u>\$ 161,796</u>	<u>\$ 157,623</u>
Liabilities		
Notes payable to AgFirst Farm Credit Bank	\$ 139,900	\$ 137,021
Accrued interest payable	470	466
Patronage refund payable	3	334
Minimum pension liability	1,221	1,104
Other liabilities	3,543	1,722
Total liabilities	<u>145,137</u>	<u>140,647</u>
Commitments and contingencies		
Members' Equity		
Capital stock and participation certificates	3,854	3,872
Retained earnings		
Allocated	3,902	4,360
Unallocated	10,225	10,066
Accumulated other comprehensive income (loss)	(1,322)	(1,322)
Total members' equity	<u>16,659</u>	<u>16,976</u>
Total liabilities and members' equity	<u>\$ 161,796</u>	<u>\$ 157,623</u>

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

Valley Farm Credit, ACA
Consolidated Statements of Income
(unaudited)

<i>(dollars in thousands)</i>	For the three months ended March 31,	
	2004	2003
Interest Income		
Loans	\$ 2,249	\$ 2,212
Interest Expense		
Notes payable to AgFirst Farm Credit Bank	1,395	1,483
Net interest income	854	729
Provision for (reversal of) loan losses	—	—
Net interest income after provision for (reversal of) loan losses	854	729
Noninterest Income		
Loan fees	63	168
Fees for financially related services	20	3
Equity in earnings of AgFirst Farm Credit Bank	255	225
Gain (loss) on sale of rural home loans	170	354
Other noninterest income	38	24
Total noninterest income	546	774
Noninterest Expense		
Salaries and employee benefits	806	710
Occupancy and equipment	117	118
Insurance Fund premium	36	38
Other operating expenses	219	220
Total noninterest expense	1,178	1,086
Income before income taxes	222	417
Provision (benefit) for income taxes	—	—
Net income	\$ 222	\$ 417

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

Valley Farm Credit, ACA
**Consolidated Statements of Changes in
Members' Equity**

(unaudited)

(dollars in thousands)

	Capital Stock and Participation Certificates	Retained Earnings		Accumulated Other Comprehensive Income	Total Members' Equity
		Allocated	Unallocated		
Balance at December 31, 2002	\$ 3,896	\$ 4,343	\$ 9,400	\$ (1,527)	\$ 16,112
Net income			417		417
Capital stock/participation certificates issued	47				47
Capital stock/participation certificates retired	(54)				(54)
Retained earnings retired		(571)			(571)
Distribution adjustment		21	(29)		(8)
Balance at March 31, 2003	\$ 3,889	\$ 3,793	\$ 9,788	\$ (1,527)	\$ 15,943
Balance at December 31, 2003	\$ 3,872	\$ 4,360	\$ 10,066	\$ (1,322)	\$ 16,976
Net income			222		222
Capital stock/participation certificates issued	69				69
Capital stock/participation certificates retired	(87)				(87)
Retained earnings retired		(561)			(561)
Distribution adjustment		103	(63)		40
Balance at March 31, 2004	\$ 3,854	\$ 3,902	\$ 10,225	\$ (1,322)	\$ 16,659

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

Valley Farm Credit, ACA

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 Valley 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, 2003, are contained in the 2003 Annual Report to Stockholders. These unaudited first 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 three months ended March 31, 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 March 31, 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	\$ 2,773
(Reversal of) provision for loan losses	—
Recoveries, net of loans charged off	<u>2</u>
Balance at 3-31-03	<u>\$ 2,775</u>
Balance at 12-31-03	\$ 2,826
(Reversal of) provision for loan losses	—
Recoveries, net of loans charged off	<u>—</u>
Balance at 3-31-04	<u>\$ 2,826</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 three months ended March 31, 2004:

	For the three months ended March 31,	
	<u>2004</u>	<u>2003</u>
Pension	\$ 117	\$ 97
Thrift/deferred compensation	30	24
Other postretirement benefits	<u>47</u>	<u>47</u>
Total	<u>\$ 194</u>	<u>\$ 168</u>