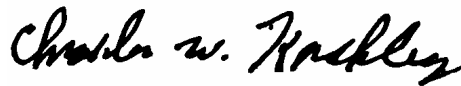


# THIRD QUARTER 2006

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Robert N. Carpenter  
Chief Executive Officer



Charles W. Kackley  
Chairman of the Board

November 9, 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 the consolidated operations of Valley Farm Credit ACA, Valley Farm Credit, FLCA and Valley Farm Credit, PCA (Association) for the period ended September 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 livestock, poultry, beef, orchards, dairy and rural home loans. Those major farm commodities totaled approximately \$129,467 or 64.19% of the loan volume as of September 30, 2006. 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 diminishes the level of dependency on a given commodity.

The gross loan volume of the Association as of September 30, 2006 was \$173,972, an increase of \$11,784 as compared to \$162,188 at December 31, 2005. Net loans outstanding at September 30, 2006 were \$173,378 as compared to \$161,478 at December 31, 2005. Net loans accounted for 91.75 percent of total assets at September 30, 2006 as compared to 91.37 percent of total assets at December 31, 2005. 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 and new loans to the residential portion of the portfolio.

There is an inherent risk in the extension of any type of credit. Portfolio credit quality continues to be maintained at an acceptable level, and credit administration remains satisfactory. Nonaccrual loans were \$0 at September 30, 2006 and December 31, 2005. Association management maintains an allowance for loan losses in an amount sufficient to absorb possible losses inherent in the loan portfolio at the balance sheet date based on current conditions. The allowance for loan losses was \$594 at September 30, 2006 and \$710 at

December 31, 2005, and was considered by management to be adequate.

## **RESULTS OF OPERATIONS**

### ***For the three months ended September 30, 2006***

Net income for the three months ended September 30, 2006, totaled \$707, as compared to \$409 for the same period in 2005. Net interest income increased \$40 for the three months ended September 30, 2006 as compared to the same period in 2005.

At September 30, 2006 interest income on loans increased \$315 as compared to the same period in 2005. Nonaccrual income was \$0 for the three months ended September 30, 2006 and for the same period in 2005. Interest expense increased \$275 for the three months ended September 30, 2006 as compared to the comparable period of 2005. Noninterest income for the three months ended September 30, 2006 totaled \$919 as compared to \$821 for the same period of 2005, an increase of \$98. Total noninterest income includes the gain on sale of assets in the amount of \$177 during the three months ended September 30, 2006, which is related to the sale of undeveloped land located in Martinsburg, WV. Noninterest expense for the three months ended September 30, 2006 decreased \$83 compared to the same period of 2005. There was a provision (benefit) for income taxes of (\$2) for the three months ended September 30, 2006 and no provision (benefit) for the same period in 2005.

### ***For the nine months ended September 30, 2006***

Net income for the nine months ended September 30, 2006, totaled \$1,073 as compared to \$1,638 for the same period in 2005. Net interest income increased \$62 for the nine months ended September 30, 2006 as compared to the same period in 2005.

At September 30, 2006 interest income on loans increased \$804 as compared to the same period in 2005. Nonaccrual income was \$0 for the nine months ended September 30, 2006 and for the same period in 2005. Interest expense increased \$742 for the nine months ended September 30, 2006 as compared to the comparable period of 2005. Noninterest income for the nine months ended September 30, 2006 totaled \$2,313 as compared to \$2,702 for the same period of 2005, a decrease of \$389. Total noninterest income includes the gain on sale of assets in the amount of \$177 during the nine months ended September 30, 2006, which is

related to the sale of undeveloped land located in Martinsburg, WV. Total noninterest income includes the gain on sale of assets in the amount of \$507 during the nine months ended September 30, 2005, which is related to the sale of developed property located in Martinsburg, WV. Noninterest expense for the nine months ended September 30, 2006 increased \$356 compared to the same period of 2005. The increase during the reporting period is mostly attributed to increased occupancy and increased insurance fund expenses. There was a provision (benefit) for income taxes of (\$2) for the nine months ended September 30, 2006 and no provision (benefit) for the same period in 2005.

## 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 September 30, 2006 was \$160,681 as compared to \$149,339 at December 31, 2005. The increase during the period is primarily attributed to an increase in loan volume.

## CAPITAL RESOURCES

Total members' equity at September 30, 2006 increased to \$24,030 from the December 31, 2005 total of \$23,180. The rise in members' equity is attributed to the increase in retained earnings in addition to the increase in capital stock and participation certificates.

Total capital stock and participation certificates were \$4,002 on September 30, 2006 compared to \$3,960 on December 31, 2005. This increase is attributed to an excess of stock purchases above the normal retirement of stock on loans liquidated in the normal course of business.

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 September 30, 2006, the Association's total surplus ratio and core surplus ratio were 11.82 percent and 10.86 percent, respectively, and the permanent capital ratio was 14.57 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.

## ACCOUNTING FOR DEFINED BENEFIT PENSION AND OTHER POSTRETIREMENT PLANS

On September 29, 2006, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 158 – Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans. The Standard requires an employer to recognize the overfunded or underfunded status of a defined benefit postretirement plan as an asset or liability in its statement of financial position and recognize changes in that funded status in the year in which the changes occur through comprehensive income. The Standard is effective for employers with publicly traded securities for the fiscal year ending after December 15, 2006 and for employers without publicly traded securities for the fiscal year ending after June 15, 2007. The Association will be required to implement the Standard for the year ended December 31, 2007. In addition, this Standard requires that the funded status of a plan be measured as of the date of the year-end financial statements. Currently, the Association uses a measurement date of September 30th. The requirement to measure the funded status as of the fiscal year-end is effective for fiscal years ending after December 15, 2008. The Association is currently evaluating the impact of implementing this Standard. It is anticipated that the impact from the implementation of this Standard will have no impact on the income statement and, based on the current funded status of the defined benefit plans, it is not expected to have a material or significant impact on the balance sheet.

**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 1-800-999-5341 or writing Mary S. Miller, Vice President and CFO, Valley Farm Credit, ACA, P.O. Box 2700, Winchester, Virginia 22604, or accessing the website, [www.valleyfc.com](http://www.valleyfc.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.

*Valley Farm Credit, ACA*  
**Consolidated Balance Sheets**

<i>(dollars in thousands)</i>	<b>September 30, 2006</b> <i>(unaudited)</i>	<b>December 31, 2005</b> <i>(audited)</i>
<b>Assets</b>		
Cash	\$ 467	\$ 602
Loans	173,972	162,188
Less: allowance for loan losses	594	710
Net loans	173,378	161,478
Accrued interest receivable	1,718	1,165
Investment in other Farm Credit institutions	2,174	2,173
Premises and equipment, net	8,550	6,933
Prepaid retirement expense	1,627	1,963
Due from AgFirst Farm Credit Bank	923	1,745
Other assets	141	669
Total assets	\$ 188,978	\$ 176,728
<b>Liabilities</b>		
Notes payable to AgFirst Farm Credit Bank	\$ 160,681	\$ 149,339
Accrued interest payable	740	594
Patronage refund payable	12	121
Postretirement benefits other than pensions	966	897
Other liabilities	2,549	2,597
Total liabilities	164,948	153,548
Commitments and contingencies		
<b>Members' Equity</b>		
Capital stock and participation certificates	4,002	3,960
Retained earnings		
Allocated	3,888	4,203
Unallocated	16,140	15,017
Total members' equity	24,030	23,180
Total liabilities and members' equity	\$ 188,978	\$ 176,728

*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 September 30,		For the nine months ended September 30,	
	2006	2005	2006	2005
<b>Interest Income</b>				
Loans	\$ 3,241	\$ 2,926	\$ 9,133	\$ 8,329
<b>Interest Expense</b>				
Notes payable to AgFirst Farm Credit Bank	2,184	1,909	6,110	5,368
Net interest income	1,057	1,017	3,023	2,961
Provision for (reversal of) loan losses	(75)	—	(116)	—
Net interest income after provision for (reversal of) loan losses	1,132	1,017	3,139	2,961
<b>Noninterest Income</b>				
Loan fees	87	112	241	266
Fees for financially related services	56	52	118	100
Equity in earnings of other Farm Credit institutions	323	307	927	890
Gains on sale of rural home loans	234	340	706	866
Gains on sale of assets, net	176	—	182	507
Other noninterest income	43	10	139	73
Total noninterest income	919	821	2,313	2,702
<b>Noninterest Expense</b>				
Salaries and employee benefits	783	845	2,617	2,479
Occupancy and equipment	208	181	598	449
Insurance Fund premium	60	28	172	59
Other operating expenses	295	375	994	1,038
Total noninterest expense	1,346	1,429	4,381	4,025
Income before income taxes	705	409	1,071	1,638
Provision (benefit) for income taxes	(2)	—	(2)	—
Net income	\$ 707	\$ 409	\$ 1,073	\$ 1,638

*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)*

	<b>Capital Stock and Participation Certificates</b>	<b>Retained Earnings</b>		<b>Total Members' Equity</b>
		<b>Allocated</b>	<b>Unallocated</b>	
Balance at December 31, 2004	\$ 3,924	\$ 4,388	\$ 12,885	\$ 21,197
Net income			1,638	1,638
Capital stock/participation certificates issued	267			267
Capital stock/participation certificates retired	(258)			(258)
Retained earnings retired		(550)		(550)
Distribution adjustment		(54)	77	23
Balance at September 30, 2005	<u>\$ 3,933</u>	<u>\$ 3,784</u>	<u>\$ 14,600</u>	<u>\$ 22,317</u>
Balance at December 31, 2005	\$ 3,960	\$ 4,203	\$ 15,017	\$ 23,180
Net income			1,073	1,073
Capital stock/participation certificates issued	233			233
Capital stock/participation certificates retired	(191)			(191)
Retained earnings retired		(275)		(275)
Distribution adjustment		(40)	50	10
Balance at September 30, 2006	<u>\$ 4,002</u>	<u>\$ 3,888</u>	<u>\$ 16,140</u>	<u>\$ 24,030</u>

*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 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, 2005, are contained in the 2005 Annual Report to Shareholders. These unaudited third quarter 2006 consolidated financial statements should be read in conjunction with the 2005 Annual Report to Shareholders.

On September 29, 2006, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 158 – Employers’ Accounting for Defined Benefit Pension and Other Postretirement Plans. The Standard requires an employer to recognize the overfunded or underfunded status of a defined benefit postretirement plan as an asset or liability in its statement of financial position and recognize changes in that funded status in the year in which the changes occur through comprehensive income. The Standard is effective for employers with publicly traded securities for the fiscal year ending after December 15, 2006 and for employers without publicly traded securities for the fiscal year ending after June 15, 2007. The Association will be required to implement the Standard for the year ended December 31, 2007. In addition, this Standard requires that the funded status of a plan be measured as of the date of the year-end financial statements. Currently, the Association uses a measurement date of September 30th. The requirement to measure the funded status as of the fiscal year-end is effective for fiscal years ending after December 15, 2008. The Association is currently evaluating the impact of implementing this Standard. It is anticipated that the impact from the implementation of this Standard will have no impact on the consolidated income statement and, based on the current funded status of the defined benefit plans, it is not expected to have a material or significant impact on the consolidated balance sheet.

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 nine months ended September 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 September 30, 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:

	<b>For the nine months ended September 30,</b>	
	<b>2006</b>	<b>2005</b>
Balance at beginning of period	\$ 710	\$ 828
Provision for (reversal of) loan losses	(116)	–
Recoveries, net of loans charged off	–	–
Balance at end of period	<u>\$ 594</u>	<u>\$ 828</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 nine months ended September 30, 2006:

	<b>For the nine months ended September 30,</b>	
	<b>2006</b>	<b>2005</b>
Pension	\$ 336	\$ 298
Thrift/deferred compensation	107	101
Other postretirement benefits	97	132
Total	<u>\$ 540</u>	<u>\$ 531</u>

As of September 30, 2006, no contributions have been made to the pension plan for 2006. The Association does not anticipate making additional contributions for the remainder of 2006.