

# ALABAMA AG CREDIT, ACA

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## 2011 Quarterly Report 2nd Quarter



**For the Quarter Ended June 30, 2011**



Part of the Farm Credit System

## REPORT OF MANAGEMENT

The consolidated financial statements of Alabama Ag Credit, ACA (Association) are prepared by management, who are responsible for the statements' integrity and objectivity, including amounts that must necessarily be based on judgments and estimates. The consolidated financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America appropriate in the circumstances. Other financial information included in the quarterly report is consistent with that in the consolidated financial statements.

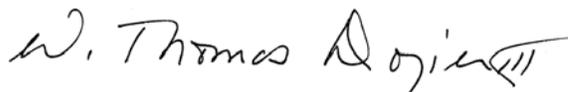
To meet its responsibility for reliable financial information, management depends on the Farm Credit Bank of Texas' (Bank) and the Association's accounting and internal control systems, which have been designed to provide reasonable, but not absolute, assurance that assets are safeguarded and transactions are properly authorized and recorded. The systems have been designed to recognize that the cost of controls must be related to the benefits derived. The annual financial statements are audited by PricewaterhouseCoopers LLP, independent accountants, who conduct a review of internal controls solely for the purpose of establishing a basis for reliance thereon in determining the nature, extent and timing of audit tests applied in the audit of the financial statements in accordance with auditing standards generally accepted in the United States of America. The Association is also examined by the Farm Credit Administration.

The audit committee of the board of directors has oversight responsibility for the Association's system of internal controls and financial reporting. The audit committee consults regularly with management and meets periodically with the independent auditors and the internal auditor to review the scope and results of their work. The independent auditors and internal auditor have direct access to the audit committee.

The undersigned certify that, to the best of our knowledge and belief, the consolidated financial statements and other financial information included in this quarterly report reliably present the financial condition of Alabama Ag Credit, ACA and the results of its operations for the periods shown.



Douglas Thiessen, President/Chief Executive Officer  
August 3, 2011



W. Thomas Dozier, III, Chairman, Board of Directors  
August 3, 2011



M. Scott Sellers, CPA, Sr. VP/Chief Financial Officer  
August 3, 2011



J.K. Love, CPA, Chairman, Audit Committee  
August 3, 2011

## **ALABAMA AG CREDIT, ACA MANAGEMENT'S DISCUSSION AND ANALYSIS**

The following commentary reviews the financial performance of the Alabama Ag Credit, ACA (Agricultural Credit Association), referred to as the Association, for the quarter and six months ended June 30, 2011. These comments should be read in conjunction with the accompanying consolidated financial statements and the December 31, 2010 Annual Report of the Association.

The Association is a member of the Farm Credit System (System), a nationwide network of cooperatively owned financial institutions established by and subject to the provisions of the Farm Credit Act of 1971, as amended, and regulations of the Farm Credit Administration (FCA) promulgated thereunder.

The consolidated financial statements comprise the operations of the ACA and its wholly-owned subsidiaries. The consolidated financial statements were prepared under the oversight of the Association's audit committee.

### **Results of Operations:**

The Association had net income of \$2,977,788 and \$5,686,377 for the three and six months ended June 30, 2011, as compared to net income of \$2,987,756 and \$6,312,700 for the same periods in 2010 reflecting a decrease of 0.3 and 9.9 percent, respectively. Net interest income was \$4,955,957 and \$9,933,295, respectively, for the three and six months ended June 30, 2011, compared to \$4,552,007 and \$9,056,445 for the same periods in 2010. Interest income for the first six months of 2011 decreased by \$105,709 or 0.6 percent from the same period of 2010, primarily due to decreases in yields, offset by an increase in average loan volume. Interest expense for the first six months of 2011 decreased by \$982,559, or 12.0 percent, from the same period of 2010 due to a decrease in interest rates, offset partially by an increase in average debt volume. Average loan volume for the second quarter of 2011 was \$663,810,467, compared to \$650,290,935 in the second quarter of 2011.

Noninterest income for the three and six months ended June 30, 2011 decreased by \$791,093 and \$1,070,016, or 75.0 percent and 65.3 percent, respectively, over the same periods of 2010. The decrease is due primarily to the implementation of ASC310 which calls for the deferral of net loan origination fees whereby the fees are amortized over the life of the loan using the effective interest method. The deferral of net loan origination fees was not implemented until the fourth quarter of 2010, therefore no deferrals had been recognized for the three and six months ended June 30, 2010. In addition, during the second quarter of 2010 the Association received a refund from the Farm Credit Insurance Corporation (FCSIC) on prior years' premiums that was not repeated for the first six months of 2011.

Noninterest expenses for the three and six months ended June 30, 2011, increased by \$245,331 and \$595,197, or 13.5 percent and 17.1 percent, respectively, as compared to the same periods of 2010. The increase is due primarily to losses on acquired property that were recorded in the first six months of 2011 as a result of decreases in the value of the properties as compared to gains that were recorded on the sales of acquired properties in the first six months of 2010. Salary and benefit costs also increased for the first six months of 2011 compared to the first six months of 2010. The primary reason for the increase in these costs is from hiring three new employees and an increase in actuarially-determined, required contributions to the defined benefit (DB) retirement plan. For more information on the DB plan, refer to the 2010 Annual Report and Note 7, "Employee Benefit Plans," to the consolidated financial statements in this quarterly report. The increase in salary and employee benefits costs was offset partially due to the implementation of ASC310 in relation to the capitalization and deferral of net loan origination fees. For the first six months of 2011 advertising costs decreased compared to the first six months of 2010. This decrease in advertising is due to the Association spending additional dollars in the first quarter of 2010 to publicize the Association's name change and expanded lending opportunities in connection with converting from a Federal Land Credit Association (FLCA) to an ACA at the beginning of 2010.

The Association's provision for loan loss was \$171,732 and \$740,132 for the quarter and six months ended June 30, 2011 as compared to \$778,173 and \$866,107 for the same periods in 2010. In the second quarter of 2011, the

Association recognized provision expense on a higher number of loans, but the loans and related loss exposures are much smaller by comparison to the prior year. The Association recognized charge-offs of \$61,859 and \$317,093 for the three and six months ended June 30, 2011, and charge-offs of \$1,305,449 and \$1,385,310 for the same periods in 2010. The Association has recorded no recoveries for the three and six months ended June 30, 2011 as compared to \$525,293 and \$600,096 for the same periods in 2010. The Association's allowance for loan losses was 0.6 percent and 0.5 percent of total loans outstanding as of June 30, 2011, and 2010, respectively.

The Association's return on average assets for the six months ended June 30, 2011, was 1.69 percent compared to 1.89 percent for the same period in 2010. The Association's return on average equity for the six months ended June 30, 2011, was 9.82 percent, compared to 11.65 percent for the same period in 2010.

### Loan Portfolio:

The Association makes and services loans to farmers, ranchers, rural homeowners and certain farm-related businesses. The Association's loan volume consists of long-term farm mortgage loans, production and intermediate-term loans, and farm-related business loans. These loans are available to eligible borrowers with competitive prime- and LIBOR-based, fixed and adjustable interest rates and loan maturities ranging up to 40 years. Loans serviced by the Association offer several installment payment cycles, the timing of which usually coincides with seasonal cash-flow capabilities of the borrower.

Total loans outstanding at June 30, 2011, stated at recorded investment (principal less funds held), were \$665,298,193 compared to \$654,208,651 at December 31, 2010, reflecting an increase of 1.7 percent. The major commodities within the Association's loan portfolio are timber, poultry, cattle and field crops.

The following table reflects the credit quality of the Association's loan volume as of:

	<u>June 30, 2011</u>	<u>December 31, 2010</u>
Acceptable	94.6 %	95.2 %
Special Mention	1.0 %	1.3 %
Substandard	4.4 %	3.5 %
Total	<u>100.0 %</u>	<u>100.0 %</u>

### Risk Exposure:

High-risk assets include nonaccrual loans, loans that are past due 90 days or more and still accruing interest, formally restructured loans and other property owned. The following table illustrates the Association's components and trends of high-risk assets.

	<u>June 30, 2011</u>		<u>December 31, 2010</u>	
	<u>Amount</u>	<u>%</u>	<u>Amount</u>	<u>%</u>
Nonaccrual	\$ 16,787,296	77.4%	\$ 11,310,269	76.1%
90 days past due and still accruing interest	-	0.0%	207,892	1.4%
Formally restructured	1,580,412	7.3%	183,696	1.2%
Other property owned, net	3,331,745	15.3%	3,167,851	21.3%
Total	<u>\$ 21,699,453</u>	<u>100.0%</u>	<u>\$ 14,869,708</u>	<u>100.0%</u>

At June 30, 2011 loans that were considered impaired were \$18,367,708, compared to \$11,701,857 at December 31, 2010. This represents 2.8 percent and 1.8 percent of loan volume, respectively. Impaired loans consist of all high-risk assets except other property owned, net. Total nonaccrual loans as of June 30, 2011 increased compared to December 31, 2010 as economic deterioration resulted in several more loans being classified as nonaccrual, due to

management’s belief that the Association will not receive all principal and interest according to the original terms of the loans. However, almost the entire increase is attributable to only one borrower with a large credit.

**Liquidity and Funding Sources:**

The Association secures the majority of its lendable funds from the Farm Credit Bank of Texas (the Bank), which obtains its funds through the issuance of System-wide obligations. The following schedule summarizes the Association’s borrowings.

	<b>June 30, 2011</b>	December 31, 2010
Note payable to the Bank	<b>\$ 562,806,245</b>	\$ 550,975,385
Accrued interest on note payable	<b>1,184,015</b>	1,265,927
Total	<b>\$ 563,990,260</b>	\$ 552,241,312

**Capital Resources:**

The Association’s capital position increased by \$5,750,679 at June 30, 2011, compared to December 31, 2010. The Association’s debt as a ratio to members’ equity was 4.75:1 as of June 30, 2011, compared to 4.94:1 as of December 31, 2010.

In December 2010, the board declared a \$5,100,000 cash patronage to be paid to stockholders from the Association’s 2010 earnings. The patronage distribution was completed in March 2011.

Under regulations governing minimum permanent capital adequacy and other capitalization issues, the Association is required to maintain a minimum adjusted permanent capital of seven percent of risk-adjusted assets as defined by the FCA. The Association’s permanent capital ratio at June 30, 2011, was 16.3 percent, which is in compliance with the FCA’s minimum permanent capital standard. The Association’s core surplus ratio and total surplus ratio at June 30, 2011, were 15.7 and 15.7 percent, respectively, which is in compliance with the FCA’s minimum surplus standard.

**Significant Recent Accounting Pronouncements:**

In June 2011, the Financial Accounting Standards Board (FASB) issued guidance entitled, “Comprehensive Income – Presentation of Comprehensive Income.” This guidance is intended to increase the prominence of other comprehensive income in financial statements. The current option that permits the presentation of other comprehensive income in the statement of changes in equity has been eliminated. The main provisions of the guidance provides that an entity that reports items of other comprehensive income has the option to present comprehensive income in either one or two consecutive financial statements:

- A single statement must present the components of net income and total net income, the components of other comprehensive income and total other comprehensive income, and a total for comprehensive income.
- In a two-statement approach, an entity must present the components of net income and total net income in the first statement. That statement must be immediately followed by a financial statement that presents the components of other comprehensive income, a total for other comprehensive income, and a total for comprehensive income.

This guidance is to be applied retrospectively. For public entities, it is effective for fiscal years, and interim periods within those years, beginning after December 15, 2011. The adoption of this guidance will not impact financial condition or results of operations, but will result in changes to the presentation of comprehensive income.

In May 2011, the FASB issued guidance entitled, “Fair Value Measurement – Amendments to Achieve Common Fair Value Measurements and Disclosure Requirements in U.S. GAAP and IFRSs.” The amendments change the

wording used to describe the requirements in U.S. GAAP for measuring fair value and for disclosing information about fair value measurements. The amendments include the following:

1. Application of the highest and best use and valuation premise is only relevant when measuring the fair value of nonfinancial assets (does not apply to financial assets and liabilities).
2. Aligning the fair value measurement of instruments classified within an entity's shareholders' equity with the guidance for liabilities. As a result, an entity should measure the fair value of its own equity instruments from the perspective of a market participant that holds the instruments as assets.
3. Clarifying that a reporting entity should disclose quantitative information about the unobservable inputs used in a fair value measurement that is categorized within Level 3 of the fair value hierarchy.
4. An exception to the requirement for measuring fair value when a reporting entity manages its financial instruments on the basis of its net exposure, rather than its gross exposure, to those risks.
5. Clarifying that the application of premiums and discounts in a fair value measurement is related to the unit of account for the asset or liability being measured at fair value. Premiums or discounts related to size as a characteristic of the entity's holding (that is, a blockage factor) instead of as a characteristic of the asset or liability (for example, a control premium), are not permitted. A fair value measurement that is not a Level 1 measurement may include premiums or discounts other than blockage factors when market participants would incorporate the premium or discount into the measurement at the level of the unit of account specified in other guidance.
6. Expansion of the disclosures about fair value measurements. The most significant change will require entities, for their recurring Level 3 fair value measurements, to disclose quantitative information about unobservable inputs used, a description of the valuation processes used by the entity, and a qualitative discussion about the sensitivity of the measurements. New disclosures are required about the use of a nonfinancial asset measured or disclosed at fair value if its use differs from its highest and best use. In addition, entities must report the level in the fair value hierarchy of assets and liabilities not recorded at fair value but where fair value is disclosed.

The amendments are to be applied prospectively. The amendments are effective during interim and annual periods beginning after December 15, 2011. Early application is not permitted.

In January 2011, the FASB issued guidance entitled, "Deferral of the Effective Date of Disclosures about Troubled Debt Restructurings." This guidance temporarily delayed the effective date of the disclosures about troubled debt restructurings (TDR) required by the guidance previously issued on "Disclosures about the Credit Quality of Financing Receivables and the Allowance for Credit Losses." The effective date of the new disclosures about TDRs coincides with the guidance for determining what constitutes a TDR as described below.

In April 2011, the FASB issued its guidance entitled, "A Creditor's Determination of Whether a Restructuring is a Troubled Debt Restructuring," which provides for clarification on whether a restructuring constitutes a TDR. In evaluating whether a restructuring is a TDR, a creditor must separately conclude that both of the following exists: (1) the restructuring constitutes a concession, and (2) the debtor is experiencing financial difficulties. For nonpublic entities, the guidance is effective for annual periods ending on or after December 15, 2012, including interim periods within those annual periods. The Bank and associations are currently evaluating the impact of adoption of this Standard on the financial condition or results of operations. The adoption will result in additional disclosures.

In July 2010, the Financial Accounting Standards Board (FASB) issued guidance on "Disclosures about the Credit Quality of Financing Receivables and the Allowance for Loan Losses," which is intended to provide additional information to assist financial statement users in assessing an entity's credit risk exposures and evaluating the adequacy of the allowance for credit losses. Existing disclosures are amended to include additional disclosures of financing receivables on a disaggregated basis (by portfolio segment and class of financing receivable) including among others, a rollforward schedule of the allowance for credit losses from the beginning of the reporting period to the end of the period on a portfolio segment basis, with the ending balance further disaggregated on the basis of the method of impairment (individually or collectively evaluated). The guidance also calls for new disclosures including but not limited to credit quality indicators at the end of the reporting period by class of financing receivables, the aging of past due financing receivables by class, the nature and extent of financing receivables modified as troubled debt restructurings by class and the effect on the allowance for credit losses. For nonpublic

entities, the disclosures are effective for annual reporting periods ending on or after December 15, 2011. The adoption of this Standard will not have an impact on the Association's financial condition or results of operations, but will result in additional disclosures for annual reporting periods ending after December 15, 2011.

In January 2010, the FASB issued guidance on "Fair Value Measurements and Disclosures," which is to improve disclosures about fair value measurement by increasing transparency in financial reporting. The changes will provide a greater level of disaggregated information and more robust disclosures of valuation techniques and inputs to fair value measurement. The new disclosures and clarification of existing disclosures were effective for interim and annual reporting periods beginning after December 15, 2009, except for the disclosures about purchases, sales, issuances and settlements in the rollforward of activity in Level 3 fair value measurements. Those disclosures are effective for fiscal years beginning after December 15, 2010, and for interim periods within those fiscal years. The adoption of this Standard did not impact the Association's financial condition or results of operations but did result in additional disclosures.

#### **Relationship with the Farm Credit Bank of Texas:**

The Association's financial condition may be impacted by factors that affect the Bank. The financial condition and results of operations of the Bank may materially affect the stockholder's investment in the Association. The Management's Discussion and Analysis and Notes to Consolidated Financial Statements contained in the December 31, 2010 Annual Report of Alabama Ag Credit, ACA more fully describe the Association's relationship with the Bank.

The Tenth Farm Credit District's (District) annual and quarterly stockholder reports are available free of charge, upon request. These reports can be obtained by writing to Farm Credit Bank of Texas, The Ag Agency, P.O. Box 202590, Austin, Texas 78720, or by calling (512) 483-9260. Copies of the District's quarterly and annual stockholder reports also can be requested by e-mail at [fcf@farmcreditbank.com](mailto:fcf@farmcreditbank.com). The District makes its annual and quarterly stockholder reports available on its web site at [www.farmcreditbank.com](http://www.farmcreditbank.com).

The Association's annual and quarterly stockholder reports are also available free of charge, upon request. These reports can be obtained by writing to Alabama Ag Credit, ACA, P.O. Box 241687, Montgomery, Alabama, 36124-1687, or by calling (334) 270-8687. Copies of the reports can also be requested by e-mailing [andra.wolf@AlabamaAgCredit.com](mailto:andra.wolf@AlabamaAgCredit.com). The Association's quarterly stockholder reports are available on its web site at [www.AlabamaAgCredit.com](http://www.AlabamaAgCredit.com) approximately 40 days after each quarter end, and the annual stockholder report is available on its web site 75 days after the fiscal year end. Copies of the annual stockholder report can also be requested 90 days after fiscal year end.

**ALABAMA AG CREDIT, ACA**

**CONSOLIDATED BALANCE SHEET**

	<b>June 30, 2011 (unaudited)</b>	<b>December 31, 2010</b>
<b><u>ASSETS</u></b>		
Cash	\$ 13,127	\$ 10,550
Loans	665,298,193	654,208,651
Less: allowance for loan losses	4,020,494	3,597,455
Net loans	<u>661,277,699</u>	<u>650,611,196</u>
Accrued interest receivable	6,742,962	6,751,262
Investment in and receivable from the Bank:		
Capital stock	11,050,455	11,050,455
Accrued patronage receivable	275,490	264,972
Other	423,691	582,689
Other property owned, net	3,331,745	3,167,851
Premises and equipment	2,664,396	2,627,020
Other assets	710,918	240,084
Total assets	<u><u>\$ 686,490,483</u></u>	<u><u>\$ 675,306,079</u></u>
<b><u>LIABILITIES</u></b>		
Note payable to the Bank	\$ 562,806,245	\$ 550,975,385
Accrued interest payable	1,184,015	1,265,927
Drafts outstanding	601,187	1,227,576
Patronage distributions payable	8,017	5,102,148
Other liabilities	2,518,351	3,113,054
Total liabilities	<u><u>567,117,815</u></u>	<u><u>561,684,090</u></u>
<b><u>MEMBERS' EQUITY</u></b>		
Capital stock and participation certificates	3,953,725	3,875,435
Unallocated retained earnings	115,496,817	109,810,440
Accumulated other comprehensive loss	(77,874)	(63,886)
Total members' equity	<u><u>119,372,668</u></u>	<u><u>113,621,989</u></u>
Total liabilities and members' equity	<u><u>\$ 686,490,483</u></u>	<u><u>\$ 675,306,079</u></u>

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

ALABAMA AG CREDIT, ACA

CONSOLIDATED STATEMENT OF INCOME

(unaudited)

	Quarter Ended		Six Months Ended	
	June 30,		June 30,	
	2011	2010	2011	2010
<b><u>INTEREST INCOME</u></b>				
Loans	\$ 8,568,936	\$ 8,634,735	\$ 17,140,218	\$ 17,245,927
<b><u>INTEREST EXPENSE</u></b>				
Note payable to the Bank	3,612,979	4,082,728	7,206,923	8,189,482
Net interest income	4,955,957	4,552,007	9,933,295	9,056,445
<b><u>PROVISION FOR LOSSES</u></b>				
Provision for loan losses	171,732	778,173	740,132	886,107
Provision for acquired property losses		16,065		16,065
Net income after provision for losses	4,784,225	3,757,769	9,193,163	8,154,273
<b><u>NONINTEREST INCOME</u></b>				
Patronage income from the Bank	207,975	212,648	416,820	426,200
Loan fees	53,916	229,985	103,337	569,630
Financially related services income	810	891	1,872	2,163
Gain on sale of premises and equipment, net	444	20,943	15,113	22,005
Other noninterest income	-	589,771	30,459	617,619
Total noninterest income	263,145	1,054,238	567,601	1,637,617
<b><u>NONINTEREST EXPENSES</u></b>				
Salaries and employee benefits	1,251,984	1,221,900	2,567,616	2,495,903
Directors' expense	75,090	54,304	151,405	135,172
Purchased services	158,130	269,815	316,109	519,048
Travel	120,894	88,638	194,162	134,118
Occupancy and equipment	87,126	76,298	170,504	159,321
Communications	24,271	22,171	50,097	53,601
Advertising	57,092	84,338	96,459	158,857
Public and member relations	33,088	36,572	79,735	81,170
Supervisory and exam expense	59,026	52,250	118,051	104,501
Insurance Fund premiums	82,590	34,469	237,086	217,044
Other noninterest expense	47,612	35,518	80,028	64,314
Loss (gain) on other property owned, net	158,813	(1,905)	184,732	(327,523)
CMS expense reimbursements	(86,134)	(150,117)	(171,597)	(316,336)
Total noninterest expenses	2,069,582	1,824,251	4,074,387	3,479,190
Net income	\$ 2,977,788	\$ 2,987,756	\$ 5,686,377	\$ 6,312,700

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

**ALABAMA AG CREDIT, ACA**

**CONSOLIDATED STATEMENT OF CHANGES IN MEMBERS' EQUITY**

(unaudited)

	<b>Capital Stock/ Participation Certificates</b>	<b>Unallocated Retained Earnings</b>	<b>Accumulated Other Comprehensive Income (Loss)</b>	<b>Total Members' Equity</b>
Balance at December 31, 2009	\$ 3,661,325	\$ 101,029,380	\$ 120,854	\$ 104,811,559
Comprehensive income				
Net income	-	6,312,700	-	6,312,700
Change in postretirement benefit plans	-	-	(19,511)	(19,511)
Total comprehensive income	-	6,312,700	(19,511)	6,293,189
Capital stock/participation certificates issued	279,800	-	-	279,800
Capital stock/participation certificates retired	(172,245)	-	-	(172,245)
<b>Balance at June 30, 2010</b>	<b>\$ 3,768,880</b>	<b>\$ 107,342,080</b>	<b>\$ 101,343</b>	<b>\$ 111,212,303</b>
Balance at December 31, 2010	\$ 3,875,435	\$ 109,810,440	\$ (63,886)	\$ 113,621,989
Comprehensive income				
Net income	-	5,686,377	-	5,686,377
Change in postretirement benefit plans	-	-	(13,988)	(13,988)
Total comprehensive income	-	5,686,377	(13,988)	5,672,389
Capital stock/participation certificates issued	253,700	-	-	253,700
Capital stock/participation certificates retired	(175,410)	-	-	(175,410)
<b>Balance at June 30, 2011</b>	<b>\$ 3,953,725</b>	<b>\$ 115,496,817</b>	<b>\$ (77,874)</b>	<b>\$ 119,372,668</b>

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

**ALABAMA AG CREDIT, ACA**  
**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**  
(UNAUDITED)

**NOTE 1 — ORGANIZATION AND SIGNIFICANT ACCOUNTING POLICIES:**

Alabama Ag Credit, ACA (Agricultural Credit Association), referred to as the Association, is a member-owned cooperative that provides credit and credit-related services to or for the benefit of eligible borrowers/stockholders for qualified agricultural purposes. The Association serves the counties of Autauga, Baldwin, Barbour, Bibb, Bullock, Butler, Chambers, Chilton, Choctaw, Clarke, Coffee, Conecuh, Coosa, Covington, Crenshaw, Dale, Dallas, Elmore, Escambia, Geneva, Greene, Hale, Henry, Houston, Lee, Lowndes, Macon, Marengo, Mobile, Monroe, Montgomery, Perry, Pickens, Pike, Russell, Sumter, Tallapoosa, Tuscaloosa, Washington and Wilcox in the state of Alabama. The Association is a lending institution of the Farm Credit System (the System), which was established by Acts of Congress to meet the needs of American agriculture.

A description of the Association's significant accounting policies and the financial condition and results of operations as of December 31, 2010 are contained in the 2010 Annual Report to the stockholders. These unaudited second quarter 2011 consolidated financial statements should be read in conjunction with the 2010 Annual Report to the stockholders.

In June 2011, the Financial Accounting Standards Board (FASB) issued guidance entitled, "Comprehensive Income – Presentation of Comprehensive Income." This guidance is intended to increase the prominence of other comprehensive income in financial statements. The current option that permits the presentation of other comprehensive income in the statement of changes in equity has been eliminated. The main provisions of the guidance provides that an entity that reports items of other comprehensive income has the option to present comprehensive income in either one or two consecutive financial statements:

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This guidance is to be applied retrospectively. For public entities, it is effective for fiscal years, and interim periods within those years, beginning after December 15, 2011. The adoption of this guidance will not impact financial condition or results of operations, but will result in changes to the presentation of comprehensive income.

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1. Application of the highest and best use and valuation premise is only relevant when measuring the fair value of nonfinancial assets (does not apply to financial assets and liabilities).
2. Aligning the fair value measurement of instruments classified within an entity's shareholders' equity with the guidance for liabilities. As a result, an entity should measure the fair value of its own equity instruments from the perspective of a market participant that holds the instruments as assets.
3. Clarifying that a reporting entity should disclose quantitative information about the unobservable inputs used in a fair value measurement that is categorized within Level 3 of the fair value hierarchy.
4. An exception to the requirement for measuring fair value when a reporting entity manages its financial instruments on the basis of its net exposure, rather than its gross exposure, to those risks.
5. Clarifying that the application of premiums and discounts in a fair value measurement is related to the unit of account for the asset or liability being measured at fair value. Premiums or discounts related to size as a characteristic of the entity's holding (that is, a blockage factor) instead of as a characteristic of the asset or

liability (for example, a control premium), are not permitted. A fair value measurement that is not a Level 1 measurement may include premiums or discounts other than blockage factors when market participants would incorporate the premium or discount into the measurement at the level of the unit of account specified in other guidance.

6. Expansion of the disclosures about fair value measurements. The most significant change will require entities, for their recurring Level 3 fair value measurements, to disclose quantitative information about unobservable inputs used, a description of the valuation processes used by the entity, and a qualitative discussion about the sensitivity of the measurements. New disclosures are required about the use of a nonfinancial asset measured or disclosed at fair value if its use differs from its highest and best use. In addition, entities must report the level in the fair value hierarchy of assets and liabilities not recorded at fair value but where fair value is disclosed.

The amendments are to be applied prospectively. The amendments are effective during interim and annual periods beginning after December 15, 2011. Early application is not permitted.

In January 2011, the FASB issued guidance entitled, “Deferral of the Effective Date of Disclosures about Troubled Debt Restructurings.” This guidance temporarily delayed the effective date of the disclosures about troubled debt restructurings (TDR) required by the guidance previously issued on “Disclosures about the Credit Quality of Financing Receivables and the Allowance for Credit Losses.” The effective date of the new disclosures about TDRs coincides with the guidance for determining what constitutes a TDR as described below.

In April 2011, the FASB issued its guidance entitled, “A Creditor’s Determination of Whether a Restructuring is a Troubled Debt Restructuring,” which provides for clarification on whether a restructuring constitutes a TDR. In evaluating whether a restructuring is a TDR, a creditor must separately conclude that both of the following exists: (1) the restructuring constitutes a concession, and (2) the debtor is experiencing financial difficulties. For nonpublic entities, the guidance is effective for annual periods ending on or after December 15, 2012, including interim periods within those annual periods. The Bank and associations are currently evaluating the impact of adoption of this Standard on the financial condition or results of operations. The adoption will result in additional disclosures.

In July 2010, the FASB issued guidance on “Disclosures about the Credit Quality of Financing Receivables and the Allowance for Loan Losses,” which is intended to provide additional information to assist financial statement users in assessing an entity’s credit risk exposures and evaluating the adequacy of the allowance for credit losses. Existing disclosures are amended to include additional disclosures of financing receivables on a disaggregated basis (by portfolio segment and class of financing receivable) including among others, a rollforward schedule of the allowance for credit losses from the beginning of the reporting period to the end of the period on a portfolio segment basis, with the ending balance further disaggregated on the basis of the method of impairment (individually or collectively evaluated). The guidance also calls for new disclosures including but not limited to credit quality indicators at the end of the reporting period by class of financing receivables, the aging of past due financing receivables by class, the nature and extent of financing receivables modified as troubled debt restructurings by class and the effect on the allowance for credit losses. For nonpublic entities, the disclosures are effective for annual reporting periods ending on or after December 15, 2011. The adoption of this Standard will not have an impact on the Association’s financial condition or results of operations, but will result in additional disclosures for annual reporting periods ending after December 15, 2011.

In January 2010, the FASB issued guidance on “Fair Value Measurements and Disclosures,” which is to improve disclosures about fair value measurement by increasing transparency in financial reporting. The changes will provide a greater level of disaggregated information and more robust disclosures of valuation techniques and inputs to fair value measurement. The new disclosures and clarification of existing disclosures were effective for interim and annual reporting periods beginning after December 15, 2009, except for the disclosures about purchases, sales, issuances and settlements in the rollforward of activity in Level 3 fair value measurements. Those disclosures are effective for fiscal years beginning after December 15, 2010, and for interim periods within those fiscal years. The adoption of this Standard did not impact the Association’s financial condition and results of operations but did result in additional disclosures.

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, except for the inclusion of a statement of cash flows. Generally accepted accounting principles require a business

enterprise that provides a set of financial statements reporting both financial position and results of operations to also provide a statement of cash flows for each period for which results of operations are provided. In regulations issued by the Farm Credit Administration (FCA), associations have the option to exclude statements of cash flows in interim financial statements. Therefore, the Association has elected not to include a statement of cash flows in these consolidated financial statements.

The consolidated financial statements comprise the operations of the ACA and its wholly-owned subsidiaries. The preparation of these consolidated financial statements requires the use of management's estimates. The results for the quarter ended June 30, 2011, are not necessarily indicative of the results to be expected for the year ended December 31, 2011. Certain amounts in the prior period's financial statements have been reclassified to conform to current financial statement presentation.

## NOTE 2 — LOANS AND ALLOWANCE FOR LOAN LOSSES:

A summary of loans follows:

Loan Type	<b>June 30, 2011</b>	December 31, 2010
	<b>Amount</b>	Amount
Real estate mortgage	\$ 646,501,856	\$ 637,733,800
Production and intermediate term	4,241,787	908,015
Agribusiness:		
Loans to cooperatives	820,267	512,000
Processing and marketing	4,193,880	5,519,684
Farm-related business	77,698	81,803
Rural residential real estate	9,462,705	9,453,349
Total	\$ 665,298,193	\$ 654,208,651

The allowance for loan losses is maintained at a level considered adequate by management to provide for estimated losses inherent in the loan portfolio. The allowance is based on a periodic evaluation of the loan portfolio by management in which numerous factors are considered, including economic conditions, loan portfolio composition and prior loan loss experience. An analysis of the allowance for loan losses follows:

	<b>June 30, 2011</b>	June 30, 2010
Balance at beginning of quarter	\$ 3,910,621	\$ 3,540,199
Provision for loan losses	171,732	778,173
Charge-offs	(61,859)	(1,305,449)
Recoveries	-	525,293
Balance at end of quarter	\$ 4,020,494	\$ 3,538,216

The following table presents information concerning impaired loans:

	<b>June 30, 2011</b>	June 30, 2010
Impaired loans with related allowance	\$ 7,575,020	\$ 4,149,162
Impaired loans with no related allowance	10,792,688	9,146,046
Total impaired loans	<u>\$ 18,367,708</u>	<u>\$ 13,295,208</u>
Allowance on impaired loans	\$ 954,090	\$ 1,653,240
Average impaired loans	\$ 18,090,116	\$ 12,737,724
Interest income on impaired loans for the quarter	\$ 41,349	\$ 17,658

### NOTE 3 — CAPITAL:

The Association's board of directors has established a Capital Adequacy Plan (Plan) that includes the capital targets that are necessary to achieve the institution's capital adequacy goals as well as the minimum permanent capital standards. The Plan monitors projected dividends, equity retirements and other actions that may decrease the Association's permanent capital. In addition to factors that must be considered in meeting the minimum standards, the board of directors also monitors the following factors: capability of management; quality of operating policies, procedures, and internal controls; quality and quantity of earnings; asset quality and the adequacy of the allowance for losses to absorb potential loss within the loan portfolio; sufficiency of liquid funds; needs of an institution's customer base; and any other risk-oriented activities, such as funding and interest rate risk, potential obligations under joint and several liability, contingent and off-balance-sheet liabilities or other conditions warranting additional capital. At least quarterly, management reviews the Association's goals and objectives with the board.

In December 2010, the board declared a \$5,100,000 cash patronage to be paid to stockholders from the Association's 2010 earnings. The patronage distribution was completed in March 2011.

### NOTE 4 — CAPITAL MARKETS:

Until the second quarter of 2007, the Association participated in the Capital Markets of the South (CMS), a joint venture created in 2003 for the purpose of expanding the participants' lending opportunities. The CMS group was comprised of the Association, Alabama Farm Credit, ACA, Mississippi Land Bank, ACA, Southern AgCredit, ACA, and the Louisiana Land Bank, ACA. During the second quarter of 2007, the CMS members decided to discontinue the joint venture. The Association will continue to service the existing CMS loan portfolio, with revenue and expenses continuing to be shared accordingly as noted below, until such time as all of the loans are fully matured or paid off.

Pursuant to the terms of the alliance, each of the five CMS participating associations generally share equally in the costs of operating the venture. All CMS noninterest expenses are recorded gross on the Association's books and then reimbursed 80 percent by the other four associations. The total amount of reimbursements is included on the statement of income in the line item entitled "CMS expense reimbursements." The Association's pro-rata share of income from CMS operations are recorded in the statement of income in their respective line items.

### NOTE 5 — INCOME TAXES:

Alabama Ag Credit, ACA and its Production Credit Association (PCA) subsidiary, Alabama Ag Credit, PCA, (Associations) are subject to federal and certain other income taxes. The Associations are eligible to operate as cooperatives that qualify for tax treatment under Subchapter T of the Internal Revenue Code. Under specified conditions, the Associations can exclude from taxable income amounts distributed as qualified patronage refunds in the form of cash, stock or allocated surplus. Provisions for income taxes are made only on those earnings that will not be distributed as qualified patronage refunds. During 2011, the Association is participating in a patronage program. Deferred taxes are recorded at the tax effect of all temporary differences based on the assumption that such temporary differences are retained by the institution and will therefore impact future tax payments. A valuation allowance is provided against deferred tax assets to the extent that it is more likely than not (more than 50 percent probability), based on management's estimate, that they will not be realized. The Association has recorded a full valuation allowance against its deferred tax asset as of June 30, 2011, based on management's estimate that it is

more likely than not that the deferred tax asset will not be realized. For the six months ended June 30, 2011, the Association had no taxable income.

The Federal Land Credit Association (FLCA) subsidiary, Alabama Ag Credit, FLCA, is exempt from federal and other income taxes as provided in the Farm Credit Act of 1971.

#### **NOTE 6 — FAIR VALUE MEASUREMENTS:**

FASB guidance defines fair value as the exchange price that would be received for an asset or paid to transfer a liability in the principal or most advantageous market for the asset or liability. See Note 12 to the 2010 Annual Report to Stockholders for a more complete description.

Assets and liabilities measured at fair value on a non-recurring basis for each of the fair value hierarchy values are summarized below:

<u>June 30, 2011</u>	<u>Fair Value Measurement Using</u>			<u>Total Fair Value</u>
	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	
Assets:				
Loans *	\$ -	\$ -	\$ 8,447,114	\$ 8,447,114
Other property owned	-	-	3,823,706	3,823,706
<u>December 31, 2010</u>	<u>Fair Value Measurement Using</u>			<u>Total Fair Value</u>
	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	
Assets:				
Loans *	\$ -	\$ -	\$ 6,953,843	\$ 6,953,843
Other property owned	-	-	3,612,044	3,612,044

\*Represents the fair value of certain loans that were evaluated for impairment under authoritative guidance, "Accounting by Creditors for Impairment of a Loan." The fair value was based upon the underlying collateral since these were collateral-dependent loans for which real estate is the collateral.

#### **Valuation Techniques**

As more fully discussed in Note 12 to the 2010 Annual Report to Stockholders, authoritative guidance establishes a fair value hierarchy, which requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. The following represent a brief summary of the valuation techniques used for the Association's assets and liabilities. For a more complete description, see Notes to the 2010 Annual Report to Stockholders.

##### *Loans*

For certain loans evaluated for impairment under authoritative guidance, the fair value is based upon the underlying collateral since the loans were collateral-dependent loans for which real estate is the collateral. The fair value measurement process uses independent appraisals and other market-based information, but in many cases it also requires significant input based on management's knowledge of and judgment about current market conditions, specific issues relating to the collateral and other matters. As a result, these fair value measurements fall within Level 3 of the hierarchy. When the value of the real estate, less estimated costs to sell, is less than the principal balance of the loan, a specific reserve is established.

##### *Other Property Owned*

Other property owned is generally classified as Level 3. The fair value is based upon the collateral value, which is generally determined using appraisals or other indications based on comparable sales of similar properties. Costs to sell represent transaction costs and are not included as a component of the asset's fair value.

By contrast, however, other property owned, net is reported in the accompanying balance sheet at the lower of the related loan's carrying amount (at acquisition) or the collateral's fair value less estimated costs to sell. As of June, 2011, other property owned, net is reported at \$3,331,745 in the balance sheet.

**NOTE 7 — EMPLOYEE BENEFIT PLANS:**

The following table summarizes the components of net periodic benefit costs of non-pension other postretirement employee benefits for the six months ended June 30,:

	Other Benefits	
	2011	2010
Service cost	\$ 26,872	\$ 23,278
Interest cost	46,288	41,540
Expected return on plan assets	-	-
Amortization of prior service costs	(18,924)	(19,511)
Amortizations of net (gain) loss	4,936	-
Net periodic benefit cost	<u>\$ 59,172</u>	<u>\$ 45,307</u>

The Association previously disclosed in its financial statements for the year ended December 31, 2010, that it expected to contribute \$25,694 to its defined pension plan in 2011. As of June 30, 2011, \$14,234 of contributions have been made. The Association's liability for the plan's unfunded accumulated obligation at June 30, 2011 was \$1,693,377 and is included in "Other Liabilities" in the balance sheet.

**NOTE 8 — COMMITMENTS AND CONTINGENT LIABILITIES:**

The Association is involved in various legal proceedings in the normal course of business. In the opinion of management, there are no legal proceedings at this time that are likely to materially affect the Association.

**NOTE 9 — SUBSEQUENT EVENTS:**

The Association has evaluated subsequent events through August 3, 2011, which is the date the financial statements were available to be issued, and determined that there are no subsequent events to report.