

FIRST QUARTER 2004

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Chief Executive Officer



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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 operations of Ag Credit Agricultural Credit Association (Association) for the three months 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, including corn, soybeans, field crops, livestock, and horticultural products. These commodities totaled approximately \$489,140 or 84 percent of the loan portfolio as of March 31, 2004. Rural home loans comprised 7 percent of the Association's portfolio.

The gross loan volume of the Association as of March 31, 2004 was \$582,395, a decrease of \$15,128 or 2.53 percent as compared to \$597,523 at December 31, 2003. Net loans outstanding at March 31, 2004 were \$571,355 as compared to \$586,481 at December 31, 2003. The \$15,126 decrease in net loan volume represents a decrease of 2.58 percent. Net loans accounted for 96.80 percent of total assets at March 31, 2004 as compared to 96.40 percent of total assets at December 31, 2003.

The decrease in gross and net loan volume during the reporting period is attributed primarily to decreases in production/intermediate-term volume (\$18,304 or 7.99 percent) with smaller decreases in finance lease and nonaccrual loan volume along with an increase in loan participations sold. The production volume, which is heavily influenced by operating-type loans, typically declines during the first quarter of each year as

borrowers pay down loan balances. The decrease in production volume for the first quarter of 2004 was larger than in previous years primarily due to improved farm earnings experienced by a significant number of borrowers. This has allowed them to reduce debt that was carried over as a result of the devastating impact of the 2002 drought. During the reporting period the Association did experience an increased demand for long-term farm mortgage loans, farm related business loans and rural home loans along with an increase in participation loans purchased.

There is an inherent risk in the extension of any type of credit. However, portfolio credit quality remains strong and credit administration is satisfactory. Nonaccrual loans decreased from \$4,409 at December 31, 2003 to \$4,267 at March 31, 2004 due to collections made on loans in nonaccrual status. There are no significant potential credit risks identified within the loan portfolio that could adversely impact the performance of the portfolio in the near future. 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 decreased by \$2 from \$11,042 at December 31, 2003 to \$11,040 at March 31, 2004. During the three months ending March 31, 2004, the Association did not make any addition to the allowance. The allowance was considered by management to be adequate to cover possible losses. The ratio of the allowance for loan losses to gross loans at March 31, 2004 was 1.90 percent as compared to 1.85 percent at December 31, 2003. In addition to the allowance for loan losses, the Association continues to emphasize the use of FSA guarantees to help manage credit risk inherent in the Association's loan portfolio and to help reduce the potential for future loan losses.

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 to the allowance for loan losses implemented at that time, which reduction may be significant.

RESULTS OF OPERATIONS

For the three months ended March 31, 2004

Net income for the three months ended March 31, 2004 (Q1 2004) totaled \$2,967, an increase of \$849, or 40.1 percent, as compared to the same period of 2003 (Q1 2003).

Net interest income increased by \$526 or 15.8 percent in the current period when compared to the same period in 2003. The change in net interest income resulted from an increase in interest income of \$169 or 2.2 percent and a decrease in interest expense of \$357 or 8.0 percent. These changes are primarily a result of the significant loan re-pricing activities experienced primarily over the course of the last nine months of 2003. The re-pricing activities and the lower general market interest rates allowed for increased earning spreads on loans and significant reduction in borrowing costs. The lower market rates continued to have an adverse impact on the earnings generated on the Association's own funds in loans.

The Association recorded a provision for loan losses of \$420 during Q1 2003 but did not record any provision for loan losses in Q1 2004. This accounts for \$420 of the \$849 increase in net income. Without this difference, the increase in net income for Q1 2004 would be \$429 or 20.3 percent in comparison to Q1 2003.

Noninterest income for the three months ended March 31, 2004 totaled \$1,085 as compared to \$1,104 for the same period of 2003 for a decrease of \$19 or 1.7 percent. Noninterest income is comprised of loan fee income, fees for financially related services (FRS), equity in earnings from AgFirst Farm Credit Bank (the Bank) and miscellaneous income. Loan fee income decreased by \$82 or 47.4 percent primarily due to decreased loan servicing fees and origination fees collected during Q1 2004 when compared to Q1 2003. FRS income increased by \$23 due to increased multi-peril crop insurance income. The equity in earnings of the Bank increased by \$34 as a result of the increase in the Association's average note payable resulting from the Association's increased loan volume when compared to Q1 2003.

Noninterest expense for Q1 2004 increased \$77 or 4.1 percent compared to the same period of 2003. The major components of noninterest expenses were salaries and employee benefits, occupancy and equipment expense, Insurance Fund premiums and general operating expenses. Salaries and benefits increased by \$84 or 6.7 percent due primarily to regular salary increases and increased pension expenses, when compared to Q1 2003. The Farm Credit System Insurance Corporation (FCSIC) decreased premiums rates for Q1 2004. The decreased premiums offset the increased loan volume and resulted in \$132 of Insurance Fund premiums for Q1 2004 compared to \$157 for Q1 2003. Occupancy and equipment expenses decreased by \$7 primarily due to lower depreciation expenses. Other operating expenses increased by \$25 primarily due to increased FSA guarantee expenses.

The provision for income taxes was \$39 at March 31, 2004 as compared to \$38 at the same time in 2003.

Key Results of Operations Ratios:

	Annualized for the three months ended 3/31/04	For the year ended 12/31/03
Return on Average Assets	2.00%	1.90%
Return on Average Members' Equity	13.11%	13.61%
Net Interest Income as a Percentage of Average Earning Assets	2.67%	2.53%

FUNDING SOURCES

The principal source of funds for the Association is the borrowing relationship established with the Bank through a General Financing Agreement. The General Financing Agreement (GFA) utilizes the Association's credit and fiscal performance as criteria for establishing a line of credit on which the Association may draw funds. Additional information on the GFA and the funding process is found on page 9 of the 2003 Annual Report. The total notes payable to the Bank at March 31, 2004 was \$490,492 as compared to \$511,870 at December 31, 2003. The \$21,378 or 4.2 percent decrease is primarily attributed to decreased loan volume as described above, increased investment in Class A preferred stock and the payment of \$4,081 to the Association by the Bank representing the Bank's 2003 patronage refund to the Association.

CAPITAL RESOURCES

Total members' equity at March 31, 2004, increased by \$5,057 or 5.8 percent to \$92,491 from the December 31, 2003 total of \$87,434. The increase is primarily from net income of \$2,967 and an increase in capital stock and participation certificates of \$2,110. The increase in capital stock and participation certificates is a result of the \$2,133 increase in Class A Preferred stock.

The Association's permanent capital ratio as of March 31, 2004 was 16.02 percent compared to 14.91 percent on December 31, 2003. The permanent capital ratio is calculated by dividing the Association's permanent capital by a risk-adjusted asset base. The increase is related to an increase in average guaranteed loan volume, rural home volume and risk-adjusted capital.

FCA regulations require all Farm Credit institutions to maintain two other minimum capital ratios: total surplus ratio of 7 percent and core surplus ratio of 3.5 percent. The total surplus and core surplus ratios are calculated by dividing the total surplus and core surplus as defined in FCA regulations by a risk-adjusted asset base. As of December 31, 2003 the Association's total surplus ratio and core surplus ratio was 12.67 percent and 11.57 percent, respectively, compared to 13.43 percent and 12.30 percent, respectively, on March 31, 2004.

Ag Credit Agricultural Credit Association
Consolidated Balance Sheets

<i>(dollars in thousands)</i>	March 31, 2004	December 31, 2003
	<i>(unaudited)</i>	
Assets		
Cash	\$ 302	\$ 363
Loans	582,395	597,523
Less: allowance for loan losses	11,040	11,042
Net loans	571,355	586,481
Accrued interest receivable	9,413	10,543
Investment in AgFirst Farm Credit Bank	5,906	4,206
Premises and equipment, net	1,751	1,757
Other assets	1,786	5,029
Total assets	<u>\$ 590,513</u>	<u>\$ 608,379</u>
Liabilities		
Notes payable to AgFirst Farm Credit Bank	\$ 490,492	\$ 511,870
Accrued interest payable	1,354	1,406
Patronage refund payable	182	2,587
Other liabilities	5,994	5,082
Total liabilities	<u>498,022</u>	<u>520,945</u>
Commitments and contingencies		
Members' Equity		
Capital stock and participation certificates	14,380	12,270
Retained earnings		
Allocated	33,778	33,503
Unallocated	44,333	41,661
Total members' equity	<u>92,491</u>	<u>87,434</u>
Total liabilities and members' equity	<u>\$ 590,513</u>	<u>\$ 608,379</u>

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

Ag Credit Agricultural Credit Association
Consolidated Statements of Income
(unaudited)

<i>(dollars in thousands)</i>	For the three months ended March 31,	
	2004	2003
Interest Income		
Loans	\$ 7,945	\$ 7,776
Interest Expense		
Notes payable to AgFirst Farm Credit Bank	4,082	4,439
Net interest income	3,863	3,337
Provision for (reversal of) loan losses	—	420
Net interest income after provision for (reversal of) loan losses	3,863	2,917
Noninterest Income		
Loan fees	91	173
Fees for financially related services	57	34
Equity in earnings of AgFirst Farm Credit Bank	934	900
Gains (losses) on other property owned, net	(1)	—
Other noninterest income	4	(3)
Total noninterest income	1,085	1,104
Noninterest Expense		
Salaries and employee benefits	1,343	1,259
Occupancy and equipment	131	138
Insurance Fund premium	132	157
Other operating expenses	336	311
Total noninterest expense	1,942	1,865
Income before income taxes	3,006	2,156
Provision (benefit) for income taxes	39	38
Net income	\$ 2,967	\$ 2,118

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

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

(unaudited)

<i>(dollars in thousands)</i>	Capital Stock and Participation Certificates	Retained Earnings		Total Members' Equity
		Allocated	Unallocated	
Balance at December 31, 2002	\$ 8,908	\$ 27,254	\$ 41,335	\$ 77,497
Net income			2,118	2,118
Capital stock/participation certificates issued	450			450
Capital stock/participation certificates retired	(330)			(330)
Patronage distribution				
Cash			(28)	(28)
Retained earnings retired		(14)		(14)
Distribution adjustment		28	(75)	(47)
Balance at March 31, 2003	<u>\$ 9,028</u>	<u>\$ 27,268</u>	<u>\$ 43,350</u>	<u>\$ 79,646</u>
Balance at December 31, 2003	\$ 12,270	\$ 33,503	\$ 41,661	\$ 87,434
Net income			2,967	2,967
Capital stock/participation certificates issued	3,147			3,147
Capital stock/participation certificates retired	(1,037)			(1,037)
Cash dividends declared/paid			(76)	(76)
Retained earnings retired		(5)		(5)
Distribution adjustment		280	(219)	61
Balance at March 31, 2004	<u>\$ 14,380</u>	<u>\$ 33,778</u>	<u>\$ 44,333</u>	<u>\$ 92,491</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 Ag Credit Agricultural Credit Association (the Association), the significant accounting policies followed, and the financial condition and results of operations as of and for the year ended December 31, 2003, are contained in the 2003 Annual Report to Stockholders. These unaudited 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	\$ 10,262
(Reversal of) provision for loan losses	420
Recoveries, net of loans charged off	<u>1</u>
Balance at 3-31-03	<u>\$ 10,683</u>
Balance at 12-31-03	\$ 11,042
(Reversal of) provision for loan losses	–
Loans (charged off), net of recoveries	<u>(2)</u>
Balance at 3-31-04	<u>\$ 11,040</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 three months ended March 31, 2004:

	For the three months ended March 31,	
	2004	2003
Service cost	\$ 92	\$ 72
Interest cost	98	81
Expected return on plan assets	(116)	(90)
Amortization of prior service cost	19	19
Recognized net actuarial (gain) loss	<u>17</u>	<u>12</u>
Net periodic benefit (income) cost	<u>\$ 110</u>	<u>\$ 94</u>

As of March 31, 2004, no contributions have been made to the pension plan for 2004. The Association anticipates contributing \$380 to fund its pension plan for the remainder of 2004.

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

The following is a table of retirement and postretirement benefit expense for the three months ended March 31, 2004:

	For the three months ended March 31,	
	2004	2003
Pension	\$ 110	\$ 94
Thrift/deferred compensation	45	44
Other postretirement benefits	<u>116</u>	<u>118</u>
Total	<u>\$ 271</u>	<u>\$ 256</u>