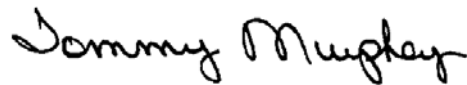



# **THIRD QUARTER 2005**

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Tommy Murphey  
Chief Executive Officer



David Leonard  
Chairman of the Board

October 28, 2005

# 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 Jackson Purchase Agricultural Credit Association (the Association) for the period ended September 30, 2005. These comments should be read in conjunction with the accompanying consolidated financial statements, notes to the consolidated financial statements and the 2004 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, poultry, and tobacco. Farm size varies and many of the borrowers in the region have diversified farming operations. This factor, along with the numerous opportunities for non-farm income in the area, somewhat reduces the level of dependency on any single commodity.

The gross loan volume of the Association as of September 30, 2005, was \$232,610, an increase of \$14,023, as compared to \$218,587 at December 31, 2004. Net loans outstanding at September 30, 2005, were \$231,459 as compared to \$217,387 at December 31, 2004. Net loans accounted for 94.56 percent of total assets at September 30, 2005, as compared to 94.28 percent of total assets at December 31, 2004. The increase in gross and net loan volume during the reporting period is partly attributable to increased borrowing on seasonal production loans, in addition to new loan volume.

There is an inherent risk in the extension of any type of credit. Portfolio credit quality continues to be maintained at an acceptable level, however, and credit administration remains satisfactory. Nonaccrual loans increased from \$723 at December 31, 2004, to \$832 at September 30, 2005. This increase is primarily the result of two loans being transferred to nonaccrual status during the period.

Association management maintains an allowance for loan losses in an amount considered sufficient to absorb possible losses in the loan portfolio based on current and expected future conditions. The allowance for loan losses at September 30, 2005, was \$1,151 compared to \$1,200 at December 31, 2004, and was considered by management to be adequate to cover probable losses.

## **RESULTS OF OPERATIONS**

### ***For the three months ended September 30, 2005***

Net income for the three months ended September 30, 2005, totaled \$1,218, as compared to \$1,331 for the same period in 2004. Net interest income increased \$65 for the three months ended September 30, 2005, as compared to the same period in 2004. Increased loan volume is the primary reason for this increase in net interest income.

Noninterest income for the three months ended September 30, 2005, totaled \$585, as compared to \$622 for the same period of 2004, a decrease of \$37. The decrease is primarily the result of decreased fee income from financially related services. Noninterest expense for the three months ended September 30, 2005, increased \$139 compared to the same period of 2004. The primary reasons for the increase in noninterest expense were an increase in the insurance fund premium, an increase in salaries and benefits, and an increase in occupancy and equipment.

### ***For the nine months ended September 30, 2005***

Net income for the nine months ended September 30, 2005, totaled \$3,186, as compared to \$2,938 for the same period in 2004. At September 30, 2005, net interest income increased by \$369 or 9.28 percent compared to September 30, 2004. Interest income on loans increased by \$1,856 and interest expense increased by \$1,487. This change in net interest income is the result of increased interest rates and cost of funds.

Nonaccrual income was \$52 for the nine months ended September 30, 2005, as compared to \$70 for the same period in 2004. The Association recorded a provision for loan loss of \$0 for the nine months ended September 30, 2005, as compared to \$0 for the same period in 2004. As discussed in the 2004 Annual Report, the Association recorded a loan loss reversal of \$2,859 in the fourth quarter of 2004 that resulted in a significant decrease in the allowance for loan losses. Please refer to the 2004 Annual Report of the Association for a more detailed explanation of this change in accounting estimate.

Noninterest income for the nine months ended September 30, 2005, totaled \$1,435, as compared to \$1,440 for the same period of 2004, a decrease of \$5. The decrease is primarily the result of a decrease in fee income. Noninterest expense for the nine months ended September 30, 2005, increased \$115 compared to the same period of 2004. The primary reason for the increase in noninterest expense was an increase in salaries and benefits, an increase in occupancy and equipment, and an increase in other operating expenses.

## FUNDING SOURCES

The principal source of funds for the Association is the borrowing relationship established with AgFirst Farm Credit Bank (the Bank) through a General Financing Agreement. The General Financing Agreement utilizes the Association's credit and fiscal performance as criteria for establishing a line of credit on which the Association may draw funds. The Bank advances funds to the Association in the form of notes payable. The notes payable are segmented into variable rate and fixed rate sections. The variable rate note is utilized by the Association to fund variable rate loan advances and operating funds requirements. The fixed rate note is used specifically to fund fixed rate loan advances made by the Association and approximately 75% of the Association's own funds. The total notes payable to the Bank at September 30, 2005, was \$205,852 compared to \$191,552 at December 31, 2004.

## CAPITAL RESOURCES

Total members' equity at September 30, 2005, increased to \$36,453 from the December 31, 2004, total of \$34,059. The increase is primarily attributed to income generated through the first three quarters reduced by the 1999 allocated surplus paid out in patronage refunds.

Total capital stock and participation certificates were \$2,778 on September 30, 2005, compared to \$2,763 on December 31, 2004. This increase is attributed to stock requirements on new loan volume.

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, 2005, the Association's total surplus ratio and core surplus ratio were 14.13 percent and 13.20 percent, respectively, and the permanent capital ratio was 15.03 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.

**NOTE:** Shareholder investment in the Association could be affected by the financial condition and results of operations of AgFirst Farm Credit Bank. Copies of AgFirst's annual and quarterly reports are available upon request free of charge by calling 1-800-845-1745, ext. 378, or writing Jay Wise, AgFirst Farm Credit Bank, P.O. Box 1499, Columbia, SC 29202. Information concerning AgFirst Farm Credit Bank can also be obtained at their website, [www.agfirst.com](http://www.agfirst.com). Copies of the Association's annual and quarterly reports are also available upon request free of charge by calling (270) 247-5613, writing Malinda Scoggins, Administrative Services Manager, Jackson Purchase ACA, P. O. Box 309, Mayfield, KY 42066, or accessing the website, [www.jacksonpurchaseaca.com](http://www.jacksonpurchaseaca.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.

*Jackson Purchase Agricultural Credit Association*  
**Consolidated Balance Sheets**

<i>(dollars in thousands)</i>	<b>September 30, 2005</b> <i>(unaudited)</i>	<b>December 31, 2004</b> <i>(audited)</i>
<b>Assets</b>		
Cash	\$ 1,743	\$ 2,516
Loans	232,610	218,587
Less: allowance for loan losses	1,151	1,200
Net loans	231,459	217,387
Accrued interest receivable	4,946	3,111
Investment in other Farm Credit institutions	3,483	3,483
Premises and equipment, net	1,146	1,158
Other assets	1,985	2,926
Total assets	\$ 244,762	\$ 230,581
<b>Liabilities</b>		
Notes payable to AgFirst Farm Credit Bank	\$ 205,852	\$ 191,552
Accrued interest payable	795	604
Patronage refund payable	14	1,548
Other liabilities	1,648	2,818
Total liabilities	208,309	196,522
Commitments and contingencies		
<b>Members' Equity</b>		
Capital stock and participation certificates	2,778	2,763
Retained earnings		
Allocated	8,489	9,444
Unallocated	25,186	21,852
Total members' equity	36,453	34,059
Total liabilities and members' equity	\$ 244,762	\$ 230,581

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

*Jackson Purchase Agricultural Association*  
**Consolidated Statements of Income**

*(unaudited)*

<i>(dollars in thousands)</i>	<b>For the three months ended September 30,</b>		<b>For the nine months ended September 30,</b>	
	<b>2005</b>	<b>2004</b>	<b>2005</b>	<b>2004</b>
<b>Interest Income</b>				
Loans	\$ 3,805	\$ 3,050	\$ 10,363	\$ 8,507
<b>Interest Expense</b>				
Notes payable to AgFirst Farm Credit Bank	2,286	1,596	6,017	4,530
Net interest income	1,519	1,454	4,346	3,977
Provision for (reversal of) loan losses	—	—	—	—
Net interest income after provision for (reversal of) loan losses	1,519	1,454	4,346	3,977
<b>Noninterest Income</b>				
Loan fees	93	59	186	117
Fees for financially related services	113	198	171	288
Equity in earnings of other Farm Credit institutions	373	348	1,034	975
Other noninterest income	6	17	44	60
Total noninterest income	585	622	1,435	1,440
<b>Noninterest Expense</b>				
Salaries and employee benefits	559	508	1,712	1,695
Occupancy and equipment	72	58	201	175
Insurance Fund premium	37	(21)	76	74
Other operating expenses	219	203	600	530
Total noninterest expense	887	748	2,589	2,474
Income before income taxes	1,217	1,328	3,192	2,943
Provision (benefit) for income taxes	(1)	(3)	6	5
Net income	\$ 1,218	\$ 1,331	\$ 3,186	\$ 2,938

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

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

*(unaudited)*

	<b>Capital Stock and Participation Certificates</b>	<b>Retained Earnings</b>		<b>Total Members' Equity</b>
		<b>Allocated</b>	<b>Unallocated</b>	
<i>(dollars in thousands)</i>				
Balance at December 31, 2003	\$ 3,777	\$ 7,475	\$ 18,805	\$ 30,057
Net income			2,938	2,938
Capital stock/participation certificates issued	168			168
Capital stock/participation certificates retired	(106)			(106)
Retained earnings retired		(827)		(827)
Distribution adjustment		(49)	29	(20)
Balance at September 30, 2004	\$ 3,839	\$ 6,599	\$ 21,772	\$ 32,210
Balance at December 31, 2004	\$ 2,763	\$ 9,444	\$ 21,852	\$ 34,059
Net income			3,186	3,186
Capital stock/participation certificates issued	175			175
Capital stock/participation certificates retired	(160)			(160)
Retained earnings retired		(856)		(856)
Distribution adjustment		(99)	148	49
Balance at September 30, 2005	\$ 2,778	\$ 8,489	\$ 25,186	\$ 36,453

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

*Jackson Purchase Agricultural Credit Association*

# Notes to the Consolidated Financial Statements

*(dollars in thousands, except as noted)  
(unaudited)*

**NOTE 1 – ORGANIZATION AND SIGNIFICANT ACCOUNTING POLICIES**

A description of the organization and operations of Jackson Purchase 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, 2004, are contained in the 2004 Annual Report to Shareholders. These unaudited third quarter 2005 consolidated financial statements should be read in conjunction with the 2004 Annual Report to Shareholders.

The accompanying consolidated financial statements contain all adjustments necessary for a fair presentation of the interim financial condition and results of operations and conform with generally accepted accounting principles. The results for the nine months ended September 30, 2005, are not necessarily indicative of the results to be expected for the year ending December 31, 2005.

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, 2005, 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 12-31-03	\$ 4,042
(Reversal of) provision for loan losses	—
Recoveries, net of loans charged off	21
Balance at 9-30-04	\$ 4,063
Balance at 12-31-04	\$ 1,200
(Reversal of) provision for loan losses	—
Loans (charged off), net of recoveries	(49)
Balance at 9-30-05	\$ 1,151

As discussed in the 2004 Annual Report, the Association recorded a loan loss reversal of \$2,859 in the fourth quarter of 2004 that resulted in a decrease in the allowance for loan losses.

**NOTE 3 – EMPLOYEE BENEFIT PLANS**

The Association participates in a defined benefit retirement plan with three other District associations. Pension costs were determined by an actuary on a separate entity basis.

The following is a table of the components of net periodic benefit (income) cost for the defined benefit retirement plan for the nine months ended September 30, 2005:

	<b>For the nine months ended September 30,</b>	
	<b>2005</b>	<b>2004</b>
Service cost	\$ 128	\$ 121
Interest cost	166	135
Expected return on plan assets	(216)	(207)
Amortization of prior service cost	27	27
Recognized net actuarial (gain) loss	30	4
Other	—	43
Net periodic benefit (income) cost	\$ 135	\$ 123

As of September 30, 2005, no contributions have been made to the pension plan for 2005. The Association does not anticipate making additional contributions for the remainder of 2005.

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 nine months ended September 30, 2005:

	<b>For the nine months ended September 30,</b>	
	<b>2005</b>	<b>2004</b>
Pension	\$ 135	\$ 123
Thrift/deferred compensation	78	73
Other postretirement benefits	(3)	(17)
Total	\$ 210	\$ 179