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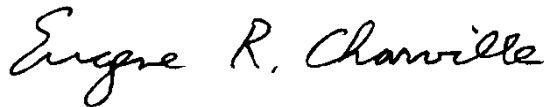
*AgCarolina Financial, ACA*

# Report on Internal Control Over Financial Reporting

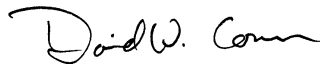
The Association's principal executives and principal financial officers, or persons performing similar functions, are responsible for establishing and maintaining adequate internal control over financial reporting for the Association's Consolidated Financial Statements. For purposes of this report, "internal control over financial reporting" is defined as a process designed by, or under the supervision of the Association's principal executives and principal financial officers, or persons performing similar functions, and effected by its Board of Directors, management and other personnel, to provide reasonable assurance regarding the reliability of financial reporting information and the preparation of the Consolidated Financial Statements for external purposes in accordance with accounting principles generally accepted in the United States of America and includes those policies and procedures that: (1) pertain to the maintenance of records that in reasonable detail accurately and fairly reflect the transactions and dispositions of the assets of the Association, (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial information in accordance with accounting principles generally accepted in the United States of America, and that receipts and expenditures are being made only in accordance with authorizations of management and directors of the Association, and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of the Association's assets that could have a material effect on its Consolidated Financial Statements.

The Association's management has completed an assessment of the effectiveness of internal control over financial reporting as of March 31, 2009. In making the assessment, management used the framework in *Internal Control—Integrated Framework*, promulgated by the Committee of Sponsoring Organizations of the Treadway Commission, commonly referred to as the "COSO" criteria.

Based on the assessment performed, the Association concluded that as of March 31, 2009 the internal control over financial reporting was effective based upon the COSO criteria. Additionally, based on this assessment, the Association determined that there were no material weaknesses in the internal control over financial reporting as of March 31, 2009.



Eugene R. Charville  
Chief Executive Officer



David Corum  
Chief Financial Officer

April 13, 2009

# 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 AgCarolina Financial (Association) for the three months ended March 31, 2009. These comments should be read in conjunction with the accompanying financial statements, notes to the financial statements and the 2008 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. Predominant commodities in the portfolio are tobacco, cotton, forestry, and hogs, which constitute \$453,744, or 54 percent, of the loan portfolio as of March 31, 2009. Other major farm commodities include poultry, landlords, farm services, field crops, horticulture, and general livestock. 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 a given commodity.

The net loan volume of the Association as of March 31, 2009, was \$825,756, a decrease of \$5,765 or .69 percent as compared to \$831,521 at December 31, 2008. Net loans accounted for 89.11 percent of total assets at March 31, 2009 as compared to 86.63 percent of total assets at December 31, 2008. The decrease in net loan volume during the reporting period is primarily attributed to seasonal lending. The short-term portfolio, which is heavily influenced by operating-type loans, normally reaches a peak in August and declines in the fall and winter months as farm commodities are marketed and proceeds are applied to the operating loans.

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 \$12,058 at December 31, 2008 to \$15,205 at March 31, 2009, for an increase of 26.10 percent. 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. During the quarter the Association recognized net loan losses of \$404 and subsequently increased the allowance for loan losses by \$400 through a provision for loan losses. The allowance for loan losses at March 31, 2009 was \$7,614 as compared to \$7,618 at December 31, 2008 and was considered by management to be adequate to cover possible losses. The ratio of the allowance for loan losses to loans at March 31, 2009 was 0.91 percent.

Other investments consists of tobacco buyout Successor-in-Interest Contracts (SIIC) which come under the FCA's Mission Related Investments. Under the SIIC, the tobacco quota holders and producers may assign their rights to receive tobacco buyout contract payments to a third party. The third party, or successor, purchases the entire contract and all related rights and obligations associated with the contract. As of March 31, 2009 the Association held tobacco buyout SIIC of \$58,252, a decrease of \$12,375, or 17.52%, as compared to \$70,627 as of December 31, 2008. The decrease is due to the receipt of the scheduled annual payment from the government during the first quarter.

## RESULTS OF OPERATIONS

### *For the three months ended March 31, 2009*

Net income for the three months ended March 31, 2009 totaled \$3,651, a decrease of \$1,176, or 24.36 percent, as compared to the same period of 2008. The primary reason for the decrease in net income is due to an increase in the provision for loan losses of \$400, and an increase in noninterest expense over the same period in 2008. At March 31, 2009, total interest income decreased by \$2,781 compared to March 31, 2008. The decrease in interest income is due to the general decrease in interest rates as compared to the same period in 2008.

Interest income from nonaccrual loans was \$71 for the three months ended March 31, 2009, an increase of \$17 from the same period of 2008. Interest expense decreased \$2,623 for the three months ended March 31, 2009, as compared to the comparable period of 2008. The decrease in interest expense is primarily attributed to the general decline in interest rates.

Noninterest income for the three months ended March 31, 2009 totaled \$3,083 as compared to \$3,125 for the same period of 2008, a decrease of \$42. The decrease is primarily due to a decrease in fee income.

Noninterest expense for the three months ended March 31, 2009 was \$4,282, an increase of \$576 as compared to the same period of 2008. The major components of noninterest expense are salaries and employee benefits, occupancy and equipment expenses, and general operating expenses. Salaries and employee benefits totaled \$2,853 for the three months ended March 31, 2009, for an increase of \$572, or 25.08 percent, as compared to the same period of 2008. The increase is primarily due to increased costs relate to the Association's pension plan.

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## LIQUIDITY AND FUNDING SOURCES

### *Liquidity*

Liquidity management is the process whereby funds are made available to meet all financial commitments including the extension of credit, payment of operating expenses and payment of debt obligations. The Association receives access to funds through its borrowing relationship with AgFirst Farm Credit Bank (Bank) and from income generated by operations. Sufficient liquid funds have been available to meet all financial obligations.

### *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 utilizes the Association's credit and fiscal performance as criteria for establishing a line of credit on which the Association may draw funds. The funds are advanced by the Bank to the Association in the form of notes payable. The notes payable are segmented into variable rate and fixed rate sections. The variable rate note is utilized by the Association to fund variable rate loan advances and operating funds requirements. The fixed rate note is used specifically to fund fixed rate loan advances made by the Association. The total notes payable to the Bank at March 31, 2009 was \$765,640 as compared to \$799,323 at December 31, 2008. The 4.21 percent decrease during the period is primarily attributed to seasonal lending.

The Association has no lines of credit outstanding with third parties as of March 31, 2009.

## CAPITAL RESOURCES

Total members' equity at March 31, 2009, increased 5.73 percent to \$140,825 from the December 31, 2008, total of \$133,194. The increase is attributed to the increase in retained earnings and capital stock. Total capital stock and participation certificates were \$15,780 on March 31, 2009, as compared to \$11,727 on December 31, 2008. The increase in capital stock resulted primarily from an increase in preferred stock. As of March 31, 2009 the Association had \$12,759 of preferred stock outstanding as compared to \$8,702 as of December 31, 2008.

Farm Credit Administration (FCA) regulations require all Farm Credit institutions to maintain minimum permanent capital, total surplus and core surplus ratios. These ratios are calculated by dividing the Association's permanent capital, total surplus and core surplus as defined in FCA regulations, by a risk-adjusted asset base. As of March 31, 2009, the Association's total surplus ratio and core surplus ratio were both 13.39 percent, and the permanent capital ratio was 15.06 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.

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**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 Stephen Gilbert, 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 1-919-250-9500, writing Linda Strickland, AgCarolina Financial, ACA, P. O. Box 14789, Raleigh, NC 27620, or accessing the website, [www.agcarolina.com](http://www.agcarolina.com). The Association prepares a quarterly report within 40 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.

# AgCarolina Financial, ACA

## Consolidated Balance Sheets

<i>(dollars in thousands)</i>	<b>March 31, 2009</b> <i>(unaudited)</i>	<b>December 31, 2008</b> <i>(audited)</i>
<b>Assets</b>		
Cash	\$ 941	\$ 1,775
Loans	833,370	839,139
Less: allowance for loan losses	7,614	7,618
Net loans	825,756	831,521
Loans held for sale		
Other investments	58,252	70,627
Accrued interest receivable	8,822	17,371
Investment in other Farm Credit institutions	13,542	13,542
Premises and equipment, net	8,243	8,347
Other property owned	—	252
Due from AgFirst Farm Credit Bank	1,548	6,330
Other assets	9,607	10,114
Total assets	\$ 926,711	\$ 959,879
<b>Liabilities</b>		
Notes payable to AgFirst Farm Credit Bank	\$ 765,640	\$ 799,323
Accrued interest payable	2,307	2,736
Patronage refund payable	309	6,592
Other liabilities	17,630	18,034
Total liabilities	785,886	826,685
Commitments and contingencies		
<b>Members' Equity</b>		
Capital stock and participation certificates	15,780	11,727
Retained earnings		
Allocated	62,065	61,465
Unallocated	62,980	60,002
Total members' equity	140,825	133,194
Total liabilities and members' equity	\$ 926,711	\$ 959,879

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

# AgCarolina Financial, ACA

## Consolidated Statements of Income

(unaudited)

For the three months  
ended March 31,

(dollars in thousands)

	2009	2008
<b>Interest Income</b>		
Loans	\$ 11,490	\$ 14,213
Other	831	889
	12,321	15,102
<b>Interest Expense</b>		
Notes payable to AgFirst Farm Credit Bank	7,071	9,694
	5,250	5,408
Provision for (reversal of allowance for) loan losses	400	—
	4,850	5,408
<b>Noninterest Income</b>		
Loan fees	1,341	1,447
Fees for financially related services	131	173
Equity in earnings of other Farm Credit institutions	1,548	1,395
Gains (losses) on other property owned, net	4	—
Gains (losses) on sale of rural home loans, net	4	7
Other noninterest income	55	103
	3,083	3,125
<b>Noninterest Expense</b>		
Salaries and employee benefits	2,853	2,281
Occupancy and equipment	270	288
Insurance Fund premium	333	284
Other operating expenses	826	853
	4,282	3,706
Income before income taxes	3,651	4,827
Provision (benefit) for income taxes	—	—
	3,651	4,827
Net income	\$ 3,651	\$ 4,827

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

AgCarolina Financial, ACA

# 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, 2007	\$ 12,092	\$ 56,644	\$ 58,446	\$ 127,182
Net income			4,827	4,827
Capital stock/participation certificates issued/(retired), net	4,905			4,905
Dividends declared/paid	126		(126)	
Patronage distribution adjustment		—	(1)	(1)
Balance at March 31, 2008	\$ 17,123	\$ 56,644	\$ 63,146	\$ 136,913
Balance at December 31, 2008	\$ 11,727	\$ 61,465	\$ 60,002	\$ 133,194
Net income			3,651	3,651
Capital stock/participation certificates issued/(retired), net	3,980			3,980
Dividends declared/paid	73		(73)	—
Patronage distribution adjustment		600	(600)	—
Balance at March 31, 2009	\$ 15,780	\$ 62,065	\$ 62,980	\$ 140,825

*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, SIGNIFICANT ACCOUNTING POLICIES, AND RECENTLY ISSUED ACCOUNTING PRONOUNCEMENTS

The accompanying financial statements include the accounts of AgCarolina Financial, ACA (the Association). A description of the organization and operations of the Association, the significant accounting policies followed, and the financial condition and results of operations as of and for the year ended December 31, 2008, are contained in the 2008 Annual Report to Shareholders. These unaudited first quarter 2009 consolidated financial statements should be read in conjunction with the 2008 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 (GAAP) and prevailing practices within the banking industry. The results for the three months ended March 31, 2009 are not necessarily indicative of the results to be expected for the year ending December 31, 2009.

Certain amounts in the prior period's consolidated financial statements may have been reclassified to conform to the current period's 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 GAAP. The loan portfolio is reviewed quarterly to determine the adequacy of the allowance for losses. As of March 31, 2009, the allowance for losses is adequate in management's opinion to provide for possible losses on existing loans.

In addition to the recently issued accounting pronouncements discussed in the 2008 Annual Report to Shareholders, effective January 1, 2009, the Association adopted Financial Accounting Standards Board (FASB) Statement of Position (FSP) No. 157-2, "Effective Date of FASB Statement No. 157." This FSP delayed the effective date of Statement No. 157 for nonfinancial assets and nonfinancial liabilities until fiscal years beginning after November 15, 2008. The impact of adoption requires additional fair value disclosures, if applicable, but does not have an impact on the Association's financial condition or results of operations.

## NOTE 2 – ALLOWANCE FOR LOAN LOSSES AND IMPAIRED LOANS

An analysis of the allowance for loan losses follows:

	For the three months ended March 31,	
	2009	2008
Balance at beginning of period	\$ 7,618	\$ 6,877
Provision for (reversal of) loan losses	400	–
Charge-offs	(405)	–
Recoveries	1	3
Balance at end of period	<u>\$ 7,614</u>	<u>\$ 6,880</u>

The following table presents information concerning impaired loans as of March 31,

	2009	2008
Impaired loans with related allowance	\$ 2,858	\$ 250
Impaired loans with no related allowance	12,424	2,931
Total impaired loans	<u>\$ 15,282</u>	<u>\$ 3,181</u>
Allowance on impaired loans	<u>\$ 728</u>	<u>\$ 150</u>

The following table summarizes impaired loan information for the three months ended March 31,

	2009	2008
Average impaired loans	\$ 12,585	\$ 2,366
Interest income recognized on impaired loans	\$ 73	\$ 55

## NOTE 3 – EMPLOYEE BENEFIT PLANS

The following is a table of retirement and other postretirement benefit expenses for the Association:

	For the three months ended March 31,	
	2009	2008
Pension	\$ 609	\$ 112
401(k)	99	105
Other postretirement benefits	108	100
Total	<u>\$ 816</u>	<u>\$ 317</u>

The following is a table of retirement and other postretirement benefit contributions for the Association:

	Actual YTD Through 3/31/09	Projected Contributions For Remainder of 2009	Projected Total Contributions 2009
Pension	\$ -	\$ -	\$ -
Other postretirement benefits	80	292	372
Total	\$ 80	\$ 292	\$ 372

Actuarial calculations as of the last plan measurement date (December 31, 2008) projected no contributions to the pension plan for 2009. However, market conditions could impact discount rates and return on plan assets which could make additional contributions necessary before the next plan measurement date of December 31, 2009.

Further details regarding employee benefit plans are contained in the 2008 Annual Report to Shareholders.

#### NOTE 4 – FAIR VALUE MEASUREMENT

Effective January 1, 2008, the Association adopted Statement of Financial Accounting Standards No. 157, "Fair Value Measurements" (SFAS No. 157). This Statement defines fair value, establishes a framework for measuring fair value and expands disclosures about fair value measurements for certain assets and liabilities measured at fair value on a recurring and non-recurring basis. These assets and liabilities primarily consist of assets held in trust funds, standby letters of credit, impaired loans, and other property owned.

SFAS No. 157 defines fair value as the exchange price that would be received for an asset or paid to transfer a liability in an orderly transaction between market participants in the principal or most advantageous market for the asset or liability.

SFAS No. 157 establishes a fair value hierarchy for disclosure of fair value measurements to maximize the use of observable inputs, that is, inputs that reflect the assumptions market participants would use in pricing an asset or liability based on market data obtained from sources independent of the reporting entity. The valuation hierarchy is based upon the transparency of inputs to the valuation of an asset or liability as of the measurement date. A financial instrument's categorization within the valuation hierarchy is based upon the lowest level of input that is significant to the fair value measurement.

The three levels of inputs and the classification of the Association's financial instruments within the fair value hierarchy are as follows:

#### Level 1

Level 1 inputs to the valuation methodology are unadjusted quoted prices for identical assets or liabilities in active markets. The Association's Level 1 assets at March 31, 2009 consist of assets held in trust funds related to deferred compensation plans. The trust funds include investments in securities that are actively traded and have quoted net asset value prices that are directly observable in the marketplace.

#### Level 2

Level 2 inputs to the valuation methodology include quoted prices for similar assets and liabilities in active markets; quoted prices in markets that are not active; and inputs that are observable, or can be corroborated, for substantially the full term of the asset or liability. The Association has no Level 2 assets and liabilities measured at fair value on a recurring basis.

#### Level 3

Level 3 inputs to the valuation methodology are unobservable and supported by little or no market activity. Valuation is determined using pricing models, discounted cash flow methodologies, or similar techniques, and could include significant management judgment or estimation. Level 3 assets and liabilities also could include instruments whose price has been adjusted based on dealer quoted pricing that is different than the third-party valuation or internal model pricing. Level 3 assets at March 31, 2009 include impaired loans which represent the fair value of certain loans that were evaluated for impairment under SFAS No. 114. The fair value was based upon the underlying collateral since these were collateral-dependent loans. 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 collateral, less estimated costs to sell, is less than the principle balance of the loan, a specific reserve is established. Other property owned is classified as a level 3 asset at March 31, 2009. The fair value for other property owned is based upon the collateral less estimated costs to sell. Level 3 liabilities at March 31, 2009 include standby letters of credit whose market value is internally calculated based on information that is not observable either directly or indirectly in the marketplace.

## Assets and Liabilities Measured at Fair Value on a Recurring Basis

The following table presents the assets and liabilities that are measured at fair value on a recurring basis at March 31, 2009 for each of the fair value hierarchy levels:

	March 31, 2009			Total Fair Value
	Level 1	Level 2	Level 3	
<b>Assets:</b>				
Assets held in trust funds	\$ 2,002	\$ -	\$ -	\$ 2,002
Assets held in Mutual funds	-	-	-	-
Total Assets	\$ 2,002	\$ -	\$ -	\$ 2,002
<b>Liabilities:</b>				
Deferred Compensation Liabilities	\$ -	\$ -	\$ -	\$ -
Standby letters of credit	\$ -	\$ -	\$ 74	\$ 74
Total Liabilities	\$ -	\$ -	\$ 74	\$ 74

The following table presents the changes in Level 3 assets and liabilities measured at fair value on a recurring basis:

	Standby Letters Of Credit
Balance at January 1, 2009	\$ 81
<b>Total gains or (losses) realized/unrealized:</b>	
Included in earnings	-
Included in other comprehensive loss	-
Purchases, sales, issuances and settlements, net	(7)
Transfers in and/or out of level 3	-
Balance at March 31, 2009	\$ 74

## Assets and Liabilities Measured at Fair Value on a Non-recurring Basis

Assets and liabilities measured at fair value on a non-recurring basis at March 31, 2009 for each of the fair value hierarchy values are summarized below:

	March 31, 2009				YTD Total
	Level 1	Level 2	Level 3	Total Fair Value	Gains (Losses)
<b>Assets:</b>					
Impaired loans	\$ -	\$ -	\$ 2,130	\$ 2,130	\$ (400)
Other property owned	\$ -	\$ -	\$ -	\$ -	\$ 7