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**ArborOne, ACA**

**THIRD QUARTER 2007**

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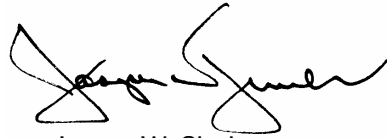
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Jasper W. Shuler  
Chief Executive Officer



James M. Ward  
Chairman of the Board

October 26, 2007

# 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 ArborOne ACA, (Association) for the period ended September 30, 2007. These comments should be read in conjunction with the accompanying consolidated financial statements, notes to the consolidated financial statements and the 2006 Annual Report of the Association. The accompanying consolidated financial statements were prepared under the oversight of the Audit Committee of the Board of Directors.

## **LOAN PORTFOLIO**

The Association provides funds to farmers, rural homeowners and farm-related businesses for financing of short and intermediate-term loans and long-term real estate mortgage loans. The Association's loan portfolio is diversified over a range of agricultural commodities in our region, including tobacco, poultry, swine and forestry. Farm size varies and many of the borrowers in the region have diversified farming operations. These factors, along with the numerous opportunities for non-farm income in the area, somewhat impact the level of dependency on a given commodity. Approximately twenty-nine percent of the portfolio has significant outside income to diversify dependence on agriculture, consisting of lifestyle loans and loans to less than full-time farmers with retirement income, salaried income and non-agricultural business income. Further, approximately thirteen percent of the assets carry federal guarantees as a risk management tool.

The gross loan volume of the Association as of September 30, 2007, was \$364,981, an increase of \$67,588 as compared to \$297,393 at December 31, 2006. Net loans outstanding at September 30, 2007, were \$364,934 as compared to \$297,150 at December 31, 2006. During the nine months ended September 30, 2007, the Association's sold participations to AgFirst Farm Credit Bank (the Bank) decreased by \$14,977. As of September 30, 2007 the Association had \$30,167 of such participations outstanding. The Association has investment securities that are classified as available for sale in the amount of \$19,280 at September 30, 2007 compared to \$10,107 at December 31, 2006. The Association has entered into commitments to acquire Successor-in-Interest Contracts (SIIC), beginning in the fourth quarter of 2005.

As of September 30, 2007, the Association had \$119,366 in other investments for SIIC, compared to \$128,053 at

December 31, 2006. Net loans and investments accounted for 95.33 percent of total assets at September 30, 2007, as compared to 94.56 percent of total assets at December 31, 2006.

The increase in gross and net loan volume during the reporting period is attributed primarily to the upswing of seasonal lending along with growth in the Rural America Bonds program which totaled \$9,676 as of September 30, 2007. The Association continues to review and engage in investment and participation opportunities, while serving customers within the territory.

There is an inherent risk in the extension of any type of credit. However, portfolio credit quality continues to be maintained at an acceptable level, and credit administration remains satisfactory. Nonaccrual loans decreased from \$1,891 at December 31, 2006, to \$697 at September 30, 2007. The decrease in nonaccrual volume is due to the transfer of a large purchased participation to acquired property by the originating association which resulted in the Association recording a receivable of \$1,262 from the originating association.

Association management maintains an allowance for loan losses in an amount considered sufficient to absorb possible losses in the loan portfolio based on historical losses, current conditions, and expected future conditions. The allowance for loan losses at September 30, 2007, was \$47, compared to \$243 at December 31, 2006, and was considered by management to be adequate to cover possible losses. There were recoveries of \$12 and no charge-offs for the nine months ended September 30, 2007. A specific reserve of \$200 was reversed during the nine month period. The Association recognized a reversal of loan losses of \$9 during the quarter.

## **RESULTS OF OPERATIONS**

### ***For the three months ended September 30, 2007***

Net income for the three months ended September 30, 2007, totaled \$2,429, as compared to \$2,410 for the same period in 2006. Net interest income increased \$16, for the three months ended September 30, 2007, as compared to the same period in 2006 due to increased loan and investment volume. A reversal of allowance for loan losses for \$9 was recognized, and noninterest income increased by \$96. These increases were partially offset by an increase in noninterest expense.

At September 30, 2007, interest income on accruing loans increased by \$478 compared to \$6,853 at September 30, 2006. Nonaccrual income was \$10 for the three months ended September 30, 2007, as compared to \$10 for the same period in 2006. Interest income on investment securities was \$177 compared to \$112 for the same period in 2006. Interest income on other investments (SIIC) was \$1,673 for the three months ended September 30, 2007, and \$1,836 for the same period in 2006. Interest expense increased \$364 for the three months ended September 30, 2007, as compared to the comparable period of 2006. This was a result of increased volume and rising interest rates.

Noninterest income for the three months ended September 30, 2007, totaled \$1,796, as compared to \$1,700 for the same period of 2006, an increase of \$96. The increase is primarily the result of increased patronage income and fees for financially related services. Noninterest expense for the three months ended September 30, 2007, increased \$93 compared to the same period of 2006. Increases in salaries and employee benefits, insurance fund premium, and other operating expenses were the primary drivers of the increase.

#### ***For the nine months ended September 30, 2007***

Net income for the nine months ended September 30, 2007, totaled \$7,176, as compared to \$6,499 for the same period in 2006. For the nine months ended September 30, 2007, net interest income increased by \$127 or 1.93 percent compared to September 30, 2006. Interest income on loans and investment securities increased by \$1,396 and interest expense increased by \$1,269. This change in net interest income is the result of both increased loan volume and interest rates.

Nonaccrual income was \$100 for the nine months ended September 30, 2007, as compared to \$80 for the same period in 2006. The Association recorded a reversal of provision for loan loss of \$209 for the nine months ended September 30, 2007, and recorded a reversal of provision for loan loss of \$211 for the same period in 2006. Growth in the portfolio has been coupled with continued geographic diversification and expanded scale with the capital markets portfolio while keeping the average individual size of those relationships relatively constant.

Noninterest income for the nine months ended September 30, 2007, totaled \$5,360, as compared to \$4,393 for the same period of 2006, an increase of \$967. The increase is primarily the result of increases in patronage income by \$850, FRS income by \$20, fees by \$56, and other income by \$41. Noninterest expense for the nine months ended September 30, 2007, increased \$407 compared to the same period of 2006. This increase is attributable to a rise in

salaries and employee benefits of \$275, occupancy and equipment expenses of \$6, insurance fund premium of \$18 and other operating expenses of \$108. The Association recorded a provision for income taxes of \$11 for the nine months ended September 30, 2007, an increase of \$8 as compared to the same period in 2006.

#### **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 September 30, 2007, was \$469,036 as compared to \$402,799 at December 31, 2006. The increase during the period is primarily attributable to increased loan volume.

#### **CAPITAL RESOURCES**

Total members' equity at September 30, 2007, increased to \$52,781 from the December 31, 2006, total of \$45,779. The increase is primarily attributable to the increase in retained earnings in excess of the reduction of protected stock and revolved equities.

Total capital stock and participation certificates were \$1,608 on September 30, 2007, compared to \$1,604 on December 31, 2006. This increase is attributable to purchases of capital stock and participation certificates in excess of retirements from customers in the normal course of business.

Farm Credit Administration (FCA) regulations require all Farm Credit institutions to maintain minimum permanent capital, total surplus and core surplus ratios. These ratios are calculated by dividing the Association's permanent capital, total surplus and core surplus as defined in FCA regulations, by a risk-adjusted asset base. As of September 30, 2007, the Association's total surplus ratio and core surplus ratio were 11.28 percent and 8.96 percent, respectively, and the permanent capital ratio was 11.63 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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## **ACCOUNTING FOR DEFINED BENEFIT PENSION AND OTHER POSTRETIREMENT PLANS**

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

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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. 316, or writing Wanda Martin, AgFirst Farm Credit Bank, P.O. Box 1499, Columbia, SC 29202. Information concerning AgFirst Farm Credit Bank can also be obtained at their website, [www.agfirst.com](http://www.agfirst.com). Copies of the Association’s annual and quarterly reports are also available upon request free of charge by calling 1-800-741-7332, writing Joan Boice, Corporate Secretary, ArborOne, ACA, P.O. Box 13209, Florence, SC 29504, or accessing the website, [www.arboroneaca.com](http://www.arboroneaca.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.

# ArborOne, ACA

## Consolidated Balance Sheets

<i>(dollars in thousands)</i>	<b>September 30, 2007</b>	<b>December 31, 2006</b>
	<i>(unaudited)</i>	<i>(audited)</i>
<b>Assets</b>		
Cash	\$ 2	\$ 2
Investment securities, available for sale	19,280	10,107
Loans	364,981	297,393
Less: allowance for loan losses	47	243
Net loans	364,934	297,150
Other investments, held to maturity	119,366	128,053
Accrued interest receivable	7,016	5,670
Investment in other Farm Credit institutions	9,660	11,609
Premises and equipment, net	566	518
Prepaid retirement expense	2,407	2,689
Due from AgFirst Farm Credit Bank	3,177	3,933
Other assets	1,839	635
Total assets	<u>\$ 528,247</u>	<u>\$ 460,366</u>
<b>Liabilities</b>		
Notes payable to AgFirst Farm Credit Bank	\$ 469,036	\$ 402,799
Accrued interest payable	2,313	2,037
Patronage refund payable	176	2,496
Other liabilities	3,941	7,255
Total liabilities	<u>475,466</u>	<u>414,587</u>
Commitments and contingencies		
<b>Members' Equity</b>		
Protected borrower equity	417	453
Capital stock and participation certificates	1,191	1,151
Retained earnings		
Allocated	26,258	26,826
Unallocated	24,997	17,349
Accumulated other comprehensive income (loss)	(82)	—
Total members' equity	<u>52,781</u>	<u>45,779</u>
Total liabilities and members' equity	<u>\$ 528,247</u>	<u>\$ 460,366</u>

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

# ArborOne, ACA

## 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>2007</b>	<b>2006</b>	<b>2007</b>	<b>2006</b>
<b>Interest Income</b>				
Loans	\$ 7,341	\$ 6,863	\$ 20,114	\$ 18,148
Investment securities	177	112	323	474
Other	1,673	1,836	4,840	5,259
Total interest income	9,191	8,811	25,277	23,881
<b>Interest Expense</b>				
Notes payable to AgFirst Farm Credit Bank	6,820	6,456	18,576	17,307
Net interest income	2,371	2,355	6,701	6,574
Provision for (reversal of allowance for) loan losses	(9)	—	(209)	(211)
Net interest income after provision for (reversal of allowance for) loan losses	2,380	2,355	6,910	6,785
<b>Noninterest Income</b>				
Loan fees	316	466	1,287	1,231
Fees for financially related services	237	235	310	290
Equity in earnings of other Farm Credit institutions	1,160	907	3,390	2,540
Other noninterest income	83	92	373	332
Total noninterest income	1,796	1,700	5,360	4,393
<b>Noninterest Expense</b>				
Salaries and employee benefits	1,024	956	3,023	2,748
Occupancy and equipment	85	82	267	261
Insurance Fund premium	127	118	343	325
Other operating expenses	502	489	1,450	1,342
Total noninterest expense	1,738	1,645	5,083	4,676
Income before income taxes	2,438	2,410	7,187	6,502
Provision (benefit) for income taxes	9	—	11	3
Net income	\$ 2,429	\$ 2,410	\$ 7,176	\$ 6,499

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

# ArborOne, ACA

## Consolidated Statements of Changes in Members' Equity

*(unaudited)*

*(dollars in thousands)*

	Protected Borrower Capital	Capital Stock and Participation Certificates	Retained Earnings		Accumulated Other Comprehensive Income	Total Members' Equity
			Allocated	Unallocated		
Balance at December 31, 2005	\$ 522	\$ 1,171	\$ 23,977	\$ 15,996	\$ —	\$ 41,666
Net income				6,499		6,499
Protected borrower equity retired	(64)					(64)
Capital stock/participation certificates issued		91				91
Capital stock/participation certificates retired		(103)				(103)
Retained earnings retired			(8)			(8)
Distribution adjustment			(434)	433		(1)
<b>Balance at September 30, 2006</b>	<b>\$ 458</b>	<b>\$ 1,159</b>	<b>\$ 23,535</b>	<b>\$ 22,928</b>	<b>\$ —</b>	<b>\$ 48,080</b>
Balance at December 31, 2006	\$ 453	\$ 1,151	\$ 26,826	\$ 17,349	\$ —	\$ 45,779
Comprehensive income						
Net income				7,176		7,176
Unrealized gains (losses) on investments available for sale					(82)	(82)
Total comprehensive income						7,094
Protected borrower equity retired	(36)					(36)
Capital stock/participation certificates issued		111				111
Capital stock/participation certificates retired		(71)				(71)
Retained earnings retired			(3)			(3)
Distribution adjustment			(565)	472		(93)
<b>Balance at September 30, 2007</b>	<b>\$ 417</b>	<b>\$ 1,191</b>	<b>\$ 26,258</b>	<b>\$ 24,997</b>	<b>\$ (82)</b>	<b>\$ 52,781</b>

*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 **ArborOne, ACA** (the Association), the significant accounting policies followed, and the financial condition and results of operations as of and for the year ended December 31, 2006, are contained in the 2006 Annual Report to Shareholders. These unaudited third quarter 2007 consolidated financial statements should be read in conjunction with the 2006 Annual Report to Shareholders.

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

The accompanying consolidated financial statements contain all adjustments necessary for a fair presentation of the interim financial condition and results of operations and conform with generally accepted accounting principles. The results for the nine months ended September 30, 2007, are not necessarily indicative of the results to be expected for the year ending December 31, 2007.

Certain amounts in prior period consolidated financial statements may 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, 2007, the allowance for losses is adequate in management’s opinion to provide for possible losses on existing loans.

**Investment Securities:** As permitted under the FCA regulations, the Association holds investments for purposes of maintaining a liquidity reserve, managing short-term surplus funds and managing interest rate risk. During 2007, the Association reclassified all of its investments from Held to Maturity (HTM) to Available for Sale (AFS) as the AFS classification more accurately reflects management’s intent regarding the Association’s investment portfolio. Thus, in accordance with Statement of Financial Accounting Standards No. 115, *Accounting for Certain Investments in Debt and Equity Securities*, investments are reported at fair value with changes in the fair value excluded from earnings and reported in a separate component of Members’ Equity called Other Comprehensive Income. Upon sale of an investment, the realized gain or loss is included in current earnings.

## NOTE 2 – ALLOWANCE FOR LOAN LOSSES

An analysis of the allowance for loan losses follows:

	<b>For the nine months ended September 30,</b>	
	<b>2007</b>	<b>2006</b>
Balance at beginning of period	\$ 243	\$ 1,011
Provision for (reversal of) loan losses	(209)	(211)
Loans (charged off), net of recoveries	13	(70)
Balance at end of period	<u>\$ 47</u>	<u>\$ 730</u>

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**NOTE 3 – EMPLOYEE BENEFIT PLANS**

The Association participates in a Districtwide defined benefit retirement plan. The costs of the plan are not segregated by participating entities but are allocated among the participating entities. Pension costs are allocated by multiplying the District's net pension expense times each institution's salary expense as a percentage of the District's salary expense. The Association also participates in Districtwide Thrift and other postretirement benefit plans.

The following is a table of retirement and postretirement benefit expense:

	<b>For the nine months ended September 30,</b>	
	<b><u>2007</u></b>	<b><u>2006</u></b>
Pension	\$ 282	\$ 295
Thrift/deferred compensation	80	61
Other postretirement benefits	191	210
Total	<b><u>\$ 553</u></b>	<b><u>\$ 566</u></b>

As of September 30, 2007, no contributions have been made to the pension plan for 2007. The Association does not anticipate making additional contributions for the remainder of 2007.