



THIRD QUARTER 2003

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William A. Garrahan
Chief Executive Officer



Juan A. Santiago
Chairman of the Board

October 29, 2003

Management's Discussion and Analysis of Financial Condition and Results of Operations

(dollars in thousands)

The following commentary reviews the consolidated financial condition and results of operations of Puerto Rico Farm Credit, ACA (Association) for the period ended September 30, 2003. These comments should be read in conjunction with the accompanying consolidated financial statements, notes to the consolidated financial statements and the 2002 annual report of the Association.

LOAN PORTFOLIO

The Association provides funds to farmers, rural homeowners and farm-related business for financing short and intermediate-term loans and long-term real estate mortgage loans. The Association also maintains a portfolio of purchased loans, originated by other Farm Credit System entities and non-system entities. The Association's predominant local service area (LSA) agricultural commodities were dairy, livestock and fruits, which totaled approximately \$120 million, or 53 percent of all outstanding loan volume at September 30, 2003. At September 30, 2003, the net participation loan portfolio totaled \$31,728, or 14.2 percent of gross loan volume.

The gross loan volume of the Association at September 30, 2003 was \$223,436, an increase of \$18,926 or 9.3 percent when compared to \$204,510 at December 31, 2002. Net loans outstanding at September 30, 2003 increased by \$19,277, or 9.7 percent, primarily due to a \$351 reduction in the allowance for loan losses during the third quarter. The material increase in gross loan volume was split almost evenly between participation loans and LSA originated loans. The Association intends to continue to grow the loan portfolio either through LSA lending or participations, as the opportunities present themselves.

Net loans at September 30, 2003 made up 97.1 percent of total assets, as compared to 96.9 percent at December 31, 2002. Both ratios reflected the decrease in other assets recorded during the fourth quarter of 2002, recognizing the underfunded status of the

retirement plan, and the elimination of the related prepaid asset. Otherwise, the increase reflected the growth in gross loan volume.

As a percentage of gross loans, nonaccrual loans equaled 1.8 percent, compared with 2.2 percent and 2.3 percent at December 31, 2002 and September 30, 2002, respectively. The decrease in the percentage was primarily the result of a partial payment received from the sale of collateral property associated with a large volume nonaccrual account. There is a plan in place to liquidate the remaining collateral. Due to the material increase in gross loan volume, the overall credit quality of the portfolio continued to show improvement during the first nine months of 2003. Credit quality was also supported by improved delinquency trends, favorable weather and local product demand.

The Association maintained an allowance for loan losses in an amount considered by management as sufficient to absorb the estimated risk inherent in the loan portfolio. The allowance for loan losses decreased to \$6,147 at September 30, 2003. The allowance was \$6,498 at September 30, 2002 and at June 30, 2003. The reduction of \$351 reflected both management's assessment of less risk in certain loans guaranteed by AgFirst FCB and technical changes made in the quarterly analysis to be in accordance with GAAP. The ratio of allowance to gross loan volume declined to 2.8 percent at September 30, 2003 from 3.2 percent at December 31, 2002 primarily as a result of both the material increase in loan volume and the reduction in the allowance. There were no charge-offs or recoveries during the first nine months of 2003.

RESULTS OF OPERATIONS

For the nine months ended September 30, 2003.

Net income for the nine months ended September 30, 2003 totaled \$1,985, a decrease of \$189 or 8.7 percent compared to the same nine-month period of 2002. This decrease was primarily the result of variances in several line items combining for an unfavorable comparison to the prior year, despite higher levels of accruing loan volume.

At September 30, 2003, net interest income was \$4,348, a decrease of \$118 or 2.6 percent when compared to the September 30, 2002 total of \$4,466. During the first nine months of 2003, interest income recognized from the collection of nonaccrual loans totaled \$202, a reduction of \$96 from the first three quarters of 2002. Management continues to project lower levels of memo interest income from nonaccrual loans, adversely impacting net interest income comparisons on a year-over-year basis.

During the third quarter of 2003, a decision by management to reduce the allowance for loan losses resulted in a \$351 reversal of provision enhancing income. This compared to the first nine months of 2002 when reductions in the allowance for loan losses resulted in a \$174 enhancement of income.

Noninterest income for the nine months ended September 30, 2003 totaled \$241, an increase of \$77 or 47 percent as compared to the first nine months of 2002. This was primarily the result of increased fee income related to the participation loan portfolio and an experience dividend related to credit life insurance services.

Noninterest expense for the nine months ended September 30, 2003 was \$2,953 compared to \$2,803 at September 30, 2002. The increase of \$150 or 5.4 percent was primarily related to salaries and employee benefits and the FCS Insurance Corporation's premium. Despite stability in actual salaries expense, employee benefits related to pension and post-retirement medical insurance increased, resulting in a net increase of \$45 in salaries and employee benefits. Monthly insurance fund premiums totaled \$186, an increase of \$140 or 304 percent compared to the first nine months of 2002. Management projects this higher level of premium expense to continue through the end of 2003.

The Association's 2003 federal tax liability has benefited from the restructuring efforts into a holding company. A majority of the Association's business has been conducted in the tax-exempt subsidiary. Taxable possession-sourced activity continues to be eligible for tax credits. Thus, no provision for federal income tax expense was recorded during the first nine months of 2003. However, this compared unfavorably to 2002's benefit for income tax of \$173 which resulted from a prior period tax refund.

For the three months ended September 30, 2003.

Net income for the third quarter of 2003 was \$965 compared to \$795 for the third quarter of 2002. Net interest income decreased by \$14 reflecting narrow portfolio margins, despite increased earning assets. Additionally, the reduction of the allowance for loan losses resulted in income being enhanced by \$351.

Noninterest income was enhanced compared to the third quarter of 2002 as a result of the absence of miscellaneous losses of \$21 recognized during 2002.

Noninterest expense decreased by \$6, with reductions in operating expenses being offset by increases in the insurance fund premium and the guarantee fee.

Key Results of Operations Ratios:

	Annualized for the nine months ended 9/30/03	For the year ended 12/31/02
Return on Average Assets	1.24%	2.15%
Return on Average Stockholders' Equity	5.77%	8.57%
Net Interest Income as a Percentage of Average Earning Assets	2.77%	3.34%

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 (the 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 notes are utilized by the Association to fund variable rate loan advances and operating

funds requirements. The total notes payable to the Bank at September 30, 2003 was \$173,684 as compared with \$154,689 at December 31, 2002. The increase of \$18,995, or 12.3 percent, very closely corresponded to the \$18,926 increase in gross loan volume.

The Association had no lines of credit outstanding with third parties as of September 30, 2003.

Funds Management

Demand for loan types is a driving force in establishing a funds management strategy. The Association offers variable rate loan products which are competitively priced according to financial market rates. Variable rate loans may be indexed to either the Prime rate or the 90-day London Interbank Offered Rate (LIBOR). The majority of the interest rate risk in the Association balance sheet is transferred to the Bank through the notes payable structure. The Bank, in turn, actively utilizes funds management techniques to identify, quantify and control interest rate risk associated with the loan portfolio.

CAPITAL RESOURCES

Total stockholders' equity at September 30, 2003 increased 4.2 percent to \$46,753 from December 31, 2002 when total stockholders' equity was \$44,877. The increase was primarily attributable to net income retained as unallocated surplus during the quarter.

Total capital stock and participation certificates were \$1,017 on September 30, 2003 compared to \$1,001 on December 31, 2002. The net increase was the result of new customers purchasing more stock than was refunded to borrowers who paid their loans in full.

Retained earnings unallocated increased \$1,832 or 4.0 percent from December 31, 2002 when unallocated retained earnings totaled \$45,914. The increase was net income in excess of equity dividends declared. The Association's directors declared cash dividends for the forty-fifth consecutive quarter. The table below sets forth the amount of dividends declared:

Quarter	Equity Based	Patronage Based
Third 2003	\$51	
Second 2003	\$51	
First 2003	\$51	
Fourth 2002		\$1,602
Third 2002	\$50	
Second 2002	\$50	
First 2002	\$49	
Fourth 2001		\$1,238

The Board of Directors intends to continue its policy of declaring and paying dividends. The Board has decided to change the quarterly declaration schedule to semi-annual (June and December) beginning in 2004. The June dividend will be equity based, using the amount of stock owned. The December dividend will continue to be based upon client patronage. The total amount of dividends, as always, will depend on continued strong earnings, the overall financial condition of the Association and other factors.

The Association's regulatory permanent capital ratio at September 30, 2003 was 24.83 percent compared to 27.10 percent at December 31, 2002. The decrease in the ratio reflected an increase in weighted average assets during the first nine months, as a result of higher gross loan volume. The Association's total surplus and core surplus ratios were both 24.26 percent at September 30, 2003. 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.

Key financial condition ratios were as follows:

	9/30/03	12/31/02
Stockholders' Equity to Assets	20.88%	21.96%
Debt to Stockholders' Equity	3.79:1	3.55:1

Puerto Rico Farm Credit, ACA
Consolidated Balance Sheets

<i>(dollars in thousands)</i>	September 30,		December 31,
	2003	2002	2002
	<i>(unaudited)</i>		
Assets			
Cash	\$ 15	\$ 21	\$ 92
Loans	223,436	189,239	204,510
Less: allowance for loan losses	6,147	6,498	6,498
Net loans	217,289	182,741	198,012
Accrued interest receivable	1,115	1,064	816
Investment in AgFirst Farm Credit Bank	4,712	4,712	4,712
Premises and equipment, net	511	762	474
Other property owned	23	—	—
Other assets	224	1,221	217
Total assets	\$ 223,889	\$ 190,521	\$ 204,323
Liabilities			
Notes payable to AgFirst Farm Credit Bank	\$ 173,684	\$ 141,935	\$ 154,689
Accrued interest payable	213	192	153
Dividends Payable	55	50	1,602
Postretirement benefits other than pensions	1,136	958	978
Minimum pension liability	1,295	—	1,260
Other liabilities	753	657	764
Total liabilities	177,136	143,792	159,446
Commitments and contingencies			
Stockholders' Equity			
Capital stock and participation certificates	1,017	997	1,001
Retained earnings unallocated	47,746	45,732	45,914
Accumulated other comprehensive income (loss)	(2,010)	—	(2,038)
Total stockholders' equity	46,753	46,729	44,877
Total liabilities and stockholders' equity	\$ 223,889	\$ 190,521	\$ 204,323

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

Puerto Rico Farm Credit, ACA
Consolidated Statements of Income

(unaudited)

<i>(dollars in thousands)</i>	For the three months ended September 30,		For the nine months ended September 30,	
	2003	2002	2003	2002
Interest Income				
Loans	\$ 2,091	\$ 2,026	\$ 6,293	\$ 6,147
Interest Expense				
Notes payable to AgFirst Farm Credit Bank	651	572	1,945	1,681
Net interest income	1,440	1,454	4,348	4,466
Provision for (reversal of) loan losses	(351)	–	(351)	(174)
Net interest income after provision for (reversal of) loan losses	1,791	1,454	4,699	4,640
Noninterest Income				
Loan fees	64	66	188	151
Fees for financially related services	4	4	32	11
Miscellaneous	2	(21)	21	2
Total noninterest income	70	49	241	164
Noninterest Expense				
Salaries and employee benefits	561	599	1,906	1,861
Occupancy and equipment	47	55	153	166
Insurance Fund premium	64	15	186	46
Guarantee fee	56	45	172	135
Other operating expenses	167	187	536	595
Total noninterest expense	895	901	2,953	2,803
Income before income taxes	966	602	1,987	2,001
Provision (benefit) for income taxes	1	(193)	2	(173)
Net income	\$ 965	\$ 795	\$ 1,985	\$ 2,174

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

Puerto Rico Farm Credit, ACA

Consolidated Statements of Changes in Stockholders' Equity

(unaudited)

<i>(dollars in thousands)</i>	Capital Stock and Participation Certificates	Retained Earnings Unallocated	Accumulated Other Comprehensive Income	Total Stockholders' Equity
Balance at December 31, 2001	\$ 974	\$ 43,712	\$ —	\$ 44,686
Net income		2,174		2,174
Capital stock/participation certificates issued	90			90
Capital stock/participation certificates retired	(67)			(67)
Cash dividends declared		(149)		(149)
Distribution adjustment		(5)		(5)
Balance at September 30, 2002	<u>\$ 997</u>	<u>\$ 45,732</u>	<u>\$ —</u>	<u>\$ 46,729</u>
Balance at December 31, 2002	\$ 1,001	\$ 45,914	\$ (2,038)	\$ 44,877
Net income		1,985		1,985
Pension liability			28	28
Total comprehensive income				2,013
Capital stock/participation certificates issued	74			74
Capital stock/participation certificates retired	(58)			(58)
Cash dividends declared		(153)		(153)
Balance at September 30, 2003	<u>\$ 1,017</u>	<u>\$ 47,746</u>	<u>\$ (2,010)</u>	<u>\$ 46,753</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 Puerto Rico Farm Credit, 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, 2002, are contained in the 2002 Annual Report to Stockholders. These unaudited third quarter 2003 consolidated financial statements should be read in conjunction with the 2002 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 nine months ended September 30, 2003, are not necessarily indicative of the results to be expected for the year ending December 31, 2003.

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, 2003, 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 12-31-01	\$ 6,674
(Reversal of) provision for loan losses	(174)
Loans (charged off), net of recoveries	<u>(2)</u>
Balance at 9-30-02	<u>\$ 6,498</u>
Balance at 12-31-02	\$ 6,498
(Reversal of) provision for loan losses	(351)
Loans (charged off), net of recoveries	<u>—</u>
Balance at 9-30-03	<u>\$ 6,147</u>

NOTE 3 – COMMITMENTS AND CONTINGENT LIABILITIES

Actions are pending against the Association in which money damages are sought. However, on the basis of information now at hand, management and legal counsel are of the opinion that the ultimate liability, if any, resulting therefrom, would not be material in relation to the overall financial position of the Association.