



**2009 Quarterly Report - Second Quarter  
For the Quarter ending June 30, 2009  
Lone Star, ACA**

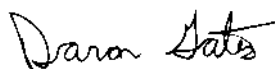


## REPORT OF MANAGEMENT

To meet its responsibility for reliable financial information, management depends on the Farm Credit Bank of Texas' and the Association's accounting and internal control systems, which have been designed to provide reasonable, but not absolute, assurance that assets are safeguarded and transactions are properly authorized and recorded. The systems have been designed to recognize that the cost of controls must be related to the benefits derived. The consolidated financial statements are audited by PricewaterhouseCoopers LLP, independent accountants, who conduct a review of internal controls solely for the purpose of establishing a basis for reliance thereon in determining the nature, extent and timing of audit tests applied in the audit of the consolidated financial statements in accordance with auditing standards generally accepted in the United States of America. The Association is also examined by the Farm Credit Administration.

The audit committee has oversight responsibility for the Association's systems of internal control and financial reporting. The audit committee consults regularly with management and meets periodically with the independent auditors and the internal auditors to review the scope and results of their work. The independent auditors and the internal auditor have direct access to the audit committee.

The undersigned certify that this annual report has been prepared in accordance with all applicable statutory or regulatory requirements and that the information contained herein is true, accurate and complete to the best of his or her knowledge or belief.



Daron Gates, Chief Executive Officer

July 28, 2009




Bruce Duncan, Chairman, Board of Directors

July 28, 2009



M'Lissa Kiel, Chief Financial Officer

July 28, 2009



Don Crawford, Audit Committee

July 28, 2009

**LONE STAR, ACA**  
**MANAGEMENT'S DISCUSSION AND ANALYSIS**

(all dollars in thousands unless otherwise noted)

The following commentary reviews the financial performance of the Lone Star, ACA (Agricultural Credit Association), referred to as the Association, for the quarter and six months ended June 30, 2009. These comments should be read in conjunction with the accompanying financial statements and the December 31, 2008, Annual Report of the Association.

The association is a member of the Farm Credit System (System), a nationwide network of cooperatively owned financial institutions established by and subject to the provisions of the Farm Credit Act of 1971, as amended, and the regulations of the Farm Credit Administration (FCA) promulgated there under.

The consolidated financial statements comprise the operations of the ACA and its wholly-owned subsidiaries. The consolidated financial statements were prepared under the oversight of the Association's audit committee.

**Loan Portfolio:**

Total loans outstanding at June 30, 2009, including nonaccrual loans and sales contracts, were \$1,182,840 compared to \$1,155,381 at December 31, 2008, reflecting an increase of 2.4 percent. Nonaccrual loans as a percentage of total loans outstanding were 1.6 percent at June 30, 2009, compared to 1.0 percent at December 31, 2008.

**Risk Exposure:**

High-risk assets include nonaccrual loans, loans that are past due 90 days or more and still accruing interest, formally restructured loans and other property owned. The following table illustrates the Association's components and trends of high-risk assets.

	<u>June 30, 2009</u>		<u>December 31, 2008</u>	
	<u>Amount</u>	<u>%</u>	<u>Amount</u>	<u>%</u>
Nonaccrual	\$ 18,673	92.5%	\$ 11,042	98.7%
90 days past due and still accruing interest	538	2.7%	50	0.5%
Other property owned, net	968	4.8%	92	0.8%
Total	<u>\$ 20,179</u>	<u>100.0%</u>	<u>\$ 11,184</u>	<u>100.0%</u>

The majority of the increase in high-risk assets is attributable to three loans to a single borrower that transferred into nonaccrual. It is probable that not all principal and interest will be collected according to contractual terms, however; collection efforts will be conducted in accordance with Association policy.

**Results of Operations:**

The Association had net income of \$5,373 and \$11,295 for the three and six months ended June 30, 2009, as compared to net income of \$6,334 and \$12,279 for the same periods in 2008 reflecting a decrease of 15.2 and 8.0 percent, respectively. Net interest income was \$8,314 and \$16,500, respectively, for the three and six months ended June 30, 2009, compared to \$7,545 and \$14,818 for the same periods in 2008. Interest income for the first six months of 2009 decreased by \$2,871 or 8.0 percent from the same periods of 2008, primarily due to a decrease in overall interest rates. Interest expense for the first six months of 2009 decreased by \$4,554, or 21.8 percent, from the same period of 2008 due to a decrease in average debt costs. Loan volume for the second quarter of 2009 was \$1,185,666, compared to \$1,083,613 in the second quarter of 2008. The average spread on the loan portfolio for the second quarter 2009 was 2.45 percent, compared to 2.35 percent in the second quarter of 2008.

The Association's noninterest income decreased from \$1,468 as of June 30, 2008, to \$1,322 as of June 30, 2009. This decrease is largely attributable to a decrease in loan fees of \$176 for the six months ending June 30, 2009, as compared to the same period in 2008.

The Association's decrease in net income was also attributable to an increase in noninterest expenses. Noninterest expenses increased \$353 for the six months June 30, 2009, as compared to the same period in 2008. Most of the increase is attributable to increases in salary and employee benefits and insurance fund premiums. Salaries and employee benefits increased \$315 resulting from the addition of staff members and insurance fund premiums increased \$98 as the result of loan volume growth and an increase premium rates.

The Association recorded \$5 in recoveries and \$653 in charge-offs for the quarter ending June 30, 2009, and \$1 in recoveries and \$46 in charge-offs for the same period in 2008. The Association's allowance for loan losses was 0.1 percent and 0.1 percent of total loans outstanding as of June 30, 2009, and December 31, 2008, respectively.

The Association's return on average assets for the six months ended June 30, 2009, was 1.86 and 2.23 percent for the same period in 2008. The Association's return on average equity for the six months ended June 30, 2009, was 13.57 and 16.69 percent for the same period in 2008.

#### **Liquidity and Funding Sources:**

The Association secures the majority of its lendable funds through a direct loan from the Farm Credit Bank of Texas (The Bank), which obtains its funds through the issuance of Systemwide obligations and with lendable equity. The interest rate risk inherent in the Association's loan portfolio is substantially mitigated through the funding and relationship with the Bank. The Bank manages interest rate risk through its direct loan pricing and asset/liability management process. The following schedule summarizes the Association's borrowings.

	<b>June 30, 2009</b>	December 31, 2008
Note payable to the Bank	\$ <b>1,044,023</b>	\$ 1,016,383
Accrued interest on note payable	<b>2,681</b>	3,173
Total	<b>\$ 1,046,704</b>	<b>\$ 1,019,556</b>

The increase of \$27,148 for the six months ended June 30, 2009, is attributable to the increase in the Association's loan volume. The note carried a weighted average interest rate of 3.04 percent as of June 30, 2009, compared to 3.63 percent as of December 31, 2008. The indebtedness is collateralized by a pledge of substantially all of the Association's assets to the Bank and is governed by a financing agreement.

The liquidity policy of the Association is to manage cash balances to maximize debt reduction, and to increase accrual loan volume. This policy will continue to be pursued during 2009. As borrower payments are received they are applied to the Association's note payable with the Bank.

The Association will continue to fund its operations through direct borrowings from the Bank, capital surplus from prior years, and borrower stock. It is management's opinion that funds available to the Association are sufficient to fund its operations for the current year.

#### **Capital Resources:**

The Association's capital position increased by \$11,304 at June 30, 2009, compared to December 31, 2008. The Association's debt as a percentage of members' equity was 6.13:1 as of June 30, 2009, compared to 6.43:1 as of December 31, 2008.

Under regulations governing minimum permanent capital adequacy and other capitalization issues, the Association is required to maintain a minimum adjusted permanent capital of seven percent of risk-adjusted assets as defined by the FCA. The Association's permanent capital ratio at June 30, 2009, was 13.1 percent, which is in compliance with the FCA's minimum permanent capital standard and meets the Association's goal of exceeding twelve percent. The Association's core surplus ratio and total surplus ratio at June 30, 2009, were 12.6 and 12.6 percent, respectively, which is in compliance with the FCA's minimum surplus standard and exceeds the Association goals of, equal to or greater than five percent and ten percent, respectively.

#### **Relationship with the Farm Credit Bank of Texas:**

The Association's financial condition may be impacted by factors that affect the Bank. The financial condition and results of operations of the Bank may materially affect the stockholder's investment in the Association. The Management's Discussion and Analysis and Notes to Financial Statements contained in the December 31, 2008, Annual Report of Lone Star, ACA more fully describe the Association's relationship with the Bank.

The Tenth Farm Credit District's (District) annual and quarterly stockholder reports are available free of charge, upon request. These reports can be obtained by writing to Farm Credit Bank of Texas, The Ag Agency, P.O. Box 202590, Austin, Texas 78720, or by calling (512) 483-9260. Copies of the District's quarterly and annual stockholder reports also can be requested by e-mail at [fcdb@farmcreditbank.com](mailto:fcdb@farmcreditbank.com). The District makes its annual and quarterly stockholder reports available on its web site at [www.farmcreditbank.com](http://www.farmcreditbank.com).

The Association's quarterly stockholder reports are also available free of charge, upon request. These reports can be obtained by writing to Lone Star ACA, 1612 Summit Ave Suite 300, Fort Worth, TX 76102 or calling (817)332-6565. Copies of the Association's quarterly stockholder reports can also be requested by e-mailing [Kimberly.Thomas@LoneStarAgCredit.com](mailto:Kimberly.Thomas@LoneStarAgCredit.com).

**LONE STAR, ACA**

**CONSOLIDATED BALANCE SHEET**

(dollars in thousands)

(unaudited)

	<b>June 30, 2009</b>	<b>December 31, 2008</b>
<b><u>ASSETS</u></b>		
Cash	\$ 34	\$ 380
Loans	1,182,840	1,155,381
Less: allowance for loan losses	(1,527)	(917)
Net loans	1,181,313	1,154,464
Accrued interest receivable	14,100	12,491
Investment in and receivable from the Bank:		
Capital stock	19,400	19,400
Other	4,111	1,927
Other property owned, net	968	92
Premises and equipment	1,773	1,684
Other assets	869	266
Total assets	\$ 1,222,568	\$ 1,190,704
<b><u>LIABILITIES</u></b>		
Note payable to the Bank	\$ 1,044,023	\$ 1,016,383
Advance conditional payments	30	220
Accrued interest payable	2,681	3,173
Drafts outstanding	348	197
Dividends Payable	5	5,430
Other liabilities	4,001	5,125
Total liabilities	1,051,088	1,030,528
<b><u>MEMBERS' EQUITY</u></b>		
Capital stock and participation certificates	4,811	4,752
Unallocated retained earnings	166,531	155,237
Accumulated other comprehensive income (loss)	138	187
Total members' equity	171,480	160,176
Total liabilities and members' equity	\$ 1,222,568	\$ 1,190,704

**LONE STAR, ACA**

**CONSOLIDATED STATEMENT OF INCOME**

(dollars in thousands)

(unaudited)

	Quarter Ended	
	June 30,	
	2009	2008
<b><u>INTEREST INCOME</u></b>		
Loans	\$ 16,445	\$ 17,374
Total interest income	16,445	17,374
<b><u>INTEREST EXPENSE</u></b>		
Note payable to the Bank	8,131	9,829
Total interest expense	8,131	9,829
Net interest income	8,314	7,545
<b><u>PROVISION FOR LOSSES</u></b>		
Provision (negative provision) for loan losses	996	(218)
Provision for acquired property losses	17	-
Net interest income after provision for loan losses	7,301	7,763
<b><u>NONINTEREST INCOME</u></b>		
Income from the bank:		
Patronage income	542	538
Loan fees	737	913
Financially related services income	35	16
Gain (loss) on other property owned, net	(1)	1
Gain (loss) on sale of premises and equipment, net	9	-
Total noninterest income	1,322	1,468
<b><u>NONINTEREST EXPENSES</u></b>		
Salaries and employee benefits	1,630	1,315
Directors' expense	86	120
Purchased services	229	231
Travel	118	105
Occupancy and equipment	185	154
Communications	45	46
Advertising	50	88
Public and member relations	126	90
Supervisory and exam expense	82	151
Insurance Fund premiums	502	404
Other noninterest expense	197	193
Total noninterest expenses	3,250	2,897
Income before income taxes	5,373	6,334
Net income	\$ 5,373	\$ 6,334

LONE STAR, ACA

CONSOLIDATED STATEMENT OF CHANGES IN MEMBERS' EQUITY

(dollars in thousands)

(unaudited)

	Capital Stock/ Participation Certificates	Retained Earnings		Accumulated Other Comprehensive Income (Loss)	Total Members' Equity
		Allocated	Unallocated		
Balance at December 31, 2007	\$ 4,667	\$ -	\$ 136,800	\$ 434	\$ 141,901
Net income	-	-	12,279	(71)	12,208
Capital stock/participation certificates issued	253	-	-	-	253
Capital stock/participation certificates and allocated retained earnings retired	(202)	-	-	-	(202)
<b>Balance at June 30, 2008</b>	<b>\$ 4,718</b>	<b>\$ -</b>	<b>\$ 149,079</b>	<b>\$ 363</b>	<b>\$ 154,160</b>
Balance at December 31, 2008	\$ 4,752	\$ -	\$ 155,237	\$ 187	\$ 160,176
Net income	-	-	11,295	-	11,295
Amortization of costs included in periodic retirement benefit costs	-	-	-	(50)	(50)
Total comprehensive income	-	-	11,295	(50)	11,245
Capital stock/participation certificates issued	327	-	-	-	327
Capital stock/participation certificates and allocated retained earnings retired	(269)	-	-	-	(269)
Other	1	-	(1)	1	1
<b>Balance at June 30, 2009</b>	<b>\$ 4,811</b>	<b>\$ -</b>	<b>\$ 166,531</b>	<b>\$ 138</b>	<b>\$ 171,480</b>

**LONE STAR, ACA**  
**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**  
(UNAUDITED)

**NOTE 1 — ORGANIZATION AND SIGNIFICANT ACCOUNTING POLICIES:**

The Lone Star, ACA (Agricultural Credit Association), referred to as the Association, is a member-owned cooperative that provides credit and credit-related services to or for the benefit of eligible borrowers/stockholders for qualified agricultural purposes. The Association serves the counties of Hood, Johnson, Somervell, Tarrant, Denton, Wise, Dallas, Bowie, Camp, Cass, Morris, Titus, Delta, Lamar, Red River, Cooke, Fannin, Grayson, Eastland, Erath, Palo Pinto, Parker, Shackelford, Stephens, Throckmorton, Young, Borden, Fisher, Kent, Mitchell, Nolan, Scurry and Taylor in the State of Texas. The Association is a lending institution of the Farm Credit System (the System), which was established by Acts of Congress to meet the needs of American agriculture.

Effective January 1, 2009, the Association adopted Financial Accounting Standards Board (FASB) Staff Position No. 157-2, “Effective Date of FASB Statement No. 157” (FSP 157-2). This FSP delayed the effective date of Statement of Financial Accounting Standard (SFAS) No. 157, “Fair Value Measurements” (SFAS 157) for nonfinancial assets and nonfinancial liabilities to fiscal years beginning after November 15, 2008. The impact of adoption resulted in additional fair value disclosures but does not have an impact on the Association’s financial condition or results of operations.

In May 2009, the FASB issued SFAS No. 165, “Subsequent Events,” which sets forth general standards of accounting for and disclosures of events that occur after the balance sheet date but before financial statements are issued or are available to be issued. Recognized subsequent events should be recognized in the financial statements since the condition existed at the date of the balance sheet. Nonrecognized subsequent events are not recognized in the financial statements since the conditions arose after the balance sheet date but before the financial statements are issued or are available to be issued. This Standard, which includes a required disclosure of the date through which an entity has evaluated subsequent events, is effective for interim or annual periods ending after June 15, 2009. See Note 5 for the date through which subsequent events were evaluated by the Association.

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, except for the inclusion of a statement of cash flows. Generally accepted accounting principles require a business enterprise that provides a set of financial statements reporting both financial position and results of operations to also provide a statement of cash flows for each period for which results of operations are provided. In regulations issued by FCA, associations have the option to exclude statements of cash flows in interim financial statements. Therefore, the Association has elected not to include a statement of cash flows in these consolidated financial statements.

The consolidated financial statements comprise the operations of the ACA and its wholly-owned subsidiaries. The preparation of these consolidated financial statements requires the use of management’s estimates. The results for the quarter and the six months ended June 30, 2009, are not necessarily indicative of the results to be expected for the year ended December 31, 2009. Certain amounts in the prior period’s financial statements have been reclassified to conform to current financial statement presentation.

## NOTE 2 — ALLOWANCE FOR LOAN LOSSES:

The loan portfolio is comprised of long-term real estate mortgages which generally have maturities ranging up to 40 years. Short-term and intermediate-term production and equipment loans have maturities of 10 years or less. Loans are carried at their principal amount outstanding less unearned income. Interest on loans is accrued and credited to interest income based upon the daily principal amount outstanding.

The amount of collateral obtained, if deemed necessary upon extension of credit, is based on management's credit evaluation of the borrower. Collateral held varies, but typically includes farmland and income-producing property, such as crops and livestock, as well as receivables. Long-term real estate loans are secured by the first liens on the underlying real property. Federal regulations state that long-term real estate loans are not to exceed 85 percent (or 97 percent if guaranteed by a government agency) of the property's appraised value. However, a decline in a property's market value subsequent to loan origination or advances, or other actions necessary to protect the financial interest of the Association in the collateral, may result in the loan-to-value ratios in excess of the regulatory maximum.

The major commodity concentrations within the Association's loan volume are timber, cattle, dairies, and field crops.

The Association has obtained loan guarantees in the form of standby commitments to purchase qualifying loans from the Federal Agricultural Mortgage Corporation through an arrangement with the Bank. At June 30, 2009 and December 31, 2008, loans totaling \$65,642 and \$70,848, respectively, were guaranteed by the commitments. Fees paid for these guarantees totaled \$134 as of June 30, 2009, and \$302 as of December 31, 2008, and are reflected in "other noninterest expense."

Impaired loans are loans for which it is probable that not all principal and interest will be collected according to the contractual terms. The following table presents information concerning impaired loans:

	<b>June 30, 2009</b>	<b>June 30, 2008</b>
Impaired loans with related allowance	\$ 10,962	\$ 810
Impaired loans with no related allowance	8,244	1,066
Total impaired loans	<u>\$ 19,206</u>	<u>\$ 1,876</u>
Allowance on impaired loans	\$ 183	\$ 60
Average impaired loans	\$ 17,363	\$ 1,886
Interest income on impaired loans for the quarter	\$ 29	\$ 34

There were no commitments to lend additional funds to debtors whose loans were classified as impaired at June 30, 2009.

The allowance for loan losses is maintained at a level considered adequate by management to provide for estimated losses inherent in the loan portfolio. The allowance is based on a periodic evaluation of the loan portfolio by management in which numerous factors are considered, including economic conditions, loan portfolio composition and prior loan loss experience. An analysis of the allowance for loan losses follows:

	<b>June 30, 2009</b>	<b>June 30, 2008</b>
Balance at beginning of quarter	\$ 1,179	\$ 1,040
Provision for loan losses	996	(218)
Charge-offs	(653)	(46)
Recoveries	5	1
Balance at end of quarter	<u>\$ 1,527</u>	<u>\$ 777</u>

### NOTE 3 — CAPITAL:

The Association's board of directors has established a Capital Adequacy Plan (Plan) that includes the capital targets that are necessary to achieve the institution's capital adequacy goals as well as the minimum permanent capital standards. The Plan monitors projected dividends, equity retirements and other actions that may decrease the Association's permanent capital. In addition to factors that must be considered in meeting the minimum standards, the board of directors also monitors the following factors: capability of management; quality of operating policies, procedures, and internal controls; quality and quantity of earnings; asset quality and the adequacy of the allowance for losses to absorb potential loss within the loan and lease portfolios; sufficiency of liquid funds; needs of an institution's customer base; and any other risk-oriented activities, such as funding and interest rate risk, potential obligations under joint and several liability, contingent and off-balance-sheet liabilities or other conditions warranting additional capital. At least quarterly, management reviews the Association's goals and objectives with the board.

### NOTE 4 — EMPLOYEE BENEFIT PLANS:

The following table summarizes the components of net periodic benefit costs for the six months ended June 30:

	Other Benefits	
	2009	2008
Service cost	\$ 28	\$ 24
Interest cost	51	46
Amortization of prior service costs	(71)	(71)
Amortizations of net (gain) loss	22	1
Net periodic benefit cost	<u>\$ 30</u>	<u>\$ -</u>

In September 2006, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 158 "Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans" (SFAS 158), which required the recognition of the overfunded or underfunded status of pension and other postretirement benefit plans on the balance sheet. The balance sheet recognition provisions of SFAS 158 were adopted at December 31, 2007. SFAS 158 also requires that employers measure the benefit obligation and plan assets as of the fiscal year end for fiscal years ending after December 15, 2008. In fiscal 2007 and earlier, we used a September 30 measurement date for pension and other postretirement benefit plans. The Standard provides two approaches for an employer to transition to a fiscal year end measurement date. We have applied the second approach, which allows for the use of the measurements determined for the prior year end.

The Association previously disclosed in its financial statements for the year ended December 31, 2008, that it expected to contribute \$54 to its defined pension plan in 2009. As of June 30, 2009, \$23 of contributions have been made.

**Note 5 – SUBSEQUENT EVENTS:**

The Association has evaluated subsequent events through July 28, 2009, which is the date the financial statements were available to be issued.