

# SECOND QUARTER 2008

Management's Discussion and Analysis of  
Financial Condition and Results of Operations..... 2

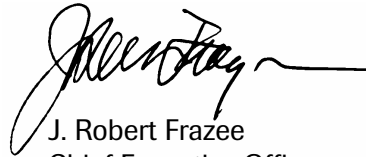
Consolidated Financial Statements

Consolidated Balance Sheets..... 4

Consolidated Statements of Income..... 5

Consolidated Statements of Changes in Members' Equity..... 6

Notes to the Consolidated Financial Statements..... 7



J. Robert Frazee  
Chief Executive Officer



John E. Wheeler, Jr.  
Chief Financial Officer



Fred Moore, Jr.  
Chairman of the Board

July 28, 2008

# 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 MidAtlantic Farm Credit, ACA (Association) for the period ended June 30, 2008. The comments contained in this report should be read in conjunction with the accompanying consolidated financial statements, notes to the consolidated financial statements and the 2007 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 the financing of short- and intermediate-term loans and long-term real estate mortgage loans. The Association's loan portfolio encompasses a well diversified range of agricultural commodities, with cash grains, poultry and dairy representing the largest segments. In addition, the Association provides a significant amount of loans to lessors of agricultural real estate. Farm size varies and many of the borrowers in the region have diversified farming operations. This factor, along with the opportunities for non-farm income, impacts the level of dependency on any particular commodity.

Gross loans at June 30, 2008 totaled \$1,941,831 compared to \$1,822,845 at December 31, 2007, increasing \$118,986 or 6.53 percent during the first six months. The Association's allowance for loan losses of \$12,251 increased \$1,249 or 11.35 percent during the first six months of 2008 resulting in net loans (gross loans less allowance for loan losses) of \$1,929,580 and \$1,811,843 at June 30, 2008 and December 31, 2007, respectively. Nonaccrual loans decreased \$1,140 or 6.72 percent from \$16,973 at December 31, 2007 to \$15,833 at June 30, 2008 resulting in a favorable decrease in the ratio of Nonaccrual loans to total loans from .93 percent to .82 percent.

There is an inherent risk in the extension of any type of credit and, accordingly, the Association maintains an allowance for loan losses consistent with the risk measured in the portfolio. Credit administration remains satisfactory and the credit quality of the Association's loan portfolio has remained strong. A provision for loan losses of \$500 and \$700 was recorded in the first and second quarters of 2008, respectively, that increased the Association's allowance \$1,249 as of June 30, 2008, after giving effect to the recovery of several loans previously written-off. The allowance for loan losses represented .63 percent and .60 percent of total loans at June 30, 2008 and December 31, 2007, respectively.

## **RESULTS OF OPERATIONS**

### ***For the three months ended June 30, 2008***

Net income for the three months ended June 30, 2008 totaled \$9,645, a decrease of \$716 or 6.91 percent compared to the three months ended June 30, 2007. Major changes in the components of net income are identified as follows:

- Net interest income increased \$582 (4.81 percent) for the quarter ended June 30, 2008 compared to the same period in 2007. The increase in net interest income is primarily attributable to incremental earnings on an increasing loan portfolio as loan volume increased \$178 million or 10.07 percent from June 30, 2007 and net of a slightly increased portfolio margin attributable to the decrease in interest rates which occurred over the past year.
- The risks identified in the Association's loan portfolio required a provision for loan losses of \$700 to be recorded in the second quarter of 2008 whereas no provision was recorded in the second quarter of 2007.
- At June 30, 2008 and 2007, the Association accrued an estimated patronage receipt (reported as "Equity in earnings of other Farm Credit institutions" on the Consolidated Statements of Income) of \$3,137 and \$2,926, respectively, which is based on second quarter operations only; management anticipates additional income for each successive quarter in 2008. Since this income from AgFirst Farm Credit Bank (the Bank) is reasonably estimable and because there is a history of these earnings, management is of the opinion that including this income in quarterly operations provides shareholders with a more accurate forecast of annualized net income. Noninterest Income in the second quarter 2007 included an insurance related refund; a similar refund was recorded in the first quarter of 2008.
- Noninterest Expense for the second quarter of 2008 was \$6,076 as compared to \$5,773 for the second quarter of 2007 or an increase of \$303 (5.25 percent). The \$119 (3.36 percent) increase in Salaries and employee benefits for the second quarter of 2008 as compared to the same period in 2007 reflects the normal annual inflation impact of salary and benefit increases. The \$54 Insurance Fund premium increase is directly attributable to the

insurance premium for loans as determined by the Farm Credit System Insurance Corporation (FCSIC) for 2008. Occupancy and equipment and other operating expenses increased \$203 principally attributable to director, technology and travel and training related expenses. There was a \$73 net loss on other property owned in the second quarter of 2007.

### **For the six months ended June 30, 2008**

Net income for the six months ended June 30, 2008 totaled \$19,672 or \$537 (2.67 percent) less than the six months ended June 30, 2007. Year-to-date operations for the Association simulated second quarter operations. Major changes in the components of net income are identified as follows:

- The increase in Net interest income of \$1,352 (5.62 percent) is primarily attributable to a \$.8 million favorable increase in volume and a \$1.1 million favorable increase in Net margin, which was partially offset by a \$.3 million decrease in interest income from nonaccrual loans and a \$.4 million decrease in earnings credit on the Association's equity due to lower short-term interest rates.
- The risks identified in the Association's loan portfolio required a provision for loan losses of \$1,200 to be recorded in the first six months of 2008 whereas no provision was recorded in the first half of 2007.
- At the period ended June 30, 2008, the Association has accrued an estimated patronage receipt of \$6,157 as compared to \$5,742 at June 30, 2007. This accrual is based on the first half of the year's operations, and management anticipates additional income for each successive quarter throughout the year. Since the patronage income from the Bank is reasonably estimable and because there is a history of these earnings, management is of the opinion that including this income in quarterly operations provides shareholders with a more accurate forecast of annualized net income.
- Noninterest expense increased \$695 or 6.25 percent for the first six months of 2008 as compared to 2007. The year-to-date increase for Salaries and employee benefits of \$376 (5.48 percent) principally reflects normal inflationary increases. The Occupancy and equipment and Other operating expenses net increase of \$293 is due to increased directors, training, travel, technology and advertising expenses. The Insurance Fund premium increase is directly related to the portfolio volume increase as premium percentage costs have remained unchanged. There was a \$73 net loss on other property owned in the first half of 2007.

### **FUNDING SOURCES**

The principal source of funds for the Association is the borrowing relationship established with the Bank through a General Financing Agreement (GFA). The GFA 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 the funds to the Association in the form of notes payable. The notes payable are

segmented into variable rate and fixed rate sectors. The Association utilizes the variable rate note 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 June 30, 2008 were \$1,637,009 compared to \$1,520,171 at December 31, 2007. This increase during the period of \$116,838 or 7.69 percent corresponds to the augmentation in the Association's loan volume, receipt of prior year Bank patronage, offset by current year net cash generated from operating activities and patronage payments.

### **CAPITAL RESOURCES**

Members' equity at June 30, 2008 totaled \$328,536 an increase of \$13,098 (4.15 percent) compared to total members' equity of \$315,438 at December 31, 2007. Net income of \$19,672 for the six months ended June 30, 2008 offset by net member capital stock/participation certificates retired of \$40, an estimated cash patronage distribution accrual for the first six months of 2008 totaling \$6,000, patronage distribution adjustment of \$524 and miscellaneous adjustments totaling \$10 account for the change.

FCA regulations require that all Farm Credit institutions maintain a minimum permanent capital ratio of 7.0 percent and total surplus and core surplus ratios equal to 3.5 percent. 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. At June 30, 2008, the Association's permanent capital, total surplus and core surplus ratios equaled 15.12 percent, 14.97 percent and 12.50 percent, respectively.

**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 1-800-333-7950, or writing John E. Wheeler, Jr., Chief Financial Officer, MidAtlantic Farm Credit, ACA, P.O. Box 770, Westminster, MD 21158-0770, or accessing the website, [www.mafc.com](http://www.mafc.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.

*MidAtlantic Farm Credit, ACA*  
**Consolidated Balance Sheets**

<i>(dollars in thousands)</i>	<b>June 30, 2008</b> <i>(unaudited)</i>	<b>December 31, 2007</b> <i>(audited)</i>
<b>Assets</b>		
Cash	\$ 2,403	\$ 4,402
Loans	1,941,831	1,822,845
Less: allowance for loan losses	12,251	11,002
Net loans	1,929,580	1,811,843
Accrued interest receivable	16,123	13,313
Investment in other Farm Credit institutions	25,483	25,400
Premises and equipment, net	7,532	7,589
Other property owned	—	100
Due from AgFirst Farm Credit Bank	6,156	13,668
Other assets	8,210	8,853
Total assets	<u>\$ 1,995,487</u>	<u>\$ 1,885,168</u>
<b>Liabilities</b>		
Notes payable to AgFirst Farm Credit Bank	\$ 1,637,009	\$ 1,520,171
Accrued interest payable	6,327	7,163
Patronage refund payable	6,016	11,726
Allocated surplus payable	40	11,975
Other liabilities	17,559	18,695
Total liabilities	<u>1,666,951</u>	<u>1,569,730</u>
Commitments and contingencies		
<b>Members' Equity</b>		
Capital stock and participation certificates	7,616	7,656
Retained earnings		
Allocated	143,631	143,316
Unallocated	177,710	164,909
Accumulated other comprehensive income (loss)	(421)	(443)
Total members' equity	<u>328,536</u>	<u>315,438</u>
Total liabilities and members' equity	<u>\$ 1,995,487</u>	<u>\$ 1,885,168</u>

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

*MidAtlantic Farm Credit, ACA*

# Consolidated Statements of Income

*(unaudited)*

<i>(dollars in thousands)</i>	For the three months ended June 30,		For the six months ended June 30,	
	2008	2007	2008	2007
<b>Interest Income</b>				
Loans	\$ 31,517	\$ 33,248	\$ 64,374	\$ 65,586
<b>Interest Expense</b>				
Notes payable to AgFirst Farm Credit Bank	18,824	21,137	38,974	41,538
Net interest income	12,693	12,111	25,400	24,048
Provision for (reversal of allowance for) loan losses	700	—	1,200	—
Net interest income after provision for (reversal of allowance for) loan losses	11,993	12,111	24,200	24,048
<b>Noninterest Income</b>				
Loan fees	388	453	748	927
Fees for financially related services	55	191	104	213
Equity in earnings of other Farm Credit institutions	3,137	2,926	6,157	5,742
Gains (losses) on other property owned, net	—	(73)	4	(73)
Gains (losses) on sale of rural home loans, net	158	14	195	25
Other noninterest income	26	230	157	247
Total noninterest income	3,764	3,741	7,365	7,081
<b>Noninterest Expense</b>				
Salaries and employee benefits	3,664	3,545	7,235	6,859
Occupancy and equipment	455	514	882	951
Insurance Fund premium	698	644	1,368	1,269
Other operating expenses	1,259	997	2,331	1,969
Total noninterest expense	6,076	5,700	11,816	11,048
Income before income taxes	9,681	10,152	19,749	20,081
Provision (benefit) for income taxes	36	(209)	77	(128)
Net income	\$ 9,645	\$ 10,361	\$ 19,672	\$ 20,209

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

*MidAtlantic Farm Credit, ACA*

# Consolidated Statements of Changes in Members' Equity

*(unaudited)*

*(dollars in thousands)*

	Capital Stock and Participation Certificates	Retained Earnings		Accumulated Other Comprehensive Income	Total Members' Equity
		Allocated	Unallocated		
Balance at December 31, 2006	\$ 9,290	\$ 130,402	\$ 160,702	\$ —	\$ 300,394
Net income			20,209		20,209
Capital stock/participation certificates issued/(retired), net	108				108
Patronage distribution					
Cash			(4,254)		(4,254)
Retained earnings retired		(564)	9		(555)
Patronage distribution adjustment		(158)	(538)		(696)
Balance at June 30, 2007	\$ 9,398	\$ 129,680	\$ 176,128	\$ —	\$ 315,206
Balance at December 31, 2007	\$ 7,656	\$ 143,316	\$ 164,909	\$ (443)	\$ 315,438
Net income			19,672		19,672
Capital stock/participation certificates issued/(retired), net	(40)				(40)
Patronage distribution					
Cash			(6,000)		(6,000)
Retained earnings retired		(6)			(6)
Patronage distribution adjustment		321	(845)		(524)
Employee benefit plans adjustments			(26)	22	(4)
Balance at June 30, 2008	\$ 7,616	\$ 143,631	\$ 177,710	\$ (421)	\$ 328,536

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

## MidAtlantic Farm Credit, ACA

# Notes to the Consolidated Financial Statements

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

### NOTE 1 – ORGANIZATION AND SIGNIFICANT ACCOUNTING POLICIES

The accompanying financial statements include the accounts of MidAtlantic Farm Credit, 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, 2007, are contained in the 2007 Annual Report to Shareholders. These unaudited second quarter 2008 consolidated financial statements should be read in conjunction with the 2007 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 accounting principles generally accepted in the United States of America (GAAP) and prevailing practices within the banking industry. The results for the six months ended June 30, 2008, are not necessarily indicative of the results to be expected for the year ending December 31, 2008.

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 Association's allowance methodology requires that the loan portfolio is reviewed quarterly to determine the adequacy of the allowance for losses. As of June 30, 2008, the allowance for losses is adequate in management's opinion to provide for possible losses on existing loans.

In December 2007, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 141R, "Business Combinations" (SFAS 141R). SFAS 141R requires business combinations to be accounted for under the acquisition method of accounting (previously called the purchase method). The acquisition method requires (a) identifying the acquirer, (b) determining the acquisition date, (c) recognizing and measuring the identifiable assets acquired, the liabilities assumed, and any noncontrolling interest in the acquiree, at their acquisition date fair values, and (d) recognizing and measuring goodwill

or a gain from a bargain purchase. SFAS 141R should be applied prospectively to business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after December 15, 2008. Early application is prohibited. The Association is still evaluating the provisions of SFAS 141R, but believes that its adoption could significantly impact its accounting for combinations/acquisitions that may occur in 2009 and beyond.

### NOTE 2 – ALLOWANCE FOR LOAN LOSSES

An analysis of the allowance for loan losses follows:

	For the six months ended June 30,	
	2008	2007
Balance at beginning of period	\$11,002	\$ 8,878
Provision for loan losses	1,200	–
Loans (charged off), net of recoveries	49	119
Balance at end of period	<u>\$12,251</u>	<u>\$ 8,997</u>

### 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 defined contribution thrift and other postretirement benefit plans.

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

	For the six months ended June 30,	
	2008	2007
Pension	\$ 447	\$ 650
Thrift/deferred compensation	184	155
Other postretirement benefits	294	248
Total	<u>\$ 925</u>	<u>\$ 1,053</u>

As of June 30, 2008, no contributions have been made to the pension plan for 2008. The Association projects making additional contributions for the remainder of 2008 of approximately \$1.4 million.

---

Market conditions could impact discount rates and return on plan assets which could change the above contribution projections by making additional contributions necessary before the next plan measurement date.

In September 2006, the Financial Accounting Standards Board (FASB) 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 by the Association.

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, a September 30 measurement date was used for pension and other postretirement benefit plans. The Standard provides two approaches for an employer to transition to a fiscal year end measurement date. The approach applied by the Association allows for the use of the measurements determined for the prior year end. Under this alternative, pension and other postretirement benefit expense measured for the three-month period October 1, 2007 to December 31, 2007 (determined using the September 30, 2007 measurement date) is reflected as an adjustment to beginning 2008 unallocated retained earnings. As a result, the Association decreased unallocated retained earnings and increased the pension liability by \$26.

Upon adoption, SFAS 158 further required the determination of the fair value of plan assets and recognition of actuarial gains and losses, prior service costs or credits, and transition assets or obligations as a component of accumulated other comprehensive income (AOCI). These amounts are subsequently recognized as components of net periodic benefit costs over time. For the first six months of 2008, \$22 has been recognized as a credit to AOCI and a debit to pension expense to reflect the amortization of the components previously recognized in AOCI.

Further details regarding employee benefit plans and adoption of SFAS 158 are contained in the 2007 Annual Report to Shareholders.