

# **SECOND QUARTER 2007**

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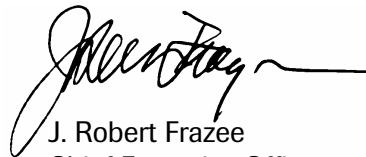
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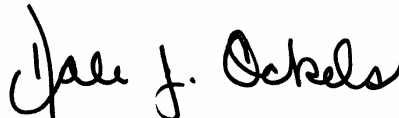
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J. Robert Frazee  
Chief Executive Officer



Dale J. Ockels  
Chairman of the Board

July 27, 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 MidAtlantic Farm Credit, ACA (Association) for the period ended June 30, 2007. 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 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 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, 2007 totaled \$1,764,245 compared to \$1,720,107 at December 31, 2006, increasing \$44,138 or 2.6 percent during the first six months. The Association's allowance for loan losses of \$8,997 increased \$119 or 1.3 percent during the first half of 2007 resulting in net loans (gross loans less allowance for loan losses) of \$1,755,248 and \$1,711,229 at June 30, 2007 and December 31, 2006, respectively.

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 continued to improve. Consequently, no provision for loan losses was recorded in the first half of 2007 that would increase the Association's allowance. The allowance for loan losses represented 0.50 percent and 0.52 percent of total loans at June 30, 2007 and December 31, 2006, respectively.

## **RESULTS OF OPERATIONS**

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

Net income for the three months ended June 30, 2007 totaled \$10,361, an increase of \$794 or 8.3 percent compared to the three months ended June 30, 2006. Major changes in the components of net income are identified as follows:

- Net interest income increased \$575 (5.0 percent) for the quarter ended June 30, 2007 compared to the same period in 2006. Earnings on the Association's loanable funds credit (investable funds) increased \$319 over last year due primarily to management's strategy of investing these funds in higher yielding notes on a portion of the funds, the increase in short-term interest rates which favorably impacts the earnings on the variable rate investments, as well as an increase in investable funds. The remaining increase in net interest income is primarily attributable to a \$186 increase in the recognition of interest income from nonaccrual loans and incremental earnings on an increasing loan portfolio net of a slightly reduced portfolio margin generally attributable to the increase in interest rates and a competitive marketplace.
- The risks identified in the Association's loan portfolio did not warrant a provision for loan losses to be recorded in either the second quarter of 2007 or 2006.
- At June 30, 2007 and 2006, the Association accrued an estimated patronage receipt (reported as "Equity in earnings of other Farm Credit institutions" on the Consolidated Statements of Income) of \$2,926 and \$2,726, respectively, which is based on second quarter operations only; management anticipates additional income for each successive quarter throughout the year. 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 for the second quarter of 2007 as compared to the same period in 2006 included increased crop insurance related income, late fee income, letter of credit fees, unused commitment fees and interest income on income tax settlements.
- Noninterest Expense for the second quarter of 2007 was \$5,773 as compared to \$5,239 for the second quarter of 2006 or an increase of \$534 (10.2 percent). The \$386 increase in Salaries and employee benefits for the second quarter of 2007 as compared to the same period in 2006 results primarily from an accrual for incentive based compensation in 2007 while no accrual for the same program was made in 2006, plus the normal annual inflation impact of salary and benefit increases. The \$121 increase in Occupancy and equipment is due primarily to a temporary office rental during a branch renovation, one additional branch location, expenses and depreciation associated with the branch renovations, and an increase in utility expenses. The \$73 decrease in Other operating expenses is primarily timing related and expected to be expended in the second half of 2007. Losses on other property owned, net relates to the sale of the Other property owned assets carried on the balance sheet since December 31, 2006.

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### **For the six months ended June 30, 2007**

Net income for the six months ended June 30, 2007 totaled \$20,209 or \$995 (5.2 percent) more than the six months ended June 30, 2006. 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 \$1,198 (5.2 percent) is attributable to an \$808 increase in the Association's earnings on the loanable funds credit (investable funds) due to management's strategy of investing in higher yielding notes on a portion of the funds and the steady increase in interest rates which favorably impacts the earnings on the variable rate investments, as well as an increase in investable funds. The remaining increase in net interest income is principally attributable to a \$214 increase in the recognition of interest income from nonaccrual loans and the increase in loan portfolio volume which was slightly offset by a decrease in portfolio yield attributable to the increase in interest rates and keen competition in the Association's marketplace.
- At the period ended June 30, 2007, the Association has accrued an estimated patronage receipt of \$5,742 as compared to \$5,404 at June 30, 2006. 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.
- Additional Other noninterest income was earned by the Association in 2006 related to the sale of an office building. Proceeds from the Association's property sales have been redeployed in updating and modernizing Association office facilities. No additional office building sales or major renovations are currently planned.
- Noninterest expense increased \$811 or 7.9 percent for the first six months of 2007 as compared to 2006. The year-to-date variance for Salaries and employee benefits was previously discussed. The Occupancy and equipment increase of \$202 is due to increased maintenance costs, utilities, depreciation and rental of a temporary branch office during renovation. The Insurance Fund premium increase is directly related to the portfolio volume increase as premium percentage costs have remained unchanged.

### **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 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, 2007 were \$1,479,071 compared to \$1,444,186 at December 31, 2006. This increase during the period of \$34,885 or 2.4 percent corresponds to the augmentation in the Association's loan volume, receipt of prior year Bank patronage, offset by net cash generated from operating activities and patronage payments.

### **CAPITAL RESOURCES**

Members' equity at June 30, 2007 totaled \$315,206 an increase of \$14,812 (4.9 percent) compared to total members' equity of \$300,394 at December 31, 2006. Net income of \$20,209 for the six months ending June 30, 2007 and net member stock issues of \$108, offset by an estimated cash patronage distribution for the first half of 2007 totaling \$4,254 and miscellaneous adjustments totaling \$1,251 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, 2007, the Association's permanent capital, total surplus and core surplus ratios equaled 15.62 percent, 15.11 percent and 13.02 percent, respectively.

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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 1-800-333-7950, 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 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.

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

<i>(dollars in thousands)</i>	<b>June 30, 2007</b>	<b>December 31, 2006</b>
	<i>(unaudited)</i>	<i>(audited)</i>
<b>Assets</b>		
Cash	\$ 3,244	\$ 8,077
Loans	1,764,245	1,720,107
Less: allowance for loan losses	8,997	8,878
Net loans	1,755,248	1,711,229
Accrued interest receivable	17,213	13,888
Investment in other Farm Credit institutions	24,439	24,424
Premises and equipment, net	7,670	6,993
Other property owned	38	769
Prepaid retirement expense	7,456	8,102
Due from AgFirst Farm Credit Bank	5,679	13,198
Other assets	1,354	1,007
Total assets	<u>\$ 1,822,341</u>	<u>\$ 1,787,687</u>
<b>Liabilities</b>		
Notes payable to AgFirst Farm Credit Bank	\$ 1,479,071	\$ 1,444,186
Accrued interest payable	7,075	6,669
Patronage refund payable	4,271	7,947
Allocated surplus payable	45	8,748
Postretirement benefits other than pensions	8,165	8,082
Other liabilities	8,508	11,661
Total liabilities	<u>1,507,135</u>	<u>1,487,293</u>
Commitments and contingencies		
<b>Members' Equity</b>		
Capital stock and participation certificates	9,398	9,290
Retained earnings		
Allocated	129,680	130,402
Unallocated	176,128	160,702
Total members' equity	<u>315,206</u>	<u>300,394</u>
Total liabilities and members' equity	<u>\$ 1,822,341</u>	<u>\$ 1,787,687</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,	
	2007	2006	2007	2006
<b>Interest Income</b>				
Loans	\$ 33,248	\$ 30,483	\$ 65,586	\$ 59,527
<b>Interest Expense</b>				
Notes payable to AgFirst Farm Credit Bank	21,137	18,947	41,538	36,677
Net interest income	12,111	11,536	24,048	22,850
Provision for (reversal of allowance for) loan losses	—	—	—	—
Net interest income after provision for (reversal of allowance for) loan losses	12,111	11,536	24,048	22,850
<b>Noninterest Income</b>				
Loan fees	453	406	927	852
Fees for financially related services	191	110	213	126
Equity in earnings of other Farm Credit institutions	2,926	2,726	5,742	5,404
Other noninterest income	244	28	272	399
Total noninterest income	3,814	3,270	7,154	6,781
<b>Noninterest Expense</b>				
Salaries and employee benefits	3,545	3,159	6,859	6,329
Occupancy and equipment	514	393	951	749
Insurance Fund premium	644	616	1,269	1,212
Other operating expenses	997	1,071	1,969	2,020
Losses on other property owned, net	73	—	73	—
Total noninterest expense	5,773	5,239	11,121	10,310
Income before income taxes	10,152	9,567	20,081	19,321
Provision (benefit) for income taxes	(209)	—	(128)	107
Net income	\$ 10,361	\$ 9,567	\$ 20,209	\$ 19,214

*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		Total Members' Equity
		Allocated	Unallocated	
Balance at December 31, 2005	\$ 9,093	\$ 110,441	\$ 161,870	\$ 281,404
Net income			19,214	19,214
Capital stock/participation certificates issued	329			329
Capital stock/participation certificates retired	(203)			(203)
Patronage distribution				
Cash			(4,035)	(4,035)
Retained earnings retired		(13)		(13)
Distribution adjustment		(70)	(278)	(348)
Balance at June 30, 2006	\$ 9,219	\$ 110,358	\$ 176,771	\$ 296,348
Balance at December 31, 2006	\$ 9,290	\$ 130,402	\$ 160,702	\$ 300,394
Net income			20,209	20,209
Capital stock/participation certificates issued	346			346
Capital stock/participation certificates retired	(238)			(238)
Patronage distribution				
Cash			(4,254)	(4,254)
Retained earnings retired, net of discount		(564)	9	(555)
Distribution adjustment		(158)	(538)	(696)
Balance at June 30, 2007	\$ 9,398	\$ 129,680	\$ 176,128	\$ 315,206

*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

A description of the organization and operations of MidAtlantic 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, 2006, are contained in the 2006 Annual Report to Shareholders. These unaudited second 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" (SFAS 158). SFAS 158 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 through comprehensive income changes in that funded status in the year in which the changes occur. The Bank and related associations will be required to implement SFAS 158 for the year ended December 31, 2007. In addition, SFAS 158 requires that the funded status of a plan be measured as of the date of the year-end financial statements. Currently, the Bank and related associations use 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 Bank and related associations are currently evaluating the impact of implementing SFAS 158.

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). The results for the six months ended June 30, 2007, are not necessarily indicative of the results to be expected for the year ending December 31, 2007.

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, 2007, 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:

	For the six months ended June 30,	
	2007	2006
Balance at beginning of period	\$ 8,878	\$10,423
Provision for (reversal of) loan losses	—	—
Recoveries, net of loans charged off	119	1
Balance at end of period	<u>\$ 8,997</u>	<u>\$10,424</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 postretirement benefit expense:

	For the six months ended June 30,	
	2007	2006
Pension	\$ 650	\$ 788
Thrift/deferred compensation	155	136
Other postretirement benefits	248	296
Total	<u>\$ 1,053</u>	<u>\$ 1,220</u>

As of June 30, 2007, no contributions have been made to the pension plan for 2007. Actuarial projections as of the last plan measurement date (September 30, 2006) did not anticipate any contributions for 2007; however, market conditions could impact discount rates and return on plan assets which could change this expectation, making contributions necessary before the next plan measurement date.

The Association also sponsors supplemental retirement and deferred compensation plans for certain key employees. The expenses of these plans are included in the pension and deferred compensation costs above. The Association contributed \$6 to these plans during the first six months of 2007. The Association anticipates making additional contributions of \$6 to these supplemental retirement and deferred compensation plans during the remainder of 2007.