

# 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



David E. Lawrence  
Chief Executive Officer



Mary S. Miller  
Chief Financial Officer



Charles W. Kackley  
Chairman of the Board

August 5, 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 the consolidated operations of Valley Farm Credit ACA, Valley Farm Credit, FLCA and Valley Farm Credit, PCA (Association) for the period ended June 30, 2008. These comments 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 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 livestock, forage crops, poultry, beef, orchards, dairy and rural home loans. Those major farm commodities totaled approximately \$141,604 or 74.86% of the loan volume as of June 30, 2008. Farm size varies and many of the borrowers in the region have diversified farming operations. This factor, along with the numerous opportunities for non-farm income in the area, somewhat impacts the level of dependency on a given commodity.

The gross loan volume of the Association as of June 30, 2008 was \$184,000, an increase of \$9,410 as compared to \$174,590 at December 31, 2007. Net loans outstanding at June 30, 2008 were \$183,306 as compared to \$174,036 at December 31, 2007. Net loans accounted for 92.03 percent of total assets at June 30, 2008 as compared to 91.25 percent of total assets at December 31, 2007. The increase in gross and net loan volume during the reporting period is attributed primarily to a blend of new loans to several different sectors of the Association's agricultural and lifestyle portfolio, new participations purchased, and new loans to the residential portion of the portfolio.

There is an inherent risk in the extension of any type of credit. Portfolio credit quality continues to be maintained at an acceptable level, and credit administration remains satisfactory. Nonaccrual loans were \$956 at June 30, 2008 and \$35 at December 31, 2007. Association management maintains an allowance for loan losses in an amount sufficient to absorb losses inherent in the loan portfolio at the balance sheet date based on current conditions. The

allowance for loan losses was \$694 at June 30, 2008 and \$554 at December 31, 2007, and was considered by management to be adequate.

## **RESULTS OF OPERATIONS**

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

Net income for the three months ended June 30, 2008, totaled \$209, as compared to \$427 for the same period in 2007. Net interest income decreased \$44 for the three months ended June 30, 2008 as compared to the same period in 2007.

At June 30, 2008 interest income on loans decreased \$305 as compared to the same period in 2007. Nonaccrual income was \$4 for the three months ended June 30, 2008 and \$0 for the same period in 2007. Interest expense decreased \$261 for the three months ended June 30, 2008 as compared to the same period in 2007. There was a provision for loan losses of \$138 for the three months ended June 30, 2008 and no change in the allowance for loan losses for the three months ended June 30, 2007. Noninterest income for the three months ended June 30, 2008 totaled \$690 as compared to \$767 for the same period of 2007, a decrease of \$77. Noninterest expense for the three months ended June 30, 2008 decreased \$73 compared to the same period of 2007. There was no provision (benefit) for income taxes at June 30, 2008 as compared to a benefit for income taxes of \$32 during the three months ended June 30, 2007. The benefit for income taxes was a result of the receipt of a state tax refund.

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

Net income for the six months ended June 30, 2008, totaled \$662, as compared to \$843 for the same period in 2007. Net interest income decreased \$146 for the six months ended June 30, 2008 as compared to the same period in 2007.

At June 30, 2008 interest income on loans decreased \$542 as compared to the same period in 2007. Nonaccrual income was \$10 for the six months ended June 30, 2008 and \$0 for the same period in 2007. Interest expense decreased \$396 for the six months ended June 30, 2008 as compared to the same period in 2007. There was a provision for loan losses of \$138 for the three months ended June 30, 2008 and no change in the allowance for loan losses for the six months ended June 30, 2007. Noninterest income for the six months ended June 30, 2008 totaled \$1,438 as compared to \$1,506 for the same period in 2007, a decrease of \$68. Noninterest expense for the six months ended June 30, 2008 decreased \$203

compared to the same period in 2007. There was no provision (benefit) for income taxes at June 30, 2008 as compared to a benefit for income taxes of \$32 during the three months ended June 30, 2007. The benefit for income taxes was a result of the receipt of a state tax refund.

## FUNDING SOURCES

The principal source of funds for the Association is the borrowing relationship established with the *AgFirst Farm Credit Bank* (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 June 30, 2008 was \$169,732 as compared to \$161,298 at December 31, 2007. The increase during the period is primarily attributed to an increase in loan volume.

## CAPITAL RESOURCES

Total members' equity at June 30, 2008 increased to \$26,432 from the December 31, 2007 total of \$26,126. The rise in members' equity is attributed to the increase in retained earnings in excess of the reduction in capital stock and participation certificates.

Total capital stock and participation certificates were \$3,942 on June 30, 2008 compared to \$3,945 on December 31, 2006. This decrease is attributed to the retirement of stock and participation certificates on loans liquidated in the normal course of business in excess of stock purchases.

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 June 30, 2008, the Association's total surplus ratio and core surplus ratio were 11.13 percent and 10.57 percent, respectively, and the permanent capital ratio was 13.48 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.

## SIGNIFICANT EVENT

Following the June 30, 2008 retirement of Robert N. Carpenter, President and Chief Executive Officer, the Association and Farm Credit of the Virginias, ACA entered

into an agreement where David E. Lawrence would serve as Chief Executive Officer for the Association effective July 1, 2008, in addition to being Chief Executive Officer of Farm Credit of the Virginias, ACA.

## RECENTLY ISSUED ACCOUNTING PRONOUNCEMENTS

Please refer to Note 1, "Organization and Significant Accounting Policies", in the Notes to the Financial Statements, and the 2007 Annual Report of the Association for recently issued accounting pronouncements.

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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. 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 1-800-999-5341 or writing Mary S. Miller, Vice President and CFO, Valley Farm Credit, ACA, P.O. Box 2700, Winchester, Virginia 22604, or accessing the website, [www.valleyfc.com](http://www.valleyfc.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.

*Valley 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	\$ 356	\$ 243
Loans	184,000	174,590
Less: allowance for loan losses	694	554
Net loans	183,306	174,036
Accrued interest receivable	1,612	1,401
Investment in other Farm Credit institutions	3,982	3,957
Premises and equipment, net	7,859	8,075
Due from AgFirst Farm Credit Bank	800	1,677
Other assets	1,263	1,338
Total assets	<u>\$ 199,178</u>	<u>\$ 190,727</u>
<b>Liabilities</b>		
Notes payable to AgFirst Farm Credit Bank	\$ 169,732	\$ 161,298
Accrued interest payable	700	764
Patronage refund payable	20	213
Other liabilities	2,294	2,326
Total liabilities	<u>172,746</u>	<u>164,601</u>
Commitments and contingencies		
<b>Members' Equity</b>		
Capital stock and participation certificates	3,942	3,945
Retained earnings		
Allocated	4,132	4,487
Unallocated	18,358	17,694
Total members' equity	<u>26,432</u>	<u>26,126</u>
Total liabilities and members' equity	<u>\$ 199,178</u>	<u>\$ 190,727</u>

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

*Valley 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	\$ 3,110	\$ 3,415	\$ 6,323	\$ 6,865
<b>Interest Expense</b>				
Notes payable to AgFirst Farm Credit Bank	2,092	2,353	4,285	4,681
Net interest income	1,018	1,062	2,038	2,184
Provision for (reversal of allowance for) loan losses	138	—	138	—
Net interest income after provision for (reversal of allowance for) loan losses	880	1,062	1,900	2,184
<b>Noninterest Income</b>				
Loan fees	75	99	168	161
Fees for financially related services	44	53	61	64
Equity in earnings of other Farm Credit institutions	413	332	813	724
Gains (losses) on sale of rural home loans, net	108	227	272	406
Gain on sale of assets	—	—	—	9
Other noninterest income	50	56	124	142
Total noninterest income	690	767	1,438	1,506
<b>Noninterest Expense</b>				
Salaries and employee benefits	754	859	1,497	1,693
Occupancy and equipment	194	226	395	429
Insurance Fund premium	63	62	125	124
Other operating expenses	350	287	659	633
Total noninterest expense	1,361	1,434	2,676	2,879
Income before income taxes	209	395	662	811
Provision (benefit) for income taxes	—	(32)	—	(32)
Net income	\$ 209	\$ 427	\$ 662	\$ 843

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

*Valley 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, 2006	\$ 4,042	\$ 4,286	\$ 16,472	\$ 24,800
Net income			843	843
Capital stock/participation certificates issued/(retired), net	(86)			(86)
Retained earnings retired		(278)		(278)
Patronage distribution adjustment		42	(52)	(10)
Balance at June 30, 2007	\$ 3,956	\$ 4,050	\$ 17,263	\$ 25,269
Balance at December 31, 2007	\$ 3,945	\$ 4,487	\$ 17,694	\$ 26,126
Net income			662	662
Capital stock/participation certificates issued/(retired), net	(3)			(3)
Retained earnings retired		(367)		(367)
Patronage distribution adjustment		12	2	14
Balance at June 30, 2008	\$ 3,942	\$ 4,132	\$ 18,358	\$ 26,432

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

Valley 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 Valley 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 generally accepted accounting principles (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 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 Statements 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 will 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:

	<b>For the six months ended June 30,</b>	
	<b>2008</b>	<b>2007</b>
Balance at beginning of period	\$ 554	\$ 594
Provision for (reversal of) loan losses	138	-
Loans (charged off), net of recoveries	2	-
Balance at end of period	<u>\$ 694</u>	<u>\$ 594</u>

**NOTE 3 – EMPLOYEE BENEFIT PLANS**

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

	<b>For the six months ended June 30,</b>	
	<b>2008</b>	<b>2007</b>
Pension	\$ 104	\$ 178
401(k)	67	67
Other postretirement benefits	50	61
Total	<u>\$ 221</u>	<u>\$ 306</u>

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

	<b>Actual YTD Through 6/30/08</b>	<b>Projected Contributions For Remainder of 2008</b>	<b>Projected Total Contributions 2008</b>
Pension	\$ -	\$ -	\$ -
Other postretirement benefits	21	31	52
Total	<u>\$ 21</u>	<u>\$ 31</u>	<u>\$ 52</u>

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.