

# **SECOND QUARTER 2007**

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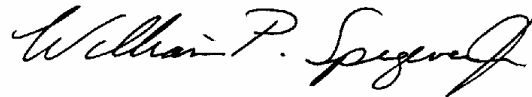
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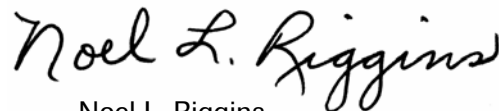
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William P. Spigener, Jr.  
Chief Executive Officer



Noel L. Riggins  
Chairman of the Board

July 14, 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 AgSouth Farm Credit, ACA (Association) for the period ended June 30, 2007. Effective January 1, 2004, pursuant to a consolidation plan approved by the Farm Credit Administration (FCA) and the Association stockholders, AgSouth Farm Credit, headquartered in Statesboro, Georgia and Palmetto Farm Credit, headquartered in Orangeburg, South Carolina merged. The surviving entity assumed the name, AgSouth Farm Credit.

This information should be read in conjunction with the accompanying financial statements, notes to the financial statements, and the 2006 Annual Report of AgSouth Farm Credit. 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 wide range of agricultural commodities produced in our region, including poultry (broilers, turkeys and eggs), timber, field crops and grains, and beef cattle. Loans to producers of these commodities total \$937,965 or 71.48 percent of the Association's portfolio. Farm size varies, and many of the Association customers have diversified farming operations. These factors, along with the numerous opportunities for non-farm income in the area, reduce to some degree the level of income dependency on any given commodity.

During the second quarter of 2007 the Association originated \$25,181 in loans for the secondary market. As of June 30, 2007, the Association held \$438 in qualifying loans for sale. These loans are classified as Other Assets on the Association's balance sheet.

## **Georgia Region**

Georgia's economy continues to grow a full percentage point above the national average. Employment in the construction and manufacturing sectors are down slightly, however growth in transportation and trade, business and professional services, and education and health services have created the overall growth. Rising interest rates have slowed the housing sector; but, Georgia continues to experience population growth at a relatively high rate providing support for the housing industry.

The Georgia region started off the year with fairly normal weather conditions however a late freeze damaged young corn and severely damaged the majority of the blueberry crop. Beginning late in March and lasting through the end of May, the region suffered from a severe drought situation that resulted in delayed planting of cotton and peanuts.

The drought did not hurt the Vidalia onion crop as irrigation is available on most of that acreage and the dry spring provided excellent digging and harvesting weather. All field harvest is now complete with yields being above average. Prices also opened strong and held for a considerable period. This year's average price received for onions is expected to be higher than 2006.

The late freeze destroyed the majority of the blueberry crop. Assessment by extension personnel indicates an estimated 75-80% loss of the rabbiteye crop and approximately a 20% loss of the high bush crop. The combined average loss of both varieties is estimated at 50%. We have made assessment of these individual accounts and believe with crop insurance and other sources of income most growers will be able to handle this adverse crop year.

The drought delayed peanut planting for most farmers. Those who waited on rain planted as many acres as possible and plan to file for 50% of their crop insurance coverage under the prevented planting provision. The price of soybeans is up significantly, and it is expected that a portion of acreage intended for cotton and peanuts will go to soybeans.

The entire Southeast has suffered from a shortage of hay due to the drought. The shortage of hay as well as high prices for available hay has forced many farmers with brood cows to sell off or cut back on their herds. Local stockyards are seeing an increase in their normal sales volume due to herd reductions.

We expect overall farm revenues to be down due to the drought. This may impact some farmers' ability to repay term loans. Operating loans should have limited disbursements coinciding with any unplanted acreage and along with crop insurance should allow for adequate repayment of operating loans. While it is too early to know for sure we do not expect any significant increase in loans that will have to be transferred to nonaccrual.

## **South Carolina Region**

Following the adversities at the beginning of the second quarter brought on by the late freeze, South Carolina crops have encountered additional growing difficulties as a result of drought conditions. Fortunately, as the second quarter came to an end most areas of South Carolina received rainfall that has mitigated drought conditions to some degree. Crops most affected by the freezing conditions were fruits, vegetables, wheat and corn. A large percentage of the association members affected by the late freeze utilized crop insurance and appropriate contacts have been made to insurance adjusters to assure that any claims can be collected upon as harvest results become apparent. Peaches and wheat harvest have been significantly impacted by the weather, while tomato and corn damaged acreage was mostly replanted. With the low percentage of loans dependent upon fruit, vegetables, wheat and corn as a primary source of repayment, some isolated repayment difficulties are expected but this should not create significant problems. Peanuts, cotton and soybeans are now planted and these crops benefited from the June rain.

Both the poultry and timber industries remain mostly unchanged since early 2007. The only impact from weather on poultry would be the use of propane to heat houses early in the second quarter. Timber prices have been relatively flat over the past quarter, and no material significant changes are noted. It is noted that most processors of timber continue to work on essentially break-even budgets, and typically the spring has represented a productive season for this industry. Several family-owned mills have indicated concerns over lumber prices as the second quarter came to an end. Some of the sawmills in South Carolina benefited substantially from Canadian tariff funds being disbursed early in the year and this nonrecurring source of cash has made a positive impact given lower housing starts, increasing interest rates and lower lumber prices during the first and second quarter of 2007.

Land sales continue to take place within the South Carolina territory and financing opportunities continue to surface. The sale of agriculture properties, especially timber tracts, are continuing at a pace comparable to 2006 but with prices stabilizing. Some pockets of the state have indicated slower movement of real estate, but in general this is not a widespread observation. The financing of real estate acquisitions and lifestyle farmers remains a significant portion of the new business being generated through the five months of 2007.

The gross loan volume of the Association as of June 30, 2007, was \$1,308,258, an increase of \$26,860 or 2.10 percent as compared to \$1,281,398 at December 31, 2006. Net loans outstanding at June 30, 2007 were \$1,304,316 as compared to \$1,277,592 at December 31, 2006. Net loans accounted for 94.32 percent of total assets at June 30, 2007, as compared to 94.26 percent of total assets at December 31, 2006.

The increase in gross and net loan volume during the reporting period is primarily attributed to draws on annual operating credits to farmer/borrowers during the planting season and new loans for real estate purchases. The

Association continues to actively make large loans, some of which are participated with AgFirst Farm Credit bank and others.

The Association typically structures loans to meet the needs of the borrower. Many term loans are made for ten years or less allowing the borrower to build equity faster and thus reducing the risk in the loan 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 decreased slightly from \$2,275 at December 31, 2006, to \$2,093 at June 30, 2007. The decrease is the result of payments and payoffs of nonaccrual accounts exceeding transfers to nonaccrual status during the reporting period. Other property owned decreased to \$525 from \$536 during the comparative reporting periods. There was no significant other property owned activity during the quarter.

Association management maintains an allowance for loan losses in an amount considered sufficient to absorb possible losses in the loan portfolio based on current and expected future conditions. The allowance for loan losses at June 30, 2007, was \$3,942 compared to \$3,806 at December 31, 2006, and was considered by management to be adequate to cover possible losses. The increase in the allowance account came from recoveries of previously charged-off amounts.

Premises and equipment, net increased \$849 from \$10,802 at December 31, 2006 to \$11,651 at June 30, 2007. The increase is primarily the result of replacement automobile purchases made in the first quarter of 2007 as well as construction in progress for a new facility to house members of the Human Resource and Accounting staff in Orangeburg, South Carolina. The Association expects to occupy this new space in August of 2007.

## **RESULTS OF OPERATIONS**

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

Net income for the three months ended June 30, 2007, totaled \$7,304 as compared to \$6,882 for the same period in 2006. Net interest income before the provision for loan loss increased \$379 for the three months ended June 30, 2007, as compared to the same period in 2006 due primarily to the increase in loan volume, and focused repricing activities. No provision expense was recorded in the quarter ending June 30, 2007. The Association's Asset/Liability Committee made the decision that no provision was needed after analyzing the risk in the current portfolio. The analysis includes reviewing historical trends, loan size, loan performance and credit quality reports.

Interest income on accruing loans increased \$2,652 from \$24,110 at June 30, 2006 to \$26,762 at June 30, 2007. The majority of this increase was due to a higher loan volume base and a higher interest rate environment. Nonaccrual income was \$40 for the three months ended June 30, 2007, as compared to \$38 for the same period in 2006.

Interest expense increased \$2,273 from \$13,880 at June 30, 2006 to \$16,153 at June 30, 2007. The increase is linked to the higher interest rate environment and the increase in the Notes Payable balance. The Notes Payable balance increases with the increase in loan volume.

Noninterest income increased \$452 over the same period last year primarily due to, higher equity in earnings from other Farm Credit institutions, and the annual savings return from the FCSIC insurance fund of \$154. The FCSIC savings return is included in other noninterest income. Both loan fees and fees for financially related services declined between the two reporting periods. Loan fees decreased \$20 and Fees from financially related services decreased \$11. The equity in earnings from other Farm Credit institutions increased \$423 from \$2,327 at June 30, 2006 to \$2,750 at June 30, 2007. The increase is the result of the higher average Notes Payable balance and patronage accrued on participations sold to other Associations. The Association's activity in the secondary market generated gains on the sale of rural home loans of \$244, compared to \$262 at the same period last year.

Noninterest expense for the three months ended June 30, 2007, increased \$371 compared to the same period of 2006. Salaries and employee benefit expense increased \$118 between the two reporting periods. The increase is attributable to normal merit and promotion increases applied at the beginning of the year and the accrual of fifty percent (50%) of the 2007 Incentive Plan payment. Association management reviewed the results as of May 31, 2007 and elected to accrue \$1,066 in salary and benefit expense. Occupancy and equipment decreased \$12 between the two reporting periods. The Insurance Fund expense increased from \$419 at June 30, 2006 to \$442 at June 30, 2007. The increase in the insurance expense is directly related to the loan volume growth in the Association. Other operating expenses increased \$238. The increase in other operating expenses includes additional expense for advertising and public and member relations, a timing issue related to the payment of supervisory and examination expenses and other miscellaneous expenses

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

Net income for the six months ended June 30, 2007, totaled \$15,637 as compared to \$13,737 for the same period in 2006. Net interest income before the provision for loan loss increased \$1,289 when compared to the same period in 2006.

Interest income increased \$6,685 from \$46,457 at June 30, 2006 to \$53,142 at June 30, 2007. The variance was due to the slightly higher interest rate environment during the comparative reporting periods and the higher loan volume. Nonaccrual income was \$193 for the six months ended June 30, 2007, as compared to \$207 for the same period in 2006.

Interest expense increased \$5,396 for the six months ended June 30, 2007. The increase is directly linked to the increase in notes payable balance.

During the six-month period ending June 30, 2007, the Association's Asset/Liability Committee determined that the allowance for loan loss reserve account was sufficient and that a provision adjustment was not needed at this time. Therefore, net interest income before and after the provision for loan losses is the same.

Noninterest income for the six months ended June 30, 2007, totaled \$8,034 as compared to \$6,861 for the same period of 2006, an increase of \$1,173. The increase resulted from higher loan fee income, higher equity in earnings from the Bank and other Farm Credit institutions, higher gains on the sale of rural home loans and higher other noninterest income. Loan Fee income increased \$131 between the 2006 and 2007 reporting periods. Fees from financially related services decreased slightly from \$213 at June 30, 2006 to \$212 at June 30, 2007. Equity earnings from the Bank and other Farm Credit institutions exceeded 2006 amounts by \$891. The increase in equity earnings is the result of the higher direct note balance and an increase in the patronage accrual for loans sold to other Associations. Gains on the sale of rural home loans increased from \$424 at June 30, 2006 to \$500 at June 30, 2007. The increase of \$76 is the result of higher premiums earned on loans sold. Other noninterest income includes an insurance refund from the FCSIC. Other noninterest income increased from \$223 to \$299 between the two reporting periods.

Noninterest expense for the six months ended June 30, 2007, increased \$512 from \$13,222 at June 30, 2006 to \$13,734 at June 30, 2007. Salaries and employee benefits expense increased \$329 between the two reporting periods. The Association accrued fifty percent (50%) of the estimated 2007 Incentive Plan payment in June. The accrual, which includes an estimate of benefit expense, totaled \$1,066. The Association's incentive plan is a comprehensive plan that requires that a specific level of income and defined goals be achieved prior to participation. At June 30, 2007, Association management elected to book the accrual in anticipation of payout of the plan. Occupancy and equipment expense increased \$139 between the two reporting periods. This increase is the result of the payment of property taxes, \$142, in the first six months of 2007. The Association also completed construction of a new office in Aiken, South Carolina and has a new facility under construction in Orangeburg, South Carolina. Insurance Fund premium expense was \$819 for the six months ending June 30, 2006 compared to \$877 for the six-month period ending June 30, 2007. The increase in insurance fund expense is tied to the loan growth of the Association.

#### **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 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, 2007 was \$1,148,888 as compared to \$1,114,330 at December 31, 2006. The increase is related to the increase in loan volume between the two reporting periods.

As of June 30, 2007, the Association had invested \$30,000 of its lendable equity in a fixed rate note. This note will mature in June, 2008.

## CAPITAL RESOURCES

Total members' equity at June 30, 2007, increased to \$207,486 from the December 31, 2006 total of \$206,313. The increase is primarily attributed to the earnings of the Association during the reporting period reduced by the revolvment of allocated equities and the retirement of capital stock, and participation certificates. In February 2007, the Association revolved \$14,677 in allocated surplus from the fiscal year 2001 series of equities. The checks and notices were mailed in late February to 12,943 customers. The revolvment is reflected in the change in allocated retained earnings during the two reporting periods. At December 31, 2006, allocated retained earnings totaled \$92,430. At June 30, 2007, the allocated retained earnings had declined to \$79,373.

Total capital stock and participation certificates were \$6,570 on June 30, 2007, compared to \$6,629 on December 31, 2006. The decrease is attributed to the retirement of protected stock and participation certificates on loans liquidated in the normal course of business, the retirement of excess stock, and new loans being capitalized at lower regulatory levels.

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, 2007, the Association's total surplus ratio and core surplus ratio were 14.65 percent and 11.29 percent, respectively, and the permanent capital ratio was 15.15 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.

The Association has a portion of the portfolio in an in-portfolio guarantee program with Farmer Mac. At June 30, 2007, the Association had loans totaling \$21,093 in this program. No additional placement of loans is scheduled at this time. The cost of the guarantees year to date was \$61. The use of the Farmer Mac In-portfolio guarantee has a positive effect on the Association's capital ratios.

## ACCOUNTING FOR DEFINED BENEFIT PENSION AND OTHER POSTRETIREMENT PLANS

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. The Standard 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 changes in that funded status in the year in which the changes occur through comprehensive income. The Standard is effective for employers with publicly traded securities for the fiscal year ending after December 15, 2006 and for employers without publicly traded securities for the fiscal year ending after June 15, 2007. The Association will be required to implement the Standard for the year ended December 31, 2007. In addition, this Standard requires that the funded status of a plan be measured as of the date of the year-end financial statements. Currently, the Association uses 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 Association is currently evaluating the impact of implementing this Standard. It is anticipated that the impact from the implementation of this Standard will have no impact on the consolidated income statement and, based on the current funded status of the defined benefit plans, it is not expected to have a material or significant impact on the consolidated balance sheet.

**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 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 1-800-310-4805, ext 237, writing Alisa D. Gunter, CFO, AgSouth Farm Credit, ACA, PO Box 4966, Spartanburg, SC 29305, or accessing the website [www.agsouthfc.com](http://www.agsouthfc.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.

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

<i>(dollars in thousands)</i>	<b>June 30, 2007</b> <i>(unaudited)</i>	<b>December 31, 2006</b> <i>(audited)</i>
<b>Assets</b>		
Cash	\$ 5,652	\$ 2,116
Loans	1,308,258	1,281,398
Less: allowance for loan losses	3,942	3,806
Net loans	1,304,316	1,277,592
Accrued interest receivable	19,141	17,113
Investment in other Farm Credit institutions	20,051	19,832
Premises and equipment, net	11,651	10,802
Other property owned	525	536
Prepaid retirement expense	13,005	13,797
Due from AgFirst Farm Credit Bank	5,039	10,433
Other assets	3,447	3,184
Total assets	<u>\$ 1,382,827</u>	<u>\$ 1,355,405</u>
<b>Liabilities</b>		
Notes payable to AgFirst Farm Credit Bank	\$ 1,148,888	\$ 1,114,330
Accrued interest payable	5,400	5,299
Patronage refund payable	156	8,529
Postretirement benefits other than pensions	11,258	11,059
Other liabilities	9,639	9,875
Total liabilities	<u>1,175,341</u>	<u>1,149,092</u>
Commitments and contingencies		
<b>Members' Equity</b>		
Protected borrower equity	485	608
Capital stock and participation certificates	6,085	6,021
Retained earnings		
Allocated	79,373	92,430
Unallocated	121,543	107,254
Total members' equity	<u>207,486</u>	<u>206,313</u>
Total liabilities and members' equity	<u>\$ 1,382,827</u>	<u>\$ 1,355,405</u>

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

*AgSouth Farm Credit, ACA*

# Consolidated Statements of Income

(unaudited)

<i>(dollars in thousands)</i>	<b>For the three months ended June 30,</b>		<b>For the six months ended June 30,</b>	
	<b>2007</b>	<b>2006</b>	<b>2007</b>	<b>2006</b>
<b>Interest Income</b>				
Loans	\$ 26,762	\$ 24,110	\$ 53,142	\$ 46,457
<b>Interest Expense</b>				
Notes payable to AgFirst Farm Credit Bank	16,096	13,844	31,607	26,261
Other	57	36	102	52
Total interest expense	16,153	13,880	31,709	26,313
Net interest income	10,609	10,230	21,433	20,144
Provision for (reversal of allowance for) loan losses	—	—	—	—
Net interest income after provision for (reversal of allowance for) loan losses	10,609	10,230	21,433	20,144
<b>Noninterest Income</b>				
Loan fees	660	680	1,485	1,354
Fees for financially related services	78	89	212	213
Equity in earnings of other Farm Credit institutions	2,750	2,327	5,538	4,647
Gains (losses) on sale of rural home loans	244	262	500	424
Other noninterest income	244	166	299	223
Total noninterest income	3,976	3,524	8,034	6,861
<b>Noninterest Expense</b>				
Salaries and employee benefits	5,067	4,949	9,281	8,952
Occupancy and equipment	497	509	1,127	988
Insurance Fund premium	442	419	877	819
Other operating expenses	1,205	967	2,435	2,462
Losses on other property owned, net	(6)	(10)	14	1
Total noninterest expense	7,205	6,834	13,734	13,222
Income before income taxes	7,380	6,920	15,733	13,783
Provision (benefit) for income taxes	76	38	96	46
Net income	\$ 7,304	\$ 6,882	\$ 15,637	\$ 13,737

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

*AgSouth Farm Credit, ACA*

# Consolidated Statements of Changes in Members' Equity

*(unaudited)*

*(dollars in thousands)*

	Protected Borrower Capital	Capital Stock and Participation Certificates	Retained Earnings		Total Members' Equity
			Allocated	Unallocated	
Balance at December 31, 2005	\$ 910	\$ 5,923	\$ 86,063	\$ 105,468	\$ 198,364
Net income				13,737	13,737
Protected borrower equity retired	(257)				(257)
Capital stock/participation certificates issued		467			467
Capital stock/participation certificates retired		(438)			(438)
Retained earnings retired			(12,222)		(12,222)
Distribution adjustment			1,248	(1,781)	(533)
Balance at June 30, 2006	\$ 653	\$ 5,952	\$ 75,089	\$ 117,424	\$ 199,118
Balance at December 31, 2006	\$ 608	\$ 6,021	\$ 92,430	\$ 107,254	\$ 206,313
Net income				15,637	15,637
Protected borrower equity retired	(123)				(123)
Capital stock/participation certificates issued		435			435
Capital stock/participation certificates retired		(371)			(371)
Retained earnings retired			(14,001)		(14,001)
Distribution adjustment			944	(1,348)	(404)
Balance at June 30, 2007	\$ 485	\$ 6,085	\$ 79,373	\$ 121,543	\$ 207,486

*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 AgSouth 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. The Standard 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 changes in that funded status in the year in which the changes occur through comprehensive income. The Standard is effective for employers with publicly traded securities for the fiscal year ending after December 15, 2006 and for employers without publicly traded securities for the fiscal year ending after June 15, 2007. The Association will be required to implement the Standard for the year ended December 31, 2007. In addition, this Standard requires that the funded status of a plan be measured as of the date of the year-end financial statements. Currently, the Association uses 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 Association is currently evaluating the impact of implementing this Standard. It is anticipated that the impact from the implementation of this Standard will have no impact on the consolidated income statement and, based on the current funded status of the defined benefit plans, it is not expected to have a material or significant impact on the consolidated balance sheet.

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

Certain amounts in prior period consolidated financial statements may 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 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	\$ 3,806	\$ 3,808
Provision for (reversal of) loan losses	—	—
Recoveries, net of loans charged off	136	24
Balance at end of period	<u>\$ 3,942</u>	<u>\$ 3,832</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 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	\$ 838	\$ 980
Thrift/deferred compensation	212	193
Other postretirement benefits	471	494
Total	<u>\$ 1,521</u>	<u>\$ 1,667</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 \$43 to these plans during the first six months of 2007. The Association anticipates making additional contributions of \$43 to these supplemental retirement and deferred compensation plans during the remainder of 2007.