
Cape Fear Farm Credit, ACA

FIRST QUARTER 2008

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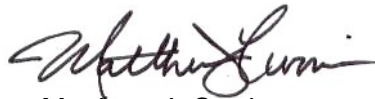
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Richard A. Eason
Chief Executive Officer



Matthew J. Currin
Chief Financial Officer



Ronald J. Allen
Chairman of the Board

April 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 Cape Fear Farm Credit, ACA, (Association) for the period ended March 31, 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 tobacco, swine, poultry, and row-crop operations. 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, lessens the level of dependency on any single given commodity. Concentration risk is further mitigated by a substantial portfolio of participation loans purchased or originated and sold.

The gross loan volume of the Association as of March 31, 2008, was \$729,718, an increase of \$26,038 as compared to \$703,680 at December 31, 2007. Net loans outstanding at March 31, 2008, were \$725,718 as compared to \$699,687 at December 31, 2007. Net loans accounted for 92.43 percent of total assets at March 31, 2008, as compared to 91.48 percent of total assets at December 31, 2007.

The increase in gross and net loan volume during the reporting period is attributed to a general increase in lending activity including seasonal lending sufficient to reflect overall growth despite significant paydowns from assignments on contract grower loans. The short-term portfolio, which is heavily influenced by operating-type loans, normally reaches a peak in August and rapidly declines in the fall months as farm commodities are marketed and proceeds are applied to the operating loans.

There is an inherent risk in the extension of any type of credit. Portfolio credit quality continues to be maintained at an acceptable level, however, and credit administration remains satisfactory. Nonaccrual loans decreased from \$5,430 at December 31, 2007, to \$4,853 at March 31, 2008. This decrease results primarily from the liquidation of one loan during the first quarter of 2008.

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 March 31, 2008, was \$4,000 which was up from \$3,993 at December 31, 2007, and was considered by management to be adequate to cover possible losses.

RESULTS OF OPERATIONS

For the three months ended March 31, 2008

Net income for the three months ended March 31, 2008, totaled \$6,320 as compared to \$4,882 for the same period in 2007. The increase of \$1,438 or 29.45 percent is attributed primarily to an increase in net interest income resulting from growth in loan volume and an increase in noninterest income.

Net interest income for the three months ended March 31, 2008, increased \$630 or 11.84 percent compared to March 31, 2007. Interest income on loans increased by \$822 and interest income from other sources increased by \$68, while interest expense increased \$200 compared to the same period last year. These increases are both due to growth in loan volume and other interest bearing assets. Nonaccrual income was \$125 for the three months ended March 31, 2008, as compared to \$63 for the same period in 2007.

Noninterest income for the three months ended March 31, 2008, totaled \$2,971 as compared to \$2,205 for the same period of 2007, an increase of \$766. The increase resulted from an increase of \$216 in patronage earnings from AgFirst Farm Credit Bank (Bank), an increase in loan fee income of \$601, and an increase of \$15 in fees for financially related services. These increases were offset by decreases in other gains/losses and noninterest income of \$36.

Noninterest expense for the three months ended March 31, 2008, decreased \$42 compared to the same period of 2007. This decrease resulted from a \$212 decrease in salaries and employee benefits, which was offset by increases of \$ 22 in Occupancy and equipment expense, \$32 in Insurance Fund premium and a \$116 increase in other operating expense.

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 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 March 31, 2008, were \$660,302 as compared to \$641,059 at December 31, 2007.

CAPITAL RESOURCES

Total members' equity at March 31, 2008, increased to \$103,226 from the December 31, 2007, total of \$102,502. This increase is primarily due to the increase in unallocated surplus that is related to the increase in the current year's income.

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 March 31, 2008, the Association's total surplus ratio and core surplus ratio were 12.04 percent and 11.16 percent, respectively, and the permanent capital ratio was 12.38 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.

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. Copies of the Association's annual and quarterly reports are also available upon request free of charge by calling 1-800-368-5819, extension 3243, writing Matthew J. Currin, Cape Fear Farm Credit, P. O. Box 2405, Fayetteville, NC 28302, or accessing the website, www.capefearfarmcredit.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.

Cape Fear Farm Credit, ACA
Consolidated Balance Sheets

<i>(dollars in thousands)</i>	March 31, 2008 <i>(unaudited)</i>	December 31, 2007 <i>(audited)</i>
Assets		
Cash	\$ 3,337	\$ 2,102
Loans	729,718	703,680
Less: allowance for loan losses	4,000	3,993
Net loans	725,718	699,687
Other investments	25,778	29,430
Accrued interest receivable	9,775	12,057
Investment in other Farm Credit institutions	10,259	10,259
Premises and equipment, net	3,449	3,490
Other property owned	95	95
Due from AgFirst Farm Credit Bank	1,562	6,799
Other assets	5,213	5,308
Total assets	<u>\$ 785,186</u>	<u>\$ 769,227</u>
Liabilities		
Notes payable to AgFirst Farm Credit Bank	\$ 660,302	\$ 641,059
Accrued interest payable	2,728	3,084
Patronage refund payable	481	11,579
Other liabilities	18,449	11,003
Total liabilities	<u>681,960</u>	<u>666,725</u>
Commitments and contingencies		
Members' Equity		
Protected borrower equity	88	124
Capital stock and participation certificates	2,571	2,542
Retained earnings		
Allocated	11,364	16,631
Unallocated	89,536	83,542
Accumulated other comprehensive income (loss)	(333)	(337)
Total members' equity	<u>103,226</u>	<u>102,502</u>
Total liabilities and members' equity	<u>\$ 785,186</u>	<u>\$ 769,227</u>

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

Cape Fear Farm Credit, ACA
Consolidated Statements of Income

(unaudited)

**For the three months
ended March 31,**

(dollars in thousands)

	2008	2007
Interest Income		
Loans	\$ 13,952	\$ 13,130
Other	395	387
Total interest income	14,347	13,517
Interest Expense		
Notes payable to AgFirst Farm Credit Bank	8,396	8,196
Net interest income	5,951	5,321
Provision for (reversal of allowance for) loan losses	—	—
Net interest income after provision for (reversal of allowance for) loan losses	5,951	5,321
Noninterest Income		
Loan fees	1,370	769
Fees for financially related services	57	72
Equity in earnings of other Farm Credit institutions	1,561	1,345
Gains (losses) on other property owned, net	(2)	2
Other noninterest income	(15)	17
Total noninterest income	2,971	2,205
Noninterest Expense		
Salaries and employee benefits	1,512	1,724
Occupancy and equipment	198	176
Insurance Fund premium	259	227
Other operating expenses	633	517
Total noninterest expense	2,602	2,644
Income before income taxes	6,320	4,882
Provision (benefit) for income taxes	—	—
Net income	\$ 6,320	\$ 4,882

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

Cape Fear Farm Credit, ACA

Consolidated Statements of Changes in Members' Equity

(unaudited)

(dollars in thousands)

	Protected Borrower Capital	Capital Stock and Participation Certificates	Retained Earnings		Accumulated Other Comprehensive	Total Members' Equity
			Allocated	Unallocated		
Balance at December 31, 2006	\$ 204	\$ 2,333	\$ 15,881	\$ 81,145	\$ (358)	\$ 99,205
Net income				4,882		4,882
Protected borrower equity retired	(51)					(51)
Capital stock/participation certificates issued/ retired, net		67				67
Retained earnings retired			(5,990)			(5,990)
Patronage distribution adjustment			—	43		43
Balance at March 31, 2007	\$ 153	\$ 2,400	\$ 9,891	\$ 86,070	\$ (358)	\$ 98,156
Balance at December 31, 2007	\$ 124	\$ 2,542	\$ 16,631	\$ 83,542	\$ (337)	\$ 102,502
Net income				6,320		6,320
Protected borrower equity retired	(36)					(36)
Capital stock/participation certificates issued		29				29
Retained earnings retired			(5,650)			(5,650)
Patronage distribution adjustment			383	(317)		66
Employee benefit plans adjustments				(9)	4	(5)
Balance at March 31, 2008	\$ 88	\$ 2,571	\$ 11,364	\$ 89,536	\$ (333)	\$ 103,226

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

Cape Fear 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 Cape Fear 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 first 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 three months ended March 31, 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 March 31, 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 No. 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 No. 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 the Standard, but believes that its adoption will significantly impact its accounting for 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 three months ended March 31,	
	2008	2007
Balance at beginning of period	\$ 3,993	\$ 3,607
Provision for (reversal of) loan losses	–	–
Loans (charged off), net of recoveries	7	21
Balance at end of period	<u>\$ 4,000</u>	<u>\$ 3,628</u>

NOTE 3 – EMPLOYEE BENEFIT PLANS

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

	For the three months ended March 31,	
	2008	2007
Pension	\$ 97	\$ 146
401(k)	67	67
Other postretirement benefits	85	97
Total	<u>\$ 249</u>	<u>\$ 310</u>

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

	Actual YTD Through 3/31/08	Projected Contributions For Remainder of 2008	Projected Total Contributions 2008
Pension	\$ 7	\$ 21	\$ 28
Other postretirement benefits	61	171	232
Total	<u>\$ 68</u>	<u>\$ 192</u>	<u>\$ 260</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.

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 for 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 2007 measurement date) was debited to beginning 2008 unallocated retained earnings. As a result, the Association decreased unallocated retained earnings and increased the pension or other postretirement benefit liability by \$9.

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. These amounts are subsequently recognized as components of net periodic benefit costs. \$4 has been recognized for the first three months of 2008 as a credit to accumulated other comprehensive income and a debit to pension or other postretirement benefit expense.

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