

FIRST QUARTER 2007

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Richard A. Eason
Chief Executive Officer



Ronald J. Allen
Chairman of the Board

April 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 Cape Fear Farm Credit ACA, (Association) for the period ended March 31, 2007. These comments 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 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, 2007, was \$646,474, an increase of \$16,067 as compared to \$630,407 at December 31, 2006. Net loans outstanding at March 31, 2007, were \$642,846 as compared to \$626,800 at December 31, 2006. Net loans accounted for 92.18 percent of total assets at March 31, 2007, as compared to 90.90 percent of total assets at December 31, 2006.

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 increased from \$921 at December 31, 2006, to \$1,733 at March 31, 2007. This increase results primarily from the addition of two loans to nonaccrual status during the first quarter of 2007.

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, 2007, was \$3,628 which was up from \$3,607 at December 31, 2006, and was considered by management to be adequate to cover possible losses.

RESULTS OF OPERATIONS

For the three months ended March 31, 2007

Net income for the three months ended March 31, 2007, totaled \$4,882 as compared to \$3,882 for the same period in 2006. The increase of \$1,000 or 25.76 percent is attributed primarily to an increase in net interest income resulting from growth in loan volume and an increase in market interest rates.

Net interest income for the three months ended March 31, 2007, increased \$836 or 18.64 percent compared to March 31, 2006. Interest income on loans increased by \$3,024 and interest income from other sources increased by \$61, while interest expense increased \$2,249 compared to the same period last year. These increases are both due to increases in market interest rates and growth in loan volume and other interest bearing assets. Nonaccrual income was \$63 for the three months ended March 31, 2007, as compared to \$78 for the same period in 2006.

Noninterest income for the three months ended March 31, 2007, totaled \$2,205 as compared to \$1,950 for the same period of 2006, an increase of \$255. The increase resulted from an increase of \$276 in patronage earnings from AgFirst Farm Credit Bank (Bank), an increase in loan fee income of \$22, and an increase of \$4 in fees for financially related services. These increases were offset by a decrease of \$47 in other noninterest income.

Noninterest expense for the three months ended March 31, 2007, increased \$110 compared to the same period of 2006. This increase resulted from increases of \$39 in Insurance Fund premium, \$56 in other operating expense, and \$27 in salaries and employee benefits. These increases were offset by a decrease in occupancy and equipment expense of \$12.

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, 2007, were \$578,287 as compared to \$563,329 at December 31, 2006.

CAPITAL RESOURCES

Total members' equity at March 31, 2007, decreased to \$98,156 from the December 31, 2006, total of \$99,205. The decrease results primarily from current year rollout of allocated surplus being in excess of the amount of net earnings for the association thus far.

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, 2007, the Association's total surplus ratio and core surplus ratio were 13.15 percent and 11.48 percent, respectively, and the permanent capital ratio was 13.51 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.

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. 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. Copies of the Association's annual and quarterly reports are also available upon request free of charge by calling 910-323-9188, extension 3243, writing Matthew J. Currin, Chief Financial Officer, 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 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.

Cape Fear Farm Credit, ACA
Consolidated Balance Sheets

<i>(dollars in thousands)</i>	March 31, 2007 <i>(unaudited)</i>	December 31, 2006 <i>(audited)</i>
Assets		
Cash	\$ 979	\$ 1,529
Loans	646,474	630,407
Less: allowance for loan losses	3,628	3,607
Net loans	642,846	626,800
Other investments, held to maturity	24,952	27,484
Accrued interest receivable	9,882	10,704
Investment in other Farm Credit institutions	8,370	8,370
Premises and equipment, net	3,482	3,261
Prepaid retirement expense	4,942	5,078
Due from AgFirst Farm Credit Bank	1,345	5,701
Other assets	592	645
Total assets	\$ 697,390	\$ 689,572
Liabilities		
Notes payable to AgFirst Farm Credit Bank	\$ 578,287	\$ 563,329
Accrued interest payable	2,853	2,736
Patronage refund payable	437	9,023
Postretirement benefits other than pensions	4,041	3,995
Minimum pension liability	374	372
Other liabilities	13,242	10,912
Total liabilities	599,234	590,367
Commitments and contingencies		
Members' Equity		
Protected borrower equity	153	204
Capital stock and participation certificates	2,400	2,333
Retained earnings		
Allocated	9,891	15,881
Unallocated	86,070	81,145
Accumulated other comprehensive income (loss)	(358)	(358)
Total members' equity	98,156	99,205
Total liabilities and members' equity	\$ 697,390	\$ 689,572

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

Cape Fear Farm Credit, ACA

Consolidated Statements of Income

(unaudited)

<i>(dollars in thousands)</i>	For the three months ended March 31,	
	2007	2006
Interest Income		
Loans	\$ 13,130	\$ 10,106
Other	387	326
Total Interest Income	13,517	10,432
Interest Expense		
Notes payable to AgFirst Farm Credit Bank	8,196	5,947
Net interest income	5,321	4,485
Provision for (reversal of allowance for) loan losses	—	—
Net interest income after provision for (reversal of allowance for) loan losses	5,321	4,485
Noninterest Income		
Loan fees	769	747
Fees for financially related services	72	68
Equity in earnings of other Farm Credit institutions	1,345	1,069
Gains (losses) on other property owned, net	2	2
Other noninterest income	17	64
Total noninterest income	2,205	1,950
Noninterest Expense		
Salaries and employee benefits	1,724	1,697
Occupancy and equipment	176	188
Insurance Fund premium	227	188
Other operating expenses	517	461
Total noninterest expense	2,644	2,534
Income before income taxes	4,882	3,901
Provision (benefit) for income taxes	—	19
Net income	\$ 4,882	\$ 3,882

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 Income	Total Members' Equity
			Allocated	Unallocated		
Balance at December 31, 2005	\$ 269	\$ 2,154	\$ 22,035	\$ 72,268	\$ (404)	\$ 96,322
Net income				3,882		3,882
Protected borrower equity retired	(48)					(48)
Capital stock/participation certificates issued		98				98
Capital stock/participation certificates retired		(64)				(64)
Retained earnings retired			(6,121)			(6,121)
Distribution adjustment			3	151		154
Balance at March 31, 2006	\$ 221	\$ 2,188	\$ 15,917	\$ 76,301	\$ (404)	\$ 94,223
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		127				127
Capital stock/participation certificates retired		(60)				(60)
Retained earnings retired			(5,990)			(5,990)
Distribution adjustment			—	43		43
Balance at March 31, 2007	\$ 153	\$ 2,400	\$ 9,891	\$ 86,070	\$ (358)	\$ 98,156

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

A description of the organization and operations of Cape Fear 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 first 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 three months ended March 31, 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 March 31, 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 three months ended March 31,	
	2007	2006
Balance at beginning of period	\$ 3,607	\$ 3,434
Provision for (reversal of) loan losses	–	–
Recoveries, net of loans charged off	21	–
Balance at end of period	<u>\$ 3,628</u>	<u>\$ 3,434</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 three months ended March 31, 2007:

	For the three months ended March 31,	
	2007	2006
Pension	\$ 146	\$ 188
Thrift/deferred compensation	67	44
Other postretirement benefits	97	100
Total	<u>\$ 310</u>	<u>\$ 332</u>

As of March 31, 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 a supplemental retirement plan for certain key employees. The expenses of this plan are included in the pension costs above. The Association contributed \$7 to this plan during the first three months of 2007. The Association anticipates making additional contributions of \$21 to the supplemental retirement plan during the remainder of 2007.