

SECOND QUARTER 2004

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Financial Condition and Results of Operations.....2

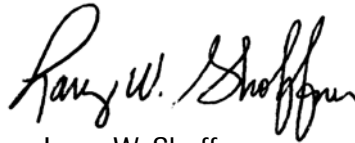
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Larry W. Shoffner
Chief Executive Officer



Bobby E. McCollum, Jr.
Chairman of the Board

July 29, 2004

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 Carolina Farm Credit, ACA (Association) for the period ended June 30, 2004. These comments should be read in conjunction with the accompanying consolidated financial statements, notes to the consolidated financial statements and the 2003 Annual Report of the Association.

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 part-time farm, poultry, and rural home loans. 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, has an impact on the level of dependency on a given agricultural commodity.

The gross loan volume of the Association as of June 30, 2004, was \$1,081,685, an increase of \$28,826 as compared to \$1,052,859 at December 31, 2003. Net loans outstanding at June 30, 2004, were \$1,059,986 as compared to \$1,030,911 at December 31, 2003. Net loans accounted for 95.65 percent of total assets at June 30, 2004, as compared to 95.41 percent of total assets at December 31, 2003.

The increase in gross and net loan volume during the reporting period is attributed primarily to seasonal lending. The short-term portfolio, which is heavily influenced by operating-type loans, normally reaches a peak balance 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 \$6,734 at December 31, 2003, to \$8,271 at June 30, 2004. This increase is primarily the result of transferring loans into nonaccrual status in excess of repayments and transfer to other property owned.

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, 2004, was \$21,699 compared to \$21,948 at December 31, 2003, and was considered by management to be adequate to cover possible losses.

In June 2003, the American Institute of Certified Public Accountants' (AICPA) Accounting Standards Executive Committee (AcSEC) issued a proposed Statement of Position – Allowance for Credit Losses, which was intended to clarify the methodology for estimating the allowance for credit losses and to enhance financial statement disclosures related to the allowance for credit losses. In January 2004, AcSEC abandoned its proposed Statement of Position and announced that it would focus instead on improving financial statement disclosures regarding the allowance for loan losses.

System institutions have initiated studies to further refine their methodologies for calculating their respective allowances for loan losses, taking into account generally accepted accounting principles and applicable Farm Credit Administration requirements, as well as the Securities and Exchange Commission and Federal Financial Institutions Examination Council guidelines. These studies are likely to be completed by the fourth quarter of 2004 with any appropriate reductions to the allowance for loan losses implemented at that time. The resulting reductions in the allowance for loan losses may be significant.

In April 2004, the Farm Credit Administration, the System's regulator, issued an "Informational Memorandum" to System institutions regarding the allowance for loan losses. The memorandum addresses the status of the AICPA's project and the Securities and Exchange Commission and the Federal Financial Institutions Examination Council guidance on the subject. The objective of the Farm Credit Administration's memorandum was to clarify its expectations regarding the analysis and related documentation for the allowance for loan losses. The Farm Credit Administration endorsed the direction provided by these other regulatory agencies and will include the conceptual framework addressed in this guidance in their examination process.

RESULTS OF OPERATIONS

For the three months ended June 30, 2004

Net income for the three months ended June 30, 2004, totaled \$4,272, as compared to \$5,079 for the same period in 2003. Net interest income decreased \$11, for the three months ended June 30, 2004, as compared to the same period in 2003.

At June 30, 2004, interest income on loans decreased \$613 compared to June 30, 2003. Nonaccrual income was \$118 for the three months ended June 30, 2004, as compared to \$18 for the same period in 2003. Interest expense decreased \$602 for the three months ended June 30, 2004, as compared to the comparable period of 2003.

Noninterest income for the three months ended June 30, 2004, totaled \$2,279, as compared to \$3,027 for the same period of 2003, a decrease of \$748. This decline in earnings is attributed to a decrease of \$611 in loans fees, \$87 in fees for financially related services, \$38 in other noninterest income and an increase of \$59 in losses on other property owned when compared to the same period in 2003. These declines were offset by an increase of \$47 in earnings of AgFirst Farm Credit Bank when compared to the same period in 2003.

Noninterest expense for the three months ended June 30, 2004, increased \$273 compared to the same period of 2003. This rise in noninterest expense is attributed to an increase of \$166 in salaries and employee benefits, \$78 in occupancy and equipment and \$69 in other operating expenses when compared to the same period in 2003. These increases were offset by a decrease of \$40 in the insurance fund premium for the same period of 2003.

The Association recorded a provision for income taxes of \$5 for the three months ended June 30, 2004 as compared to a benefit of \$20 for the same period of 2003.

For the six months ended June 30, 2004

Net income for the six months ended June 30, 2004, totaled \$9,105, as compared to \$10,126 for the same period in 2003. This decrease of \$1,021, or 10.08 percent, is attributed to changes in noninterest income. At June 30, 2004, interest income on accruing loans decreased \$1,632 compared to June 30, 2003. Nonaccrual income was \$241 for the six months ended June 30, 2004, as compared to \$176 for the same period in 2003. Interest expense decreased \$1,607 for the six months ended June 30, 2004, as compared to the same period in 2003. This change was primarily due to a decrease in our average cost of debt.

Noninterest income for the six months ended June 30, 2004, totaled \$4,699, as compared to \$6,004 for the same period of 2003, a decrease of \$1,305. The fall in earnings is attributed to a decrease of \$1,112 in loan fees, \$84 in fees for financially related services, \$26 in the gain on other property owned, and \$211 in other noninterest income when compared to the same period in 2003. These declines were offset by an increase of \$128 in earnings of AgFirst Farm Credit Bank (Bank) when compared to the same period in 2003.

Noninterest expense for the six months ended June 30, 2004, increased \$249 compared to the same period of 2003. This rise in noninterest expense is attributed to an increase of \$58 in salaries and employee benefits, \$113 in occupancy and equipment and \$157 in other operating expenses when compared to the same period in 2003. These increases were offset by a decrease of \$79 in the insurance fund premium for the same period of 2003.

The Association recorded a provision for income taxes of \$9 for the six months ended June 30, 2004 as compared to a provision of \$2 for the same period of 2003.

FUNDING SOURCES

The principal source of funds for the Association is the borrowing relationship established with 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, 2004, was \$930,527 as compared to \$904,991 at December 31, 2003. The increase during the period is attributable to new borrowing by the Association for funds advanced to its borrowers.

The Association has no lines of credit outstanding with third parties as of June 30, 2004.

CAPITAL RESOURCES

Total members' equity at June 30, 2004, increased to \$155,033 from the December 31, 2003, total of \$146,286. The change in capital is attributed to net earnings for the six months ending June 30, 2004.

Total capital stock and participation certificates were \$9,603 on June 30, 2004, compared to \$9,905 on December 31, 2003. This decrease is attributable to the retirement of protected and at-risk stock and participation certificates on loans liquidated in the normal course of business and new loans being capitalized at new 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, 2004, the Association's total surplus ratio and core surplus ratio were 14.04 percent and 10.40 percent, respectively, and the permanent capital ratio was 14.91 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.

Carolina Farm Credit, ACA
Consolidated Balance Sheets

<i>(dollars in thousands)</i>	June 30, 2004	December 31, 2003
	<i>(unaudited)</i>	
Assets		
Cash	\$ 1,152	\$ 1,353
Loans	1,081,685	1,052,859
Less: allowance for loan losses	21,699	21,948
Net loans	1,059,986	1,030,911
Accrued interest receivable	12,131	10,109
Investment in other Farm Credit institutions	14,184	14,191
Premises and equipment, net	8,870	8,778
Other property owned	844	369
Deferred tax asset, net	1,661	1,661
Other assets	9,399	13,172
Total assets	\$ 1,108,227	\$ 1,080,544
Liabilities		
Notes payable to AgFirst Farm Credit Bank	\$ 930,527	\$ 904,991
Accrued interest payable	3,161	3,144
Patronage refund payable	391	4,681
Postretirement benefits other than pensions	8,144	7,475
Minimum pension liability	5,434	5,708
Other liabilities	5,537	8,259
Total liabilities	953,194	934,258
Commitments and contingencies		
Members' Equity		
Protected borrower equity	1,025	1,288
Capital stock and participation certificates	8,578	8,617
Retained earnings		
Allocated	87,116	86,999
Unallocated	69,515	60,583
Accumulated other comprehensive income (loss)	(11,201)	(11,201)
Total members' equity	155,033	146,286
Total liabilities and members' equity	\$ 1,108,227	\$ 1,080,544

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

Carolina 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,	
	2004	2003	2004	2003
Interest Income				
Loans	\$ 16,936	\$ 17,549	\$ 33,666	\$ 35,233
Interest Expense				
Notes payable to AgFirst Farm Credit Bank	9,418	10,020	18,692	20,299
Net interest income	7,518	7,529	14,974	14,934
Provision for (reversal of) loan losses	—	250	—	500
Net interest income after provision for (reversal of) loan losses	7,518	7,279	14,974	14,434
Noninterest Income				
Loan fees	511	1,122	1,008	2,120
Fees for financially related services	78	165	211	295
Equity in earnings of other Farm Credit institutions	1,742	1,695	3,452	3,324
Gains (losses) on other property owned, net	(66)	(7)	(17)	9
Other noninterest income	14	52	45	256
Total noninterest income	2,279	3,027	4,699	6,004
Noninterest Expense				
Salaries and employee benefits	3,805	3,639	7,189	7,131
Occupancy and equipment	432	354	842	729
Insurance Fund premium	251	291	504	583
Other operating expenses	1,032	963	2,024	1,867
Total noninterest expense	5,520	5,247	10,559	10,310
Income before income taxes	4,277	5,059	9,114	10,128
Provision (benefit) for income taxes	5	(20)	9	2
Net income	\$ 4,272	\$ 5,079	\$ 9,105	\$ 10,126

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

Carolina 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, 2002	\$ 1,739	\$ 8,814	\$ 81,979	\$ 63,669	\$ (12,107)	\$ 156,201
Net income				10,126		10,126
Protected borrower equity retired	(385)					(385)
Capital stock/participation certificates issued		473				473
Capital stock/participation certificates retired		(551)				(551)
Retained earnings retired			(28)			(28)
Distribution adjustment			2,483	(2,673)		(190)
Balance at June 30, 2003	\$ 1,354	\$ 8,736	\$ 84,434	\$ 71,122	\$ (12,107)	\$ 165,646
Balance at December 31, 2003	\$ 1,288	\$ 8,617	\$ 86,999	\$ 60,583	\$ (11,201)	\$ 146,286
Net income				9,105		9,105
Protected borrower equity retired	(263)					(263)
Capital stock/participation certificates issued		430				430
Capital stock/participation certificates retired		(469)				(469)
Distribution adjustment			117	(173)		(56)
Balance at June 30, 2004	\$ 1,025	\$ 8,578	\$ 87,116	\$ 69,515	\$ (11,201)	\$ 155,033

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 Carolina 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, 2003, are contained in the 2003 Annual Report to Stockholders. These unaudited second quarter 2004 consolidated financial statements should be read in conjunction with the 2003 Annual Report to Stockholders.

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, 2004, are not necessarily indicative of the results to be expected for the year ending December 31, 2004.

Certain amounts in prior period consolidated financial statements 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, 2004, 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:

Balance at 12-31-02	\$ 21,571
(Reversal of) provision for loan losses	500
Loans (charged off), net of recoveries	<u>(98)</u>
Balance at 6-30-03	<u>\$ 21,973</u>
Balance at 12-31-03	\$ 21,948
(Reversal of) provision for loan losses	–
Loans (charged off), net of recoveries	<u>(249)</u>
Balance at 6-30-04	<u>\$ 21,699</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, 2004:

	For the six months ended June 30,	
	2004	2003
Pension	\$ 982	\$ 1,030
Thrift/deferred compensation	140	138
Other postretirement benefits	<u>980</u>	<u>930</u>
Total	<u>\$ 2,102</u>	<u>\$ 2,098</u>

As of June 30, 2004, the Association had contributed \$1,257 to the Districtwide defined benefit retirement plan. The Association anticipates making additional contributions prior to September 30, 2004 in amounts sufficient to eliminate its accrued benefit obligation.