

# **FIRST QUARTER 2006**

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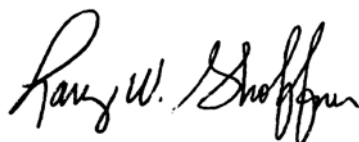
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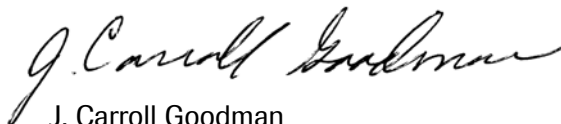
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Larry W. Shoffner  
Chief Executive Officer



J. Carroll Goodman  
Chairman of the Board

April 28, 2006

# 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 March 31, 2006. These comments should be read in conjunction with the accompanying consolidated financial statements, notes to the consolidated financial statements and the 2005 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 March 31, 2006, was \$1,087,569, a decrease of \$29,301 as compared to \$1,116,870 at December 31, 2005. Net loans outstanding at March 31, 2006, were \$1,084,877 as compared to \$1,111,164 at December 31, 2005. Net loans accounted for 90.33 percent of total assets at March 31, 2006, as compared to 91.60 percent of total assets at December 31, 2005.

The decrease in gross and net loan volume during the reporting period is attributed to heavier than normal loan repayments and less than normal demand for operating loans attributed to the tobacco buyout program. 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 \$4,720 at December 31, 2005, to \$5,390 at March 31, 2006. This increase is primarily the result of transferring loans into nonaccrual status in excess of repayments.

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, 2006, was \$2,692 compared to \$2,706 at December 31, 2005, and was considered by management to be adequate to cover possible losses.

## **RESULTS OF OPERATIONS**

### ***For the three months ended March 31, 2006***

Net income for the three months ended March 31, 2006, totaled \$5,974, as compared to \$5,465 for the same period in 2005. Net interest income increased \$400, for the three months ended March 31, 2006, as compared to the same period in 2005.

At March 31, 2006, interest income on loans increased \$3,158 compared to March 31, 2005. Nonaccrual income was \$135 for the three months ended March 31, 2006, as compared to \$93 for the same period in 2005. Interest expense increased \$2,758 for the three months ended March 31, 2006, as compared to the comparable period of 2005.

Noninterest income for the three months ended March 31, 2006, totaled \$2,506, as compared to \$2,298 for the same period of 2005, an increase of \$208. This rise in earnings is attributed to an increase of \$127 in loans fees, \$9 in fees for financially related services, \$13 in earnings of AgFirst Farm Credit Bank, and a decrease of \$83 in losses on other property owned when compared to the same period in 2005. These increases were offset by a decrease of \$24 in other noninterest income when compared to the same period in 2005.

Noninterest expense for the three months ended March 31, 2006, increased \$125 compared to the same period of 2005. This rise in noninterest expense is attributed to an increase of \$141 in occupancy and equipment, \$274 in the insurance fund premium and \$20 in other operating expenses when compared to the same period in 2005. These increases were offset by a decrease of \$310 in salaries and employee benefits when compared to the same period in 2005.

The Association recorded a provision for income taxes of \$8 for the three months ended March 31, 2006 as compared to a provision of \$34 for the same period of 2005.

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## 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 is 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, 2006, was \$974,670 as compared to \$994,284 at December 31, 2005. The decrease during the period is primarily attributed to the decline in loan volume.

The Association has no lines of credit outstanding with third parties as of March 31, 2006.

## CAPITAL RESOURCES

Total members' equity at March 31, 2006, increased to \$198,964 from the December 31, 2005, total of \$192,955. The change in capital is attributed to net earnings for the three months ending March 31, 2006.

Total capital stock and participation certificates were \$8,974 on March 31, 2006, compared to \$9,017 on December 31, 2005. 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 March 31, 2006, the Association's total surplus ratio and core surplus ratio were 16.67 percent and 12.60 percent, respectively, and the permanent capital ratio was 17.47 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.

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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 Jay Wise, 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 1-800-521-9952, or writing Larry W. Shoffner, CEO, Carolina Farm Credit, ACA, P.O. Box 1827, Statesville NC 28687-1827, or accessing the website, [www.carolinafarmcredit.com](http://www.carolinafarmcredit.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.

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

<i>(dollars in thousands)</i>	<b>March 31, 2006</b>	<b>December 31, 2005</b>
	<i>(unaudited)</i>	<i>(audited)</i>
<b>Assets</b>		
Cash	\$ 4,686	\$ 4,583
Loans	1,087,569	1,116,870
Less: allowance for loan losses	2,692	2,706
Net loans	1,084,877	1,114,164
Other investments	50,035	27,512
Accrued interest receivable	14,069	13,893
Investment in other Farm Credit institutions	13,573	13,621
Premises and equipment, net	13,169	13,111
Other property owned	209	359
Deferred tax asset, net	632	632
Prepaid retirement expense	14,200	14,627
Due from AgFirst Farm Credit Bank	4	10,593
Other assets	5,524	3,196
Total assets	\$ 1,200,978	\$ 1,216,291
<b>Liabilities</b>		
Notes payable to AgFirst Farm Credit Bank	\$ 974,670	\$ 994,284
Accrued interest payable	4,417	4,222
Patronage refund payable	550	5,946
Postretirement benefits other than pensions	10,207	10,078
Minimum pension liability	47	38
Other liabilities	12,123	8,768
Total liabilities	1,002,014	1,023,336
Commitments and contingencies		
<b>Members' Equity</b>		
Protected borrower equity	523	763
Capital stock and participation certificates	8,451	8,254
Retained earnings		
Allocated	93,372	93,647
Unallocated	96,618	90,291
Total members' equity	198,964	192,955
Total liabilities and members' equity	\$ 1,200,978	\$ 1,216,291

*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>	<b>For the three months ended March 31,</b>	
	<b>2006</b>	<b>2005</b>
<b>Interest Income</b>		
Loans	\$ 21,099	\$ 18,553
Other	612	—
Total Interest Income	21,711	18,553
<b>Interest Expense</b>		
Notes payable to AgFirst Farm Credit Bank	12,934	10,176
Net interest income	8,777	8,377
Provision for (reversal of allowance for) loan losses	—	—
Net interest income after provision for (reversal of allowance for) loan losses	8,777	8,377
<b>Noninterest Income</b>		
Loan fees	544	417
Fees for financially related services	116	107
Equity in earnings of other Farm Credit institutions	1,785	1,772
Gains (losses) on other property owned, net	(25)	(108)
Other noninterest income	86	110
Total noninterest income	2,506	2,298
<b>Noninterest Expense</b>		
Salaries and employee benefits	3,364	3,674
Occupancy and equipment	588	447
Insurance Fund premium	375	101
Other operating expenses	974	954
Total noninterest expense	5,301	5,176
Income before income taxes	5,982	5,499
Provision (benefit) for income taxes	8	34
Net income	\$ 5,974	\$ 5,465

*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)*

	<b>Protected Borrower Capital</b>	<b>Capital Stock and Participation Certificates</b>	<b>Retained Earnings</b>		<b>Total Members' Equity</b>
			<b>Allocated</b>	<b>Unallocated</b>	
Balance at December 31, 2004	\$ 996	\$ 8,456	\$ 85,136	\$ 88,494	\$ 183,082
Net income				5,465	5,465
Protected borrower equity retired	(167)				(167)
Capital stock/participation certificates issued		208			208
Capital stock/participation certificates retired		(2)			(2)
Distribution adjustment			287	(431)	(144)
Balance at March 31, 2005	<u>\$ 829</u>	<u>\$ 8,662</u>	<u>\$ 85,423</u>	<u>\$ 93,528</u>	<u>\$ 188,442</u>
Balance at December 31, 2005	\$ 763	\$ 8,254	\$ 93,647	\$ 90,291	\$ 192,955
Net income				5,974	5,974
Protected borrower equity retired	(240)				(240)
Capital stock/participation certificates issued		212			212
Capital stock/participation certificates retired		(15)			(15)
Distribution adjustment			(275)	353	78
Balance at March 31, 2006	<u>\$ 523</u>	<u>\$ 8,451</u>	<u>\$ 93,372</u>	<u>\$ 96,618</u>	<u>\$ 198,964</u>

*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, 2005, are contained in the 2005 Annual Report to Shareholders. These unaudited first quarter 2006 consolidated financial statements should be read in conjunction with the 2005 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. The results for the three months ended March 31, 2006, are not necessarily indicative of the results to be expected for the year ending December 31, 2006.

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 March 31, 2006, 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 12-31-04	\$ 2,572
(Reversal of) provision for loan losses	—
Loans (charged off), net of recoveries	<u>(117)</u>
Balance at 3-31-05	<u>\$ 2,455</u>
Balance at 12-31-05	\$ 2,706
(Reversal of) provision for loan losses	—
Loans (charged off), net of recoveries	<u>(14)</u>
Balance at 3-31-06	<u>\$ 2,692</u>

## NOTE 3 – COMMITMENTS AND CONTINGENT LIABILITIES

Actions are pending against the Association in which money damages are sought. However, on the basis of information now at hand, management and legal counsel are of the opinion that the ultimate liability, if any, resulting therefrom, would not be material in relation to the overall financial position of the Association.

## NOTE 4 – 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, 2006:

	<b>For the three months ended March 31,</b>	
	<b>2006</b>	<b>2005</b>
Pension	\$ 437	\$ 420
Thrift/deferred compensation	71	75
Other postretirement benefits	<u>249</u>	<u>403</u>
Total	<u>\$ 757</u>	<u>\$ 898</u>

As of March 31, 2006, no contributions have been made to the pension plan for 2006. Actuarial projections as of the last plan measurement date (September 30, 2005) did not anticipate any contributions for 2006; 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.