First South Farm Credit, ACA

FIRST QUARTER 2003

Stephen L. Rochelle
Chief Executive Officer

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April 29, 2003

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 First South Farm Credit, ACA, (Association) for the period ended March 31, 2003. These comments should be read in conjunction with the accompanying consolidated financial statements, notes to the consolidated financial statements and the 2002 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. The Association's loan portfolio is diversified over a range of agricultural commodities in our region, including poultry, cotton, livestock, and forestry. 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, somewhat impacts the level of dependency on a given commodity.

The gross loan volume of the Association as of March 31, 2003, was $811,440, a decrease of $33,061 as compared to $844,501 at December 31, 2002. Net loans outstanding at March 31, 2003, were $790,439 as compared to $823,784 at December 31, 2002. Net loans accounted for 89.71 percent of total assets at March 31, 2003, as compared to 89.47 percent of total assets at December 31, 2002.

The decrease in gross and net loan volume during the reporting period is primarily attributed to seasonal loan payments. The short-term portfolio is heavily influenced by operating-type loans that normally peak in September and rapidly decline in the fall and winter months when farm commodities are marketed.

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 $3,683 at December 31, 2002, to $3,290 at March 31, 2003. This decrease is primarily the result of liquidation, normal payouts, and upgrading to performing status. As of March 31, 2003, there were loans in the amount of $145 that were over 90 days past due but still accruing interest. In management's opinion, these loans are fully secured and are in the process of collection. 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, 2003, was $21,001 compared to $20,717 at December 31, 2002, and was considered by management to be adequate to cover possible losses.

RESULTS OF OPERATIONS

For the three months ended March 31, 2003

Net income for the three months ended March 31, 2003, totaled $2,631, as compared to $2,477 for the same period in 2002. Net interest income increased $688 for the three months ended March 31, 2003, as compared to the same period in 2002.

At March 31, 2003, interest income on accruing loans increased $499 compared to March 31, 2002. Nonaccrual income was $136 for the three months ended March 31, 2003, as compared to $74 for the same period in 2002, an increase of $62. Interest expense decreased $127 for the three months ended March 31, 2003, as compared to the comparable period in 2002. Noninterest income for the three months ended March 31, 2003, totaled $1,968 as compared to $1,941 for the same period of 2002, an increase of $27. Noninterest expense for the three months ended March 31, 2003, increased $659 compared to the same period of 2002.

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 March 31, 2003, was $676,254 as compared to $718,417 at December 31, 2002. The decrease during the period is primarily attributed to the decrease in loan volume.

CAPITAL RESOURCES

Total members' equity at March 31, 2003, increased to $179,759 from the December 31, 2002, total of $176,973. The increase is primarily attributed to the Association's net income for the three months ended March 31, 2003.

Total capital stock and participation certificates were $62,572 on March 31, 2003, compared to $62,407 on December 31, 2002.

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, 2003, the Association's total surplus ratio and core surplus ratio were 13.37 percent and 9.36 percent, respectively, and the permanent capital ratio was 14.81 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.

First South Farm Credit, ACA

Consolidated Balance Sheets

(dollars in thousands)	**March 31, 2003** *(unaudited)*	**December 31, 2002**
Assets		
Cash	$ 4,287	$ 5,091
Loans	811,440	844,501
Less: allowance for loan losses	21,001	20,717
Net loans	790,439	823,784
Accrued interest receivable	8,942	10,067
Investment in AgFirst Farm Credit Bank	63,705	63,705
Premises and equipment, net	3,277	3,260
Other property owned	567	56
Deferred tax asset, net	288	288
Other assets	9,586	14,533
Total assets	$ 881,091	$ 920,784
Liabilities		
Notes payable to AgFirst Farm Credit Bank	$ 676,254	$ 718,417
Accrued interest payable	2,014	2,178
Patronage refund payable	2	3,729
Postretirement benefits other than pensions	10,117	10,015
Other liabilities	12,945	9,472
Total liabilities	701,332	743,811
Commitments and contingencies		
Members' Equity		
Protected borrower equity	153	147
Capital stock and participation certificates	62,419	62,260
Retained earnings		
Allocated	45,999	46,056
Unallocated	71,188	68,510
Total members' equity	179,759	176,973
Total liabilities and members' equity	$ 881,091	$ 920,784

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

First South Farm Credit, ACA

Consolidated Statements of Income

(unaudited)

(dollars in thousands)	For the three months ended March 31, 2003	2002
Interest Income		
Loans	$ 11,695	$ 11,134
Interest Expense		
Notes payable to AgFirst Farm Credit Bank	5,958	6,084
Other	3	4
Total interest expense	5,961	6,088
Net interest income	5,734	5,046
Provision for (reversal of) loan losses	300	300
Net interest income after provision for (reversal of) loan losses	5,434	4,746
Noninterest Income		
Loan fees	576	607
Fees for financially related services	18	73
Equity in earnings of AgFirst Farm Credit Bank	1,288	1,113
Gains (losses) on other property owned, net	—	1
Miscellaneous	86	147
Total noninterest income	1,968	1,941
Noninterest Expense		
Salaries and employee benefits	3,217	2,585
Occupancy and equipment	298	293
Insurance Fund premium	235	52
Other operating expenses	899	1,060
Total noninterest expense	4,649	3,990
Income before income taxes	2,753	2,697
Provision (benefit) for income taxes	122	220
Net income	$ 2,631	$ 2,477

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

First South Farm Credit, ACA

Consolidated Statements of Changes in Members' Equity

(unaudited)

(dollars in thousands)	Protected Borrower Capital	Capital Stock and Participation Certificates	Retained Earnings Allocated	Retained Earnings Unallocated	Total Members' Equity
Balance at December 31, 2001	$ 175	$ 61,448	$ 41,390	$ 70,414	$ 173,427
Net income				2,477	2,477
Protected borrower equity retired	(24)				(24)
Capital stock/participation certificates issued		598			598
Capital stock/participation certificates retired		(346)			(346)
Retained earnings retired			(6,539)		(6,539)
Distribution adjustment			6	(17)	(11)
Balance at March 31, 2002	$ 151	$ 61,700	$ 34,857	$ 72,874	$ 169,582
Balance at December 31, 2002	$ 147	$ 62,260	$ 46,056	$ 68,510	$ 176,973
Net income				2,631	2,631
Protected borrower equity retired	6				6
Capital stock/participation certificates issued		494			494
Capital stock/participation certificates retired		(335)			(335)
Retained earnings retired			(16)		(16)
Distribution adjustment			(41)	47	6
Balance at March 31, 2003	$ 153	$ 62,419	$ 45,999	$ 71,188	$ 179,759

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 First South 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, 2002, are contained in the 2002 Annual Report to Stockholders. These unaudited first quarter 2003 consolidated financial statements should be read in conjunction with the 2002 Annual Report to Stockholders.

As disclosed in the 2002 Annual Report, pursuant to a plan of restructuring approved by the Farm Credit Administration and Association shareholders, the Association reorganized its organizational structure effective January 1, 2002. Pursuant to this restructuring, a Federal Land Credit Association (FLCA) and Production Credit Association (PCA) were formed as wholly owned subsidiaries of the Association. The formation of these subsidiaries enables the Association to take advantage of the tax-exempt status of net income from operations of the FLCA. This restructuring was accounted for as a reorganization of entities under common control similar to a pooling of interests.

Prior to the restructuring, the Association was subject to federal and state income tax. As a result of the restructuring, long-term participation lending activity has been separated into a wholly owned FLCA subsidiary which is exempt from federal and state income tax. The ACA, which is the holding company, along with the wholly owned PCA subsidiary, will continue to be subject to income tax.

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, 2003, are not necessarily indicative of the results to be expected for the year ending December 31, 2003.

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, 2003, 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 12-31-01	$ 19,628
(Reversal of) provision for loan losses	300
Recoveries, net of loans charged off	42
Balance at 3-31-02	$ 19,970
Balance at 12-31-02	$ 20,717
(Reversal of) provision for loan losses	300
Loans (charged off), net of recoveries	(16)
Balance at 3-31-03	$ 21,001