First South Farm Credit, ACA

SECOND QUARTER 2003

Stephen L. Rochelle
Chief Executive Officer

William H. Voss
Chairman of the Board

July 29, 2003

First South Farm Credit, ACA

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 June 30, 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 June 30, 2003, was $901,389, an increase of $56,888 as compared to $844,501 at December 31, 2002. Net loans outstanding at June 30, 2003, were $880,227 as compared to $823,784 at December 31, 2002. Net loans accounted for 90.57 percent of total assets at June 30, 2003, as compared to 89.47 percent of total assets at December 31, 2002.

The increase in gross and net loan volume during the reporting period is attributed primarily to seasonal lending. 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 $2,405 at June 30, 2003. This decrease is primarily the result of liquidation, normal payouts, and upgrading to performing status. As of June 30, 2003, there were loans in the amount of $855 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 June 30, 2003, was $21,162 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 June 30, 2003

Net income for the three months ended June 30, 2003, totaled $3,384, as compared to $3,490 for the same period in 2002, a decrease of $106. Net interest income increased $604, for the three months ended June 30, 2003, as compared to the same period in 2002.

At June 30, 2003, interest income on accruing loans decreased $117 compared to June 30, 2002. Nonaccrual income was $214 for the three months ended June 30, 2003, as compared to $138 for the same period in 2002. Interest expense decreased $645 for the three months ended June 30, 2003, as compared to the comparable period of 2002. Noninterest income for the three months ended June 30, 2003, totaled $2,136 as compared to $1,903 for the same period of 2002, an increase of $233. Noninterest expense for the three months ended June 30, 2003, increased $935 compared to the same period of 2002.

For the six months ended June 30, 2003

Net income for the six months ended June 30, 2003, totaled $6,015, as compared to $5,967 for the same period in 2002. This increase of $48, or .80 percent, is attributed to an increase in net interest income of $1,292, an increase in non-interest income of $260, and a decrease in provision for income taxes of $90, partially offset by an increase in non-interest expense of $1,594. At June 30, 2003, interest income on accruing loans increased $382 compared to June 30, 2002, as a result of an increase in average loans outstanding of $59,465, partially offset by a decrease in the average interest rate on loans to members of 35 basis points. Nonaccrual income was $350 for the six months ended June 30, 2003, as compared to $212 for the same period in 2002. Interest expense decreased $772 for the six months ended June 30, 2003, as compared to the same period in 2002. This change is primarily due to a decrease in the average interest rate on notes payable to AgFirst Farm Credit Bank (the Bank) of 51 basis points, partially offset by an increase in the average notes payable to the Bank of $50,536.

Noninterest income for the six months ended June 30, 2003, totaled $4,104, as compared to $3,844 for the same period of 2002, an increase of $260. The increase resulted from an increase in loan fees of $100, an increase in equity in earnings of the Bank of $338 and an increase in gains on other property owned of $31, partially offset by a decrease in fees for financially related services of $190 and a decrease in miscellaneous income of $19.

Noninterest expense for the six months ended June 30, 2003, increased $1,594 compared to the same period of 2002. This increase is attributed to an increase in salaries and benefits expense of $1,349, an increase in occupancy and equipment expense of $35 and an increase in the Insurance Fund premium of $373, partially offset by a decrease in other operating expense of $163. The increase in salaries and benefits expense relates primarily to the recognition of liabilities related to the Association's retirement plan and its related health care costs. The Association recorded a provision for income taxes of $90 for the six months ended June 30, 2003, as compared to $180 for the same period in 2002.

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 June 30, 2003, was $775,613 as compared to $718,417 at December 31, 2002. The increase during the period is primarily attributed to the increase in loan volume.

CAPITAL RESOURCES

Total members' equity at June 30, 2003, increased to $177,982 from the December 31, 2002, total of $176,973. The increase primarily resulted from net income for the six months ended June 30, 2003, of $6,015 and an increase in capital stock and participation certificates of $489, partially offset by cash patronage of $5,507.

Total capital stock and participation certificates were $62,896 on June 30, 2003, compared to $62,407 on December 31, 2002. This increase is attributed to the issuance of member stock associated with the increase in gross loan volume at June 30, 2003, compared to 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 June 30, 2003, the Association's total surplus ratio and core surplus ratio were 12.40 percent and 9.02 percent, respectively, and the permanent capital ratio was 13.82 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)	**June 30, 2003**	**December 31, 2002**
	(unaudited)	
Assets		
Cash	$ 3,569	$ 5,091
Loans	901,389	844,501
Less: allowance for loan losses	21,162	20,717
Net loans	880,227	823,784
Accrued interest receivable	10,070	10,067
Investment in other Farm Credit institutions	63,706	63,705
Premises and equipment, net	3,318	3,260
Other property owned	470	56
Deferred tax asset, net	288	288
Other assets	10,272	14,533
Total assets	$ 971,920	$ 920,784
Liabilities		
Notes payable to AgFirst Farm Credit Bank	$ 775,613	$ 718,417
Accrued interest payable	2,020	2,178
Patronage refund payable	4	3,729
Postretirement benefits other than pensions	10,219	10,015
Other liabilities	6,082	9,472
Total liabilities	793,938	743,811
Commitments and contingencies		
Members' Equity		
Protected borrower equity	153	147
Capital stock and participation certificates	62,743	62,260
Retained earnings		
Allocated	40,509	46,056
Unallocated	74,577	68,510
Total members' equity	177,982	176,973
Total liabilities and members' equity	$ 971,920	$ 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 June 30, 2003	For the three months ended June 30, 2002	For the six months ended June 30, 2003	For the six months ended June 30, 2002
Interest Income				
Loans	$ 12,346	$ 12,387	$ 24,041	$ 23,521
Interest Expense				
Notes payable to AgFirst Farm Credit Bank	6,042	6,686	12,000	12,770
Other	2	3	5	7
Total interest expense	6,044	6,689	12,005	12,777
Net interest income	6,302	5,698	12,036	10,744
Provision for (reversal of) loan losses	300	300	600	600
Net interest income after provision for (reversal of) loan losses	6,002	5,398	11,436	10,144
Noninterest Income				
Loan fees	562	431	1,138	1,038
Fees for financially related services	104	239	122	312
Equity in earnings of other Farm Credit institutions	1,403	1,240	2,691	2,353
Gains (losses) on other property owned, net	22	(10)	22	(9)
Miscellaneous	45	3	131	150
Total noninterest income	2,136	1,903	4,104	3,844
Noninterest Expense				
Salaries and employee benefits	3,230	2,513	6,447	5,098
Occupancy and equipment	299	269	597	562
Insurance Fund premium	247	57	482	109
Other operating expenses	1,010	1,012	1,909	2,072
Total noninterest expense	4,786	3,851	9,435	7,841
Income before income taxes	3,352	3,450	6,105	6,147
Provision (benefit) for income taxes	(32)	(40)	90	180
Net income	$ 3,384	$ 3,490	$ 6,015	$ 5,967

The accompanying notes are an intergral 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				5,967	5,967
Protected borrower equity retired	(25)				(25)
Capital stock/participation certificates issued		1,129			1,129
Capital stock/participation certificates retired		(590)			(590)
Retained earnings retired			(6,543)		(6,543)
Distribution adjustment			6	(16)	(10)
Balance at June 30, 2002	$ 150	$ 61,987	$ 34,853	$ 76,365	$ 173,355
Balance at December 31, 2002	$ 147	$ 62,260	$ 46,056	$ 68,510	$ 176,973
Net income				6,015	6,015
Protected borrower equity retired	6				6
Capital stock/participation certificates issued		1,120			1,120
Capital stock/participation certificates retired		(637)			(637)
Retained earnings retired			(5,507)		(5,507)
Distribution adjustment			(40)	52	12
Balance at June 30, 2003	$ 153	$ 62,743	$ 40,509	$ 74,577	$ 177,982

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

First South 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 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 second 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 six months ended June 30, 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 June 30, 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	600
Loans (charged off), net of recoveries	(40)
Balance at 6-30-02	$ 20,188
Balance at 12-31-02	$ 20,717
(Reversal of) provision for loan losses	600
Loans (charged off), net of recoveries	(155)
Balance at 6-30-03	$ 21,162