First South Farm Credit, ACA

SECOND QUARTER 2006

Stephen L. Rochelle
Chief Executive Officer

William H. Voss
Chairman of the Board

July 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 *First South Farm Credit, ACA* (Association) for the period ended June 30, 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. 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. The Association's loan portfolio is diversified over a range of agricultural commodities 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 reduces the level of dependency on any single commodity.

The gross loan volume of the Association as of June 30, 2006, was $1,101,562, an increase of $116,076, as compared to $985,486 at December 31, 2005. Net loans outstanding at June 30, 2006, were $1,095,816 as compared to $980,061 at December 31, 2005. Net loans accounted for 91.48 percent of total assets at June 30, 2006, as compared to 89.31 percent of total assets at December 31, 2005. The increase in gross and net loan volume during the reporting period is partly attributable 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 and credit administration remains satisfactory. Nonaccrual loans increased from $2,484 at December 31, 2005, to $3,511 at June 30, 2006.

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, 2006, was $5,746 compared to $5,425 at December 31, 2005, and was considered by management to be adequate to cover probable losses.

RESULTS OF OPERATIONS

For the three months ended June 30, 2006

Net income for the three months ended June 30, 2006, totaled $4,726, as compared to $4,643 for the same period in 2005. Net interest income increased $732 for the three months ended June 30, 2006, as compared to the same period in 2005. The increase in net interest income was primarily the result of an increase in average accruing loans outstanding of 8.19 percent for the three months ending June 30, 2006, compared to the same period of 2005.

Noninterest income for the three months ended June 30, 2006, totaled $2,279, as compared to $2,256 for the same period of 2005, an increase of $23. The increase is primarily the result of an increase in equity in earnings of AgFirst Farm Credit Bank (the Bank) of $107 and an increase in other noninterest income of $18, partially offset by a decrease in loan fees of $57, a decrease in fees for financially related services of $40, and a decrease in gains on other property owned of $5.

Noninterest expense for the three months ended June 30, 2006, increased $291 compared to the same period of 2005. The primary reasons for the increase in noninterest expense were an increase in salaries and benefits of $68, an increase in occupancy and equipment expense of $28, and an increase in the Insurance Fund premium of $267, partially offset by a decrease in other operating expenses of $72.

The Association recorded a provision for loan loss of $330 for the three months ended June 30, 2006, compared to no provision for the same period in 2005. This addition is the result of continued loan growth and the assessment of the related risk in the loan portfolio. The Association recorded a benefit from income taxes of $16 for the three months ended June 30, 2006, compared to a benefit of $67 for the same period in 2005.

For the six months ended June 30, 2006

Net income for the six months ended June 30, 2006, totaled $8,975, as compared to $8,641 for the same period in 2005. At June 30, 2006, net interest income increased by $1,600 or 11.52 percent compared to June 30, 2005. Interest income on loans increased by $7,289 and interest expense increased by $5,689. This change in net interest income is primarily the result of an increase in average accruing loans outstanding of 8.91 percent for the six months ending June 30, 2006, compared to the same period of 2005.

Noninterest income for the six months ended June 30, 2006, totaled $4,578, as compared to $4,461 for the same period of 2005, an increase of $117. The increase is primarily the result of an increase in equity in earnings of the Bank of $214 and an increase in other noninterest income of $39, partially offset by a decrease in loan fees of $66, a decrease in fees for financially related services of $33, and a decrease in gains on other property owned of $37.

Noninterest expense for the six months ended June 30, 2006, increased $866 compared to the same period of 2005. The primary reasons for the increase in noninterest expense were an increase in salaries and employee benefits expense of $156, an increase in occupancy and equipment expense of $77, an increase in the Insurance Fund premium of $521, and an increase in other operating expenses of $112. The increase in the Insurance Fund premium reflects the continued loan growth in the Farm Credit System.

The Association recorded a provision for loan loss of $530 for the six months ended June 30, 2006, compared to no provision for the same period in 2005. This addition is the result of continued loan growth and the assessment of the related risk in the loan portfolio. The Association recorded a benefit from income taxes of $1 for the six months ended June 30, 2006, compared to a provision of $12 for the same period in 2005.

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 Bank advances funds 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, 2006, was $960,766 as compared to $856,986 at December 31, 2005.

CAPITAL RESOURCES

Total members' equity at June 30, 2006, increased to $215,766 from the December 31, 2005, total of $213,834. The increase is primarily attributed to net income of $8,975 and an increase in capital stock and participation certificates of $192, partially offset by the retirement of allocated earnings of $7,170.

Total capital stock and participation certificates were $64,259 on June 30, 2006, compared to $64,067 on December 31, 2005. This increase is attributed to the issuance of member stock associated with the increase in gross loan volume at June 30, 2006, compared to December 31, 2005.

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, 2006, the Association's total surplus ratio and core surplus ratio were 13.23 percent and 11.49 percent, respectively, and the permanent capital ratio was 14.41 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.

STOCKHOLDER INVESTMENT

Stockholder investment in the Association could be affected by the financial condition and results of operations of AgFirst Farm Credit Bank. Copies of AgFirst Farm Credit Bank's Quarterly and Annual Reports are on the AgFirst website, ***www.agfirst.com***, or may be obtained at no charge by calling 1-800-845-1745, extension 316, or writing Wanda Martin, AgFirst Farm Credit Bank, P.O. Box 1499, Columbia, SC 29202. Copies of the Association's Annual and Quarterly reports are also on the Association's website, ***www.firstsouthfarmcredit.com***, or may be obtained upon request free of charge by calling 1-800-955-1722 or writing Bryan Applewhite, First South Farm Credit, ACA, P. O. Box 6008, Ridgeland, MS 39158-6008. 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.

First South Farm Credit, ACA

Consolidated Balance Sheets

(dollars in thousands)	June 30, 2006 *(unaudited)*	December 31, 2005 *(audited)*
Assets		
Cash	$ 8,943	$ 20,207
Loans	1,101,562	985,486
Less: allowance for loan losses	5,746	5,425
Net loans	1,095,816	980,061
Accrued interest receivable	15,634	12,621
Investment in other Farm Credit institutions	61,849	61,849
Premises and equipment, net	4,592	4,351
Other property owned	480	479
Prepaid retirement expense	6,567	7,523
Due from AgFirst Farm Credit Bank	3,170	9,311
Other assets	787	991
Total assets	$ 1,197,838	$ 1,097,393
Liabilities		
Notes payable to AgFirst Farm Credit Bank	$ 960,766	$ 856,986
Accrued interest payable	3,852	3,334
Patronage refund payable	5	3,199
Postretirement benefits other than pensions	11,542	11,560
Other liabilities	5,907	8,480
Total liabilities	982,072	883,559
Commitments and contingencies		
Members' Equity		
Protected borrower equity	139	140
Capital stock and participation certificates	64,120	63,927
Retained earnings		
Allocated	61,080	68,020
Unallocated	90,427	81,747
Total members' equity	215,766	213,834
Total liabilities and members' equity	$ 1,197,838	$ 1,097,393

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, 2006	For the three months ended June 30, 2005	For the six months ended June 30, 2006	For the six months ended June 30, 2005
Interest Income				
Loans	$ 18,832	$ 15,106	$ 35,619	$ 28,330
Interest Expense				
Notes payable to AgFirst Farm Credit Bank	10,818	7,824	20,126	14,437
Net interest income	8,014	7,282	15,493	13,893
Provision for (reversal of allowance for) loan losses	330	—	530	—
Net interest income after provision for (reversal of allowance for) loan losses	7,684	7,282	14,963	13,893
Noninterest Income				
Loan fees	518	575	1,156	1,222
Fees for financially related services	95	135	108	141
Equity in earnings of other Farm Credit institutions	1,647	1,540	3,169	2,955
Gains (losses) on other property owned, net	1	6	—	37
Other noninterest income	18	—	145	106
Total noninterest income	2,279	2,256	4,578	4,461
Noninterest Expense				
Salaries and employee benefits	3,470	3,402	6,990	6,834
Occupancy and equipment	283	255	574	497
Insurance Fund premium	358	91	692	171
Other operating expenses	1,142	1,214	2,311	2,199
Total noninterest expense	5,253	4,962	10,567	9,701
Income before income taxes	4,710	4,576	8,974	8,653
Provision (benefit) for income taxes	(16)	(67)	(1)	12
Net income	$ 4,726	$ 4,643	$ 8,975	$ 8,641

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, 2004	$ 142	$ 63,360	$ 58,064	$ 81,097	$ 202,663
Net income				8,641	8,641
Capital stock/participation certificates issued		962			962
Capital stock/participation certificates retired		(548)			(548)
Retained earnings retired			(6,536)		(6,536)
Distribution adjustment			154	(221)	(67)
Balance at June 30, 2005	$ 142	$ 63,774	$ 51,682	$ 89,517	$ 205,115
Balance at December 31, 2005	$ 140	$ 63,927	$ 68,020	$ 81,747	$ 213,834
Net income				8,975	8,975
Protected borrower equity retired	(1)				(1)
Capital stock/participation certificates issued		869			869
Capital stock/participation certificates retired		(676)			(676)
Retained earnings retired			(7,170)		(7,170)
Distribution adjustment			230	(295)	(65)
Balance at June 30, 2006	$ 139	$ 64,120	$ 61,080	$ 90,427	$ 215,766

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, 2005, are contained in the 2005 Annual Report to Shareholders. These unaudited second 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 six months ended June 30, 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 June 30, 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	$ 5,189
(Reversal of) provision for loan losses	–
Recoveries, net of loans charged off	100
Balance at 6-30-05	$ 5,289
Balance at 12-31-05	$ 5,425
(Reversal of) provision for loan losses	530
Loans (charged off), net of recoveries	(209)
Balance at 6-30-06	$ 5,746

NOTE 3 – EMPLOYEE BENEFIT PLANS

The Association's employees participate in a defined benefit retirement plan. This plan is noncontributory and covers substantially all employees of the Association.

The following is a table of the components of net periodic benefit (income) cost for the defined benefit retirement plan for the six months ended June 30, 2006:

	For the six months ended June 30,	
	2006	**2005**
Service cost	$ 754	$ 619
Interest cost	1,175	1,141
Expected return on plan assets	(1,435)	(1,261)
Amortization of net (gain) loss	(169)	(169)
Amortization of prior service cost	71	71
Recognized net actuarial (gain) loss	560	378
Net periodic benefit (income) cost	$ 956	$ 779

As of June 30, 2006, no contributions have been made to the pension plan for 2006. The total employer contribution expected for 2006 is $1,250.

The Association also participates in Districtwide thrift and other postretirement benefit plans. The other postretirement benefit plan provides certain benefits (primarily health care) to its retirees.

The following is a table of retirement and postretirement benefit expense for the six months ended June 30, 2006:

	For the six months ended June 30,	
	2006	**2005**
Pension	$ 956	$ 779
Thrift/deferred compensation	123	117
Other postretirement benefits	200	417
Total	$1,279	$1,313