First South Farm Credit, ACA

THIRD QUARTER 2006

Stephen L. Rochelle
Chief Executive Officer

William H. Voss
Chairman of the Board

October 27, 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 September 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 September 30, 2006, was $1,172,733, an increase of $187,247, as compared to $985,486 at December 31, 2005. Net loans outstanding at September 30, 2006, were $1,166,845 as compared to $980,061 at December 31, 2005. Net loans accounted for 91.74 percent of total assets at September 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 primarily 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 $2,680 at September 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 September 30, 2006, was $5,888 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 September 30, 2006

Net income for the three months ended September 30, 2006, totaled $5,146, as compared to $5,333 for the same period in 2005. Net interest income increased $364 for the three months ended September 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 6.60 percent for the three months ending September 30, 2006, compared to the same period of 2005.

Noninterest income for the three months ended September 30, 2006, totaled $2,540, as compared to $2,358 for the same period of 2005, an increase of $182. The increase is primarily the result of an increase in loan fees of $31, an increase in equity in earnings of AgFirst Farm Credit Bank (the Bank) of $135, and an increase in gains on other property owned of $24, partially offset by a decrease in fees for financially related services of $3 and a decrease in other noninterest income of $5. Noninterest expense for the three months ended September 30, 2006, increased $692 compared to the same period of 2005. The primary reasons for the increase in noninterest expense were an increase in salaries and benefits expense of $78, an increase in occupancy and equipment expense of $14, an increase in the Insurance Fund premium of $235, and an increase in other operating expenses of $365.

The Association recorded a provision for loan loss of $400 for the three months ended September 30, 2006, compared to a provision of $305 for the same period in 2005. The Association recorded a benefit from income taxes of $10 compared to a provision of $44 for the same period in 2005.

For the nine months ended September 30, 2006

Net income for the nine months ended September 30, 2006, totaled $14,121, as compared to $13,974 for the same period in 2005. At September 30, 2006, net interest income increased by $1,339 or 6.11 percent compared to September 30, 2005. Interest income on loans increased by $11,240 and interest expense increased by $9,276. This change in net interest income is primarily the result of an increase in average accruing loans outstanding of 8.04 percent for the nine months ending September 30, 2006, compared to the same period of 2005.

Noninterest income for the nine months ended September 30, 2006, totaled $7,118, as compared to $6,819 for the same period of 2005, an increase of $299. The increase is primarily the result of an increase in equity in earnings of the Bank of $349 and an increase in other noninterest income of $34, partially offset by a decrease in loan fees of $35, a decrease in fees for financially related services of $36, and a decrease in gains on other property owned of $13.

Noninterest expense for the nine months ended September 30, 2006, increased $1,558 compared to the same period of 2005. The primary reasons for the increase in noninterest expense were an increase in salaries and employee benefits of $234, an increase in occupancy and equipment of $91, an increase in The Insurance Fund Premium of $756, and an increase in other operating expenses of $477. 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 $930 for the nine months ended September 30, 2006, compared to a provision of $305 for the same period in 2005. The increase in the provision 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 $11 compared to a provision of $56 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 September 30, 2006, was $1,029,440 as compared to $856,986 at December 31, 2005.

CAPITAL RESOURCES

Total members' equity at September 30, 2006, increased to $220,948 from the December 31, 2005, total of $213,834. The increase is primarily attributed to net income of $14,121 and an increase in capital stock and participation certificates of $237, partially offset by the retirement of allocated earnings of $7,182.

Total capital stock and participation certificates were $64,304 on September 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 September 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 September 30, 2006, the Association's total surplus ratio and core surplus ratio were 12.09 percent and 10.53 percent, respectively, and the permanent capital ratio was 13.26 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.

ACCOUNTING FOR DEFINED BENEFIT PENSION AND OTHER POSTRETIREMENT PLANS

On September 29, 2006, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 158 – Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans. The Standard requires an employer to recognize the overfunded or underfunded status of a defined benefit postretirement plan as an asset or liability in its statement of financial position and recognize changes in that funded status in the year in which the changes occur through comprehensive income. The Standard is effective for employers with publicly traded securities for the fiscal year ending after December 15, 2006 and for employers without publicly traded securities for the fiscal year ending after June 15, 2007. The Association will be required to implement the Standard for the year ended December 31, 2007. In addition, this Standard requires that the funded status of a plan be measured as of the date of the year-end financial statements. Currently, the Association uses a measurement date of September 30th. The requirement to measure the funded status as of the fiscal year-end is effective for fiscal years ending after December 15, 2008. The Association is currently evaluating the impact of implementing this Standard. It is anticipated that the impact from the implementation of this Standard will have no impact on the income statement and, based on the current funded status of the defined benefit plans, it is not expected to have a material or significant impact on the balance sheet.

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)	September 30, 2006	December 31, 2005
	(unaudited)	*(audited)*
Assets		
Cash	$ 5,695	$ 20,207
Loans	1,172,733	985,486
Less: allowance for loan losses	5,888	5,425
Net loans	1,166,845	980,061
Accrued interest receivable	20,091	12,621
Investment in other Farm Credit institutions	61,849	61,849
Premises and equipment, net	4,575	4,351
Other property owned	83	479
Prepaid retirement expense	6,816	7,523
Due from AgFirst Farm Credit Bank	5,099	9,311
Other assets	782	991
Total assets	$ 1,271,835	$ 1,097,393
Liabilities		
Notes payable to AgFirst Farm Credit Bank	$ 1,029,440	$ 856,986
Accrued interest payable	4,563	3,334
Patronage refund payable	5	3,199
Postretirement benefits other than pensions	11,535	11,560
Other liabilities	5,344	8,480
Total liabilities	1,050,887	883,559
Commitments and contingencies		
Members' Equity		
Protected borrower equity	110	140
Capital stock and participation certificates	64,194	63,927
Retained earnings		
Allocated	61,068	68,020
Unallocated	95,576	81,747
Total members' equity	220,948	213,834
Total liabilities and members' equity	$ 1,271,835	$ 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 September 30, 2006	For the three months ended September 30, 2005	For the nine months ended September 30, 2006	For the nine months ended September 30, 2005
Interest Income				
Loans	$ 22,156	$ 18,205	$ 57,775	$ 46,535
Interest Expense				
Notes payable to AgFirst Farm Credit Bank	13,456	9,869	33,582	24,306
Net interest income	8,700	8,336	24,193	22,229
Provision for (reversal of) loan losses	400	305	930	305
Net interest income after provision for (reversal of) loan losses	8,300	8,031	23,263	21,924
Noninterest Income				
Loan fees	487	456	1,643	1,678
Fees for financially related services	101	104	209	245
Equity in earnings of other Farm Credit institutions	1,926	1,791	5,095	4,746
Gains (losses) on other property owned, net	26	2	26	39
Other noninterest income	—	5	145	111
Total noninterest income	2,540	2,358	7,118	6,819
Noninterest Expense				
Salaries and employee benefits	3,521	3,443	10,511	10,277
Occupancy and equipment	300	286	874	783
Insurance Fund premium	405	170	1,097	341
Other operating expenses	1,478	1,113	3,789	3,312
Total noninterest expense	5,704	5,012	16,271	14,713
Income before income taxes	5,136	5,377	14,110	14,030
Provision (benefit) for income taxes	(10)	44	(11)	56
Net income	$ 5,146	$ 5,333	$ 14,121	$ 13,974

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				13,974	13,974
Protected borrower equity retired	(2)				(2)
Capital stock/participation certificates issued		1,372			1,372
Capital stock/participation certificates retired		(811)			(811)
Retained earnings retired			(6,576)		(6,576)
Distribution adjustment			155	(216)	(61)
Balance at September 30, 2005	$ 140	$ 63,921	$ 51,643	$ 94,855	$ 210,559
Balance at December 31, 2005	$ 140	$ 63,927	$ 68,020	$ 81,747	$ 213,834
Net income				14,121	14,121
Protected borrower equity retired	(30)				(30)
Capital stock/participation certificates issued		1,237			1,237
Capital stock/participation certificates retired		(970)			(970)
Retained earnings retired			(7,182)		(7,182)
Distribution adjustment			230	(292)	(62)
Balance at September 30, 2006	$ 110	$ 64,194	$ 61,068	$ 95,576	$ 220,948

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 third quarter 2006 consolidated financial statements should be read in conjunction with the 2005 Annual Report to Shareholders.

On September 29, 2006, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 158 – Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans. The Standard requires an employer to recognize the overfunded or underfunded status of a defined benefit postretirement plan as an asset or liability in its statement of financial position and recognize changes in that funded status in the year in which the changes occur through comprehensive income. The Standard is effective for employers with publicly traded securities for the fiscal year ending after December 15, 2006 and for employers without publicly traded securities for the fiscal year ending after June 15, 2007. The Association will be required to implement the Standard for the year ended December 31, 2007. In addition, this Standard requires that the funded status of a plan be measured as of the date of the year-end financial statements. Currently, the Association uses a measurement date of September 30th. The requirement to measure the funded status as of the fiscal year-end is effective for fiscal years ending after December 15, 2008. The Association is currently evaluating the impact of implementing this Standard. It is anticipated that the impact from the implementation of this Standard will have no impact on the consolidated income statement and, based on the current funded status of the defined benefit plans, it is not expected to have a material or significant impact on the consolidated balance sheet.

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 nine months ended September 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 September 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:

	For the nine months ended September 30,	
	2006	**2005**
Balance at beginning of period	$ 5,425	$ 5,189
Provision for (reversal of) loan losses	930	305
Loans (charged off), net of recoveries	(467)	(29)
Balance at end of period	$ 5,888	$ 5,465

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 nine months ended September 30, 2006:

	For the nine months ended September 30,	
	2006	**2005**
Service cost	$ 1,132	$ 929
Interest cost	1,762	1,711
Expected return on plan assets	(2,153)	(1,892)
Amortization of net (gain) loss	(253)	(254)
Amortization of prior service cost	107	107
Recognized net actuarial (gain) loss	839	567
Net periodic benefit (income) cost	$ 1,434	$ 1,168

The Association had previously anticipated making a contribution of $1,250 to the defined benefit retirement plan during 2006 based upon actuarial projections as of the last plan measurement date (September 30, 2005). However, due to market conditions affecting discount rates and return on plan assets, current actuarial projections indicated that a lower contribution was needed at September 30, 2006. During the third quarter of 2006, the Association contributed $727 to the defined benefit retirement plan. The Association does not anticipate making additional contributions for the remainder of 2006.

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 nine months ended September 30, 2006:

	For the nine months ended September 30,	
	2006	**2005**
Pension	$ 1,434	$1,168
Thrift/deferred compensation	187	178
Other postretirement benefits	300	626
Total	$ 1,921	$1,972