
FIRST SOUTH FARM CREDIT, ACA

2007 ANNUAL REPORT

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Management

Stephen L. Rochelle.....	President & Chief Executive Officer
Bryan Applewhite.....	Senior Vice President/Chief Financial Officer/Treasurer
Sells J. Newman, Jr.....	Senior Vice President/Marketing
Randy Underwood.....	Senior Vice President/Chief Credit Officer
Roger Chappell.....	President, North Alabama Division
Cecil Corbello.....	President, Louisiana Division
John Barnard.....	President, Mississippi Division
Camp Powers.....	President, South Alabama Division

Board of Directors

Shepherd Morris.....	Chairman
Dan West.....	Vice Chairman
Bobby G. Briscoe.....	Director
John R. Burden.....	Director
Paul Clark.....	Director
Dr. Marty J. Fuller.....	Director
Dr. William E. Hardy, Jr.....	Director
William T. Kyser.....	Director
Ray Makamson.....	Director
Alan Marsh.....	Director
James F. Martin, Jr.....	Director
Daniel C. Mattingly.....	Director
Joe H. Morgan.....	Director
Thomas H. Nelson, Jr.....	Director
James M. Norsworthy, III.....	Director
Thomas A. Parker.....	Director
Ted S. Passmore.....	Director
W.S. Patrick.....	Director
Robert E. Potts.....	Director
Walter R. Richardson.....	Director
Mike Unkel.....	Director
Daniel Viator.....	Director
William H. Voss.....	Director

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Message from the Chief Executive Officer

First South Farm Credit continued to experience tremendous success in 2007, a testament to the hard work and dedication of its members, board of directors and staff.

- First South's 2007 earnings exceeded \$21 million, while loan volume peaked at \$1.3 billion. We are proud of our earnings and growth and it is important to point out that our credit quality remained strong at 98.8%.

First South operates as a true cooperative. As history demonstrates, when the Association and its customers do well, First South pays a portion of its profits to its stockholders.

- For the 13th consecutive year the First South Board of Directors approved the distribution of association earnings and voted to distribute the allocated surplus from 2002. These checks for an estimated \$9.3 million will be delivered to our Association stockholders in the first quarter of 2008.
- Since 1995 First South has distributed to its stockholders over \$148 million in cash and allocated surplus. This is proof of how First South Farm Credit adds value for our customers and stockholders.

There are challenges ahead for First South and its members.

- As a major player in financing agriculture and agribusiness, First South and its board of directors understand the importance of the farm bill and how it can effect the Association and its stockholders as well as the economies of Alabama, Mississippi and Louisiana. First South will continue to be cognizant of the country's farm policy.
- A complex global economy, changing markets, weather and technology are but a few of the challenges facing the board of directors and management of First South. Challenges bring opportunity and the Association has developed a sound business plan to address these challenges and opportunities.

First South Farm Credit is the Farm Credit System's largest agricultural lender in Alabama, Mississippi and Louisiana, specializing in the financing of production agriculture, agribusiness and land mortgages to fulltime, part-time, young, beginning, small and minority farmers.

First South will continue to take a leadership roll in providing choices of competitive credit and credit services to the agricultural communities of Alabama, Louisiana and Mississippi.

Our commitment is to you. Thank you for making First South your first choice.



Stephen L. Rochelle
Chief Executive Officer

February 28, 2008

Report of Management

The accompanying consolidated financial statements and related financial information appearing throughout this annual report have been prepared by management of First South Farm Credit, ACA (Association) in accordance with generally accepted accounting principles appropriate in the circumstances. Amounts which must be based on estimates represent the best estimates and judgments of management. Management is responsible for the integrity, objectivity, consistency, and fair presentation of the consolidated financial statements and financial information contained in this report.

Management maintains and depends upon an internal accounting control system designed to provide reasonable assurance that transactions are properly authorized and recorded, that the financial records are reliable as the basis for the preparation of all financial statements, and that the assets of the Association are safeguarded. The design and implementation of all systems of internal control are based on judgments required to evaluate the costs of controls in relation to the expected benefits and to determine the appropriate balance between these costs and benefits. The Association maintains an internal audit program to monitor compliance with the systems of internal accounting control. Audits of the accounting records, accounting systems and internal controls are performed and internal audit reports, including appropriate recommendations for improvement, are submitted to the Board of Directors.

The consolidated financial statements have been examined by independent public auditors, whose report appears elsewhere in this annual report. The Association is also subject to examination by the Farm Credit Administration.

The consolidated financial statements, in the opinion of management, fairly present the financial condition of the Association. The undersigned certify that the 2007 Annual Report has been prepared in accordance with all applicable statutory or regulatory requirements and that the information contained herein is true, accurate, and complete to the best of our knowledge and belief.

The accompanying consolidated financial statements were prepared under the oversight of the Audit Committee of the Board of Directors.



Shepherd Morris
Chairman of the Board



Stephen L. Rochelle
Chief Executive Officer



Bryan Applewhite
Chief Financial Officer

February 28, 2008

Consolidated Five - Year Summary of Selected Financial Data

<i>(dollars in thousands)</i>	2007	2006	December 31, 2005	2004	2003
Balance Sheet Data					
Cash	\$ 8,356	\$ 15,743	\$ 20,207	\$ 10,375	\$ 10,372
Loans	1,240,078	1,118,377	985,486	889,076	839,911
Less: allowance for loan losses	6,961	5,876	5,425	5,189	20,630
Net loans	1,233,117	1,112,501	980,061	883,887	819,281
Investments in other Farm Credit institutions	68,575	66,260	61,849	61,513	62,314
Other property owned	5	83	479	739	434
Other assets	33,606	36,885	34,797	29,042	26,438
Total assets	\$ 1,343,659	\$ 1,231,472	\$ 1,097,393	\$ 985,556	\$ 918,839
Notes payable to AgFirst Farm Credit Bank*	\$ 1,088,297	\$ 978,396	\$ 856,986	\$ 759,497	\$ 712,060
Accrued interest payable and other liabilities with maturities of less than one year	29,366	29,701	26,573	23,396	24,794
Total liabilities	1,117,663	1,008,097	883,559	782,893	736,854
Protected borrower stock	111	92	140	142	147
Capital stock and participation certificates	64,347	64,236	63,927	63,360	62,952
Retained earnings					
Allocated	84,707	77,039	68,020	58,064	52,081
Unallocated	83,048	82,008	81,747	81,097	66,805
Accumulated other comprehensive income (loss)	(6,217)	—	—	—	—
Total members' equity	225,996	223,375	213,834	202,663	181,985
Total liabilities and members' equity	\$ 1,343,659	\$ 1,231,472	\$ 1,097,393	\$ 985,556	\$ 918,839
Statement of Income Data					
Net interest income	\$ 34,118	\$ 32,592	\$ 30,265	\$ 25,975	\$ 25,885
Provision for (reversal of allowance for) loan losses	1,050	930	305	(14,809)	1,200
Noninterest income (expense), net	(12,002)	(12,345)	(9,512)	(10,478)	(11,944)
Net income	\$ 21,066	\$ 19,317	\$ 20,448	\$ 30,306	\$ 12,741
Key Financial Ratios					
Rate of return on average:					
Total assets	1.60%	1.67%	1.91%	3.20%	1.36%
Total members' equity	9.28%	8.89%	9.92%	16.52%	7.09%
Net interest income as a percentage of					
average earning assets	2.81%	3.07%	3.09%	2.98%	3.00%
Net chargeoffs (recoveries) to average loans	(0.003)%	0.045%	0.007%	0.072%	0.148%
Total members' equity to total assets	16.82%	18.14%	19.49%	20.56%	19.81%
Debt to members' equity (:1)	4.95	4.51	4.13	3.86	4.05
Allowance for loan losses to loans	0.56%	0.53%	0.55%	0.58%	2.46%
Permanent capital ratio	12.54%	13.50%	13.63%	13.59%	13.84%
Total surplus ratio	11.51%	12.33%	12.43%	12.21%	12.46%
Core surplus ratio	10.40%	10.77%	10.40%	9.38%	9.40%
Net Income Distribution					
Estimated patronage refunds:					
Cash	\$ 3,838	\$ 2,775	\$ 3,195	\$ 3,101	\$ 2,800
Qualified allocated retained earnings	3,838	4,162	4,792	4,652	4,199
Nonqualified allocated retained earnings	6,267	5,915	5,799	3,845	3,069
Nonqualified retained earnings	6,267	5,915	5,799	4,651	4,466

* General financing agreement is renewable on three-year cycles. The next renewal date is December 31, 2010.

Management's Discussion & Analysis of Financial Condition & Results of Operations

(dollars in thousands, except as noted)

GENERAL OVERVIEW

The following commentary summarizes the financial condition and results of operations of First South Farm Credit, ACA, (Association) for the year ended December 31, 2007 with comparisons to the years ended December 31, 2006 and December 31, 2005. This information should be read in conjunction with the Consolidated Financial Statements, Notes to the Consolidated Financial Statements and other sections in this Annual Report. The accompanying consolidated financial statements were prepared under the oversight of the Audit Committee of the Board of Directors. For a list of the Audit Committee members, refer to the "Report of the Audit Committee" reflected in this Annual Report. Information in any part of this Annual Report may be incorporated by reference in answer or partial answer to any other item of the Annual Report.

The Association is an institution of the Farm Credit System (System), which was created by Congress in 1916 and has served agricultural producers for over 90 years. The System's mission is to maintain and improve the income and well-being of American farmers, ranchers, and producers or harvesters of aquatic products and farm-related businesses. The System is the largest agricultural lending organization in the United States. The System is regulated by the Farm Credit Administration, (FCA), which is an independent safety and soundness regulator.

The Association is a cooperative, which is owned by the members (also referred to throughout this Annual Report as stockholders or shareholders) served. The territory of the Association extends across a diverse agricultural region of Alabama, Louisiana, and Mississippi. Refer to Note 1, "Organization and Operations," of the Notes to the Consolidated Financial Statements for further description of the Association's territory. The Association provides credit to farmers, ranchers, rural residents, and agribusinesses. Our success begins with our extensive agricultural experience and knowledge of the market.

Copies of the Association's Annual and Quarterly reports are also available upon request free of charge on the Association's website, (www.firstsouthfarmcredit.com), or 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 an electronic version of the Annual Report, which is available on the website, within 75 days after the end of the fiscal year and distributes the Annual Reports to shareholders within 90 days after the end of the fiscal year. The Association prepares an electronic version of the Quarterly report within 40 days after the end of each fiscal quarter, except that no report needs to be prepared for the fiscal quarter that coincides with the end of the fiscal year of the Association.

The Association obtains funding from AgFirst Farm Credit Bank (AgFirst or Bank). The Association is materially affected

and shareholder investment in the Association could be affected by the financial condition and results of operations of the Bank. Copies of the Bank's Annual and Quarterly Reports are on the AgFirst website, www.agfirst.com, or may be obtained at no charge by calling 1-800-845-1745, extension 378, or writing Stephen Gilbert, AgFirst Farm Credit Bank, P. O. Box 1499, Columbia, SC 29202.

FORWARD LOOKING INFORMATION

This annual information statement contains forward-looking statements. These statements are not guarantees of future performance and involve certain risks, uncertainties and assumptions that are difficult to predict. Words such as "anticipates," "believes," "could," "estimates," "may," "should," "will," or other variations of these terms are intended to identify the forward-looking statements. These statements are based on assumptions and analyses made in light of experience and other historical trends, current conditions, and expected future developments. However, actual results and developments may differ materially from our expectations and predictions due to a number of risks and uncertainties, many of which are beyond our control. These risks and uncertainties include, but are not limited to:

- political, legal, regulatory and economic conditions and developments in the United States and abroad;
- economic fluctuations in the agricultural, rural utility, international, and farm-related business sectors;
- weather-related, disease, and other adverse climatic or biological conditions that periodically occur that impact agricultural productivity and income;
- changes in United States government support of the agricultural industry; and
- actions taken by the Federal Reserve System in implementing monetary policy.

AGRICULTURAL OUTLOOK

In November 2007, the United States Department of Agriculture (USDA) estimated that 2007 farmers' net cash income (a measure of cash income after payment of business expenses) increased to \$85.7 billion, up \$17.8 billion from the 2006 forecast and up \$20.3 billion from its 10 year average. Contributing to this sizeable increase in net cash income were increases in cash receipts for crops and livestock of \$22.6 billion and \$20.3 billion, respectively, an increase in farm-related income of \$300 million, offset in part by an increase in cash expenses of \$21.7 billion and a decrease in direct government payments of \$3.7 billion. Corn prices have risen as a result of a

combination of continued food and feed demand and expanding ethanol demand. Other crop prices, in general, were positively impacted by increased acreage used to plant corn, decreasing the amount of acreage available for other crops. Wheat and soybeans compete with corn as a feed source so both wheat and soybean prices have risen since late 2006. Livestock cash receipts increased as domestic and export demand for beef have risen. The following table, which is based on information published by the USDA, sets forth the commodity prices per bushel for certain crops and by hundredweight for beef cattle from December 31, 2004 to December 31, 2007:

Commodity	12/31/04	12/31/05	12/31/06	12/31/07
Corn	\$2.04	\$1.92	\$3.01	\$3.76
Soybeans	\$5.45	\$5.77	\$6.18	\$10.00
Wheat	\$3.39	\$3.54	\$4.52	\$7.74
Beef Cattle	\$86.80	\$93.30	\$83.10	\$88.90

Rising commodity prices can have both positive and negative impacts on the Association, as a lender to the agricultural and rural sectors. Higher commodity prices have resulted in increased seasonal demand for agribusiness loans. Higher grain prices positively impact grain farmers. However, higher feed costs negatively impact the profitability of livestock producers, as well as those who use corn or other grains as ingredients in processed foods. To date, this has not significantly affected the Association's credit quality. In addition to higher feed costs, most other production cash expenses, such as fertilizer, seed, energy and labor costs, are forecast to rise further in 2008.

The USDA's 2007 income outlook showed a great deal of variation depending on farm size, geographic location and commodity specialties. While we utilized the USDA analysis to provide a general understanding of the U.S. agricultural economic outlook, this outlook does not take into account all aspects of our business.

The USDA classifies all farms into three primary categories: commercial farms, intermediate farms and rural residential farms. Commercial farms represent about 11 percent of U.S. farms by number and represent 75 percent of total U.S. farm production. Intermediate farms (where the primary occupation is farming and gross sales are below \$250,000) represent 26 percent of U.S. farms by number and account for 16 percent of total production. The remaining 63 percent of U.S. farms are classified as rural residential farms and only account for 9 percent of total production.

In addition to farmers' net cash income, off-farm income is an important source of repayment for farm debt obligations and is less subject to cycles in agriculture. The USDA measures farm household income, which is defined as earnings from farming activities plus off-farm income. Nearly 100 percent of farm household income for operators of rural residential farms and more than 80 percent of farm household income for intermediate farms is generated from off-farm sources. Further, USDA data suggests that about 30 percent of farm household income for commercial farms is generated from off-farm income. USDA estimated 2007 farm household income to increase 21 percent for commercial farms, 8 percent for intermediate farms and 4 percent for rural residential farms.

According to the USDA, farm business balance sheets have shown improvement over the last few years, as measured by debt relative to assets and equity levels. Farmers' equity (farm business assets less farm business debt) is expected to have increased in 2007. One measure of the financial health of the agricultural sector used by the USDA is the assessment of farmers' utilization of their capacity to repay debt (actual debt as a percentage of maximum debt that can be supported by farmers' current income). Higher capacity utilization rates indicate tighter cash flow positions and, consequently, higher exposure to financial risk. These estimates do not take into account, however, off-farm income sources. Since 1970, debt repayment capacity utilization has ranged from a low of 35.8 percent in 1973 to 104.1 percent in 1981, and has remained relatively stable since 1987, averaging about 50 percent. The USDA suggests a decrease in the use of repayment capacity from 57 percent in 2006 to 48 percent in 2007.

Farm business debt, defined by the USDA as debt incurred by those involved in on-farm agricultural production, is estimated to have grown 3.8 percent in 2007, the fourth consecutive year of rising farm debt, following a rise of 7.3 percent in 2006. The recent rise in debt can be at least partially attributed to farmers' positive view of the sector's future. Farm real estate debt accounted for approximately 53 percent of all farm debt for 2007 and 2006.

In general, agriculture has experienced a long period of favorable economic conditions, due to stronger commodity prices, higher land values, and, to a lesser extent, government support programs. To date, the Association's financial results and credit quality have been positively impacted by these conditions. Production agriculture, however, remains a cyclical business that is heavily influenced by commodity prices. In some areas, land values recently have been negatively affected by less favorable economic conditions. Economic conditions in agriculture may not be as favorable in the near future. In an environment of adverse economic conditions in agriculture and without sufficient government support programs, the Association's financial performance and credit quality measures would likely be negatively impacted. However, any negative impacts should be lessened by geographic and commodity diversification and the substantial influence of off-farm income sources supporting agricultural-related debt.

CRITICAL ACCOUNTING POLICIES

The financial statements are reported in conformity with accounting principles generally accepted in the United States of America. Our significant accounting policies are critical to the understanding of our results of operations and financial position because some accounting policies require us to make complex or subjective judgments and estimates that may affect the value of certain assets or liabilities. We consider these policies critical because management must make judgments about matters that are inherently uncertain. For a complete discussion of significant accounting policies, see Note 2, "Summary of Significant Accounting Policies," of the Notes to the Consolidated Financial Statements. The following is a summary of certain critical policies.

- *Allowance for loan losses* — The allowance for loan losses is management’s best estimate of the amount of probable losses existing in and inherent in our loan portfolio. The allowance for loan losses is increased through provisions for loan losses and loan recoveries and is decreased through allowance reversals and loan charge-offs. The allowance for loan losses is determined based on a periodic evaluation of the loan portfolio, which generally considers relevant historical charge-off experience adjusted for relevant factors. These factors include types of loans, credit quality, specific industry conditions, general economic and political conditions, and changes in the character, composition, and performance of the portfolio, among other factors.

Significant individual loans are evaluated based on the borrower’s overall financial condition, resources, and payment record, the prospects for support from any financially responsible guarantor, and, if appropriate, the estimated net realizable value of any collateral. The allowance for loan losses attributable to these loans is established by a process that estimates the probable loss inherent in the loans, taking into account various historical and projected factors, internal risk ratings, regulatory oversight, and geographic, industry and other factors.

Changes in the factors considered by management in the evaluation of losses in the loan portfolios could result in a change in the allowance for loan losses and could have a direct impact on the provision for loan losses and the results of operations.

- *Valuation methodologies* — Management applies various valuation methodologies to assets and liabilities that often involve a significant degree of judgment, particularly when liquid markets do not exist for the particular items being valued. Quoted market prices are referred to when estimating fair values for certain assets for which an observable liquid market exists, such as most investment securities. Management utilizes significant estimates and assumptions to value items for which an observable liquid market does not exist. Examples of these items include impaired loans, pension and other postretirement benefit obligations, and certain other financial instruments. These valuations require the use of various assumptions, including, among others, discount rates, rates of return on assets, repayment rates, cash flows, default rates, costs of servicing and liquidation values. The use of different assumptions could produce significantly different results, which could have material positive or negative effects on the Association’s results of operations.
- *Pensions* — The Association employees participate in a defined benefit retirement plan. This plan is noncontributory and benefits are based on salary and years of service. In addition, the Association employees participate in a defined contribution retirement savings plan. Pension expense is recorded as part of salaries and employee benefits. Pension expense for the defined benefit retirement plan is determined by actuarial valuations based on certain assumptions, including expected long-term rate of return on plan assets and discount rate. The expected return on plan assets for the year is calculated based on the composition of assets at the beginning of the year and the expected long-term rate of return on that

portfolio of assets. The discount rate is used to determine the present value of our future benefit obligations. The discount rate assumption used to determine future pension obligations was based on the plan’s projected benefit stream and the Hewitt Yield Curve (HYC). The HYC was designed by Hewitt Associates (a global human resource service provider) to provide a means for plan sponsors to value the liabilities of their retirement benefit plans.

ECONOMIC CONDITIONS

During 2007, economic conditions in our region continued to be mixed. Portions of our territory remained under economic stress resulting from the continued aftermath of Hurricanes Katrina and Rita, while other areas continued to experience generally favorable economic conditions. Our market base evolved further over the past year, with the Association buying and selling loan participations and expanding its involvement in government guarantee programs. The Association continues to target certain areas of our business with a goal of increasing market share. Continued efforts are being made to expand services, increase public knowledge of our services and streamline our current delivery of products to enhance our existing portfolio.

LOAN PORTFOLIO

The Association provides funds to farmers, rural homeowners, and farm-related businesses for financing of short and intermediate-term loans through numerous product types.

The diversification of the Association loan volume by type for each of the past three years is shown below.

Loan Type	December 31,					
	2007		2006		2005	
	<i>(dollars in thousands)</i>					
Production and intermediate-term	\$ 1,141,386	92.04%	\$ 1,040,601	93.05%	\$ 956,274	97.03%
Agribusiness:						
Loans to cooperatives	692	.06	2,408	.22	583	.06
Processing and marketing	49,975	4.02	32,500	2.91	4,799	.49
Farm-related business	33,235	2.68	36,279	3.24	17,041	1.73
Communication	7,498	.61	—	—	778	.08
Energy	3,804	.31	3,861	.34	3,906	.40
Rural residential real estate	3,488	.28	2,728	.24	2,105	.21
Total	\$ 1,240,078	100.00%	\$ 1,118,377	100.00%	\$ 985,486	100.00%

While we make loans and provide financially related services to qualified borrowers in the agricultural and rural sectors and to certain related entities, our loan portfolio is diversified.

The geographic distribution of the loans by state for the past three years is as follows:

State	12/31/07	12/31/06	12/31/05
Alabama	49.64%	47.14%	46.91%
Louisiana	19.19	19.83	22.72
Mississippi	31.17	33.03	30.37
Total	100.00%	100.00%	100.00%

Commodity and industry categories are based upon the Standard Industrial Classification system published by the federal government. The system is used to assign commodity or industry categories based upon the largest agricultural commodity of the customer.

The major commodities in the Association loan portfolio are shown below. The predominant commodities are poultry, forestry, cotton, and livestock, which constitute over 60 percent of the entire portfolio.

Commodity Group	December 31,		
	2007	2006	2005
Poultry	28%	30%	31%
Forestry	21	20	18
Other	21	14	10
Cotton	9	12	13
Livestock	7	7	8
Sugar Cane	5	6	7
Catfish	2	4	4
Rice	3	3	4
Soybeans	2	2	2
Dairy	1	1	1
Peanuts	1	1	2
	100%	100%	100%

Repayment ability is closely related to the commodities produced by our borrowers, and increasingly, the off-farm income of borrowers. The Association's loan portfolio contains a concentration of poultry, forestry, and cotton producers. Although a large percentage of the loan portfolio is concentrated in these enterprises, many of these operations are diversified within their enterprise and/or with crop production that reduces overall risk exposure. Demand for beef, prices of field grains, and international trade are some of the factors affecting the price of these commodities. Even though the concentration of large loans has increased over the past several years, the agricultural enterprise mix of these loans is diversified and similar to that of the overall portfolio. The risk in the portfolio associated with commodity concentration and large loans is reduced by the range of diversity of enterprises in the Association's territory.

The increase in gross loan volume for the twelve months ended December 31, 2007, is primarily attributed to the growth in new loan volume across several commodity groups.

The Association's portfolio, which is heavily influenced by operating-type loans, normally reaches a peak balance in September and rapidly declines in the fall months as commodities are marketed and proceeds are applied to repay operating loans.

During 2007, the Association increased activity in the buying and selling of loan participations within and outside of the System. This provides a means for the Association to spread credit concentration risk and realize non-patronage sourced interest and fee income, which is intended to strengthen our capital position.

Loan Participations:	December 31,		
	2007	2006	2005
	<i>(dollars in thousands)</i>		
Participations Purchased			
– FCS Institutions	\$ 127,520	\$ 86,865	\$ 41,155
Participations Purchased			
– Non-FCS Institutions	90,467	52,371	38,792
Participations Sold	(31,050)	(37,255)	(7,435)
Total	\$ 186,937	\$ 101,981	\$ 75,512

The Association did not have any loans sold with recourse, retained subordinated participation interests in loans sold, or interests in pools of subordinated participation interests for the period ended December 31, 2007.

INVESTMENT SECURITIES

As permitted under FCA regulations, the Association is authorized to hold eligible investments for the purposes of reducing interest rate risk and managing surplus short-term funds. The Bank is responsible for approving the investment policies of the Association. The Bank annually reviews the investment portfolio of every Association that it funds. At December 31, 2007, the Association had no investment securities.

CREDIT RISK MANAGEMENT

Credit risk arises from the potential inability of an obligor to meet its repayment obligation. As part of the process to evaluate the success of a loan, the Association continues to review the credit quality of the loan portfolio on an ongoing basis. With the approval of the Association Board of Directors, the Association establishes underwriting standards and lending policies that provide direction to loan officers. Underwriting standards include, among other things, an evaluation of:

- Character – borrower integrity and credit history
- Capacity – repayment capacity of the borrower based on cash flows from operations or other sources of income
- Collateral – protection for the lender in the event of default and a potential secondary source of repayment
- Capital – ability of the operation to survive unanticipated risks
- Conditions – intended use of the loan funds

The credit risk management process begins with an analysis of the borrower's credit history, repayment capacity, and financial position. Repayment capacity focuses on the borrower's ability to repay the loan based upon cash flows from operations or other sources of income, including non-farm income. As required by FCA regulations, each institution that makes loans on a collateralized basis must have collateral evaluation policies and procedures. In addition, each loan is assigned a credit risk rating based upon the underwriting standards. This credit risk rating process incorporates objective and subjective criteria to identify inherent strengths, weaknesses, and risks in a particular relationship.

We review the credit quality of the loan portfolio on an ongoing basis as part of our risk management practices. Each loan is classified according to the Uniform Classification System, which is used by all Farm Credit System institutions. Below are the classification definitions.

- Acceptable – Assets are expected to be fully collectible and represent the highest quality.
- Other Assets Especially Mentioned (OAEM) – Assets are currently collectible but exhibit some potential weakness.
- Substandard – Assets exhibit some serious weakness in repayment capacity, equity, and/or collateral pledged on the loan.

- Doubtful – Assets exhibit similar weaknesses to substandard assets. However, doubtful assets have additional weaknesses in existing facts, conditions and values that make collection in full highly questionable.
- Loss – Assets are considered uncollectible.

The following table presents selected statistics related to the credit quality of loans including accrued interest at December 31.

Credit Quality	2007	2006	2005
Acceptable & OAEM	98.78%	98.81%	98.49%
Substandard	1.22	1.19	1.51
Doubtful	–	–	–
Loss	–	–	–
Total	100.00%	100.00%	100.00%

Nonperforming Assets

The Association's loan portfolio is divided into performing and high-risk categories. The high-risk assets, including accrued interest, are detailed below:

High-risk Assets	December 31,		
	2007	2006	2005
	<i>(dollars in thousands)</i>		
Nonaccrual loans	\$ 3,520	\$ 2,964	\$ 2,484
Restructured loans	836	851	842
Accruing loans 90 days past due	4	737	195
Total high-risk loans	4,360	4,552	3,521
Other property owned	5	83	479
Total high-risk assets	\$ 4,365	\$ 4,635	\$ 4,000

Ratios

Nonaccrual loans to total loans	.28%	.27%	.25%
High-risk assets to total assets	.32%	.38%	.36%

Nonaccrual loans represent all loans where there is a reasonable doubt as to the collection of principal and/or future interest accruals, under the contractual terms of the loan. In substance, nonaccrual loans reflect loans where the accrual of interest has been suspended. Nonaccrual loans increased \$556 or 18.76 percent in 2007. Of the \$3,520 in nonaccrual volume at December 31, 2007, \$281 or 7.98% compared to 11.54% and 48.03% at December 31, 2006 and 2005, respectively, was current as to scheduled principal and interest payments, but did not meet all regulatory requirements to be transferred into accrual status.

Loan restructuring is available to financially distressed borrowers. Restructuring of loans occurs when the Association grants a concession to a borrower based on either a court order or good faith in a borrower's ability to return to financial viability. The concessions can be in the form of a modification of terms or rates, a compromise of amounts owed, or deed in lieu of foreclosure. Other receipts of assets and/or equity to pay the loan in full or in part are also considered restructured loans. The type of alternative financing structure chosen is based on minimizing the loss incurred by both the Association and the borrower.

Allowance for Loan Losses

The allowance for loan losses at each period end was considered by Association management to be adequate to absorb probable losses existing in and inherent to its loan portfolio.

The following table presents the activity in the allowance for loan losses for the most recent three years:

Allowance for Loan Losses Activity:	Year Ended December 31,		
	2007	2006	2005
	<i>(dollars in thousands)</i>		
Balance at beginning of year	\$ 5,876	\$ 5,425	\$ 5,189
Charge-offs:			
Production and intermediate-term	(70)	(616)	(217)
Total charge-offs	(70)	(616)	(217)
Recoveries:			
Production and intermediate-term	105	131	148
Agribusiness	–	6	–
Total recoveries	105	137	148
Net (charge-offs) recoveries	35	(479)	(69)
Provision for (reversal of allowance for) loan losses	1,050	930	305
Balance at end of year	\$ 6,961	\$ 5,876	\$ 5,425
Ratio of net (charge-offs) recoveries during the period to average loans outstanding during the period	.003%	(.045)%	(.007)%

The allowance for loan losses by loan type for the most recent three years is as follows:

Allowance for Loan Losses by Type	December 31,		
	2007	2006	2005
	<i>(dollars in thousands)</i>		
Production and intermediate-term	\$ 6,443	\$ 5,556	\$ 5,281
Agribusiness	451	292	116
Communication	34	–	3
Energy	17	16	16
Rural residential real estate	16	12	9
Total allowance for loan losses	\$ 6,961	\$ 5,876	\$ 5,425

The allowance for loan losses as a percentage of loans outstanding and as a percentage of certain other credit quality indicators is shown below:

Allowance for Loan Losses as a Percentage of:	2007	2006	2005
Total loans	.56%	.53%	.55%
Nonperforming loans	159.66%	129.09%	154.08%
Nonaccrual loans	197.76%	198.25%	218.40%

The financial positions of our borrowers have generally strengthened during the past decade as farmers' net cash income has been at a favorable level due, in part, to direct federal government payments and steady increases in land values over the period. With borrowers' strengthened financial positions and the continued emphasis on sound underwriting standards, the credit quality of our loan portfolio has remained healthy. Please refer to Note 3, "Loans and Allowance for Loan Losses," of the Notes to the Consolidated Financial Statements, for further information concerning the allowance for loan losses.

RESULTS OF OPERATIONS

Net Interest Income

Net interest income was \$34.1 million, \$32.6 million and \$30.3 million in 2007, 2006 and 2005, respectively. Net interest income is the difference between interest income and interest expense. Net interest income is the principal source of earnings for the Association and is impacted by volume, yields on assets and cost of debt. The effects of changes in average volume and interest rates on net interest income over the past three years are presented in the following table:

Change in Net Interest Income:

	Volume*	Rate	Nonaccrual	Total
			Income	
<i>(dollars in thousands)</i>				
12/31/07 - 12/31/06				
Interest income	\$ 11,276	\$ 2,667	\$ 13	\$ 13,956
Interest expense	7,418	5,012	—	12,430
Change in net interest income	\$ 3,858	\$ (2,345)	\$ 13	\$ 1,526
12/31/06 - 12/31/05				
Interest income	\$ 5,408	\$ 9,719	\$ (139)	\$ 14,988
Interest expense	3,082	9,579	—	12,661
Change in net interest income	\$ 2,326	\$ 140	\$ (139)	\$ 2,327

* Volume variances can be the result of increased/decreased loan volume or from changes in the percentage composition of assets and liabilities between periods.

Noninterest Income

Noninterest income for each of the three years ended December 31 is shown in the following table:

Noninterest Income	For the Year Ended			Percentage Increase/(Decrease)	
	December 31,			2007/	2006/
	2007	2006	2005	2006	2005
<i>(dollars in thousands)</i>					
Loan fees	\$ 2,429	\$ 2,054	\$ 2,134	18.26%	(3.75)%
Fees for financially related services	587	549	590	6.92	(6.95)
Patronage refund from other Farm Credit Institutions	9,631	8,444	9,318	14.06	(9.38)
Gains (losses) on sales of other property owned, net	13	20	40	(35.00)	(50.00)
Other noninterest income	141	130	151	8.46	(13.91)
Total noninterest income	\$12,801	\$11,197	\$12,233	14.33%	(8.47)%

Noninterest Expense

Noninterest expense for each of the three years ended December 31 is shown in the following table:

Noninterest Expense	For the Year Ended			Percentage Increase/(Decrease)	
	December 31,			2007/	2006/
	2007	2006	2005	2006	2005
<i>(dollars in thousands)</i>					
Salaries and employee benefits	\$15,907	\$15,913	\$15,639	(.04)%	1.75%
Occupancy and equipment	1,268	1,260	1,149	.63	9.66
Insurance Fund premiums	1,720	1,503	466	14.44	222.53
Other operating expenses	5,875	5,059	4,473	16.13	13.10
Total noninterest expense	\$24,770	\$23,735	\$21,727	4.36%	9.24%

Salaries and employee benefits decreased in 2007, as compared with 2006, primarily due to decreased costs associated with employee benefit plans. Noninterest expense increased \$1,035 or 4.36 percent for December 31, 2007, as compared to the same period of 2006 and increased \$3,043 or 14.01 percent compared to December 31, 2005. The increase in the Insurance Fund premium in 2007 and 2006 reflects the continued loan growth in the Farm Credit System. A significant amount of the increase in other operating expense in 2007 and 2006 was related to increases in advertising expense of \$515 and \$276, respectively.

Income Taxes

The Association recorded a provision for income taxes of \$33 for the year ended December 31, 2007, as compared to a benefit of \$193 for 2006 and a provision of \$18 for 2005.

Key Results of Operations Comparisons

Key results of operations comparisons for each of the twelve months ended December 31 are shown in the following table:

Key Results of Operations Comparisons	For the 12 Months Ended		
	12/31/07	12/31/06	12/31/05
Return on average assets	1.60%	1.67%	1.91%
Return on average members' equity	9.28%	8.89%	9.92%
Net interest income as a percentage of average earning assets	2.81%	3.07%	3.09%
Net charge-offs (recoveries) to average loans	—	.05%	.01%

A key factor in the growth of net income for future years will be continued improvement in net interest and noninterest income. Our goal is to generate earnings sufficient to fund operations, adequately capitalize the Association, and achieve an adequate rate of return for our members. To meet this goal, the agricultural economy must continue the improvement shown in recent years and the Association must meet certain objectives. These objectives are to attract and maintain high quality loan volume priced at competitive rates and to manage credit risk in our entire portfolio, while efficiently meeting the credit needs of our members.

LIQUIDITY AND FUNDING SOURCES

Liquidity and Funding

The principal source of funds for the Association is the borrowing relationship established with the Bank through a General Financing Agreement (GFA). The GFA 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 the funds to the Association, creating notes payable (or direct loans) to the Bank. The Bank manages interest rate risk through direct loan pricing and asset/liability management. The notes payable are segmented into variable rate and fixed rate components. 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. Association capital levels effectively create a borrowing margin between the amount of loans outstanding and the amount of notes payable outstanding. This margin is commonly referred to as "Loanable Funds".

Liquidity management is the process whereby funds are made available to meet all financial commitments including the extension of credit, payment of operating expenses and payment of debt obligations. The Association receives access to funds through its borrowing relationship with the Bank and from income generated by operations. The liquidity policy of the Association is to manage cash balances to maximize debt reduction and to increase loan volume. As borrower payments are received, they are applied to the Association's note payable to the Bank. Sufficient liquid funds have been available to meet all financial obligations. There are no known trends likely to result in a liquidity deficiency for the Association.

Total notes payable to the Bank at December 31, 2007, was \$1,088,297 as compared to \$978,396 at December 31, 2006 and \$856,986 at December 31, 2005. The increase of 11.23 percent compared to December 31, 2006 and the increase of 26.99 percent compared to December 31, 2005, was attributable to continued loan growth in the Association. The average volume of outstanding notes payable to the Bank was \$1,066,597 and \$921,624 for the years ended December 31, 2007 and 2006, respectively. Refer to Note 6, "Notes Payable to AgFirst Farm Credit Bank," of the Notes to the Consolidated Financial Statements, for weighted average interest rates and maturities, and additional information concerning the Association's notes payable.

The Association had no lines of credit from third party financial institutions as of December 31, 2007.

Funds Management

The Bank and the Association manage assets and liabilities to provide a broad range of loan products and funding options, which are designed to allow the Association to be competitive in all interest rate environments. The primary objective of the asset/liability management process is to provide stable and rising earnings, while maintaining adequate capital levels by managing exposure to credit and interest rate risks.

Demand for loan types is a driving force in establishing a funds management strategy. The Association offers fixed, adjustable and variable rate loan products that are marginally priced according to financial market rates. Variable rate loans may be indexed to market indices such as the Prime Rate or the 90-day London Interbank Offered Rate (LIBOR). Adjustable rate mortgages are indexed to U.S. Treasury Rates. Fixed rate loans are priced based on the current cost of System debt of similar terms to maturity.

The majority of the interest rate risk in the Association's Consolidated Balance Sheets is transferred to the Bank through the notes payable structure. The Bank, in turn, actively utilizes funds management techniques to identify, quantify and control risk associated with the loan portfolio.

CAPITAL RESOURCES

Capital serves to support asset growth and provide protection against unexpected credit and interest rate risk and operating losses. Capital is also needed for future growth and investment in new products and services.

The Association Board of Directors establishes, adopts, and maintains a formal written capital adequacy plan to ensure that adequate capital is maintained for continued financial viability, to provide for growth necessary to meet the needs of members/borrowers, and to ensure that all stockholders are treated equitably. There were no material changes to the capital plan for 2007 that would affect minimum stock purchases or would have an effect on the Association's ability to retire stock and distribute earnings.

Total members' equity at December 31, 2007, increased 1.17 percent to \$225,996 from the December 31, 2006, total of \$223,375. At December 31, 2006, total members' equity increased 4.46 percent from the December 31, 2005 total of \$213,834. The increase in both years was primarily attributed to net income partially offset by cash patronage, and in 2007, the increase was further offset by the recognition of a comprehensive loss resulting from the Association's adoption of FAS 158. See Note 9, "Employee Benefit Plans," of the Consolidated Financial Statements, for the impact of the adoption of FAS 158 on the current period.

Total capital stock and participation certificates were \$64,458 on December 31, 2007, compared to \$64,328 on December 31, 2006 and \$64,067 on December 31, 2005. The increase was attributed to the increase in the Association's loan volume.

FCA sets minimum regulatory capital requirements for System banks and associations. Capital adequacy is evaluated using a number of regulatory ratios. According to the FCA regulations, each institution's permanent capital ratio is calculated by dividing permanent capital by a risk-adjusted asset base. Risk adjusted assets mean the total dollar amount of the institution's assets adjusted by an appropriate credit conversion factor as defined by regulation. For all periods represented, the Association exceeded minimum regulatory standard for all the ratios.

The Association's capital ratios as of December 31 and the FCA minimum requirements follow:

	2007	2006	2005	Regulatory Minimum
Permanent capital ratio	12.54%	13.50%	13.63%	7.00%
Total surplus ratio	11.51%	12.33%	12.43%	7.00%
Core surplus ratio	10.40%	10.77%	10.40%	3.50%

The decrease in the Association's permanent capital, total surplus, and core surplus for December 31, 2007 and December 31, 2006 was attributed to the increase in the Association's loan volume. There are no trends, commitments, contingencies, or events that are likely to affect the Association's ability to meet regulatory minimum capital standards and capital adequacy requirements.

See Note 7, "Members' Equity," of the Consolidated Financial Statements, for further information concerning capital resources.

PATRONAGE PROGRAM

Prior to the beginning of any fiscal year, the Association’s Board of Directors, by adoption of a resolution, may establish a Patronage Allocation Program to distribute its available consolidated net earnings. This resolution provides for the application of net earnings in the manner described in the Association’s Bylaws. This includes the setting aside of funds to increase surplus to meet minimum capital adequacy standards established by FCA Regulations, to increase surplus to meet Association capital adequacy standards to a level necessary to support competitive pricing at targeted earnings levels, and for reasonable reserves for necessary purposes of the Association. After excluding net earnings attributable to (a) the portion of loans participated to another institution, and (b) participation loans purchased, remaining consolidated net earnings are eligible for allocation to borrowers. Refer to Note 7, “Members’ Equity,” of the Notes to the Consolidated Financial Statements, for more information concerning the patronage distributions. The Association declared patronage distributions of \$20,210 in 2007, \$18,767 in 2006, and \$19,585 in 2005.

YOUNG, BEGINNING AND SMALL (YBS) FARMERS AND RANCHERS PROGRAM

The Association’s mission includes providing sound and constructive credit and related services to young, beginning and small (YBS) farmers and ranchers. First South’s mission is directed by board and management to ensure that our Association is making every effort possible to implement our YBS program.

The Association has in place a flexible YBS program with policies and procedures that are designed to meet the needs of YBS farmers in our Association’s territory. The First South Board approves the YBS policy as well as the annual business plan which outlines practices to accomplish the First South YBS mission.

YBS farmers and ranchers are defined as:

Young Farmer: A farmer, rancher, or producer or harvester of aquatic products who is age 35 or younger as of the date the loan is originally made.

Beginning Farmer: A farmer, rancher, or producer or harvester of aquatic products who has 10 years or less farming or ranching experience as of the date the loan is originally made.

Small Farmer: A farmer, rancher, or producer or harvester of aquatic products who normally generates less than \$250 in annual gross sales of agricultural or aquatic products at the date the loan is originally made.

The Association’s young, beginning, and small farmer and rancher program (YBS) complies with statutory and regulatory requirements which includes qualitative and quantitative goals. Goals include coordinating with government agencies that offer loan guarantees for risk management purposes. First South is a FSA approved lender.

The Association business plan also outlines strategies to increase market share success, a market outreach program that generates participation, and involvement by Association staff at the field level. Strategies include (1) YBS Program on the Association website, (2) First South Market Outreach Program, (3) Country Loan and Small Loan Program, (4) demographic information by state and county, and (5) sponsorships and educational programs. The results of these outreach and education programs are reported to the Association Board of Directors on an annual basis.

The Association business plan also includes a budget recommended by management that is sufficient to carry out the Association’s YBS mission and performance goals.

The following table outlines the loan volume and number of YBS loans in the loan portfolio as of December 31, 2007 for the Association.

	As of December 31, 2007	
	Number of Loans	Amount of Loans
Young	1,425	\$162,827
Beginning	1,860	228,317
Small	5,031	394,879

For purposes of the above table, a loan could be included in more than one of the categories depending on the characteristics of the underlying borrower.

The 2002 USDA Ag Census data has been used as a benchmark to measure penetration of the Association YBS marketing efforts. The census data indicates the number of farmers that, by definition, were young, beginning or small within our three-state territory. First South then makes a comparative analysis of the ag census data to our December 31, 2007 data for young, beginning and small farmers within our portfolio. This analysis is reported to the Board of Directors and to the regulator. As of December 31, 2007 of the Association’s total portfolio, 15.6% were young farmers, 20.4% were beginning farmers, and 51.3% were small farmers.

REGULATORY MATTERS

Proposed Federal Legislation

The current Farm Bill expired on September 30, 2007. In July 2007, the House of Representatives passed its version of a new Farm Bill, the Farm, Nutrition, and Bioenergy Act of 2007. Under the Farm Bill as passed by the House of Representatives, the Congressional Budget Office estimated that payments to farmers under the commodity programs (i.e., direct and countercycle payments and loan deficiency payments) would be reduced by an estimated \$825 million in total over the next 10 years, as compared with a current services baseline of approximately \$75 billion for commodities. However, the specific provisions of the Farm Bill may increase payments for certain commodities or increase them in certain years and reduce them in others. This Farm Bill would also revise certain income payment limitations.

The Farm Bill as passed by the House of Representatives also contains provisions that would expand certain authorities of the Farm Credit System Insurance Corporation. The proposed changes generally would authorize the Insurance Corporation to collect higher levels of premiums and expand the base upon which premiums are charged. Premiums of up to 20 basis points could be charged against insured debt, adjusted to exclude an amount equal to government-guaranteed loans and investment securities. Up to an additional 10 basis points could be charged for any loan volume that is nonaccrual or investments that are other-than-temporarily impaired. Currently, premiums of up to 15 basis points may be charged on accruing loans and up to 25 basis points on nonaccrual loans.

In December 2007, the Senate passed its version of the Farm Bill, the Food and Energy Security Act of 2007. As reported, the bill proposes adjustments to current farm policy while maintaining the basic safety net structure of current law. The bill, when combined with tax provisions previously reported by the Senate Finance Committee, would provide for a permanent disaster fund and provide new incentives for farmers to engage in soil conservation activities. Before these changes are enacted into law, the Senate must conference their actions with the bill earlier approved by the House. It is premature to predict the final outcome of this process. The Senate Farm Bill contains the same expanded authorities with respect to the Insurance Corporation as noted above.

The Senate has named conferees. Conference Committee deliberation, however, awaits the naming of House conferees before it can move forward.

RECENTLY ISSUED ACCOUNTING PRONOUNCEMENTS

In July 2006, the Financial Accounting Standards Board (FASB) issued Interpretation No. 48, "*Accounting for Uncertainty in Income Taxes — an Interpretation of FASB Statement No. 109*" (FIN 48 or Interpretation) that was effective for fiscal years beginning after December 15, 2006. FIN 48 clarifies how an enterprise should recognize, measure, present and disclose in its financial statements uncertain tax positions that the enterprise has taken or expects to take on a tax return. Under the Interpretation, the financial statements reflect expected future tax consequences of income tax positions presuming the relevant taxing authority's full knowledge of the position and all relevant facts, but without considering time values. FIN 48 is applicable to all uncertain positions for taxes accounted for under FASB Statement No. 109. The Association adopted FIN 48 on January 1, 2007 and determined that interest and penalties would be classified as a component of income taxes.

There were no uncertain positions for income taxes at January 1, 2007 identified as a result of the adoption and therefore no cumulative adjustment to beginning members' equity was required. The tax years that remain open for federal and major state income tax jurisdictions are 2004 and forward.

On September 29, 2006, the FASB 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 other comprehensive income. The Standard further requires the determination of the fair value of plan assets at year-end and recognition of actuarial gains and losses, prior service costs or credits, and transition assets and obligations as a component of other comprehensive income. 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. See Note 9, "Employee Benefit Plans," of the Consolidated Financial Statements, for the impact of the adoption of FAS 158 on the current period.

In September 2006, the FASB also issued Statement of Financial Accounting Standards No. 157, "*Fair Value Measurements*." This Statement defines fair value, establishes a framework for measuring fair value and expands disclosures about fair value measurements. As a result, there is now a common definition of fair value to be used throughout generally accepted accounting principles. The FASB believes that the new standard will make the measurement of fair value more consistent and comparable and improve disclosures about those measures. This Statement clarifies that the term fair value is intended to mean a market-based measure, not an entity-specific measure. In measuring fair value for a financial statement item, the Statement sets forth a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value into three broad levels. The highest priority is given to quoted prices in active markets and the lowest priority to unobservable inputs. Additional disclosure requirements will be required for the lowest priority level. The Statement became effective as of January 1, 2008, and will be applied to our consolidated financial statements on a prospective basis.

In February 2007, the FASB issued Statement of Financial Accounting Standards No. 159, "*Fair Value Option for Financial Assets and Financial Liabilities*." The Standard permits entities to choose on an instrument-by-instrument basis, at specified election dates, to measure financial assets and liabilities and certain other items at fair value (the "fair value option"). Unrealized gains and losses on items for which the fair value option has been elected must be reported in earnings at each subsequent reporting date. Upfront costs and fees related to items for which the fair value option is elected shall be recognized in earnings as incurred and not deferred. This Standard became effective as of January 1, 2008. The Association has not made any elections under the fair value option, thus there will be no impact of the initial adoption of the Standard. However, the Association may elect to apply the fair value option to financial instruments acquired in future periods.

Disclosure Required by Farm Credit Administration Regulations

Description of Business

Descriptions of the territory served, persons eligible to borrow, types of lending activities engaged in, financial services offered and related Farm Credit organizations are incorporated herein by reference to Note 1 of the Consolidated Financial Statements, "Organization and Operations," included in this Annual Report to shareholders.

The description of significant developments that had or could have a material impact on earnings or interest rates to borrowers, acquisitions or dispositions of material assets, material changes in the manner of conducting the business, seasonal characteristics, and concentrations of assets, if any, is incorporated in "Management's Discussion and Analysis of Financial Condition and Results of Operations" included in this Annual Report.

Description of Property

The following table sets forth certain information regarding the properties of the reporting entity, all of which are located in Alabama, Mississippi and Louisiana:

<u>Location</u>	<u>Description</u>	<u>Form of Ownership</u>
713 S. Pear Orchard Rd. Ridgeland, MS	Administrative	Leased
713 S. Pear Orchard Rd. Ridgeland, MS	Division/Branch	Leased
700 Hwy. 80 West Demopolis, AL	Branch	Owned
2341 AL Hwy. 21 South Oxford, AL	Branch	Owned
1824 Eva Rd., NE Cullman, AL	Division/Branch	Owned
320 AL Hwy. 75 N Albertville, AL	Branch	Owned
30035 Hwy. 72 West Madison, AL	Branch	Owned
14390 Market St. Moulton, AL	Branch	Owned
970 Hwy. 20 East Tuscumbia, AL	Branch	Owned
4210 McFarland Blvd. Northport, AL	Branch	Owned
1434 S. Union Ave. Ozark, AL	Branch	Owned
1401 Forest Ave. Montgomery, AL	Division/Branch	Owned
141 Lee St. Luverne, AL	Branch	Owned
209 E. Second St. Bay Minette, AL	Branch	Leased
5070 Boll Weevil Circle Enterprise, AL	Branch	Owned
1103 Bypass West Andalusia, AL	Branch	Owned
914 Van Buren Ave. Oxford, MS	Branch	Owned

<u>Location</u>	<u>Description</u>	<u>Form of Ownership</u>
Hwy. 9 North Calhoun City, MS	Branch	Owned
2216 S. Gloster St. Tupelo, MS	Branch	Owned
306 E. Jefferson St. Aberdeen, MS	Branch	Owned
103 Professional Plaza Greenwood, MS	Branch	Owned
203 Cossar Blvd. Charleston, MS	Branch	Owned
505 E. Second St. Clarksdale, MS	Branch	Owned
250 S. Shelby St. Greenville, MS	Closed	Owned
1021 Highway 82 East Leland, MS	Branch	Owned
303 S. Sharpe St. Cleveland, MS	Branch	Owned
209 Second St. Indianola, MS	Branch	Owned
105 Church St. Belzoni, MS	Closed	Owned
306 N. Main St. Newton, MS	Branch	Owned
701 Haley Barbour Parkway Yazoo City, MS	Branch	Owned
501 Apache Drive McComb, MS	Branch	Owned
749 Cosby St. Centreville, MS	Closed	Owned
1711 Hardy St. Hattiesburg, MS	Branch	Owned
728 Sawmill Rd. Laurel, MS	Branch	Owned
5057 Hwy. I-49 South Service Rd. Opelousas, LA	Division/Branch	Owned
222 N. Cedar St. Tallulah, LA	Branch	Owned
1211 S. Louisa St. Rayville, LA	Closed	Owned
109 Davis St. Lake Providence, LA	Branch	Owned
811 Jackson St. Winnsboro, LA	Branch	Owned
2308 S. MacArthur Dr. Alexandria, LA	Branch	Owned
321 South Main St. Marksville, LA	Branch	Owned
1007 Guy Dr. St. Martinville, LA	Branch	Owned
3206 South LA 13 Crowley, LA	Branch	Owned
407 N. Church St. Jennings, LA	Branch	Owned
4696 Hwy. 19 Zachary, LA	Branch	Owned
725 Hospital Rd. New Roads, LA	Branch	Owned

<u>Location</u>	<u>Description</u>	<u>Form of Ownership</u>
1001 N.W. Central Ave. Amite, LA	Branch	Owned
1725 St. Mary Hwy. Thibodaux, LA	Branch	Owned

Lease Information Disclosure:

<u>Location</u>	<u>Term of Lease</u>	<u>Expiration Date</u>	<u>Monthly Lease Amount</u>
Ridgeland, MS	5 yrs.	03/01/10	\$8,339.00
Ridgeland, MS	3 yrs.	06/30/08	\$5,658.00
Bay Minette, AL	3 yrs.	08/02/08	\$1,500.00

Legal Proceedings

Information, if any, to be disclosed in this section is incorporated herein by reference to Note 12 of the Consolidated Financial Statements, "Commitments and Contingencies," included in this Annual Report.

Description of Capital Structure

Information to be disclosed in this section is incorporated herein by reference to Note 7 of the Consolidated Financial Statements, "Members' Equity," included in this Annual Report.

Description of Liabilities

The description of liabilities, contingent liabilities and intrasystem financial assistance rights and obligations to be disclosed in this section is incorporated herein by reference to Notes 2, 6, 10 and 12 of the Consolidated Financial Statements included in this Annual Report.

Management's Discussion and Analysis of Financial Condition and Results of Operations

"Management's Discussion and Analysis of Financial Condition and Results of Operations," which appears in this Annual Report and is to be disclosed in this section, is incorporated herein by reference.

Senior Officers

The following represents certain information regarding the senior officers of the Association and their business experience for the past five years:

<u>Senior Officer</u>	<u>Position & Other Business Interests</u>
Stephen L. Rochelle	<i>President & Chief Executive Officer</i> since July 1992.
Bryan Applewhite	<i>Chief Financial Officer /Senior Vice President/Treasurer</i> since November 2001.
Sells J. Newman, Jr.	<i>Senior Vice President/Marketing</i> since October 1987.
Randy Underwood	<i>Senior Vice President/Chief Credit Officer</i> since April 1994.
Roger Chappell	<i>President, North Alabama Division</i> since June 1988. He serves on the Board of Directors of the Alabama Poultry and Egg Association (promotes the poultry industry in Alabama) and the Alabama Feed and Grain Association (promotes agriculture in Alabama).

<u>Senior Officer</u>	<u>Position & Other Business Interests</u>
Cecil Corbello	<i>President, Louisiana Division</i> since June 1988. He serves on the Board of Directors of the St. Landry Parish Farm Bureau, and as Treasurer of the St. Landry Parish Cattlemen's Association (both support agriculture in St. Landry Parish, Louisiana).
John Barnard	<i>President, Mississippi Division</i> since April 1994.
Camp Powers	<i>President, South Alabama Division</i> since June 1988. He serves as Vice President of Southeastern Livestock Exposition (promotes livestock in Alabama).

The total amount of compensation earned by the CEO and all senior officers as a group during the years ended December 31, 2007, 2006 and 2005, is as follows:

<u>Name of Individual or Number in Group</u>	<u>Year</u>	<u>Annual</u>			<u>Deferred/- Other</u>	<u>Total</u>
		<u>Salary</u>	<u>Bonus</u>	<u>Perquisites</u>		
Stephen L. Rochelle	2007	\$229,952	\$ 60,000	\$6,103	-	\$ 296,055
Stephen L. Rochelle	2006	\$221,109	\$ 50,000	\$5,037	-	\$ 276,146
Stephen L. Rochelle	2005	\$212,604	\$ 46,000	-	-	\$ 258,604
7	2007	\$907,373	\$187,105	-	-	\$1,094,478
7	2006	\$872,473	\$173,761	-	-	\$1,046,234
7	2005	\$836,557	\$179,003	-	-	\$1,015,560

The Association had an incentive plan for 2007. The Incentive Plan consists of three different plans within the overall incentive plan. Plan A is based upon new business development, Plan B is based upon bottom line profitability from operations for the 12-month calendar year and Plan C is based upon lease income development. Employees share on a pro rata salary basis at the branch level and an average basis at the administrative level and are limited to a maximum of 25 percent of individual salaries. Incentives are paid within 45 days of the year end. The incentives/bonuses are shown in year earned which may be different than the year of payment. Seven senior officers shared in the 2007 incentive.

Disclosure of information on the total compensation paid during 2007 to any senior officer, or to any other individual included in the total, is available to shareholders upon request.

Directors

Directors and senior officers are reimbursed on an actual cost basis for all expenses incurred in the performance of official duties. Such expenses may include transportation, lodging, meals, tips, tolls, parking of cars, laundry, registration fees, and other expenses associated with travel on official business. A copy of the policy is available to shareholders of the Association upon request.

The aggregate amount of reimbursement for travel, subsistence and other related expenses for all directors as a group was \$198,439 for 2007, \$173,813 for 2006, and \$172,274 for 2005.

Subject to approval by the board, the Association may allow directors honorarium of \$500 per day for attendance at official board meetings, \$250 per day for auxiliary board and committee meetings, \$50 for telephone conference calls and \$100 to \$400 travel on a pro rata mileage basis. Total compensation paid to directors as a group was \$216,617.

The following represents certain information regarding the directors of the Association:

Shepherd (Shep) Morris, Chairman, has a 2,400-acre cotton and grain operation which has been his primary operation for the past five years. He serves as a board member of Autauga Quality Cotton Association, a marketing organization and River Bank and Trust, a community bank. He also serves as president of the Macon County Farmers Federation and a supervisor for Macon County Soil and Water District, both which promoting agriculture in Macon County. He is also president of Milstead Farm Group, Inc., a ginning operation, and serves on the National Cotton Council, a trade association. During 2007, he served 18 days at Association board meetings and 18 days in other official activities, and was paid \$12,710. His term of office is 2006 – 2008.

Dan West, Vice-Chairman, has a row crop and timber operation in Monroe County, Mississippi, consisting of cotton, corn, peanuts and timber, which has been his primary operation for the past five years. He is part owner of Hamilton Electric Gin and Warehouse, a cotton gin and warehouse. He serves on the board of Mississippi Peanut Growers Association which promotes the peanut industry in Mississippi and is a member of Southern Ginners Association. He is also a regional director of Staplcotn, an agricultural marketing cooperative. He has served on the board of Monroe County Farm Bureau, Mississippi Bollweevil Management Corporation and is past president of the Mississippi Ginners Association all of which promote agriculture in Mississippi. During 2007, he served 11 days at Association board meetings and 7 days in other official activities, and was paid \$8,150. His term of office is 2007 – 2009.

Bobby G. Briscoe has a row crop, cattle and timber operation in Lafayette and Panola counties in Mississippi, which has been his primary operation for the past five years. He is also owner of a construction company, Briscoe Construction Company. Mr. Briscoe has served three terms as president of Northeast Mississippi Homebuilders Association which supports the home building industry in Mississippi and is a member of the Rural Housing Commission. During 2007, he served 15 days at Association board meetings and 8 days in other official activities, and was paid \$9,780. His term of office expired December 31, 2007.* Because of the age limitation, Mr. Briscoe was not eligible for re-election.

John R. Burden has a dairy operation in Baileyton, Alabama, which has been his primary operation for the past five years. He is a member of Patron Council for Goldkist, a poultry integrator, and he is former director of DHIA which serves the dairy industry. During 2007, he served 11 days at Association board meetings and 3 days in other official activities, and was paid \$8,100. His term of office is 2007 – 2009.

Paul Clark has a row crop operation in Courtland, Alabama, which has been his primary operation for the past five years. He is also co-owner of Clark and Reed, an ag consulting firm. He is a member of the National Alliance of Independent Consultants, Registry of Environmental and Agricultural Professionals and member and past president of Alabama Ag Consulting Association all of which support and promote the profession of agricultural consulting. He is also a director of Autauga Quality Cotton Association, a cotton marketing group. During 2007, he served 14 days at Association board meetings and 23 days in other official activities, and was paid \$13,520. His term of office is 2005 – 2007.

Dr. Marty J. Fuller serves as a board appointed director, and is not a member of the Association. He is President and CEO of Federal Solutions LLC specializing in government relations and business development. Prior to this role he served as the Director of Federal Relations for Mississippi State University (MSU). Dr. Fuller also served previously as the Associate Director of the Mississippi Agricultural and Forestry Experiment Station (MAFES) and is an Emeritus Professor in the Department of Agricultural Economics at Mississippi State University. During 2007, he served 9 days at Association board meetings and 10 days in other official activities, and was paid \$6,700. His term of office is April 1, 2005 – March 31, 2008.

Dr. William E. Hardy, Jr., serves as a board appointed director, and is not a member of the Association. He is Professor of Agricultural Economics in the College of Agriculture at Auburn University. He served as Associate Dean in the college from January 2000 until August 2007. Dr. Hardy became a member of the Auburn University faculty in the Department of Agricultural Economics in October 1972. He has taught economics, quantitative methods and agricultural finance, and has also done significant research in the area of agriculture finance. He currently teaches a course in agricultural law. Dr. Hardy received his B.S., M.S. and PhD. degrees in Agricultural Economics from Virginia Tech. He also received a J.D. degree from Jones School of Law at Faulkner University in Montgomery, Alabama and is a member of the Alabama Bar. During 2007, he served 14 days at Association board meetings and 8 days in other official activities, and was paid \$8,350. His term of office is April 1, 2007 – March 31, 2010.

William T. (Bill) Kyser, a resident of Hale County, Alabama, has a catfish, beef cattle and timber operation which has been his primary operation for the past five years. He has served as a director for Catfish Farmers of America, Alabama Farmers Federation, Auburn Agricultural Alumni Association, Greensboro Farmers Cooperative, and Hale County Cattlemen's Association. These organizations promote agriculture and agricultural commodities nationally and in Alabama. He has also served as a director of Eagle Aquaculture and Falcon Protein Products, catfish businesses. During 2007, he served 17 days at Association board meetings and 6 days in other official activities, and was paid \$9,950. His term of office is 2005 – 2007.

Ray Makamson is managing partner of a cotton gin, Greenwood Gin, Inc., and has been farming for 33 years. He is owner of Ray Makamson Farms. His farming operation consists of 2,650 acres of cotton and 750 acres of soybeans which has been his primary operation for the past five years. He is part owner of Ag-Concepts, a flying service, and part owner of Delta Farm and Auto, a parts store. Mr. Makamson serves on the board of PYCO Industries, a cottonseed crushing operation. During 2007, he served 16 days at Association board meetings and 4 days in other official activities, and was paid \$7,990. His term of office is 2006 – 2008.

Alan Marsh is a partner of Marsh Farms, a 3,000-acre family farming operation consisting of 2,000 acres of cotton, along with corn, soybeans, and wheat which has been his primary operation for the past five years. He is a director of the Limestone Farmers' Federation, the National Cotton Council, the Alt. Cotton Incorporated, the Alabama Cotton Commission, all of which support and promote the cotton industry nationally and in the state of Alabama. He is also President of South Limestone Gin, a

local cotton gin. During 2007, he served 13 days at Association board meetings and 7 days in other official activities, and was paid \$10,550. His term of office is 2005 – 2007.

James F. Martin, Jr. has a dairy and row crop operation in Enterprise, Alabama, which has been his primary operation for the past five years. He is a member and director of the Coffee County Farmers Cooperative, an agricultural cooperative. He is on the Board of Trustees of Covington Electric Cooperative which is a member of PowerSouth, an electric cooperative that serves all of Alabama and parts of Mississippi and Florida. He is also on the Board of Supervisors of the Soil Conservation Services of Coffee County, Alabama. During 2007, he served 13 days at Association board meetings and 19 days in other official activities, and was paid \$13,800. His term of office is 2007 – 2009.

Daniel Mattingly is the Agricultural Manager for Lula-Westfield, L.L.C. Lula Factory Division (raw sugar factory). He also manages 9,500 acres of farmland owned by Savoie Industries, Inc., and is the voting member of the company for First South. This has been his primary operation for the past five years. Mr. Mattingly serves as treasurer of Assumption Parish Farm Bureau which promotes agriculture in Assumption Parish where he has been a member for eight years. He is a member and secretary of the Board of Directors of Savoie Industries, a sugarcane mill, having served on that board for the past five years. He is active in the Assumption Area Chamber of Commerce, Knights of Columbus, and is Vice President of West Ascension Recreation Board, a local non-profit youth organization. During 2007, he served 12 days at Association board meetings and 9 days in other official activities, and was paid \$7,340. His term of office is 2007 – 2009.

Joe H. Morgan has a 2,300-acre row crop operation consisting of cotton and peanuts which has been his primary operation for the past five years. He is a member and former officer and director of Forrest County Farm Bureau which promotes agriculture in Forrest County, Mississippi and serves as chairman of the Forrest County FSA Committee which assists the federal farm service agency locally in administering and managing farm commodity, credit, conservation, disaster and loan programs. He is also a member of Staplcotn Advisory Committee, a cotton marketing cooperative. He is President of Mississippi Peanut Growers Association, a trade organization and partner and part-owner of Reeves West Bay Peanut LLC, a peanut marketing cooperative. Mr. Morgan is a former recipient of the Outstanding Young Farmer of the Year Award and the Outstanding Farmer Award for Outstanding Service in soil and water Conservation. During 2007, he served 7 days at Association board meetings and 1 day in other official activities, and was paid \$4,310. His term of office is 2007 – 2009.

Thomas H. Nelson, Jr. has a 4,700-acre row crop operation in Chatham, Mississippi, which has been his primary operation for the past five years. He is a director of Washington County Farm Bureau which supports and promotes agriculture in Washington County, Mississippi. During 2007, he served 18 days at Association board meetings and 6 days in other official activities, and was paid \$9,340. His term of office is 2005 – 2007.

James M. Norsworthy, III has a row crop and cattle operation near Jackson, Louisiana, which has been his primary operation for the past five years. He serves as an officer/member of the Feliciana Farm Bureau which promotes agriculture and Jackson Baseball Association, a local non-profit youth organization. He is

also a member of Jackson Assembly and Feliciana Forestry Association. During 2007, he served 19 days at Association board meetings and 17 days in other official activities, and was paid \$12,440. His term of office is 2005 – 2007.

Thomas A. Parker has a 4,000-acre farming operation in Lake Providence, Louisiana, consisting of cotton, corn, rice and soybeans which has been his primary operation for the past five years. He also manages an 8,000-acre farm in Arkansas, is part owner of 300 acres of catfish ponds in Arkansas and is managing partner of Hollybrook Enterprises, a cotton agribusiness. Mr. Parker serves as a director on the Staplcotn Board, an agricultural marketing cooperative and the Hibernia Bank City Board, a financial institution. He is the Louisiana member on the Cotton Board, President of East Carroll Farm Bureau and President of Louisiana Cotton Producers all of which promote and support cotton and agriculture. During 2007, he served 11 days at Association board meetings and 8 days in other official activities, and was paid \$8,070. His term of office is 2007 – 2009.

Ted S. Passmore's primary operation for the past five years has been 5,000 acres in a row crop general partnership with his brother in Deville, Louisiana. He is a member of Louisiana Farm Bureau which promotes agriculture in Louisiana. During 2007, he served 17 days at Association board meetings and 7 days in other official activities, and was paid \$9,790. His term of office is 2006 – 2008.

W. S. Patrick has a cotton and soybean operation in Canton, Mississippi, which has been his primary operation for the past five years. He is a director and officer of the Madison County Cooperative, an agricultural cooperative and Madison County Farm Service Agency which assists the federal farm service agency locally in administering and managing farm commodity, credit, conservation, disaster and loan programs. During 2007, he served 19 days at Association board meetings and 16 days in other official activities, and was paid \$10,550. His term of office is 2006 – 2008.

Robert E. Potts operates a 220-acre beef cattle operation, after owning and operating a dairy for the past 37 years. He is a member of Dairy Farmers of America, Farm Bureau and Spring Creek Masonic Lodge. He is also a board member of a local school board serving the Tangipahoa Parish School System. During 2007, he served 14 days at Association board meetings and 7 days in other official activities, and was paid \$9,100. His term of office is 2006 – 2008.

Walter R. Richardson's primary operation for the past five years has been row crop and cattle in Leroy, Alabama. He serves on the Washington County Soil Conservation Board and is a director of Washington County Farmers Federation which promotes agriculture in Washington County and past President and current board member of the Washington County Cattlemen's Association which promotes the cattle industry. During 2007, he served 12 days at Association board meetings and 9 days in other official activities, and was paid \$8,850. His term of office is 2006 – 2008.

Mike Unkel has a rice, soybean and cattle operation in Kinder, Louisiana, which has been his primary operation for the past five years. He is a member of Allen Parish Rice Growers and Allen Parish Cattlemen's Association, organizations promoting the rice and cattle industry in Allen Parish, Louisiana. Mr. Unkel serves as president of Kinder Canal Company, Kinder Bean Elevator,

Kinder Liquid Fertilizer, and Kinder Farm Supply, which are all various agribusinesses in south Louisiana. During 2007, he served 12 days at Association board meetings and 4 days in other official activities, and was paid \$8,870. His term of office expired December 31, 2007.* Because of the age limitation, Mr. Unkel was not eligible for re-election.

Daniel Viator is owner of Triple V. Farm, Inc., a 2,550-acre sugarcane operation in Youngsville, Louisiana, and is a partner in Viator Farm, LLC in Jeanerette, Louisiana, a 1,250-acre sugarcane farm. He is past president and current director/finance chairman of the American Sugarcane League, a sugarcane trade organization. He is a member of the American Society of Sugarcane Technologists, Louisiana Farm Bureau and the Louisiana Association of Agronomists all of which promote sugarcane and/or agriculture. He is also a member of Southwest Feed Co-op, an agricultural cooperative, in Opelousas. During 2007, he served 13 days at Association board meetings and 9 days in other official activities, and was paid \$9,100. His term of office is 2006 – 2008.

William H. Voss has commercial cattle and timber operations in Pike and Amite Counties, Mississippi, and is involved in land and commercial property management. This has been his primary operation for the past five years. His career includes production agriculture, agribusiness and real estate. He is a former agricultural commodities and securities broker. He currently serves on the Board of AgFirst Farm Credit Bank and is a member of the AgFirst Employee Benefits Committee. He has also served as chairman of the Mississippi Real Estate Commission which administers control over the commercial real estate industry in Mississippi and chairman of the Pike County Farm Service Committee which assists the federal farm service agency locally in administering and managing farm commodity, credit, conservation, disaster and loan programs. During 2007, he served 15 days at Association board meetings and 8 days in other official activities, and was paid \$8,810. His term of office is 2005 – 2007.

* *Directors serve through the annual meeting following the expiration of their term.*

The following chart details the number of meetings, other activities and additional compensation paid for other activities (if applicable) for each director with committee assignments:

Name of Director	Days Served		Committee Assignments	Comp. Paid for other Activities*
	Regular Board Meetings	Other Official Activities*		
Shep Morris, <i>Chairman</i>	18	18	Compensation	\$3,250
Dan West, <i>Vice-Chairman</i>	11	7	SubChapter T	1,000
Paul Clark	14	23	Audit, Retirement	2,950
Marty Fuller	9	10	Compensation, Audit	1,200
William Hardy	14	8	Audit	950
Alan Marsh	13	7	SubChapter T	1,000
Jimmy Martin	13	19	Compensation, SubChapter T	3,250
Daniel Mattingly	12	9	Compensation	1,500
Jimmy Norsworthy	19	17	Audit, Retirement	3,900
Ted Passmore	17	7	SubChapter T	1,250
Steve Patrick	19	16	SubChapter T, Audit, Retirement	1,850
Mike Unkel	12	4	Compensation, SubChapter T	750
Bill Voss	15	8	Compensation	1,350

* *Includes board committee meetings and other board activities other than regular board meetings.*

Transactions with Senior Officers and Directors

The reporting entity's policies on loans to and transactions with its officers and directors, to be disclosed in this section are incorporated herein by reference to Note 11 of the Consolidated Financial Statements, "Related Party Transactions," included in this Annual Report. There have been no transactions between the Association and senior officers or directors which require reporting per FCA regulations.

Involvement in Certain Legal Proceedings

There were no matters which came to the attention of management or the board of directors regarding involvement of current directors or senior officers in specified legal proceedings which should be disclosed in this section. No directors or senior officers have been involved in any legal proceedings during the last five years which require reporting per FCA regulations.

Relationship with Independent Auditors and Other Qualified Public Accountants

There were no changes in or material disagreements with our independent auditors on any matter of accounting principles or financial statement disclosure during this period.

Aggregate fees paid by the Association for services rendered by its independent auditors and other qualified public accountants for the year ended December 31, 2007 were as follows:

	<u>2007</u>
Independent Auditor	
PricewaterhouseCoopers LLP	
Audit services	<u>\$ 51,119</u>

Audit fees were for the annual audit of the consolidated financial statements.

All nonaudit service fees incurred by the Association are approved by the Audit Committee.

Consolidated Financial Statements

The consolidated financial statements, together with the report thereon of PricewaterhouseCoopers LLP dated February 28, 2008 and the report of management, which appear in this Annual Report are incorporated herein by reference.

Copies of the Association's quarterly reports are available upon request free of charge by calling 1-888-297-1722, or writing to Bryan Applewhite, P.O. Box 6008, Ridgeland, MS 39158-6008. The Association prepares an electronic version of the Annual Report which is available on the Association's web site within 75 days after the end of the fiscal year and distributes the Annual Reports to shareholders within 90 days after the end of the fiscal year. The Association prepares an electronic version of the Quarterly report within 40 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.

Borrower Information Regulations

Since 1972, Farm Credit Administration (FCA) regulations have required that borrower information be held in strict confidence by Farm Credit System (FCS) institutions, their directors, officers and employees. These regulations provide Farm Credit institutions clear guidelines for protecting their borrowers' nonpublic personal information.

On November 10, 1999, the FCA Board adopted a policy that requires FCS institutions to formally inform new borrowers at loan closing of the FCA regulations on releasing borrower information and to address this information in the Annual Report. The implementation of these measures ensures that new and existing borrowers are aware of the privacy protections afforded them through FCA regulations and Farm Credit System institution efforts.

Credit and Services to Young, Beginning, and Small Farmers and Ranchers and Producers or Harvesters of Aquatic Products

Information to be disclosed in this section is incorporated herein by reference to the similarly named section in the Management's Discussion and Analysis of Financial Condition and Results of Operations section included in this Annual Report to the shareholders.

Shareholder Investment

Shareholder investment in the Association could be affected by the financial condition and results of operations of AgFirst Farm Credit Bank (Bank or AgFirst). Copies of the Bank's Annual and Quarterly reports are available upon request free of charge by calling 1-800-845-1745, ext. 378, or writing Stephen Gilbert, AgFirst Farm Credit Bank, P. O. Box 1499, Columbia, SC 29202. Information concerning AgFirst Farm Credit Bank can also be obtained by going to AgFirst's web site at www.agfirst.com. The Bank prepares an electronic version of the Annual Report, which is available on the website, within 75 days after the end of the fiscal year and distributes the Annual Reports to shareholders within 90 days after the end of the fiscal year. The Bank prepares an electronic version of the Quarterly report within 40 days after the end of each fiscal quarter, except that no report needs to be prepared for the fiscal quarter that coincides with the end of the fiscal year of the Bank.

Report of the Audit Committee

The Audit Committee of the Board of Directors (Committee) is comprised of the directors named below. None of the directors who serve on the Committee is an employee of First South Farm Credit, ACA (Association) and in the opinion of the Board of Directors, each is free of any relationship with the Association or management that would interfere with the director's independent judgment on the Committee.

The Committee has adopted a written charter that has been approved by the Board of Directors. The Committee has reviewed and discussed the Association's audited financial statements with management, which has primary responsibility for the financial statements.

PricewaterhouseCoopers LLP (PwC), the Association's independent auditor for 2007, is responsible for expressing an opinion on the conformity of the Association's audited financial statements with accounting principles generally accepted in the United States of America. The Committee has discussed with PwC the matters that are required to be discussed by Statement on Auditing Standards No. 114 (*The Auditor's Communication With Those Charged With Governance*). PwC has provided to the Committee the written disclosures and the letter required by Independence Standards Board Standard No. 1 (*Independence Discussions with Audit Committees*), and the Committee has discussed with PwC that firm's independence.

The Committee has also concluded that PwC's provision of non-audit services, if any, to the Association is compatible with PwC's independence.

Based on the considerations referred to above, the Committee recommended to the Board of Directors that the audited financial statements be included in the Association's Annual Report for 2007. The foregoing report is provided by the following independent directors, who constitute the Committee:



Dr. Marty J. Fuller
Chairman of the Audit Committee

Members of Audit Committee

Paul Clark
James M. Norsworthy, III
W.S. Patrick
Dr. William E. Hardy, Jr.

February 28, 2008

Report of Independent Auditors



PricewaterhouseCoopers LLP
10 Tenth Street, Suite 1400
Atlanta, GA 30309
Telephone (678) 419 1000

Report of Independent Auditors

To the Board of Directors and Members
of First South Farm Credit, ACA

In our opinion, the accompanying consolidated balance sheets and the related consolidated statements of income, of changes in members' equity and of cash flows present fairly, in all material respects, the financial position of First South Farm Credit, ACA (the Association) and its subsidiaries at December 31, 2007, 2006 and 2005, and the results of their operations and their cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America. These financial statements are the responsibility of the Association's management. Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits of these statements in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

PricewaterhouseCoopers LLP

February 28, 2008

Consolidated Balance Sheets

<i>(dollars in thousands)</i>	December 31, 2007	December 31, 2006	December 31, 2005
Assets			
Cash	\$ 8,356	\$ 15,743	\$ 20,207
Loans	1,240,078	1,118,377	985,486
Less: allowance for loan losses	6,961	5,876	5,425
Net loans	1,233,117	1,112,501	980,061
Accrued interest receivable	17,313	16,601	12,621
Investments in other Farm Credit institutions	68,575	66,260	61,849
Premises and equipment, net	5,294	4,624	4,351
Other property owned	5	83	479
Due from AgFirst Farm Credit Bank	9,611	8,437	9,311
Other assets	1,388	7,223	8,514
Total assets	<u>\$ 1,343,659</u>	<u>\$ 1,231,472</u>	<u>\$ 1,097,393</u>
Liabilities			
Notes payable to AgFirst Farm Credit Bank	\$ 1,088,297	\$ 978,396	\$ 856,986
Accrued interest payable	5,100	4,471	3,334
Patronage refund payable	3,843	2,779	3,199
Other liabilities	20,423	22,451	20,040
Total liabilities	<u>1,117,663</u>	<u>1,008,097</u>	<u>883,559</u>
Commitments and contingencies			
Members' Equity			
Protected borrower stock	111	92	140
Capital stock and participation certificates	64,347	64,236	63,927
Retained earnings			
Allocated	84,707	77,039	68,020
Unallocated	83,048	82,008	81,747
Accumulated other comprehensive income (loss)	(6,217)	—	—
Total members' equity	<u>225,996</u>	<u>223,375</u>	<u>213,834</u>
Total liabilities and members' equity	<u>\$ 1,343,659</u>	<u>\$ 1,231,472</u>	<u>\$ 1,097,393</u>

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

Consolidated Statements of Income

<i>(dollars in thousands)</i>	For the year ended December 31,		
	2007	2006	2005
Interest Income			
Loans	\$ 93,706	\$ 79,750	\$ 64,762
Interest Expense			
Notes payable to AgFirst Farm Credit Bank	59,588	47,158	34,497
Net interest income	34,118	32,592	30,265
Provision for (reversal of allowance for) loan losses	1,050	930	305
Net interest income after provision for (reversal of allowance for) loan losses	33,068	31,662	29,960
Noninterest Income			
Loan fees	2,429	2,054	2,134
Fees for financially related services	587	549	590
Patronage refund from other Farm Credit institutions	9,631	8,444	9,318
Gains (losses) on other property owned, net	13	20	40
Other noninterest income	141	130	151
Total noninterest income	12,801	11,197	12,233
Noninterest Expense			
Salaries and employee benefits	15,907	15,913	15,639
Occupancy and equipment	1,268	1,260	1,149
Insurance Fund premiums	1,720	1,503	466
Other operating expenses	5,875	5,059	4,473
Total noninterest expense	24,770	23,735	21,727
Income before income taxes	21,099	19,124	20,466
Provision (benefit) for income taxes	33	(193)	18
Net income	\$ 21,066	\$ 19,317	\$ 20,448

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

Consolidated Statements of Changes in Members' Equity

<i>(dollars in thousands)</i>	Protected Borrower Stock	Capital Stock and Participation Certificates	Retained Earnings		Accumulated Other Comprehensive Income	Total Members' Equity
			Allocated	Unallocated		
Balance at December 31, 2004	\$ 142	\$ 63,360	\$ 58,064	\$ 81,097	\$ —	\$ 202,663
Net income				20,448		20,448
Protected borrower stock retired	(2)					(2)
Capital stock/participation certificates issued/(retired), net		567				567
Patronage distribution						
Cash				(3,195)		(3,195)
Qualified allocated retained earnings			4,792	(4,792)		—
Nonqualified allocated retained earnings			5,799	(5,799)		—
Nonqualified retained earnings			5,799	(5,799)		—
Retained earnings retired			(6,589)			(6,589)
Patronage distribution adjustment			155	(213)		(58)
Balance at December 31, 2005	140	63,927	68,020	81,747	—	213,834
Net income				19,317		19,317
Protected borrower stock retired	(48)					(48)
Capital stock/participation certificates issued/(retired), net		309				309
Patronage distribution						
Cash				(2,775)		(2,775)
Qualified allocated retained earnings			4,162	(4,162)		—
Nonqualified allocated retained earnings			5,915	(5,915)		—
Nonqualified retained earnings			5,915	(5,915)		—
Retained earnings retired			(7,203)			(7,203)
Patronage distribution adjustment			230	(289)		(59)
Balance at December 31, 2006	92	64,236	77,039	82,008	—	223,375
Net income				21,066		21,066
Protected borrower stock retired	19					19
Capital stock/participation certificates issued/(retired), net		111				111
Patronage distribution						
Cash				(3,838)		(3,838)
Qualified allocated retained earnings			3,838	(3,838)		—
Nonqualified allocated retained earnings			6,267	(6,267)		—
Nonqualified retained earnings			6,267	(6,267)		—
Retained earnings retired			(8,578)			(8,578)
Patronage distribution adjustment			(126)	184		58
Adjustment to initially apply FAS No. 158					(6,217)	(6,217)
Balance at December 31, 2007	\$ 111	\$ 64,347	\$ 84,707	\$ 83,048	\$ (6,217)	\$ 225,996

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

Consolidated Statements of Cash Flows

<i>(dollars in thousands)</i>	For the year ended December 31,		
	2007	2006	2005
Cash flows from operating activities:			
Net income	\$ 21,066	\$ 19,317	\$ 20,448
Adjustments to reconcile net income to net cash provided by (used in) operating activities:			
Depreciation on premises and equipment	358	361	282
Provision for (reversal of allowance for) loan losses	1,050	930	305
(Gains) losses on other property owned, net	(13)	(20)	(40)
Changes in operating assets and liabilities:			
(Increase) decrease in accrued interest receivable	(712)	(3,980)	(3,117)
(Increase) decrease in due from AgFirst Farm Credit Bank	(1,174)	874	(756)
(Increase) decrease in other assets	5,835	1,291	(1,428)
Increase (decrease) in accrued interest payable	629	1,137	1,081
Increase (decrease) in other liabilities	(8,245)	2,411	2,002
Total adjustments	(2,272)	3,004	(1,671)
Net cash provided by (used in) operating activities	18,794	22,321	18,777
Cash flows from investing activities:			
Net (increase) decrease in loans	(121,773)	(133,084)	(96,792)
(Increase) decrease in investment in other Farm Credit institutions	(2,315)	(4,411)	(336)
Purchases of premises and equipment	(1,028)	(634)	(736)
Proceeds from sales of other property owned	198	130	613
Net cash provided by (used in) investing activities	(124,918)	(137,999)	(97,251)
Cash flows from financing activities:			
Advances on (repayment of) notes payable to AgFirst Farm Credit Bank, net	109,901	121,410	97,489
Protected borrower stock retired	19	(48)	(2)
Capital stock and participation certificates issued/(retired), net	111	309	567
Patronage refunds and dividends paid	(2,716)	(3,254)	(3,159)
Retained earnings retired	(8,578)	(7,203)	(6,589)
Net cash provided by (used in) financing activities	98,737	111,214	88,306
Net increase (decrease) in cash	(7,387)	(4,464)	9,832
Cash, beginning of period	15,743	20,207	10,375
Cash, end of period	\$ 8,356	\$ 15,743	\$ 20,207
Supplemental schedule of non-cash activities:			
Financed sales of other property owned	\$ —	\$ 390	\$ 161
Loans transferred to other property owned	107	104	474
Cash dividends or patronage distributions declared or payable	3,838	2,775	3,195
Increase in liability resulting from adoption of FAS 158	6,217	—	—
Supplemental information:			
Interest paid	\$ 58,959	\$ 46,021	\$ 33,416
Taxes (refunded) paid, net	(1)	20	399

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

Notes to the Consolidated Financial Statements

(dollars in thousands, except as noted)

Note 1 — Organization and Operations

A. **Organization:** First South Farm Credit, ACA (the Association or ACA) is a member-owned cooperative which provides credit and credit-related services to or for the benefit of eligible borrowers/shareholders for qualified agricultural purposes in the states of Alabama and Mississippi, Marion County in the state of Tennessee, and all but certain parishes within the northwestern portion of Louisiana.

The Association is a lending institution of the Farm Credit System (System), a nationwide system of cooperatively owned banks and associations, which was established by Acts of Congress to meet the credit needs of American agriculture and is subject to the provisions of the Farm Credit Act of 1971, as amended (Farm Credit Act). The most recent significant amendment to the Farm Credit Act was the Agricultural Credit Act of 1987. At December 31, 2007, the System was comprised of four Farm Credit Banks, one Agricultural Credit Bank and ninety-four Associations.

AgFirst Farm Credit Bank (Bank) and its related Associations are collectively referred to as the "District." The Bank provides funding to associations within the District and is responsible for supervising certain activities of the Association, as well as the other Associations operating within the District. The District consists of the Bank and twenty-three Agricultural Credit Associations (ACAs), all of which are structured as ACA parent-companies, which have two wholly owned subsidiaries, a Federal Land Credit Association (FLCA) and a Production Credit Association (PCA). FLCAs are tax-exempt while ACAs and PCAs are taxable.

The Association makes short- and intermediate-term loans for agricultural production or operating purposes and collateralized real estate loans.

The Farm Credit Administration (FCA) is delegated authority by Congress to regulate the System banks and associations. The FCA examines the activities of the associations and certain actions by the associations are subject to the prior approval of the FCA and the supervising Bank.

The Farm Credit Act established the Farm Credit System Insurance Corporation (Insurance Corporation) to administer the Farm Credit Insurance Fund (Insurance Fund). The Insurance Fund is required to be used (1) to ensure the timely payment of principal and interest on Systemwide debt obligations (Insured debt), (2) to ensure the retirement of protected borrower capital at par or stated value, and (3) for other specified purposes. The Insurance Fund is also available for discretionary uses by the Insurance Corporation to provide assistance to certain troubled System institutions and to cover the operating expenses of the Insurance Corporation. Each System bank is required to pay premiums, which may be passed on to the Association, into the Insurance Fund, based on its annual average loan principal outstanding until the monies in the Insurance Fund reach the "secure base amount." The secure base amount is defined in the Farm Credit Act as 2.0 percent of the aggregate insured

obligations (Systemwide debt obligations) or such other percentage of the aggregate obligations as the Insurance Corporation in its sole discretion determines to be actuarially sound. When the amount in the Insurance Fund exceeds the secure base amount, the Insurance Corporation is required to reduce premiums, but it still must ensure that reduced premiums are sufficient to maintain the level of the Insurance Fund at the secure base amount.

B. **Operations:** The Farm Credit Act sets forth the types of authorized lending activity, persons eligible to borrow, and financial services which can be offered by the Association. The Association is authorized to provide, either directly or in participation with other lenders, credit, credit commitments and related services to eligible borrowers. Eligible borrowers include farmers, ranchers, producers or harvesters of aquatic products, rural residents, and farm-related businesses.

The Association may sell to any System borrowing member, on an optional basis, credit or term life insurance appropriate to protect the loan commitment in the event of death of the debtor(s). The sale of other insurance necessary to protect a member's farm or aquatic unit is permitted, but limited to hail and multi-peril crop insurance, and insurance necessary to protect the facilities and equipment of aquatic borrowers.

Note 2 — Summary of Significant Accounting Policies

The accounting and reporting policies of the Association conform with accounting principles generally accepted in the United States of America (GAAP) and prevailing practices within the banking industry. The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the amounts reported in the Consolidated Financial Statements and accompanying notes. Significant estimates are discussed in these footnotes, as applicable. Actual results may differ from these estimates.

Certain amounts in prior years' financial statements have been reclassified to conform to the current year's presentation. Such reclassifications had no effect on net income or total members' equity of prior years. The Consolidated Financial Statements include the accounts of the FLCA and the PCA. All significant inter-company transactions have been eliminated in consolidation.

A. **Cash:** Cash, as included in the statements of cash flows, represents cash on hand and on deposit at banks.

B. **Loans and Allowance for Loan Losses:** Substantially all short- and intermediate-term loans for agricultural production or operating purposes have maturities of 10 years or less. Loans are carried at their principal amount outstanding less unearned income. Interest on loans is accrued and credited to interest income based upon the daily principal amount outstanding.

Loans are generally placed in nonaccrual status when principal or interest is delinquent for 90 days (unless adequately collateralized and in the process of collection) or circumstances indicate that collection of principal and/or interest is in doubt. When a loan is

placed in nonaccrual status, accrued interest deemed uncollectible is reversed (if accrued in the current year) or charged against the allowance for loan losses (if accrued in the prior year).

When loans are in nonaccrual status, the interest portion of payments received in cash is recognized as interest income if collection of the recorded investment in the loan is fully expected and the loan does not have a remaining unrecovered prior charge-off associated with it. Otherwise, loan payments are applied against the recorded investment in the loan. Nonaccrual loans may be returned to accrual status when principal and interest are current, prior charge-offs have been recovered, the ability of the borrower to fulfill the contractual repayment terms is fully expected and the loan is not classified "doubtful" or "loss."

Loans are charged-off, wholly or partially, as appropriate, at the time they are determined to be uncollectible.

In cases where a borrower experiences financial difficulties and the Association makes certain monetary concessions to the borrower through modifications to the contractual terms of the loan, the loan is classified as a restructured loan. If the borrower's ability to meet the revised payment schedule is uncertain, the loan is classified as a nonaccrual loan.

The allowance for loan losses is a valuation account used to reasonably estimate loan and lease losses existing as of the financial statement date. Determining the appropriate allowance for loan losses balance involves significant judgment about when a loss has been incurred and the amount of that loss.

The allowance is based on a periodic evaluation of the loan portfolio by management in which numerous factors are considered, including economic conditions, loan portfolio composition and prior loan loss experience. It is based on estimates, appraisals and evaluations of loans which, by their nature, contain elements of uncertainty and imprecision. The possibility exists that changes in the economy and its impact on borrower repayment capacity will cause these estimates, appraisals and evaluations to change.

The level of allowance for loan losses is generally based on recent charge-off experience adjusted for relevant environmental factors. The Association considers the following factors when adjusting the historical charge-offs experience:

- Changes in credit risk classifications,
- Changes in collateral values,
- Changes in risk concentrations,
- Changes in weather related conditions, and
- Changes in economic conditions.

Impaired loans are loans for which it is probable that not all principal and interest will be collected according to the contractual terms of the loan. Impaired loans include nonaccrual loans, restructured loans, and loans past due 90 days or more and still accruing interest. A loan is considered contractually past due when any principal repayment or interest payment required by the loan instrument is not received on or before the due date. A loan shall remain contractually past due until it is formally restructured or until the entire amount past due, including principal, accrued interest, and penalty interest incurred as the result of past due status, is collected or otherwise discharged in full.

A specific allowance may be established for impaired loans under Statement of Financial Accounting Standards No. 114. Impairment of these loans is measured based on the present value of expected future cash flows discounted at the loan's effective interest rate or, as practically expedient, at the loan's observable

market price or fair value of the collateral if the loan is collateral dependent.

The allowance for loan losses is maintained at a level considered adequate by management to provide for probable and estimable losses inherent in the loan portfolio. The allowance is increased through provisions for loan losses and loan recoveries and is decreased through allowance reversals and loan charge-offs.

- C. **Investment in AgFirst Farm Credit Bank and Other Farm Credit Institutions:** The Association is required to maintain ownership in the Bank in the form of Class C stock. Accounting for this investment is on the cost plus allocated equities basis. Patronage refunds from the Bank are accrued as earned. The receivable for such patronage refunds is classified as due from AgFirst Farm Credit Bank.
- D. **Other Property Owned:** Other property owned, consisting of real and personal property acquired through a collection action, is recorded upon acquisition at fair value less estimated selling costs. Revised estimates to the fair value less cost to sell are reported as adjustments to the carrying amount of the asset, provided that such adjusted value is not in excess of the carrying amount at acquisition. Income, expenses, and carrying value adjustments related to other property owned are included in gains (losses) on other property owned, net.
- E. **Premises and Equipment:** Premises and equipment are carried at cost less accumulated depreciation. Land is carried at cost. Depreciation is provided on the straight-line method over the estimated useful lives of the assets. Gains and losses on dispositions are reflected in current earnings. Maintenance and repairs are charged to expense and improvements are capitalized.
- F. **Advanced Conditional Payments:** The Association is authorized under the Farm Credit Act to accept advance payments from borrowers. To the extent the borrower's access to such advance payments is restricted, the advanced conditional payments are netted against the borrower's related loan balance. Amounts in excess of the related loan balance and amounts to which the borrower has unrestricted access are presented as interest-bearing liabilities in the accompanying Consolidated Balance Sheets. Advanced conditional payments are not insured. Interest is generally paid by the Association on such accounts.
- G. **Employee Benefit Plans:** Substantially all employees of the Association may participate in a defined benefit retirement plan (Plan). The "Projected Unit Credit" actuarial method is used for financial reporting purposes. As a result of the funded status at the Plan's measurement date (September 30) of the underlying Plan, the Association may record a minimum liability, an intangible asset relating to unrecognized prior service cost and other comprehensive income (loss). The adjustment to other comprehensive income (loss) would be net of deferred taxes, if significant. See Note 9, Employee Benefit Plans, for the impact of the adoption of FAS 158.
- Substantially all employees of the Association may also be eligible to participate in the District's thrift/deferred compensation plan (Thrift Plan); a percentage of employee contributions is matched by the Association. Thrift Plan costs are expensed as funded.
- Effective January 1, 2006 the Districtwide 401(k) Plan known as the AgFirst Farm Credit Employee Thrift Plan merged with the Farm Credit Bank of Texas Thrift Plus Plan. The new plan is known as the AgFirst/FCBT 401(k) Employee Benefit Plan.
- The Association may provide certain health care and life insurance benefits to eligible retired employees. Substantially all

employees may become eligible for these benefits if they reach early retirement age while working for the Association.

H. Income Taxes: The Association is generally subject to Federal and certain other income taxes. As previously described, the ACA holding company has two wholly-owned subsidiaries, a PCA and a FLCA. The FLCA subsidiary is exempt from federal and state income taxes as provided in the Farm Credit Act. The ACA holding company and the PCA subsidiary are subject to federal, state and certain other income taxes.

The Association is eligible to operate as a cooperative that qualifies for tax treatment under Subchapter T of the Internal Revenue Code. Accordingly, under specified conditions, the Association can exclude from taxable income amounts distributed as qualified patronage refunds in the form of cash, stock or allocated surplus. Provisions for income taxes are made only on those taxable earnings that will not be distributed as qualified patronage refunds. The Association distributes patronage on the basis of book income.

The Association accounts for income taxes under the asset and liability method, recognizing deferred tax assets and liabilities for the expected future tax consequences of the temporary differences between the carrying amounts and tax bases of assets and liabilities. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be realized or settled.

The Association records a valuation allowance at the balance sheet dates against that portion of the Association's deferred tax assets that, based on management's best estimates of future events and circumstances, more likely than not (a likelihood of more than 50 percent) will not be realized. The consideration of valuation allowances involves various estimates and assumptions as to future taxable earnings, including the effects of our expected patronage program, which reduces taxable earnings.

- I. Patronage Refund from AgFirst and Other Financial Institutions:** The Association records patronage refunds from the Bank and certain District Associations on an accrual basis.
- J. Recently Issued Accounting Pronouncements:** In June 2006, the Financial Accounting Standards Board (FASB) issued Interpretation No. 48, "Accounting for Uncertainty in Income Taxes — an Interpretation of FASB Statement No. 109" (FIN 48 or Interpretation) that was effective for fiscal years beginning after December 15, 2006. FIN 48 clarifies how an enterprise should recognize, measure, present and disclose in its financial statements uncertain tax positions that the enterprise has taken or expects to take on a tax return. Under the Interpretation, the financial statements reflect expected future tax consequences of income tax positions presuming the relevant taxing authority's full knowledge of the position and all relevant facts, but without considering time values. FIN 48 is applicable to all uncertain positions for taxes accounted for under FASB Statement No. 109. The Association adopted FIN 48 on January 1, 2007 and determined that interest and penalties would be classified as a component of income taxes.

There were no uncertain positions for income taxes at January 1, 2007 identified as a result of the adoption and therefore no cumulative adjustment to beginning members' equity was required. The tax years that remain open for federal and major state income tax jurisdictions are 2004 and forward.

On September 29, 2006, the FASB 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 other comprehensive income. The Standard further requires the determination of the fair value of plan assets at year-end and recognition of actuarial gains and losses, prior service costs or credits, and transition assets and obligations as a component of other comprehensive income. 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 District 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. See Note 9, Employee Benefit Plans, for the impact of the adoption of FAS 158 on the current period.

In September 2006, the FASB also issued Statement of Financial Accounting Standards No. 157, "Fair Value Measurements." This Statement defines fair value, establishes a framework for measuring fair value and expands disclosures about fair value measurements. As a result, there is now a common definition of fair value to be used throughout generally accepted accounting principles. The FASB believes that the new standard will make the measurement of fair value more consistent and comparable and improve disclosures about those measures. This Statement clarifies that the term fair value is intended to mean a market-based measure, not an entity-specific measure. In measuring fair value for a financial statement item, the Statement sets forth a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value into three broad levels. The highest priority is given to quoted prices in active markets and the lowest priority to unobservable inputs. Additional disclosure requirements will be required for the lowest priority level. The Statement became effective as of January 1, 2008, and will be applied to the Association's Consolidated Financial Statements on a prospective basis.

In February 2007, the FASB issued Statement of Financial Accounting Standards No. 159, "Fair Value Option for Financial Assets and Financial Liabilities." The Standard permits entities to choose on an instrument-by-instrument basis, at specified election dates, to measure financial assets and liabilities and certain other items at fair value (the "fair value option"). Unrealized gains and losses on items for which the fair value option has been elected must be reported in earnings at each subsequent reporting date. Upfront costs and fees related to items for which the fair value option is elected shall be recognized in earnings as incurred and not deferred. This Standard became effective as of January 1, 2008. The Association has not made any elections under the fair value option, thus there will be no impact of the initial adoption of the Standard. However, the Association may elect to apply the fair value option to financial instruments acquired in future periods.

Note 3 — Loans and Allowance for Loan Losses

A summary of loans follows:

	December 31,		
	2007	2006	2005
Production and intermediate term Agribusiness:	\$ 1,141,386	\$ 1,040,601	\$ 956,274
Loans to cooperatives	692	2,408	583
Processing and marketing	49,975	32,500	4,799
Farm related business	33,235	36,279	17,041
Communication	7,498	-	778
Energy	3,804	3,861	3,906
Rural residential real estate	3,488	2,728	2,105
Total loans	<u>\$ 1,240,078</u>	<u>\$ 1,118,377</u>	<u>\$ 985,486</u>

The Association's concentration of credit risk in various agricultural commodities is shown in the following table. While the amounts represent the Association's maximum potential credit risk as it relates to recorded loan principal, a substantial portion of the Association's lending activities is collateralized and the Association's exposure to credit loss associated with lending activities is reduced accordingly. An estimate of the Association's credit risk exposure is considered in the determination of the allowance for loan losses.

Total loans at December 31, 2007, 2006 and 2005 consisted of the following commodity types:

Commodity Type	December 31,		
	2007	2006	2005
Poultry	28%	30%	31%
Forestry	21	20	18
Other	21	14	10
Cotton	9	12	13
Livestock	7	7	8
Sugar Cane	5	6	7
Rice	3	3	4
Catfish	2	4	4
Soybeans	2	2	2
Dairy	1	1	1
Peanuts	1	1	2
Total	100%	100%	100%

The amount of collateral obtained, if deemed necessary upon extension of credit, is based on management's credit evaluation of the borrower. Collateral held varies, but typically includes farmland and income-producing property, such as crops and livestock, as well as receivables. Real estate loans are collateralized by the first liens on the underlying real property. Federal regulations state that long-term real estate loans are not to exceed 85 percent (97 percent if guaranteed by a government agency) of the property's appraised value. However, a decline in a property's market value subsequent to loan origination or advances, or other actions necessary to protect the financial interest of the Association in the collateral, may result in the loan to value ratios in excess of the regulatory maximum.

Impaired loans are loans for which it is probable that not all principal and interest will be collected according to the contractual terms.

The following table presents information relating to impaired loans.

	December 31,		
	2007	2006	2005
Nonaccrual loans:			
Current as to principal and interest	\$ 281	\$ 342	\$ 1,193
Past due	3,239	2,622	1,291
Total nonaccrual loans	3,520	2,964	2,484
Impaired accrual loans:			
Restructured accrual loans	836	851	842
Accrual loans 90 days or more past due	4	737	195
Total impaired accrual loans	840	1,588	1,037
Total impaired loans	\$4,360	\$4,552	\$3,521

There were no material commitments to lend additional funds to debtors whose loans were classified as impaired at December 31, 2007.

Interest income is recognized and cash payments are applied on nonaccrual impaired loans as described in Note 2. The following table presents interest income recognized on impaired loans.

	Year Ended December 31,		
	2007	2006	2005
Interest income recognized on nonaccrual loans	\$ 186	\$ 173	\$ 312
Interest income on impaired accrual loans	10	13	267
Interest income recognized on impaired loans	\$ 196	\$ 186	\$ 579

The following table presents information concerning impaired loans as of December 31,

	2007	2006	2005
Impaired loans with related allowance	\$ 202	\$ 929	\$ 865
Impaired loans with no related allowance	4,158	3,623	2,656
Total impaired loans	\$ 4,360	\$ 4,552	\$ 3,521
Allowance on impaired loans	\$ 131	\$ 378	\$ 251

The following table summarizes impaired loan information for the year ended December 31,

	2007	2006	2005
Average impaired loans	\$ 3,852	\$ 3,163	\$ 4,321

The following table summarizes interest income on nonaccrual and accruing restructured loans that would have been recognized under the original terms of the loans:

	Year Ended December 31,		
	2007	2006	2005
Interest income which would have been recognized under the original loan terms	\$ 601	\$ 475	\$ 508
Less: interest income recognized	186	173	312
Foregone interest income	\$ 415	\$ 302	\$ 196

The changes in the allowance for loan losses are as follows:

	Year Ended December 31,		
	2007	2006	2005
Balance at beginning of year	\$ 5,876	\$ 5,425	\$ 5,189
Charge-offs:			
Production and intermediate term	(70)	(616)	(217)
Total charge-offs	(70)	(616)	(217)
Recoveries:			
Production and intermediate term	105	131	148
Agribusiness	-	6	-
Total recoveries	105	137	148
Net (charge-offs) recoveries	35	(479)	(69)
Provision for (reversal of allowance for) loan losses	1,050	930	305
Balance at end of year	\$ 6,961	\$ 5,876	\$ 5,425
Ratio of net (charge-offs) recoveries during the period to average loans outstanding during the period	0.003%	(0.045)%	(0.007)%

In addition, the following is a breakdown of the allowance for loan losses for the end of the last three fiscal years:

	December 31, 2007		December 31, 2006	
	Amount	%	Amount	%
Production and intermediate term	\$ 6,443	92.6%	\$ 5,556	94.6%
Agribusiness	451	6.5	292	4.9
Communication	34	0.5	—	—
Energy	17	0.3	16	0.3
Rural residential real estate	16	0.2	12	0.2
Total	<u>\$ 6,961</u>	<u>100.0%</u>	<u>\$ 5,876</u>	<u>100.0%</u>

	December 31, 2005	
	Amount	%
Production and intermediate term	\$ 5,281	97.3%
Agribusiness	116	2.1
Communication	3	0.1
Energy	16	0.3
Rural residential real estate	9	0.2
Total	<u>\$ 5,425</u>	<u>100.0%</u>

Note 4 — Investment in AgFirst Farm Credit Bank

The Association is required to maintain ownership in the Bank of Class C stock (net of any investment by the Bank in the Association) as determined by the Bank. The Bank may require additional capital contributions to maintain its capital requirements.

The Bank has a reciprocal investment in the Association of \$50,589 representing 10,117,847 shares of its nonvoting common stock.

Note 5 — Premises and Equipment

Premises and equipment consisted of the following:

	December 31,		
	2007	2006	2005
Land	\$ 1,646	\$ 1,333	\$ 1,320
Buildings and improvements	6,852	6,368	6,156
Furniture and equipment	2,269	2,257	2,158
	<u>10,767</u>	<u>9,958</u>	<u>9,634</u>
Less: accumulated depreciation	5,473	5,334	5,283
Total	<u>\$ 5,294</u>	<u>\$ 4,624</u>	<u>\$ 4,351</u>

Note 6 — Notes Payable to AgFirst Farm Credit Bank

The Association's indebtedness to the Bank represents borrowings by the Association to fund its loan portfolio. This indebtedness is collateralized by a pledge of substantially all of the Association's assets and the terms of the revolving lines of credit are governed by a general financing agreement. Interest rates on both variable and fixed rate notes payable are generally established loan-by-loan based on the Bank's marginal cost of funds, capital position, operating costs and return objectives. The interest rate is periodically adjusted by the Bank based upon agreement between the Bank and Association. The weighted average interest rates on the variable rate notes were 5.81 percent for LIBOR-based loans, 5.74 percent for Prime-based loans, and the weighted average remaining maturities were 2.3 years and 1.8 years, respectively, at December 31, 2007. The weighted average interest rate on the fixed rate and adjustable rate mortgage (ARM) loans which are match funded by the Bank was 5.48 percent and the weighted average remaining maturity was 4.6 years at December 31, 2007. The weighted average interest rate on all interest-bearing notes payable was 6.19 percent and the weighted average remaining maturity was 4.4 years at December 31, 2007.

Variable rate and fixed rate notes payable represent approximately 14.05 percent and 85.95 percent, respectively, of total notes payable at December 31, 2007.

Under the Farm Credit Act, the Association is obligated to borrow only from the Bank, unless the Bank approves borrowing from other funding sources. The Bank, consistent with FCA regulations, has established limitations on the Association's ability to borrow funds based on specified factors or formulas relating primarily to credit quality and financial condition. At December 31, 2007, the Association's notes payable were within the specified limitations.

Note 7 — Members' Equity

A description of the Association's capitalization requirements, protection mechanisms, regulatory capitalization requirements and restrictions, and equities are provided below.

A. Protected Borrower Stock

Protection of certain borrower stock is provided under the Farm Credit Act, which requires the Association, when retiring protected borrower stock, to retire such stock at par or stated value regardless of its book value. Protected borrower stock includes capital stock and participation certificates, which were outstanding as of January 6, 1988, or were issued or allocated prior to October 6, 1988. If an Association is unable to retire protected borrower stock at par value or stated value, amounts required to retire this equity would be obtained from the Insurance Fund.

B. Capital Stock and Participation Certificates

In accordance with the Farm Credit Act and the Association's capitalization bylaws, each borrower is required to invest in Class C stock for agricultural loans, or participation certificates in the case of rural home and farm related business loans, as a condition of borrowing. The initial borrower investment, through either purchase or transfer, must be in an amount equal to 2 percent of the loan, or \$5 thousand, whichever is less. The Board of Directors may increase the amount of investment if necessary to meet the Association's capital needs. Loans designated for sale or sold into the Secondary Market on or after April 16, 1996 will have no voting stock or participation certificate purchase requirement if sold within 180 days following the date of designation.

The borrower acquires ownership of the capital stock or participation certificates at the time the loan is made, but usually does not make a cash investment. The aggregate par value is generally added to the principal amount of the related loan obligation. The Association retains a first lien on the stock or participation certificates owned by borrowers. Retirement of such equities will generally be at the lower of par or book value, and repayment of a loan does not automatically result in retirement of the corresponding stock or participation certificates.

C. Regulatory Capitalization Requirements and Restrictions

The FCA's capital adequacy regulations require the Association to achieve permanent capital of seven percent of risk-adjusted assets and off-balance-sheet commitments. Failure to meet the seven percent capital requirement can initiate certain mandatory and possibly additional discretionary actions by the FCA that, if undertaken, could have a direct material effect on the Association's financial statements. The Association is prohibited from reducing permanent capital by retiring stock or making certain other distributions to shareholders unless prescribed capital standards are met. The FCA regulations also require that

additional minimum standards for capital be achieved. These standards require all System institutions to achieve and maintain ratios as defined by FCA regulations. These required ratios are total surplus as a percentage of risk-adjusted assets of seven percent and of core surplus as a percentage of risk-adjusted assets of three and one-half percent. The Association's permanent capital, total surplus and core surplus ratios at December 31, 2007 were 12.54 percent, 11.51 percent and 10.40 percent, respectively.

An FCA regulation empowers it to direct a transfer of funds or equities by one or more System institutions to another System institution under specified circumstances. The Association has not been called upon to initiate any transfers and is not aware of any proposed action under this regulation.

D. Description of Equities

The Association is authorized to issue or have outstanding Class A Nonvoting Common Stock, Class C Voting Common Stock, and Class D Preferred Stock, and nonvoting Participation Certificates. All stock and participation certificates have a par or face value of five dollars (\$5.00) per share.

The Association had the following shares outstanding at December 31, 2007:

Class	Protected	Shares Outstanding	
		Number	Aggregate Par Value
A Common/Nonvoting	No	11,235	\$ 56
A Common/Nonvoting	Yes	22,193	111
C Common/Voting	No	2,672,290	13,362
Common Issued to Bank/Nonvoting	No	10,117,847	50,589
C Participation Certificates/Nonvoting	No	67,935	340
Total Capital Stock and Participation Certificates		12,891,500	\$ 64,458

Protected common stock and participation certificates are retired at par or face value in the normal course of business. At-risk common stock and participation certificates are retired at the sole discretion of the Board at book value not to exceed par or face amounts, provided the minimum capital adequacy standards established by the Board are met.

Surplus Accounts

The Association maintains an unallocated surplus account and an allocated surplus account. The minimum aggregate amounts of these two accounts shall be prescribed by the Farm Credit Act and the FCA regulations. The allocated surplus account consists of earnings held therein and allocated to borrowers on a patronage basis.

In the event of a net loss for any fiscal year, such loss shall be absorbed by, first, charges to the unallocated surplus account; second, impairment of paid-in surplus; and third, impairment of the allocated surplus account on the basis of latest allocations first.

The Association shall have a first lien on all surplus account allocations owned by any borrower, and all distributions thereof, as additional collateral for such borrower's indebtedness to the Association. When the debt of a borrower is in default or is in the process of final liquidation, the Association may, upon notice to the borrower, order any and all surplus account allocations owned by such borrower to be applied against the indebtedness. Any such retirement and application against indebtedness of surplus account allocations shall be before similar retirement and

application of stock or participation certificates owned by the borrower.

When all of the stock and participation certificates of the Association owned by a borrower are retired or otherwise disposed of, any surplus account allocations owned by such borrower may also be retired upon request by the borrower and subject to the approval of the Board, and the proceeds paid to the borrower. Alternatively, if the Board so directs, upon notice to the borrower such surplus account allocations may be applied against any of the borrower's indebtedness to the Association.

Subject to the Farm Credit Act and FCA regulations, allocated surplus may be distributed in cash, oldest allocations first. The cash proceeds may be applied against the indebtedness of the borrower to the Association. In no event shall such distributions reduce the surplus account below the minimum amount prescribed by the Farm Credit Act and FCA regulations. Distributions of less than the full amount of all allocations issued as of the same date shall be on a pro rata basis.

Allocated equities shall be retired solely at the discretion of the Board; provided, however, that minimum capital standards established by the FCA and the Board are met.

At December 31, 2007, allocated members' equity consisted of \$27,016 of qualified and \$57,691 of nonqualified distributions. Nonqualified distributions are tax deductible only when redeemed.

Patronage Distributions

Prior to the beginning of any fiscal year, the Board, by adoption of a resolution, may obligate the Association to distribute to borrowers on a patronage basis all or any portion of available net earnings for such fiscal year or for that and subsequent fiscal years. Patronage distributions are based on the proportion of the borrower's interest to the amount of interest earned by the Association on its total loans unless another proportionate patronage basis is approved by the Board.

If the Association meets its capital adequacy standards after making the patronage distributions, the patronage distributions may be in cash, authorized stock of the Association, allocations of earnings retained in an allocated members' equity account, or any one or more of such forms of distribution. Patronage distributions of the Association's earnings may be paid on either a qualified or nonqualified basis, or a combination of both, as determined by the Board. A minimum of 20 percent of the total qualified patronage distribution to any borrower for any fiscal year shall always be paid in cash.

Transfer

Stock and participation certificates may be transferred only to persons eligible to purchase and hold such stock or participation certificates.

Impairment

Any net losses recorded by the Association shall first be applied against unallocated members' equity. To the extent such losses would exceed unallocated members' equity, such losses would be applied consistent with the Association's bylaws and distributed pro rata to each share and/or unit outstanding in the class, in the following order:

1. Allocated Surplus
2. Class A Nonvoting Common Stock and Class C Voting Common Stock and unit of participation certificates outstanding.
3. Class D Preferred Stock.

Liquidation

In the event of liquidation or dissolution of the Association, any assets of the Association remaining after payment or retirement of all liabilities shall be distributed to the holders of stock and participation certificates in the following order of priority:

1. To the holders of Class D Preferred Stock, if any, pro rata in proportion to the number of shares then issued and outstanding until an amount equal to the aggregate par value of all such shares has been distributed to all such holders.
2. To the holders of Class A Nonvoting Common Stock and Class C Voting Common Stock and participation certificates, pro rata in proportion to the number of shares or units of each such class of stock or participation certificates then issued and outstanding until an amount equal to the aggregate par value of all such shares or units has been distributed to all such holders.
3. To the holders of allocated surplus evidenced by written notices of allocation on a pro-rata basis until all such allocated surplus has been distributed to such holders.
4. Any remaining assets of the Association after such distributions shall be distributed to the holders of Class A Nonvoting Common Stock and Class C Voting Common Stock, and participation certificates, pro rata in proportion to the number of shares or units then outstanding.

E. Other Comprehensive Income (Loss)

The Association reports other comprehensive income (loss) (OCI) in its consolidated statements of changes in members' equity. The Association recognized OCI of \$(6,217) in 2007 adopting FAS 158 (see Note 9, Employee Benefit Plans, for further information).

Note 8 — Income Taxes

The provision (benefit) for income taxes follows:

	Year Ended December 31,		
	2007	2006	2005
Current:			
Federal	\$ 28	\$ 2	\$ (20)
State	5	-	35
	<u>33</u>	<u>2</u>	<u>15</u>
Deferred:			
Federal	-	(184)	3
State	-	(11)	-
	<u>-</u>	<u>(195)</u>	<u>3</u>
Total provision (benefit) for income taxes	<u>\$ 33</u>	<u>\$ (193)</u>	<u>\$ 18</u>

The provision (benefit) for income tax differs from the amount of income tax determined by applying the applicable U.S. statutory federal income tax rate to pretax income as follows:

	December 31,		
	2007	2006	2005
Federal tax at statutory rate	\$ 7,174	\$ 6,502	\$ 6,959
State tax, net	5	-	23
Patronage distributions	(2,610)	(2,359)	(2,716)
Tax-exempt FLCA earnings	(4,948)	(4,350)	(4,146)
Change in valuation allowance	1,733	879	-
Implementation of FAS 158	(1,538)	-	-
Other	217	(865)	(102)
Provision (benefit) for income taxes	<u>\$ 33</u>	<u>\$ (193)</u>	<u>\$ 18</u>

Deferred tax assets and liabilities result from the following at:

	December 31,		
	2007	2006	2005
Deferred income tax assets:			
Allowance for loan losses	\$ 1,254	\$ 1,032	\$ 1,061
Nonaccrual loan interest	684	651	323
Pensions and other			
postretirement benefits	2,777	2,719	2,237
Depreciation	-	48	57
Other	-	-	11
Gross deferred tax assets	<u>4,715</u>	<u>4,450</u>	<u>3,689</u>
Less: valuation allowance	<u>(4,705)</u>	<u>(2,958)</u>	<u>(2,079)</u>
Gross deferred tax assets, net of valuation allowance	<u>10</u>	<u>1,492</u>	<u>1,610</u>
Deferred income tax liabilities:			
Loan fees	-	-	(6)
Pensions and other			
postretirement benefits	-	(1,492)	(1,799)
Depreciation	(10)	-	-
Gross deferred tax liability	<u>(10)</u>	<u>(1,492)</u>	<u>(1,805)</u>
Net deferred tax asset (liability)	<u>\$ -</u>	<u>\$ -</u>	<u>\$ (195)</u>

At December 31, 2007, deferred income taxes have not been provided by the Association on approximately \$55.7 million of patronage refunds received from the Bank prior to January 1, 1993. Such refunds, distributed in the form of stock, are subject to tax only upon conversion to cash. The tax liability related to future conversions is not expected to be material.

The Association recorded a valuation allowance of \$4,705, \$2,958 and \$2,079 during 2007, 2006 and 2005, respectively. The Association will continue to evaluate the realizability of these deferred tax assets and adjust the valuation allowance accordingly.

The Association adopted the provisions of the Financial Accounting Standards Board Interpretation No. 48, "Accounting for Uncertainty in Income Taxes," on January 1, 2007. As a result of the adoption, there were no uncertain positions for income taxes identified and therefore the Association recognized no change in the liability for unrecognized tax benefits and no reduction to the January 1, 2007 balance of retained earnings. The Association recognizes interest and penalties related to unrecognized tax benefits as a component of income tax expense. There were no uncertain tax positions identified related to the current year. The tax years that remain open for federal and major state income tax jurisdictions are 2004 and forward.

Note 9 — Employee Benefit Plans

The employees of the Association may participate in a defined benefit retirement plan. This plan is noncontributory and covers substantially all employees of the Association. Benefits are based on salary and years of service. The measurement date for the plan is September 30. The Association funded \$759 for 2007, \$727 for 2006 and \$2,500 for 2005. Plan expenses included in salaries and employee benefits were \$1,005 for 2007, \$1,912 for 2006, and \$1,558 for 2005.

On December 31, 2007, the Association adopted SFAS 158, which requires the recognition of a plan's over-funded or under-funded status as an asset or liability with an offsetting adjustment to accumulated other comprehensive income, net of tax. SFAS 158 requires the determination of the fair values of a plan's assets at year-end and recognition of actuarial gains and losses, prior service costs or credits, and transition assets or obligations as a component of accumulated other comprehensive income, net of tax. These amounts

were previously netted against the plans' funded status in the Association's Consolidated Balance Sheets pursuant to the provisions of SFAS 87. These amounts will be subsequently recognized as components of net periodic benefit costs. Further, actuarial gains and losses that arise in subsequent periods that are not initially recognized as a component of net periodic benefit cost will be recognized as a component of accumulated other comprehensive income, net of tax. Those amounts will subsequently be recognized as a component of net periodic benefit cost as they are amortized during future periods.

The incremental effects of adopting the provisions of SFAS 158 on the Association's Consolidated Balance Sheets at December 31, 2007 are presented in the following table. The adoption of SFAS 158 had no effect on the Consolidated Statements of Income for the year ended December 31, 2007, or for any year presented.

	Before Application of SFAS 158		After Application of SFAS 158
		Adjustments	
Other assets	\$ 7,480	\$ (6,092)	\$ 1,388
Total assets	1,349,751	(6,092)	1,343,659
Other liabilities	20,298	125	20,423
Total liabilities	1,117,538	125	1,117,663
Accumulated other comprehensive, net of tax	-	(6,217)	(6,217)
Total retained earnings	232,213	(6,217)	225,996
Total liabilities and retained earnings	\$ 1,349,751	\$ (6,092)	\$ 1,343,659

The estimated net actuarial gain/loss, transition asset/liabilities and prior service cost for the pension plan that will be amortized into income during 2008 are \$206, \$12 and \$58, respectively.

SFAS No. 158 also requires that the funded status of a plan be measured as of the date of the year-end for fiscal years ending after December 15, 2008. The current measurement date of September 30 will be changed to December 31 beginning in 2008.

The funding status and the amounts recognized in the Consolidated Balance Sheets of the Association for the retirement plan follows:

	Pension Benefits		
	2007	2006	2005
Change in benefit obligation			
Benefit obligation at beginning of year	\$ 42,820	\$ 45,478	\$ 38,737
Service cost	1,264	1,509	1,238
Interest cost	2,522	2,349	2,281
Actuarial loss (gain)	(1,599)	(4,990)	4,625
Benefits paid	(1,613)	(1,526)	(1,403)
Benefit obligation at end of year	\$ 43,394	\$ 42,820	\$ 45,478
Change in plan assets			
Fair value of plan assets, beginning of year	\$ 38,663	\$ 36,740	\$ 32,402
Actual return on plan assets	5,755	3,041	3,513
Employer contributions	759	727	2,500
Benefits paid	(1,613)	(1,526)	(1,403)
Expenses	(295)	(319)	(272)
Fair value of plan assets, end of year	\$ 43,269	\$ 38,663	\$ 36,740
Funded status	\$ (125)	\$ (4,157)	\$ (8,738)
Unrecognized net actuarial loss (gain)	-	11,366	17,328
Unrecognized prior service cost	-	(521)	(379)
Unrecognized net (asset) or obligation	-	(350)	(688)
Net amount recognized - September 30	(125)	6,338	7,523
Fourth quarter contributions	-	-	-
Net amount recognized	\$ (125)	\$ 6,338	\$ 7,523
Amounts recognized consist of:			
Current liabilities	\$ -	\$ -	\$ -
Noncurrent liabilities	(125)	-	-
Net amount recognized	\$ (125)	\$ -	\$ -

The following represent the amounts included in accumulated other comprehensive income at December 31, 2007:

	Pension Plan
Net actuarial loss (gain)	\$ 6,692
Prior service costs (credit)	(463)
Net transition obligation (asset)	(12)
Total amount recognized in OCI	\$ 6,217

The accumulated benefit obligation for the defined benefit plans were \$36,679, \$35,803 and \$36,529 at September 30, 2007, 2006 and 2005.

Information for pension plans with a projected benefit obligation in excess of plan assets:

	2007	2006	2005
Projected benefit obligation	\$ 43,394	\$ 42,820	\$ 45,478
Accumulated benefit obligation	36,679	35,803	36,529
Fair value of plan assets	43,269	38,663	36,740

The net periodic benefit expense for other postretirement benefit plans included in the Consolidated Statements of Income is comprised of the following:

	Pension Benefits		
	2007	2006	2005
Components of net periodic benefit (income) cost			
Service cost	\$ 1,264	\$ 1,509	\$ 1,239
Interest cost	2,522	2,349	2,281
Expected return on plan assets	(3,017)	(2,870)	(2,523)
Amortization of net (gain) loss	(338)	(338)	(338)
Amortization of prior service cost	(58)	143	143
Recognized net actuarial (gain)/loss	632	1,119	756
Net periodic benefit (income) cost	\$ 1,005	\$ 1,912	\$ 1,558

	2007	2006	2005
Decrease in minimum liability included in other comprehensive income	-	-	-

Assumptions:	2007	2006	2005
Weighted-average assumptions used to determine benefit obligations at December 31			
Discount rate	6.45%	6.00%	5.25%
Rate of compensation increase	4.50%	4.50%	5.00%

Weighted-average assumptions used to determine net periodic benefit cost for years ended December 31	2007	2006	2005
Discount rate	6.00%	5.25%	6.00%
Expected long-term return on plan assets	8.00%	8.00%	8.00%
Rate of compensation increase	4.50%	4.50%	5.00%

In 2007, 2006 and 2005 the Association used a long-term rate of return of 8 percent. The Association utilizes a weighted average of expected returns for each major class based on the asset allocation percentages for the plan assets. Prevailing market conditions, historical trends and peer comparisons were also utilized in assigning the 8 percent expected rate of return.

PLAN ASSETS	2007	2006	2005
Asset Category			
Equity Securities	68%	68%	67%
Debt Securities	30%	30%	29%
Other	2%	2%	4%
	100%	100%	100%

Target allocation for asset categories for 2008 are as follows:

<u>Asset Category</u>	
Equity securities	60-70%
Debt securities	30-40%
	100%

Cash Flows

Contributions: The total employer contribution expected during 2008 is \$790.

Estimated Benefit Payments: Estimated future benefit payments are as follows:

Fiscal 2008	\$ 1,704
Fiscal 2009	\$ 1,720
Fiscal 2010	\$ 1,781
Fiscal 2011	\$ 1,903
Fiscal 2012	\$ 2,321
Fiscal 2013 – 2017	\$ 16,011

The Association also participates in a Districtwide Thrift Plan. The Thrift Plan requires the Association to match 50 percent of employee optional contributions up to a maximum employee contribution of 6 percent of total compensation. Employee deferrals are not to exceed the maximum deferral as adjusted by the Internal Revenue Service. Employer contributions to this plan were \$325, \$306, and \$270 for the years ended December 31, 2007, 2006 and 2005, respectively.

Note 10 — Intra-System Financial Assistance

The Farm Credit Act provided for capital assistance to System institutions experiencing severe financial stress through the issuance, prior to October 1, 1992, by the Financial Assistance Corporation of U.S. Treasury-guaranteed 15-year bonds, of which \$1.261 billion in principal amount was originally issued. The last remaining Financial Assistance Corporation bonds matured and were repaid on June 10, 2005.

Pursuant to the Farm Credit Act, the U.S. Treasury paid \$440 million, on behalf of the System, in interest costs on \$844 million of the Financial Assistance Corporation bonds issued for purposes other than funding Capital Preservation Agreement accruals. The Banks had irrevocably set aside funds, including interest earned, that totaled the \$440 million needed to repay the interest advanced by the U.S. Treasury. On June 10, 2005, the Banks repaid the U.S. Treasury the interest advanced. The Farm Credit Administrative Board cancelled the Financial Assistance Corporation's charter as of December 31, 2006.

Note 11 — Related Party Transactions

In the ordinary course of business, the Association enters into loan transactions with officers and directors of the Association, their immediate families and other organizations with which such persons may be associated. Such loans are subject to special approval requirements contained in the FCA regulations and are made on the same terms, including interest rates and collateral, as those prevailing at the time for comparable transactions with unrelated borrowers.

Total loans to such persons at December 31, 2007 amounted to \$11,736. During 2007, \$18,381 of new loans were made and repayments totaled \$19,674. In the opinion of management, none of these loans outstanding at December 31, 2007 involved more than a normal risk of collectibility.

Note 12 — Commitments and Contingencies

The Association has various commitments outstanding and contingent liabilities.

The Association may participate in financial instruments with off-balance-sheet risk to satisfy the financing needs of its borrowers and to manage their exposure to interest-rate risk. These financial instruments include commitments to extend credit and/or commercial letters of credit. The instruments involve, to varying degrees, elements of credit risk in excess of the amount recognized in the financial statements. Commitments to extend credit are agreements to lend to a borrower as long as there is not a violation of any condition established in the contract. Commercial letters of credit are agreements to pay a beneficiary under conditions specified in the letter of credit. Commitments and letters of credit generally have fixed expiration dates or other termination clauses and may require payment of a fee. At December 31, 2007, \$295,118 of commitments to extend credit and \$0 of commercial letters of credit were outstanding.

Since many of these commitments are expected to expire without being drawn upon, the total commitments do not necessarily represent future cash requirements. However, these credit-related financial instruments have off-balance-sheet credit risk because their amounts are not reflected on the Consolidated Balance Sheets until funded or drawn upon. The credit risk associated with issuing commitments and letters of credit is substantially the same as that involved in extending loans to borrowers and management applies the same credit policies to these commitments. Upon fully funding a commitment, the credit risk amounts are equal to the contract amounts, assuming that borrowers fail completely to meet their obligations and the collateral or other security is of no value. The amount of collateral obtained, if deemed necessary upon extension of credit, is based on management's credit evaluation of the borrower.

The Association also participates in standby letters of credit to satisfy the financing needs of its borrowers. These letters of credit are irrevocable agreements to guarantee payments of specified financial obligations. At December 31, 2007, the Association had outstanding \$6,847 of standby letters of credit, with expiration dates ranging from January 2008 to September 2018. The maximum potential amount of future payments the Association may be required to make under these existing guarantees is \$6,847.

A guarantor is required to recognize at the inception of a guarantee, a liability for the fair value of the guarantee commitment. The Association has determined the fair value of the guarantee commitment based upon the fees to be earned over the life of the guarantee. The fair value is updated periodically to reflect changes in individual guarantee amounts and the remaining life to maturity of the individual guarantees in the Association's inventory. At December 31, 2007, the Association's inventory of standby letters of credit had a fair value of \$338 and was included in other liabilities.

Note 13 — Disclosures About Fair Value of Financial Instruments

The following table presents the carrying amounts and fair values of the Association's financial instruments at December 31, 2007, 2006 and 2005. The fair value of a financial instrument is generally defined as the amount at which the instrument could be exchanged in a current transaction between willing parties, other than in a forced or liquidation sale.

Quoted market prices are generally not available for certain System financial instruments, as described below. Accordingly fair values are based on judgments regarding anticipated cash flows, future expected loss experience, current economic conditions, risk characteristics of various financial instruments, and other factors. These estimates involve uncertainties and matters of judgment, and therefore cannot be determined with precision. Changes in assumptions could significantly affect the estimates.

The estimated fair values of the Association's financial instruments are as follows:

	December 31, 2007		December 31, 2006	
	Carrying Amount	Estimated Fair Value	Carrying Amount	Estimated Fair Value
Financial assets:				
Cash	\$ 8,356	\$ 8,356	\$ 15,743	\$ 15,743
Loans	\$ 1,240,078	\$ 1,271,784	\$ 1,118,377	\$ 1,138,623
Allowance for loan losses	6,961	—	5,876	—
Loans, net	\$ 1,233,117	\$ 1,271,784	\$ 1,112,501	\$ 1,138,623

Financial liabilities:				
Notes payable to AgFirst Farm Credit Bank	\$ 1,088,297	\$ 1,108,655	\$ 978,396	\$ 981,247

	December 31, 2005	
	Carrying Amount	Estimated Fair Value
Financial assets:		
Cash	\$ 20,207	\$ 20,207
Loans	\$ 985,486	\$ 988,645
Allowance for loan losses	5,425	—
Loans, net	\$ 980,061	\$ 988,645

Financial liabilities:		
Notes payable to AgFirst Farm Credit Bank	\$ 856,986	\$ 851,290

A description of the methods and assumptions used to estimate the fair value of each class of the Association's financial instruments for which it is practicable to estimate that value follows:

- A. **Cash:** The carrying value is a reasonable estimate of fair value.
- B. **Loans:** Because no active market exists for the Association's loans, fair value is estimated by discounting the expected future cash flows using the Association's current interest rates at which similar loans would be made to borrowers with similar credit risk. As the discount rates are based on the Bank's loan rates, as well as management estimates, management has no basis to determine whether the fair values presented would be indicative of the value negotiated in an actual sale.

For purposes of determining fair value of accruing loans, the loan portfolio is segregated into pools of loans with homogeneous characteristics based upon repricing and credit risk. Expected future cash flows and interest rates reflecting appropriate credit risk are separately determined for each individual pool.

Fair value of loans in a nonaccrual status is estimated to be the carrying amount less specific reserves.

The carrying value of accrued interest approximates its fair value.

- C. **Investment in AgFirst Farm Credit Bank and Other Farm Credit Institutions:** Estimating the fair value of the Association's investment in the Bank and Other Farm Credit Institutions is not practicable because the stock is not traded. As described in Note 4, the net investment is a requirement of

borrowing from the Bank and is carried at cost plus allocated equities in the accompanying Consolidated Balance Sheets. The Association owns 5.80 percent of the issued stock of the Bank as of December 31, 2007 net of any reciprocal investment. As of that date, the Bank's assets totaled \$26.9 billion and shareholders' equity totaled \$1,457 million. The Bank's earnings were \$192 million during 2007.

In addition, the Association has an investment of \$38 related to other Farm Credit institutions.

- D. **Notes Payable to AgFirst Farm Credit Bank:** The notes payable are segregated into pricing pools according to the types and terms of the loans (or other assets) which they fund. Fair value of the notes payable is estimated by discounting the anticipated cash flows of each pricing pool using the current rate that would be charged for additional borrowings. For purposes of this estimate it is assumed the cash flow on the notes is equal to the principal payments on the Association's loan receivables plus accrued interest on the notes payable. This assumption implies that earnings on the Association's interest margin are used to fund operating expenses and capital expenditures.

- E. **Commitments to Extend Credit and Standby Letters of Credit:** The estimated market value of off-balance-sheet commitments is minimal since the committed rate approximates current rates offered for commitments with similar rate and maturity characteristics and since the related credit risk is not significant.

Note 14 — Quarterly Financial Information (Unaudited)

Quarterly results of operations for the years ended December 31, 2007, 2006 and 2005 follow:

	2007				
	First	Second	Third	Fourth	Total
Net interest income	\$ 8,070	\$ 8,554	\$ 8,952	\$ 8,542	\$ 34,118
Provision for (reversal of allowance for) loan losses	250	400	400	—	1,050
Noninterest income (expense), net	(2,807)	(2,904)	(2,652)	(3,639)	(12,002)
Net income (loss)	\$ 5,013	\$ 5,250	\$ 5,900	\$ 4,903	\$ 21,066

	2006				
	First	Second	Third	Fourth	Total
Net interest income	\$ 7,479	\$ 8,014	\$ 8,700	\$ 8,399	\$ 32,592
Provision for (reversal of allowance for) loan losses	200	330	400	—	930
Noninterest income (expense), net	(3,030)	(2,958)	(3,154)	(3,203)	(12,345)
Net income (loss)	\$ 4,249	\$ 4,726	\$ 5,146	\$ 5,196	\$ 19,317

	2005				
	First	Second	Third	Fourth	Total
Net interest income	\$ 6,611	\$ 7,282	\$ 8,336	\$ 8,036	\$ 30,265
Provision for (reversal of allowance for) loan losses	—	—	305	—	305
Noninterest income (expense), net	(2,613)	(2,639)	(2,698)	(1,562)	(9,512)
Net income (loss)	\$ 3,998	\$ 4,643	\$ 5,333	\$ 6,474	\$ 20,448