First South Farm Credit, ACA

SECOND QUARTER 2008

Stephen L. Rochelle

Stephen L. Rochelle
Chief Executive Officer

Bryan Applewhite

Bryan Applewhite
Chief Financial Officer

Shepherd Morris

Shepherd Morris
Chairman of the Board

August 4, 2008

First South Farm Credit, ACA

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

(dollars in thousands)

The following commentary reviews the financial condition and results of operations of *First South Farm Credit, ACA* (Association) for the period ended June 30, 2008. These comments should be read in conjunction with the accompanying consolidated financial statements, notes to the consolidated financial statements and the 2007 Annual Report of the Association. The accompanying consolidated financial statements were prepared under the oversight of the Audit Committee of the Board of Directors.

LOAN PORTFOLIO

The Association provides funds to farmers, rural homeowners and farm-related businesses for financing of short and intermediate-term loans. The Association's loan portfolio is diversified over a range of agricultural commodities including poultry, cotton, livestock and forestry. Farm size varies and many of the borrowers in the region have diversified farming operations. This factor, along with the numerous opportunities for non-farm income in the area, somewhat reduces the level of dependency on any single commodity.

The gross loan volume of the Association as of June 30, 2008, was $1,190,121, a decrease of $49,957, as compared to $1,240,078 at December 31, 2007. Net loans outstanding at June 30, 2008, were $1,183,316 as compared to $1,233,117 at December 31, 2007. Net loans accounted for 90.93 percent of total assets at June 30, 2008, as compared to 91.77 percent of total assets at December 31, 2007. The decrease in loan volume during the reporting period is primarily attributable to increased loan participations sold to AgFirst Farm Credit Bank (the Bank). Loans are sold to the Bank as a risk management tool. Loan volume before loan participations sold to the Bank increased for the six months ended June 30, 2008. This growth is primarily attributable to seasonal lending associated with the short-term part of the portfolio.

There is an inherent risk in the extension of any type of credit. Portfolio credit quality continues to be maintained at an acceptable level and credit administration remains satisfactory. Nonaccrual loans decreased from $3,520 at December 31, 2007, to $2,405 at June 30, 2008, a decrease of $1,115.

Association management maintains an allowance for loan losses in an amount considered sufficient to absorb possible losses in the loan portfolio based on current and expected future conditions. The allowance for loan losses at June 30, 2008, was $6,805 compared to $6,961 at December 31, 2007, and was considered by management to be adequate to cover probable losses.

RESULTS OF OPERATIONS

For the three months ended June 30, 2008

Net income for the three months ended June 30, 2008, totaled $5,531, as compared to $5,250 for the same period in 2007. Net interest income decreased $1,259 for the three months ended June 30, 2008, as compared to the same period in 2007. The decrease in net interest income was primarily the result of the decrease in loan volume associated with the increased loan participations sold to the Bank.

Noninterest income for the three months ended June 30, 2008, totaled $4,503, as compared to $2,629 for the same period of 2007, an increase of $1,874. The increase is primarily the result of an increase in loan fees of $214, an increase in fees for financially related services of $23, an increase in equity in earnings of the Bank of $1,636, and an increase in gains on other property owned of $12, partially offset by a decrease in other noninterest income of $11.

Noninterest expense for the three months ended June 30, 2008, increased $195 compared to the same period of 2007. The primary reasons for the increase in noninterest expense were an increase in salaries and employee benefits of $170, an increase in occupancy and equipment expense of $28, and an increase in other operating expenses of $23, partially offset by a decrease in the Insurance Fund premium of $26.

The Association recorded a provision for loan loss of $508 for the three months ended June 30, 2008, compared to a provision of $400 for the same period in 2007. The Association recorded a provision for income taxes of $35 for the three months ended June 30, 2008, compared to a provision of $4 for the same period in 2007.

For the six months ended June 30, 2008

Net income for the six months ended June 30, 2008, totaled $11,013, as compared to $10,263 for the same period in 2007. Net interest income decreased $1,782 or 10.72 percent, as compared to the same period in 2007. The decrease in net interest income was primarily the result of a decrease in loan volume associated with the increased loan participations sold to the Bank.

Noninterest income for the six months ended June 30, 2008, totaled $7,658, as compared to $5,307 for the same period of 2007, an increase of $2,351. The increase is primarily the result of an increase in loan fees of $484, an increase in equity in earnings of the Bank of $1,865, and an increase in gains on other property owned of $13, partially offset by a decrease in fees for financially related services of $3 and a decrease in other noninterest income of $8. The increase in equity in the Bank's earnings is primarily the result of the increase in loan participations sold to the Bank compared to the same period in 2007.

Noninterest expense for the six months ended June 30, 2008, increased $403 compared to the same period of 2007. The primary reasons for the increase in noninterest expense was an increase in salaries and employee benefits of $317, an increase in occupancy and equipment expense of $49, and an increase in other operating expenses of $74, partially offset by a decrease in the Insurance Fund premium of $37.

The Association recorded a provision for loan loss of $45 for the six months ended June 30, 2008, compared to a provision of $650 for the same period in 2007.

FUNDING SOURCES

The principal source of funds for the Association is the borrowing relationship established with the Bank through a General Financing Agreement. The General Financing Agreement utilizes the Association's credit and fiscal performance as criteria for establishing a line of credit on which the Association may draw funds. The Bank advances funds to the Association in the form of notes payable. The notes payable are segmented into variable rate and fixed rate sections. The variable rate note is utilized by the Association to fund variable rate loan advances and operating funds requirements. The fixed rate note is used specifically to fund fixed rate loan advances made by the Association. The total notes payable to the Bank at June 30, 2008, was $1,047,235 as compared to $1,088,297 at December 31, 2007, a decrease of $41,062 or 3.77 percent. The decrease in notes payable is primarily related to the decrease in loan volume associated with the increased loan participations sold to the Bank.

CAPITAL RESOURCES

Total members' equity at June 30, 2008, increased to $231,784 from the December 31, 2007, total of $225,996. The increase is primarily attributed to net income of $11,013 and an increase in capital stock of $292, partially offset by the retirement of allocated earnings of $5,509. Total capital stock and participation certificates were $64,750 on June 30, 2008, compared to $64,458 on December 31, 2007.

Farm Credit Administration (FCA) regulations require all Farm Credit institutions to maintain minimum permanent capital, total surplus and core surplus ratios. These ratios are calculated by dividing the Association's permanent capital, total surplus and core surplus as defined in FCA regulations, by a risk-adjusted asset base. As of June 30, 2008, the Association's total surplus ratio and core surplus ratio were 11.46 percent and 10.27 percent, respectively, and the permanent capital ratio was 12.69 percent. All three ratios were well above the minimum regulatory ratios of 7.00 percent for permanent capital and total surplus ratios and 3.50 percent for the core surplus ratio.

STOCKHOLDER INVESTMENT

Stockholder investment in the Association could be affected by the financial condition and results of operations of AgFirst Farm Credit Bank. Copies of AgFirst Farm Credit Bank's Quarterly and Annual Reports are on the AgFirst website, *www.agfirst.com*, or may be obtained at no charge by calling 1-800-845-1745, extension 378, or writing Stephen Gilbert, AgFirst Farm Credit Bank, P.O. Box 1499, Columbia, SC 29202. Copies of the Association's Annual and Quarterly reports are also on the Association's website, *www.firstsouthfarmcredit.com*, or may be obtained upon request free of charge by calling 1-800-955-1722 or writing Bryan Applewhite, First South Farm Credit, ACA, P. O. Box 6008, Ridgeland, MS 39158-6008. The Association prepares a quarterly report within 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.

First South Farm Credit, ACA

Consolidated Balance Sheets

(dollars in thousands)	**June 30, 2008**	**December 31, 2007**
	(unaudited)	*(audited)*
Assets		
Cash	$ 2,820	$ 8,356
Loans	1,190,121	1,240,078
Less: allowance for loan losses	6,805	6,961
Net loans	1,183,316	1,233,117
Accrued interest receivable	14,715	17,313
Investment in other Farm Credit institutions	86,996	68,575
Premises and equipment, net	6,460	5,294
Other property owned	5	5
Due from AgFirst Farm Credit Bank	5,647	9,611
Other assets	1,459	1,388
Total assets	$ 1,301,418	$ 1,343,659
Liabilities		
Notes payable to AgFirst Farm Credit Bank	$ 1,047,235	$ 1,088,297
Accrued interest payable	3,657	5,100
Patronage refund payable	6	3,843
Other liabilities	18,736	20,423
Total liabilities	1,069,634	1,117,663
Commitments and contingencies		
Members' Equity		
Protected borrower equity	98	111
Capital stock and participation certificates	64,652	64,347
Retained earnings		
Allocated	78,856	84,707
Unallocated	94,327	83,048
Accumulated other comprehensive income (loss)	(6,149)	(6,217)
Total members' equity	231,784	225,996
Total liabilities and members' equity	$ 1,301,418	$ 1,343,659

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

First South Farm Credit, ACA

Consolidated Statements of Income

(unaudited)

(dollars in thousands)	For the three months ended June 30, 2008	2007	For the six months ended June 30, 2008	2007
Interest Income				
Loans	18,119	22,908	37,365	43,636
Interest Expense				
Notes payable to AgFirst Farm Credit Bank	10,824	14,354	22,523	27,012
Net interest income	7,295	8,554	14,842	16,624
Provision for (reversal of allowance for) loan losses	508	400	45	650
Net interest income after provision for (reversal of allowance for) loan losses	6,787	8,154	14,797	15,974
Noninterest Income				
Loan fees	819	605	1,826	1,342
Fees for financially related services	57	34	42	45
Equity in earnings of other Farm Credit institutions	3,606	1,970	5,634	3,769
Gains (losses) on other property owned, net	20	8	22	9
Other noninterest income	1	12	134	142
Total noninterest income	4,503	2,629	7,658	5,307
Noninterest Expense				
Salaries and employee benefits	3,593	3,423	7,162	6,845
Occupancy and equipment	308	280	621	572
Insurance Fund premium	391	417	765	802
Other operating expenses	1,432	1,409	2,873	2,799
Total noninterest expense	5,724	5,529	11,421	11,018
Income before income taxes	5,566	5,254	11,034	10,263
Provision (benefit) for income taxes	35	4	21	–
Net income	$ 5,531	$ 5,250	$ 11,013	$ 10,263

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

First South Farm Credit, ACA

Consolidated Statements of Changes in Members' Equity

(unaudited)

(dollars in thousands)	Protected Borrower Capital	Capital Stock and Participation Certificates	Retained Earnings Allocated	Retained Earnings Unallocated	Accumulated Other Comprehensive Income	Total Members' Equity
Balance at December 31, 2006	$ 92	$ 64,236	$ 77,039	$ 82,008	$ –	$ 223,375
Net income				10,263		10,263
Protected borrower equity retired	(1)					(1)
Capital stock/participation certificates issued/(retired), net		198				198
Retained earnings retired			(8,577)			(8,577)
Patronage distribution adjustment			(127)	181		54
Balance at June 30, 2007	$ 91	$ 64,434	$ 68,335	$ 92,452	$ –	$ 225,312
Balance at December 31, 2007	$ 111	$ 64,347	$ 84,707	$ 83,048	$ (6,217)	$ 225,996
Net income				11,013		11,013
Protected borrower equity retired	(13)					(13)
Capital stock/participation certificates issued/(retired), net		305				305
Retained earnings retired			(5,509)			(5,509)
Patronage distribution adjustment			(342)	450		108
Employee benefit plans adjustments				(184)	68	(116)
Balance at June 30, 2008	$ 98	$ 64,652	$ 78,856	$ 94,327	$ (6,149)	$ 231,784

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

Notes to the Consolidated Financial Statements

(dollars in thousands, except as noted)
(unaudited)

NOTE 1 — ORGANIZATION AND SIGNIFICANT ACCOUNTING POLICIES

The accompanying financial statements include the accounts of First South Farm Credit, ACA (the Association). A description of the organization and operations of the Association, the significant accounting policies followed, and the financial condition and results of operations as of and for the year ended December 31, 2007, are contained in the 2007 Annual Report to Shareholders. These unaudited second quarter 2008 consolidated financial statements should be read in conjunction with the 2007 Annual Report to Shareholders.

The accompanying consolidated financial statements contain all adjustments necessary for a fair presentation of the interim financial condition and results of operations and conform with generally accepted accounting principles (GAAP) and prevailing practices within the banking industry. The results for the six months ended June 30, 2008, are not necessarily indicative of the results to be expected for the year ending December 31, 2008.

Certain amounts in the prior period's consolidated financial statements may have been reclassified to conform to the current period's consolidated financial statement presentation. Such reclassifications had no effect on the prior period net income or total capital as previously reported.

The Association maintains an allowance for loan losses in accordance with GAAP. The loan portfolio is reviewed quarterly to determine the adequacy of the allowance for losses. As of June 30, 2008, the allowance for losses is adequate in management's opinion to provide for possible losses on existing loans.

In December 2007, the Financial Accounting Standards Board issued Statements of Financial Accounting Standards No. 141R, "Business Combinations" (SFAS 141R). SFAS 141R requires business combinations to be accounted for under the acquisition method of accounting (previously called the purchase method). The acquisition method requires (a) identifying the acquirer, (b) determining the acquisition date, (c) recognizing and measuring the identifiable assets acquired, the liabilities assumed, and any noncontrolling interest in the acquiree, at their acquisition date fair values, and (d) recognizing and measuring goodwill or a gain from a bargain purchase. SFAS 141R should be applied prospectively to business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after December 15, 2008. Early application is prohibited. The Association is still evaluating the provisions of SFAS 141R, but believes that its adoption will significantly impact its accounting for combinations/acquisitions that may occur in 2009 and beyond.

NOTE 2 — ALLOWANCE FOR LOAN LOSSES

An analysis of the allowance for loan losses follows:

	For the six months ended June 30,	
	2008	**2007**
Balance at beginning of period	$ 6,961	$ 5,876
Provision for (reversal of) loan losses	45	650
Loans (charged off), net of recoveries	(201)	(5)
Balance at end of period	$ 6,805	$ 6,521

NOTE 3 — EMPLOYEE BENEFIT PLANS

The following is a table of retirement and other postretirement benefit expenses for the Association:

	For the six months ended June 30,	
	2008	**2007**
Pension	$ 368	$ 502
401(k)	135	127
Other postretirement benefits	215	171
Total	$ 718	$ 800

The following is a table of retirement and other postretirement benefit contributions for the Association:

	Actual YTD Through 6/30/08	Projected Contributions For Remainder of 2008	Projected Total Contributions 2008
Pension	$ -	$ 790	$ 790
Other postretirement benefits	209	261	470
Total	$ 209	$1,051	$1,260

Market conditions could impact discount rates and return on plan assets which could change the above contribution projections by making additional contributions necessary before the next plan measurement date.

In September 2006, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards No. 158, *Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans* (SFAS 158), which required the recognition of the overfunded or underfunded status of pension and other postretirement benefit plans on the balance sheet. The balance sheet recognition provisions of SFAS 158 were adopted at December 31, 2007 by the Association.

SFAS 158 also requires that employers measure the benefit obligation and plan assets as of the fiscal year end for fiscal years ending after December 15, 2008. In fiscal 2007 and earlier, a September 30 measurement date was used for pension and other postretirement benefit plans. The Standard provides two approaches for an employer to transition to a fiscal year end measurement date. The approach applied by the Association allows for the use of the measurements determined for the prior year end. Under this alternative, pension and other postretirement benefit expense measured for the three-month period October 1, 2007 to December 31, 2007 (determined using the September 30, 2007 measurement date) is reflected as an adjustment to beginning 2008 unallocated retained earnings. As a result, the Association decreased unallocated retained earnings and increased the pension liability by $184 thousand.

Upon adoption, SFAS 158 further required the determination of the fair value of plan assets 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 (AOCI). These amounts are subsequently recognized as components of net periodic benefit costs over time. For the first six months of 2008, $68 thousand has been recognized as a credit to accumulated other comprehensive income and a debit to pension expense to reflect the amortization of the components previously recognized in AOCI.

Further details regarding employee benefit plans and adoption of SFAS 158 are contained in the 2007 Annual Report to Shareholders.