

Featured Products & Services

Business Free Checking

First South Bank prides itself in being a leader in offering Business Free Checking. As a business, we understand the importance of a strong business relationship and we know businesses need a bank they can count on for all their financial needs. Choosing the right checking account can be one of the most important decisions your business undertakes. Business Free Checking allows you to save money and avoid high fees that are often accompanied with a checking account. If you have not received any information on Business Free Checking, give us a call today and we will be glad to visit with you and your business associates.

Group Banking

If you are a business customer of First South Bank, your employees are eligible for our group banking package. Group Banking provides free checking, interest on your deposits, no monthly service charges, and no minimum balance requirements. We will even provide your employees with their first order of personalized checks free.

UVEST Financial Services

First South Bank has partnered with UVEST Financial Services to provide our customers access to discount brokerage services. This allows you the opportunity to handle all financial transactions in one convenient location. As a customer, you can avoid the higher commissions associated with full service brokerage firms by placing your trades through UVEST.

UVEST can provide you with a complete array of investments alternatives including stocks, corporate bonds, mutual funds, and tax-free municipal bonds, and government bonds. UVEST can automatically debit or credit your First South Bank checking account, making it easy and convenient for you to pay or receive payments for your trades. For more informations, contact First South Bank toll free at 1-800-946-4178

Securities offered by, and Financial Consultants registered with UVEST Financial Services, Member NASD, SIPC.

Investment products are not FDIC insured, are not bank guaranteed, and may lose value.

First South Bank

Member FDIC

Corporate Office

1311 Carolina Avenue
Washington, NC 27889
(252) 946-4178

Full-Service Branch Offices

| | |
|------------------|------------------|
| Buxton | Kill Devil Hills |
| Chocowinity | Kinston |
| Durham | Lumberton (2) |
| Elizabeth City | New Bern (3) |
| Fayetteville (2) | Raleigh |
| Greenville (2) | Rocky Mount (5) |
| Hope Mills | Tarboro |
| Washington (3) | |

Loan Production Office

Kill Devil Hills

First South Leasing, LLC

Greenville

Shareholder Information

Stock Listing:

NASDAQ - National Market System
Symbol - FSBK

Registrar and Transfer Agent:

Registrar and Transfer Company
10 Commerce Drive
Cranford, NJ 07016-3572
1-800-368-5948

Investor Relations:

PO Box 2047
Washington, North Carolina 27889
1-800-946-4178

www.firstsouthnc.com

Quarterly Financial Report

September 30, 2006

First South Bancorp

Dear Shareholders:

First South Bancorp, Inc., the parent holding company of First South Bank, is pleased to report its unaudited consolidated results of operations for the quarter ended September 30, 2006 and the first nine months of the year ending December 31, 2006.

Net income for the quarter ended September 30, 2006 increased 17.5% to \$4,317,013 from net income of \$3,674,362 earned in the quarter ended September 30, 2005. Diluted earnings per share increased 16.2% to \$0.43 per share for the quarter ended September 30, 2006 from \$0.37 per share for the quarter ended September 30, 2005. Net income for the nine months ended September 30, 2006 increased 28.1% to \$12,827,219 from net income of \$10,013,033 earned in the nine months ended September 30, 2005. Diluted earnings per share increased 29.0% to \$1.29 per share for the nine months ended September 30, 2006 from \$1.00 per share for the nine months ended September 30, 2005.

Our core earnings continue to be supported by the strength of our net interest income, during a period of rising interest rates and many challenging issues facing our country. The net loan and leases receivable portfolio increased 7.5% to \$762.0 million at September 30, 2006 from \$708.8 million at September 30, 2005, while deposits increased 9.9% to \$803.5 million at September 30, 2006 from \$731.4 million at September 30, 2005.


Total assets of the Company increased to \$916.9 million at September 30, 2006 from \$825.3 million at September 30, 2005, reflecting an 11.1% annualized growth rate. Net interest income increased 10.5% to \$10.6 million for the quarter ended September 30, 2006 from \$9.6 million for the quarter ended September 30, 2005, reflecting both our balance sheet and interest rate risk management efforts.

We continue to focus on our operating efficiency by managing net interest income, growing non-interest income, and controlling operating expenses, resulting in a 44.5% efficiency ratio for the quarter ended September 30, 2006. In addition, our key performance ratios, return on average assets (ROA) and return on average equity (ROE), continue to place us at the top of our peer group. Our ROA and ROE was 1.9% and 23.1%, respectively, for the quarter ended September 30, 2006.

We are pleased to enclose our dividend check of \$0.17 per share, payable to shareholders of record as of October 10, 2006. This dividend payment represents a payout ratio of 38.6% of this quarter's basic earnings and is the Company's thirty-eighth consecutive quarterly cash dividend.

The Board of Directors, officers and staff of the Company and First South Bank pledge our continued commitment to you and we welcome your comments and suggestions. Thank you for your support and continued investment in First South Bancorp.

Sincerely,



Tom Vann
President and Chief Executive Officer

Condensed Statements of Financial Condition

(dollars in thousands)

| | September 30, 2006 (unaudited) | December 31, 2005** |
|---|--------------------------------------|------------------------|
| Assets | | |
| Cash and cash equivalents | \$ 29,151 | \$ 32,943 |
| Investment securities | 56,462 | 41,828 |
| Mortgage backed securities | 37,719 | 22,703 |
| Loans and leases receivable, net | 762,020 | 708,929 |
| Premises and equipment | 8,665 | 8,831 |
| Goodwill | 4,219 | 4,219 |
| Federal Home Loan Bank stock | 2,077 | 1,689 |
| Accrued interest receivable | 5,675 | 4,289 |
| Mortgage servicing rights | 1,349 | 1,402 |
| Income tax receivable | 2,176 | 1,146 |
| Other Assets | 7,401 | 6,255 |
| Total Assets | \$ 916,914 | \$ 834,234 |
| Liabilities and Stockholders' Equity | | |
| Deposits | \$ 803,512 | \$ 733,753 |
| Borrowings | 15,397 | 11,788 |
| Junior subordinated debentures | 10,310 | 10,310 |
| Other liabilities | 11,420 | 10,192 |
| Total liabilities | 840,639 | 766,043 |
| Total Stockholders' Equity | 76,275 | 68,191 |
| Total Liabilities and Stockholder's Equity | \$ 916,914 | \$ 834,234 |

Condensed Statements of Income (unaudited)

(dollars in thousands, except per share data)

| | Three Months Ended September 30 | | Six Months Ended September 30 | |
|---|------------------------------------|-----------------|----------------------------------|------------------|
| | 2006 | 2005 | 2006 | 2005 |
| Interest income | \$ 17,528 | \$ 13,912 | \$ 49,903 | \$ 38,244 |
| Interest expense | 6,960 | 4,350 | 18,264 | 10,903 |
| Net interest income | 10,568 | 9,562 | 31,639 | 27,341 |
| Provision for credit losses | 150 | 394 | 933 | 1,445 |
| Net interest income after provision for credit losses | 10,418 | 9,168 | 30,706 | 25,896 |
| Non-interest income | 2,516 | 2,265 | 7,069 | 6,074 |
| Non-interest expense | 5,758 | 5,432 | 16,675 | 15,625 |
| Income before taxes | 7,176 | 6,001 | 21,100 | 16,345 |
| Income tax expense | 2,859 | 2,327 | 8,273 | 6,332 |
| Net Income | \$ 4,317 | \$ 3,674 | \$ 12,827 | \$ 10,013 |
| Basic earnings per share | \$ 0.44* | \$ 0.39* | \$ 1.32* | \$ 1.06* |
| Diluted earnings per share | \$ 0.43* | \$ 0.37* | \$ 1.29* | \$ 1.00* |
| Dividends per share | \$ 0.17* | \$ 0.13* | \$ 0.51* | \$ 0.39* |
| Weighted average shares - basic | 9,776,933* | 9,421,101* | 9,693,010* | 9,476,055* |
| Weighted average shares - diluted | 10,070,678* | 9,930,546* | 9,981,253* | 9,966,906* |

* Adjusted for three-for-two stock split on May 25, 2006.

** Derived from audited consolidated financial statements.