COOPERATIVE BANKSHARES INC
Form 10-Q
May 14, 2003

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington D.C. 20549

FORM 10-Q

(Mark One)

[X] QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended March 31, 2003

OR

[ ] TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from   to

Commission File Number: 0-24626

COOPERATIVE BANKSHARES, INC.
(Exact name of registrant as specified in its charter)

North Carolina	56-1886527
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
201 Market Street, Wilmington, North Carolina	28401
(Address of principal executive offices)	(Zip Code)

Registrant's telephone number, including area code: (910) 343-0181

Former name, former address and former fiscal year, if changed since last report

N/A

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 of 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

[X] Yes   [ ] No

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act).

[ ] Yes [X] No

APPLICABLE ONLY TO CORPORATE ISSUERS: Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date. 2,847,947 shares at April 30, 2003

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COOPERATIVE BANKSHARES, INC. AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF FINANCIAL CONDITION

	MARCH 31, 2003 (UNAUDITED)	Decemb
ASSETS		
Cash and due from banks, noninterest-bearing	$ 13,205,668	$
Interest-bearing deposits in other banks	3,155,941	
Total cash and cash equivalents	16,361,609	
Securities:		
Available for sale (amortized cost of $39,355,848 in March 2003 and $41,033,409 in December 2002)	40,225,231	
Held to maturity (estimated market value of $7,728,406 in March 2003 and $8,009,087 in December 2002)	7,593,362	
FHLB stock	3,804,600	
Loans held for sale	20,757,817	
Loans	404,077,345	3
Less allowance for loan losses	2,996,843	
Net loans	401,080,502	3
Other real estate owned	920,643	
Accrued interest receivable	2,192,839	
Premises and equipment, net	7,603,824	
Other assets	12,037,943	
Total assets	$512,578,370	$5
LIABILITIES AND STOCKHOLDERS' EQUITY		
Deposits	$375,020,415	$3
Short-term borrowings	51,728,252	
Escrow deposits	381,491	
Accrued interest payable	278,302	
Accrued expenses and other liabilities	2,262,185	
Long-term obligations	43,091,411	
Total liabilities	472,762,056	4
Stockholders' equity:		
Preferred stock, $1 par value, 3,000,000 shares authorized, no shares issued and outstanding	-	
Common stock, $1 par value, 7,000,000 shares authorized, 2,847,947 and 2,835,947 shares issued and outstanding	2,847,947	
Additional paid-in capital	2,613,153	
Accumulated other comprehensive income	573,793	
Retained earnings	33,781,421	
Total stockholders' equity	39,816,314	
Total liabilities and stockholders' equity	$512,578,370	$5
Book value per common share	$ 13.98	$

The accompanying notes are an integral part of the consolidated financial statements.

COOPERATIVE BANKSHARES, INC. AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF OPERATIONS
(UNAUDITED)

	THREE MONTHS ENDED MARCH 31, 2003	2002
INTEREST INCOME:		
Loans	$ 6,525,593	$ 6,595,546
Securities	603,090	695,887
Other	9,806	12,293
Dividends on FHLB stock	45,575	58,909
Total interest income	7,184,064	7,362,635
INTEREST EXPENSE:		
Deposits	2,038,260	2,845,342
Borrowed funds	891,943	912,653
Total interest expense	2,930,203	3,757,995
NET INTEREST INCOME	4,253,861	3,604,640
Provision for loan losses	200,000	280,000
Net interest income after provision for loan losses	4,053,861	3,324,640
NONINTEREST INCOME:		
Gain on sale of loans	1,026,756	18,279
Net gain on sale of securities	-	116,766
Service charges and fees on loans	138,331	201,382
Deposit-related fees	256,871	248,235
Gain on sale of real estate	-	464,977
Bank-owned life insurance earnings	97,074	99,837
Other income, net	52,625	60,116
Total noninterest income	1,571,657	1,209,592
NONINTEREST EXPENSE:		
Compensation and fringe benefits	2,274,258	1,435,853
Occupancy and equipment	647,931	518,210
Professional and examination fees	101,247	130,581
Advertising	120,555	70,503
Real estate owned	17,890	6,542
Other	456,886	388,381
Total noninterest expenses	3,618,767	2,550,070
Income before income taxes	2,006,751	1,984,162
Income tax expense	619,101	695,660

NET INCOME	$ 1,387,650	$ 1,288,502
NET INCOME PER SHARE:		
Basic	$ 0.49	$ 0.45
Diluted	$ 0.48	$ 0.45
WEIGHTED AVERAGE COMMON SHARES OUTSTANDING:		
Basic	2,844,678	2,835,447
Diluted	2,887,096	2,843,398

The accompanying notes are an integral part of the consolidated financial statements.

COOPERATIVE BANKSHARES, INC. AND SUBSIDIARY
CONSOLIDATED STATEMENT OF STOCKHOLDERS' EQUITY
(UNAUDITED)

	COMMON STOCK	ADDITIONAL PAID-IN CAPITAL	ACCUMULATED OTHER COMPREHENSIVE INCOME	RETAINED EARNINGS
Balance, December 31, 2002	$ 2,835,947	$ 2,440,645	$ 635,500	$ 32,536,169
Exercise of stock options	12,000	158,500	--	--
Tax benefit of stock option exercise	--	14,008	--	--
Other comprehensive loss, net of taxes	--	--	(61,707)	--
Net income	--	--	--	1,387,650
Cash dividends ($.05 per share)	--	--	--	(142,398)
Balance, March 31, 2003	$ 2,847,947	$ 2,613,153	$ 573,793	$ 33,781,421

The accompanying notes are an integral part of the consolidated financial statements.

COOPERATIVE BANKSHARES, INC. AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF CASH FLOWS
(UNAUDITED)

	THREE MONTHS MARCH 2003
OPERATING ACTIVITIES:	
Net income	$ 1,387,650

Adjustments to reconcile net income to net cash provided by operating activities:	
Net accretion, amortization, and depreciation	318,037
Net gain on sale securities	--
Net gain on sale of loans	(1,026,756)
Provision (benefit) from deferred income taxes	(43,329)
Gain on sale of premises and equipment	--
Loss on sales of foreclosed real estate	534
Valuation losses on foreclosed real estate	107,880
Provision for loan losses	200,000
Originations of loans held for sale	(56,336,726)
Proceeds from sales of loans held for sale	62,230,202
Changes in assets and liabilities:	
Accrued interest receivable	46,987
Prepaid expenses and other assets	62,917
Accrued interest payable	(6,266)
Accrued expenses and other liabilities	(1,058,443)
Net cash provided by operating activities	5,882,687
INVESTING ACTIVITIES:	
Purchases of securities available for sale	--
Proceeds from sale of securities available for sale	--
Repayments of mortgage-backed securities available for sale	1,619,390
Repayments of mortgage-backed securities held to maturity	226,074
Loan originations, net of principal repayments	(10,848,421)
Proceeds from disposals of foreclosed real estate	74,390
Net expenditures on foreclosed real estate	(4,822)
Purchases of FHLB stock	(350,000)
Proceeds from sale of FHLB stock	600,100
Purchases of premises and equipment	(803,952)
Proceeds from sale of premises and equipment	--
Net cash used in investing activities	(9,487,241)
FINANCING ACTIVITIES:	
Net increase in deposits	17,766,319
Net repayments on short-term borrowings	(9,857,575)
Repayments on long-term obligations	(1,181)
Proceeds from issuance of common stock	184,508
Dividends paid	(142,398)
Net change in escrow deposits	157,887
Net cash provided by financing activities	8,107,560
INCREASE IN CASH AND CASH EQUIVALENTS	4,503,006
CASH AND CASH EQUIVALENTS:	
BEGINNING OF PERIOD	11,858,603
END OF PERIOD	$ 16,361,609

(Continued)

COOPERATIVE BANKSHARES, INC. AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF CASH FLOWS, CONTINUED

	THREE MONTHS ENDED MARCH 31, 2003	2002
Cash paid for:		
Interest	$ 2,936,469	$ 3,718,
Income taxes	207,652	92,
Summary of noncash investing and financing activities:		
Transfer from loans to foreclosed real estate	479,462	500,
Unrealized loss on securities available for sale, net of taxes	(61,707)	(622,
Reclassifications between Long-term obligations and short-term borrowings	-	5,000,

The accompanying notes are an integral part of the consolidated financial statements.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. Accounting Policies: The significant accounting policies followed by Cooperative Bankshares, Inc. (the "Company") for interim financial reporting are consistent with the accounting policies followed for annual financial reporting. These unaudited consolidated financial statements have been prepared in accordance with Rule 10-01 of Regulation S-X, and, in management's opinion, all adjustments of a normal recurring nature necessary for a fair presentation have been included. The accompanying consolidated financial statements do not purport to contain all the necessary financial disclosures that might otherwise be necessary in the circumstances and should be read in conjunction with the consolidated financial statements and notes thereto in the Company's annual report for the year ended December 31, 2002 (the "Annual Report"). The results of operations for the three-month period ended March 31, 2003 are not necessarily indicative of the results to be expected for the full year.

2. Basis of Presentation: The accompanying unaudited consolidated financial statements include the accounts of Cooperative Bankshares, Inc., Cooperative Bank (the Bank) and its wholly owned subsidiaries, Lumina Mortgage Company, Inc. (Lumina) & CS&L Holdings, Inc. (Holdings), and Holdings' majority owned subsidiary, CS&L Real Estate Trust, Inc. (REIT). All significant intercompany items have been eliminated. Certain items for prior periods have been reclassified to conform to the current period presentation. These reclassifications have no effect on the net income or stockholders' equity as previously reported.

3. Earnings Per Share: Earnings per share (EPS) are calculated by dividing net income by the weighted average number of common shares outstanding (basic EPS) and the sum of the weighted average number of common shares outstanding and potential common stock (diluted EPS). Potential common stock consists of stock options issued and outstanding. In determining the number of potential common stock, the treasury stock method was applied. This method assumes that the number of shares issuable upon exercise of the

stock options is reduced by the number of common shares assumed purchased at market prices with the proceeds from the assumed exercise of the common stock options plus any tax benefits received as a result of the assumed exercise. The following table provides a reconciliation of income available to common stockholders and the average number of shares outstanding for the periods below:

	THREE MONTHS ENDED MARCH 31, 2003	THREE MONTHS ENDED MARCH 31, 2002
Net income (numerator)	$1,387,650	$1,288,502
Shares for basic EPS (denominator)	2,844,678	2,835,447
Dilutive effect of stock options	42,418	7,951
Shares for diluted EPS (denominator)	2,887,096	2,843,398

For the periods ended March 31, 2003 and 2002, there were 4,204 and 14,204 options outstanding respectively that were antidilutive since the exercise price exceeds the average market price. The options have been omitted from the calculation of the dilutive effect of stock options.

4. <u>Comprehensive Income:</u> Comprehensive income includes net income and all other changes to the Company's equity, with the exception of transactions with shareholders ("other comprehensive income"). The Company's only components of other comprehensive income relate to unrealized gains and losses on available for sale securities. The following table sets forth the components of other comprehensive income and total comprehensive income for the three months ended March 31:

	THREE MONTHS ENDED MARCH 31, 2003	THREE MONTHS ENDED MARCH 31, 2002
Net income	$ 1,387,650	$ 1,288,502
Other comprehensive income (loss):		
Reclassification to realized gains	-	116,766
Unrealized loss arising during the period	(172,420)	(1,137,295)
Income tax benefit	110,713	398,007
Other comprehensive loss	(61,707)	(622,522)
Comprehensive income	$ 1,325,943	$ 665,980

5. <u>Stock-Based Compensation:</u> On January 1, 1996 the Company adopted SFAS No. 123, "Accounting for Stock-Based Compensation". As permitted by SFAS No. 123, the Company has chosen to continue to apply APB Opinion No. 25,

"Accounting for Stock Issued to Employees" and related interpretations. The option exercise price is the market price of the common stock on the date the option is granted. Accordingly, no compensation cost has been recognized for options granted under the Option Plan. Had compensation cost for the Company's Option Plan been determined based on the fair value at the grant dates for awards under the option plan consistent with the method of SFAS No. 123, the Company's net income and net income per share would have been reduced to the pro forma amounts indicated below.

	Three Months Ended March 31, 2003	Three Months Ended March 31, 2002
Net income, as reported	$ 1,387,650	$ 1,288,502
Deduct: Total stock-based employee compensation expense determined under fair value based method for all awards, net of related tax effects	-	(60,543)
Proforma net income	$ 1,387,650	$ 1,227,959
Earnings per share:		
Basic-as reported	$ 0.49	$ 0.45
Basic-proforma	$ 0.49	$ 0.43
Diluted-as reported	$ 0.48	$ 0.45
Diluted-proforma	$ 0.48	$ 0.43

6. New Accounting Prouncements: On January 1, 2003, the Company adopted SFAS No. 146, "Accounting for Costs Associated with Exit or Disposal Activities". SFAS No. 146 addresses financial accounting and reporting for costs associated with exit or disposal activities and nullifies Emerging Issues Task Force (EITF) Issue 94-3, "Liability Recognition for Certain Employee Termination Benefits and Other Costs to Exit an Activity." The adoption of SFAS No. 146 did not have a material effect on the Company's consolidated financial statements.

In November 2002, the Financial Accounting Standards Board (FASB) issued Interpretation No. 45, "Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness to Others, an interpretation of FASB Statements No. 5, 57 and 107 and a rescission of FASB Interpretation No. 34." This Interpretation elaborates on the disclosures to be made by a guarantor in its interim and annual financial statements about its obligations under guarantees issued. The Interpretation also clarifies that a guarantor is required to recognize, at inception of a guarantee, a liability for the fair value of the obligation undertaken. The initial recognition and measurement provisions of the Interpretation are applicable to guarantees issued or modified after December 31, 2002 and are not expected to have a material effect on the Company's consolidated financial statements. The disclosure requirements are effective for financial statements of interim and annual periods ending after December 15, 2002.

In January 2003, the FASB issued Interpretation No. 46, "Consolidation of Variable Interest Entities, an interpretation of ARB No. 51". This Interpretation addresses the consolidation by business enterprises of variable interest entities as defined in the Interpretation. The Interpretation applies immediately to variable interests in variable interest entities created after January 31, 2003, and to variable interests in variable interest entities obtained after January 31, 2003. For public enterprises with a variable interest in a variable interest equity created before February 1, 2003, the interpretation applies to that enterprise no later than the beginning of the first interim or annual reporting period beginning after June 15, 2003. The application of this Interpretation is not expected to have a material effect on the Company's consolidated financial statements. The Interpretation requires certain disclosures in financial statements issued after January 31, 2003 if it is reasonably possible that the Company will consolidate or disclose information about variable interest entities when the Interpretation becomes effective.

ITEM 2 - MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

GENERAL

Cooperative Bankshares, Inc. (the "Company") is a registered bank holding company incorporated in North Carolina in 1994. The Company is the parent company of Cooperative Bank (the "Bank"); a North Carolina chartered commercial bank. Cooperative Bank, headquartered in Wilmington, North Carolina, was chartered in 1898. The Bank provides financial services through 17 financial centers in Eastern North Carolina. One of the Bank's subsidiaries, Lumina Mortgage Company, Inc. ("Lumina") is a mortgage banking firm originating and selling residential mortgage loans through offices in Wilmington, North Carolina; North Myrtle Beach, South Carolina; and Virginia Beach, Virginia. The Bank's other subsidiary, CS&L Holdings, Inc. ("Holdings") is a holding company for CS&L Real Estate Trust, Inc. (the "REIT"), which is a real estate investment trust.

Through its financial centers, the Bank provides a wide range of banking products, including interest-bearing and non-interest-bearing checking accounts, certificates of deposit and individual retirement accounts, which are insured up to the applicable limits of the Federal Deposit Insurance Corporation ("FDIC"). It offers an array of loan products: overdraft protection, commercial, consumer, agricultural, real estate, residential mortgage and home equity loans. Also offered are safe deposit boxes and automated banking services through ATMs and Access24 Phone Banking. In addition, the Bank offers discount brokerage services, annuity sales and mutual funds through a third party arrangement with UVEST Investment Services. Lumina delivers a wide range of mortgage loan products to its market area.

MISSION STATEMENT

It is the mission of the Company to provide the maximum in safety and security for our depositors, an equitable rate of return for our stockholders, excellent service for our customers, and to do so while operating in a fiscally sound and conservative manner, with fair pricing of our products and services, good working conditions, outstanding training and opportunities for our staff, along with a high level of corporate citizenship.

MANAGEMENT STRATEGY

Cooperative Bank's lending activities have traditionally concentrated on the origination of loans for the purpose of constructing, financing or refinancing residential properties. In recent years however, the Bank has emphasized origination of nonresidential real estate loans and secured and unsecured consumer and business loans. As of March 31, 2003, approximately $276 million, or 68%, of the Bank's loan portfolio, which excludes loans held for sale, consisted of loans secured by residential properties. This compared to approximately $268 million, or 69% at December 31, 2002. The Bank originates adjustable rate and fixed rate loans. As of March 31, 2003, adjustable rate and fixed rate loans totaled approximately 64.5% and 35.5%, respectively, of the Bank's total loan portfolio.

The Bank has chosen to sell a larger percentage of its fixed rate mortgage loan originations in the secondary market and through brokered arrangements. This enables the Bank to reinvest these funds in commercial loans, while increasing fee income. This is part of the continuing effort to restructure the balance sheet and operations to be more reflective of a commercial bank. The Bank is building additional branches in Wilmington, North Carolina and Morehead City, North Carolina.

INTEREST RATE SENSITIVITY ANALYSIS

Interest rate sensitivity refers to the change in interest spread resulting from changes in interest rates. To the extent that interest income and interest expense do not respond equally to changes in interest rates, or that all rates do not change uniformly, earnings will be affected. Interest rate sensitivity, at a point in time, can be analyzed using a static gap analysis that measures the match in balances subject to repricing between interest-earning assets and interest-bearing liabilities. Gap is considered positive when the amount of interest rate sensitive assets exceed the amount of interest rate sensitive liabilities. Gap is considered negative when the amount of interest rate sensitive liabilities exceed the amount of interest rate sensitive assets. At March 31, 2003, Cooperative had a one-year positive gap position of 2.1%. During a period of falling interest rates, a positive gap would tend to adversely affect net interest income, while a negative gap would tend to result in an increase in net interest income. During a period of rising interest rates, a positive gap would tend to result in an increase in net interest income while a negative gap would tend to adversely affect net interest income. It is important to note that certain shortcomings are inherent in static gap analysis. Although certain assets and liabilities may have similar maturities or periods of repricing, they may react in different degrees to changes in market interest rates. For example, a part of the Company's adjustable-rate mortgage loans are indexed to the National Monthly Median Cost of Funds to SAIF-insured institutions. This index is considered a lagging index that may lag behind changes in market rates. The one-year or less interest-bearing liabilities also include checking, savings, and money market deposit accounts. Experience has shown that the Company sees relatively modest repricing of these transaction accounts. Management takes this into consideration in determining acceptable levels of interest rate risk.

When Lumina gives a rate lock commitment to a customer, there is a concurrent "lock in" for the loan with a secondary market investor under a best efforts delivery mechanism. Therefore, interest rate risk is mitigated because any commitments to fund a loan available for sale is concurrently hedged by a commitment from an investor to purchase the loan under the same terms. Loans are usually sold within 60 days after closing.

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CONTRACTUAL OBLIGATIONS AND COMMITMENTS

The Bank enters into agreements that obligate it to make future payments under contracts, such as debt and lease agreements. In addition, the Bank commits to lend funds in the future such as credit lines and loan commitments. Below is a table of such contractual obligations and commitments at March 31, 2003 (in thousands).

Contractual Obligations	Payments Due by Period			
	Total	Less than 1 year	1-3 years	4-5 years
Borrowed Funds	$ 94,820	$ 51,728	$ 10,000	$ 10,0
Lease Obligations	2,956	313	441	2
Deposits	375,020	315,982	58,856	1
Total Contractual Cash Obligations	$472,796	$368,023	$ 69,297	$ 10,4

Other Commitments	Amount of Commitment Expiratio Per Period			
	Total Amounts Committed	Less than 1 year	1-3 years	4-5 year
Undisbursed portion of home equity collateralized primarily by junior liens on 1-4 family properties	$ 15,176	$ 1,339	$ 1,285	$ 6
Other commitments and credit lines	13,214	5,413	5,038	
Undisbursed portion of construction loans	33,797	33,797	--	
Available for sale mortgage loan commitments	6,397	6,397	--	
Fixed-rate mortgage loan commitments	3,335	3,335	--	
Adjustable-rate mortgage loan commitments	1,483	1,483	--	
Total Commitments	$ 73,402	$ 51,764	$ 6,323	$ 6

LIQUIDITY

The Company's goal is to maintain adequate liquidity to meet potential funding needs of loan and deposit customers, pay operating expenses, and meet regulatory liquidity requirements. Maturing securities, principal repayments of loans and securities, deposits, income from operations and borrowings are the main sources of liquidity. The Bank has been granted a line of credit by the Federal Home Loan Bank of Atlanta ("FHLB") in an amount of up to 25% of the Bank's total assets. At March 31, 2003, the Bank's borrowed funds from the FHLB equaled 14.8% of its total assets. Scheduled loan repayments are a relatively predictable source of funds, unlike deposits and loan prepayments that are significantly influenced by general interest rates, economic conditions and competition.

At March 31, 2003, the estimated market value of liquid assets (cash, cash equivalents, marketable securities and loans held for sale) was approximately $85.1 million, which represents 18.1% of deposits and borrowed funds as compared to $87.6 million or 19.0% of deposits and borrowed funds at December 31, 2002. The decrease in liquid assets was primarily due to a decrease in loans held for sale.

The Company's primary uses of liquidity are to fund loans and to make investments. At March 31, 2003, outstanding off-balance sheet commitments to extend credit totaled $39.6 million, and the undisbursed portion of

construction loans was $33.8 million. Management considers current liquidity levels adequate to meet the Company's cash flow requirements.

CAPITAL

Stockholders' equity at March 31, 2003, was $39.8 million, up 3.6% from $38.4 million at December 31, 2002. Stockholders' equity at March 31, 2003, includes an unrealized gain net of tax, of $573,793 as compared to an unrealized gain net of tax at December 31, 2002, of $635,500 on securities available for sale marked to estimated fair market value.

Under the capital regulations of the FDIC, the Bank must satisfy minimum leverage ratio requirements and risk-based capital requirements. Banks supervised by the FDIC must maintain a minimum leverage ratio of core (Tier I) capital to average adjusted assets ranging from 3% to 5%. At March 31, 2002, the Bank's ratio of Tier I capital was 7.72%. The FDIC's risk-based capital rules require banks supervised by the FDIC to maintain risk-based capital to risk-weighted assets of at least 8.00%. Risk-based capital for the Bank is defined as Tier I capital plus the balance of allowance for loan losses. At March 31, 2003, the Bank had a ratio of qualifying total capital to risk-weighted assets of 11.11%.

The Company, as a bank holding company, is also subject, on a consolidated basis, to the capital adequacy guidelines of the Board of Governors of the Federal Reserve (the "Federal Reserve Board"). The capital requirements of the Federal Reserve Board are similar to those of the FDIC governing the Bank.

The Company currently exceeds all of its capital requirements. Management expects the Company to continue to exceed these capital requirements without altering current operations or strategies.

On March 14, 2003, the Company's Board of Directors approved a quarterly cash dividend of $.05 per share. The dividend was paid on April 16, 2003 to stockholders of record as of April 1, 2003. Any future payment of dividends is dependent on the financial condition and capital needs of the Company, requirements of regulatory agencies, and economic conditions in the marketplace.

CRITICAL ACCOUNTING POLICY

The Bank's most significant critical accounting policy is the determination of its allowance for loan losses. A critical accounting policy is one that is both very important to the portrayal of the Bank's financial condition and results, and requires management's most difficult, subjective or complex judgments. What makes these judgments inherently difficult, subjective and/or complex is the need to make estimates about the effects of matters that are inherently uncertain. For further information on the allowance for loan losses, see the "Financial Condition" in Management's Discussion and Analysis and Note 3 of "Notes to Consolidated Financial Statements" included in the Annual Report.

FINANCIAL CONDITION AT MARCH 31, 2003, COMPARED TO DECEMBER 31, 2002

The Company's total assets increased 1.7% to $512.6 million at March 31, 2003, as compared to $504.2 million at December 31, 2002. The major change in the assets is an increase of $4.5 million (38.0%) in cash and cash equivalents, which was caused by an increase in deposits of $17.8 million (5.0%). The increase in deposits was mainly in the six month certificates, due to the customers' desire to stay short in the current rate environment, and non-interest-bearing checking accounts due to the emphasis of the Bank on obtaining business accounts. The Bank also attracted an additional $8.3 million in internet deposits because the rates were competitive with the Bank's local markets. Internet deposits are usually obtained from other financial institutions with terms primarily of one or two years. The rise in deposits and income from operations enabled the Bank to fund an increase in loans of $10.3 million (2.6%) as well as repay $5 million of borrowed funds from the FHLB. Borrowed funds, collateralized through an agreement with the FHLB for advances, are secured by the Bank's investment in FHLB stock and qualifying first mortgage loans. There was a decrease of $4.9 million in loans held for sale, which was primarily funded by a short-term borrowing at another financial institution. This loan was reduced $5.1 million since December 31, 2002 and is collateralized by the loans held for sale. Securities available for sale decreased $1.8 million (4.4%) during the first three months of 2003 due to payments of mortgage backed securities. The increase of $584,605 in premises and equipment, during this same period, is primarily due to the building of two new branches. A reduction in accounts payable caused the decrease of $1.1 million in accrued expenses and other liabilities from December 31, 2002 to March 31, 2003.

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The Company's non-performing assets (loans 90 days or more delinquent and foreclosed real estate) were $1.3 million, or 0.26% of assets, at March 31, 2003, compared to $1.2 million, or 0.24% of assets, at December 31, 2002. Foreclosed real estate increased to $920,643 at March 31, 2003, from $619,163 at December 31, 2002, but only four properties make up this balance. The Company assumes an aggressive position in collecting delinquent loans and disposing of foreclosed assets to minimize balances of non-performing assets and continues to evaluate the loan and real estate portfolios to provide loss reserves as considered necessary. For further information see "Comparison of Operating Results - Provision and Reserve for Loan Losses".

COMPARISON OF OPERATING RESULTS

OVERVIEW

The net income of the Company depends primarily upon net interest income. Net interest income is the difference between the interest earned on loans, the securities portfolios and interest-earning deposits and the cost of funds, consisting principally of the interest paid on deposits and borrowings. The Company's operations are materially affected by general economic conditions, the monetary and fiscal policies of the Federal government, and the policies of regulatory authorities. Yields and costs have declined because of the actions the Federal Reserve took over the last 2 years to reduce interest rates in hopes of spurring the economy.

NET INCOME

Net income for the three-month period ended March 31, 2003, of $1.4 million represents a 7.7% increase as compared to the same period last year. The increase in net income for the period ended March 31, 2003 can be attributed to increases in net interest income of $649,221 and non-interest income of $362,065, as well as decreases in the provision for loan losses and income tax expense of $80,000 and $76,559 respectively. These changes were partially offset by an increase in non-interest expense of $1.1 million during the same period.

INTEREST INCOME

For the three-month period ended March 31, 2003, interest income decreased 2.4% as compared to the same period a year ago. The average balance of interest-earning assets increased 9.7% but the average yield decreased 75 basis points as compared to the same period a year ago. The yield on average interest-earning assets decreased to 6.05% as compared to 6.80% for the same period a year ago. The increase in the average balance of interest-earning assets had a positive effect on interest income while the reduction in yield had a negative impact on interest income.

INTEREST EXPENSE

Interest expense decreased 22.0% for the three-month period ended March 31, 2003, as compared to the same period a year ago. This decrease was due to the average cost of interest-bearing liabilities decreasing 104 basis points as compared to the same period a year ago. The average balance of interest-bearing liabilities increased 8.2% as compared to the same period a year ago. The cost of interest-bearing liabilities decreased to 2.67% as compared to 3.71% for the same period last year.

NET INTEREST INCOME

Net interest income for the three-month period ended March 31, 2003, as compared to the same period a year ago, increased 18.0%. The increase was due to a larger decrease in the cost of liabilities versus the yield on assets, which can be attributed to the fact that deposits continue to reprice at lower yields caused by the Federal Reserve's rate reductions. See "Average Yield/Cost Analysis" table for further information on interest income and interest expense.

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AVERAGE YIELD/COST ANALYSIS

The following table contains information relating to the Company's average balance sheet and reflects the average yield on assets and average cost of liabilities for the periods indicated. Such annualized yields and costs are derived by dividing income or expense by the average balances of assets or liabilities, respectively, for the periods presented. The average loan portfolio balances include nonaccrual loans.

	For the quarter ended				
	March 31, 2003			March 31,	
(DOLLARS IN THOUSANDS)	Average Balance	Interest	Average Yield/ Cost	Average Balance	Interes
Interest-earning assets:					
Interest-bearing deposits in other banks	$ 3,554	$ 10	1.13%	$ 2,810	$ 12
Securities:					
Available for sale	40,339	493	4.89%	43,398	607
Held to maturity	7,783	109	5.60%	5,000	89
FHLB stock	4,124	46	4.46%	4,155	59
Loan portfolio	418,860	6,526	6.23%	377,481	6,596
Total interest-earning assets	474,660	7,184	6.05%	432,844	7,363
Non-interest earning assets	26,266			23,648	

Total assets	$500,926			$456,492	
Interest-bearing liabilities:					
Deposits	344,844	2,038	2.36%	326,812	2,845
Borrowed funds	93,473	892	3.82%	78,427	913
Total interest-bearing liabilities	438,317	$2,930	2.67%	405,239	$3,758
Non-interest bearing liabilities	23,772			16,859	
Total liabilities	462,089			422,098	
Stockholders' equity	38,837			34,394	
Total liabilities and stockholders' equity	$500,926			$456,492	
Net interest income		$4,254			$3,605
Interest rate spread			3.38%		
Net yield on interest-earning assets			3.58%		
Percentage of average interest-earning assets to average interest-bearing liabilities			108.3%		

PROVISION AND RESERVE FOR LOAN LOSSES

During the three-month period ended March 31, 2003 the Bank had net charge-offs against the allowance for loan losses of $139,952 compared to $213,165 for the same period in 2002. This decrease was primarily due to one larger credit being charged off during the first quarter of 2002. The Bank added $200,000 to the allowance for loan losses for the current three-month period increasing the balance to $3.0 million at March 31, 2003. Management considers the current level of the allowance to be appropriate based on loan composition, the current level of delinquencies and other non-performing assets, overall economic conditions and other factors. Future increases to the allowance may be necessary, however, due to changes in loan composition or loan volume, changes in economic or market area conditions and other factors. Additionally, various regulatory agencies, as an integral part of their examination process, periodically review the Company's allowance for loan losses. Such agencies may require the recognition of adjustments to the allowance for loan losses based on their judgments of information available to them at the time of their examination.

NONINTEREST INCOME

Noninterest income increased by 29.9% for the three-month period ended March 31, 2003, as compared to the same period a year ago. The change in noninterest income can be attributed to gain on sale of loans increasing over $1 million primarily as a result of the purchase of Lumina. The Bank has also started to sell a larger percentage of its fixed rate mortgage loan originations in the secondary market instead of through brokered arrangements. This change causes an increase in gain on sale of loans and a reduction to service charges and fees on loans. During the first quarter of 2002 the Bank sold a parking lot for $500,000, resulting in the gain on sale of real estate, and the gain of $116,766 on sale of securities was due to selling bonds and purchasing mortgage backed securities to give the Bank greater cash flow. No similar transactions occurred during the three months ended March 31, 2003.

NONINTEREST EXPENSE

For the three-month period ended March 31, 2003, noninterest expense increased 41.9% as compared to the same period last year. Compensation and related costs increased 58.4%. Higher personnel costs associated with the purchase of Lumina accounted for the majority of the increase. Also, in January 2003, the Company granted 117 shares of preferred stock in the REIT to officers, directors, and Bank employees with at least one month of service and certain other parties. Each individual that was granted the preferred stock received one share that had a $500 value, for an aggregate increase to compensation expense of $58,500. In addition, the increase was due to increases in costs of benefits, staffing levels and normal increases in salaries. Occupancy and equipment expense increased $129,721 primarily because of the Lumina purchase and an increase in depreciation expense due to upgrades in hardware and software systems purchased in 2002. The increase in advertising and other noninterest expenses of $50,052 and $68,505 respectively, was mainly due to the purchase of Lumina.

INCOME TAXES

The effective tax rate for the three-month periods ended March 31, 2003 and 2002, was 30.9% and 35.1% respectively. The decrease resulted from the formation of Holdings and the REIT in December 2002.

NOTE REGARDING FORWARD-LOOKING STATEMENTS

In addition to historical information contained herein, the discussion contains forward-looking statements that involve risks and uncertainties. Economic circumstances, the Company's operations, and the Company's actual results could differ significantly from those discussed in the forward-looking statements. Some of the factors that could cause or contribute to such differences are discussed herein, but also include changes in the economy and interest rates in the nation, changes in the Company's regulatory environment and the Company's market area.

ITEM 3 - MARKET RISK

The Company's primary market risk is interest rate risk. Interest rate risk is the result of differing maturities or repricing intervals of interest earning assets and interest bearing liabilities and the fact that rates on these financial instruments do not change uniformly. These conditions may impact the earnings generated by the Company's interest earning assets or the cost of its interest bearing liabilities, thus directly impacting the Company's overall earnings. The Company's management actively monitors and manages interest rate risk. One way this is accomplished is through the development of and adherence to the Company's asset/liability policy. This policy sets

forth management's strategy for matching the risk characteristics of the Company's interest earning assets and liabilities so as to mitigate the effect of changes in the rate environment. The Company's market risk profile has not changed significantly since December 31, 2002.

ITEM 4 - CONTROLS AND PROCEDURES

The Company's Chief Executive Officer and Chief Financial Officer have evaluated the Company's disclosure controls and procedures (as such term is defined in Rule 13a-14(c) under the Exchange Act) as of a date within 90 days of the date of filing of this Form 10-Q. Based upon such evaluation, the Company's Chief Executive Officer and Chief Financial Officer have concluded that the Company's disclosure controls and procedures were effective.

There have been no significant changes in the Company's internal controls or in other factors that could significantly affect internal controls subsequent to the date of the evaluation described above.

PART II - OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

Not applicable

ITEM 2. CHANGES IN SECURITIES AND USE OF PROCEEDS

(a) Not applicable

(b) Not applicable

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

(a) Not applicable

(b) Not applicable

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY-HOLDERS

None

ITEM 5. OTHER INFORMATION

None

ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K

(a) Exhibits

Exhibit 99 - CERTIFICATE PURSUANT TO 18 U.S.C. SECTION 1350, AS ADOPTED PURSUANT TO SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

(b) Reports on Form 8-K

The Company filed a Current Report on Form 8-K dated January 28, 2003 to report fiscal year 2002 earnings, a Current Report on Form 8-K dated March 31, 2003 to report a change in auditor and a Current Report on Form 8-K/A dated March 31, 2003 to amend the Form 8-K reporting the change in auditor.

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

Dated May 14, 2003

Cooperative Bankshares, Inc.

/s/ Frederick Willetts, III

Frederick Willetts, III
President/Chief Executive Officer

Dated: May 14, 2003

/s/ Todd L. Sammons

Todd L. Sammons
Senior Vice President/Chief Financial Officer

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CERTIFICATION

I, Frederick Willetts, III, President and Chief Executive Officer of Cooperative Bankshares, Inc., certify that:

1. I have reviewed this quarterly report on Form 10-Q of Cooperative Bankshares, Inc.;

2. Based on my knowledge, this quarterly report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this quarterly report;

3. Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this quarterly report;

4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and have:

(a) Designed such disclosure controls and procedures to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this quarterly report is being prepared;

(b) Evaluated the effectiveness of the registrant's disclosure controls and procedures as of a date within 90 days prior to the filing date of this quarterly report (the "Evaluation Date"); and

(c) Presented in this quarterly report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date;

5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation, to the registrant's auditors and the audit committee of the registrant's board or directors (or persons fulfilling the equivalent

functions):

(a) all significant deficiencies in the design or operation of internal controls which could adversely affect the registrant's ability to record, process, summarize and report financial data and have identified for the registrant's auditors any material weaknesses in internal controls; and

(b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls; and

6. The registrant's other certifying officer and I have indicated in this quarterly report whether there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

Date: May 14, 2003

/s/ Frederick Willetts, III

Frederick Willetts, III
President and Chief Executive Officer

CERTIFICATION

I, Todd L. Sammons, Senior Vice President and Chief Financial Officer of Cooperative Bankshares, Inc., certify that:

1. I have reviewed this quarterly report on Form 10-Q of Cooperative Bankshares, Inc.;

2. Based on my knowledge, this quarterly report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this quarterly report;

3. Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this quarterly report;

4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and have:

(a) Designed such disclosure controls and procedures to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this quarterly report is being prepared;

(b) Evaluated the effectiveness of the registrant's disclosure controls and procedures as of a date within 90 days prior to the filing date of this quarterly report (the "Evaluation Date"); and

(c) Presented in this quarterly report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date;

5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation, to the registrant's auditors and the audit committee of the registrant's board or directors (or persons fulfilling the equivalent functions):

(a) all significant deficiencies in the design or operation of internal controls which could adversely affect the registrant's ability to record, process, summarize and report financial data and have identified for the registrant's auditors any material weaknesses in internal controls; and

(b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls; and

6. The registrant's other certifying officer and I have indicated in this quarterly report whether there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

Date: May 14, 2003

/s/ Todd L. Sammons

Todd L. Sammons
Senior Vice President and Chief Financial Officer