COOPERATIVE BANKSHARES INC
Form 10-Q
November 13, 2002

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 September 30, 2002

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.

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

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. 2,835,947 shares at November 8, 2002

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

	SEPTEMBER 30, 200
	(UNAUDITED)
ASSETS	
Cash and due from banks, noninterest-bearing	$ 16,089,833
Interest-bearing deposits in other banks	--
Total cash and cash equivalents	16,089,833
Securities:	
Available for sale (amortized cost of $42,307,557 in September 2002	

and $42,661,527 in December 2001)	42,988,564
Held to maturity (estimated market value of $8,483,291 in September 2002 and $5,282,815 in December 2001)	8,309,326
FHLB stock	4,154,900
Loans held for sale	18,285,278
Loans	389,642,176
Less allowance for loan losses	2,702,124
Net loans	386,940,052
Other real estate owned	599,588
Accrued interest receivable	2,315,623
Premises and equipment, net	7,137,366
Other assets	11,214,535
Total assets	$ 498,035,065
LIABILITIES AND STOCKHOLDERS' EQUITY	
Deposits	$ 359,872,874
Short-term borrowings	53,039,188
Escrow deposits	730,464
Accrued interest payable	114,882
Accrued expenses and other liabilities	4,118,613
Long-term obligations	43,093,756
Total liabilities	460,969,777
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, 2,835,947 and 2,835,447 shares issued and outstanding	2,835,947
Additional paid-in capital	2,440,644
Accumulated other comprehensive income	415,414
Retained earnings	31,373,283
Total stockholders' equity	37,065,288
Total liabilities and stockholders' equity	$ 498,035,065

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 SEPTEMBER 30, 2002	2001	2
INTEREST INCOME:			
Loans	$ 6,682,082	$ 7,034,182	$ 19,
Securities	610,326	748,095	1,
Other	18,473	23,640	

Dividends on FHLB stock	54,981	63,892	
Total interest income	7,365,862	7,869,809	22,
INTEREST EXPENSE:			
Deposits	2,462,594	3,857,524	7,
Borrowed funds	917,751	889,419	2,
Total interest expense	3,380,345	4,746,943	10,
NET INTEREST INCOME	3,985,517	3,122,866	11,
Provision for loan losses	120,000	120,000	
Net interest income after provision for loan losses	3,865,517	3,002,866	10,
NONINTEREST INCOME:			
Net gains on sale of loans	704,043	--	
Net gains on sale of securities	--	98,086	
Service charges and fees on loans	140,280	176,025	
Deposit-related fees	259,586	257,946	
Gain (loss) on sale of premises and equipment	--	--	
Bank-owned life insurance earnings	85,658	--	
Other income, net	84,664	813	
Total noninterest income	1,274,231	532,870	3,
NONINTEREST EXPENSE:			
Compensation and fringe benefits	2,083,599	1,223,555	5,
Occupancy and equipment	619,565	540,116	1,
Advertising	103,043	89,984	
Real estate owned	(1,267)	5,594	
Other	472,247	432,811	1,
Total noninterest expenses	3,277,187	2,292,060	8,
Income before income taxes	1,862,561	1,243,676	5,
Income tax expense	642,682	438,211	1,
NET INCOME	$ 1,219,879	$ 805,465	$ 3,
NET INCOME PER SHARE:			
Basic	$ 0.43	$ 0.29	$
Diluted	$ 0.43	$ 0.28	$
WEIGHTED AVERAGE COMMON SHARES OUTSTANDING:			
Basic	2,835,947	2,814,347	2,
Diluted	2,861,290	2,828,829	2,

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 NET	RETA EARN
Balance, December 31, 2001	$ 2,835,447	$ 2,435,720	$ 188,278	$ 28,1
Exercise of stock options	500	4,924	--	
Other comprehensive income, net of taxes	--	--	227,136	
Net income	--	--	--	3,6
Cash dividends ($.15 per share)	--	--	--	(4
Balance, September 30, 2002	$ 2,835,947	$ 2,440,644	$ 415,414	$ 31,3

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

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

	NINE MONTHS ENDED SEPTEMBER 30 2002	2001
OPERATING ACTIVITIES:		
Net income	$ 3,639,543	$ 2,082,721
Adjustments to reconcile net income to net cash used in operating activities:		
Net accretion, amortization, and depreciation	791,310	525,593
Net gain on sale of securities	(135,182)	(110,485)
Gain on sale of loans	(765,385)	(2,420)
Deferred income taxes	49,499	(168,527)
Loss (gain) on sale of premises and equipment	(464,977)	3,318
Gain on sales of foreclosed real estate	(6,855)	(6,956)
Valuation losses on foreclosed real estate	108,446	2,807
Provision for loan losses	520,000	300,000
Proceeds from sale of loans	37,347,800	27,115
Loan originations held for sale	(54,867,693)	--
Changes in assets and liabilities:		
Accrued interest receivable	321,744	108,358
Other assets	(328,818)	(7,661,439)
Accrued interest payable	(149,509)	20,291
Accrued expenses and other liabilities	3,023,703	151,136
Net cash used in operating activities	(10,916,374)	(4,728,488)

INVESTING ACTIVITIES:

Purchases of securities available for sale	(22,717,557)	(62,517,100)
Purchases of securities held to maturity	(4,165,348)	--
Purchase of Lumina Mortgage Company	(773,188)	--
Proceeds from sale of securities available for sale	19,058,014	28,092,663
Proceeds from maturity of securities available for sale	4,802,669	17,645,964
Proceeds from maturity of securities held to maturity	--	5,000,000
Loan originations, net of principal repayments	(14,047,379)	(18,225,565)
Proceeds from disposals of foreclosed real estate	204,766	238,860
Additions to other real estate owned	(101,455)	--
Purchases of premises and equipment	(1,217,422)	(453,464)
Proceeds from sale of premises and equipment	499,070	11,418
Net cash used in investing activities	(18,457,830)	(30,207,224)
FINANCING ACTIVITIES:		
Net increase in deposits	20,042,822	13,302,956
Net change in short-term borrowings	18,039,188	5,000,000
Net change in long-term obligations	(5,003,400)	7,996,782
Proceeds from issuance of common stock, net	5,424	199,589
Dividends	(425,095)	(421,261)
Net change in escrow deposits	509,520	151,268
Net cash provided by financing activities	33,168,459	26,229,334
INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	3,794,255	(8,706,378)
CASH AND CASH EQUIVALENTS:		
BEGINNING OF PERIOD	12,295,578	18,148,436
END OF PERIOD	$ 16,089,833	$ 9,442,058

(Continued)

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

	NINE MONTHS ENDED SEPTEMBER 30, 2002	NINE MONTHS ENDED SEPTEMBER 30, 2001
Cash paid for:		
Interest	$10,789,953	$14,521,353
Income taxes	1,857,763	1,254,583
Summary of noncash investing and financing activities:		
Transfer from loans to foreclosed real estate	963,668	1,080,372
Loans to facilitate the sale of foreclosed real estate	918,450	--
Unrealized gain on securities available for sale, net of taxes	227,136	336,766
Transfer of securities from held to maturity to available for sale-fair value	--	5,946,000

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 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, 2001. The results of operations for the three and nine-month periods ended September 30, 2002 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 For Savings, Inc., SSB (the "Bank") and its wholly owned subsidiary, Lumina Mortgage Company, Inc. In October of 2002, the Bank changed the name of its subsidiary from CS&L Services, Inc. to Lumina Mortgage Company, Inc. ("Lumina"). 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 are calculated by dividing net income by the sum of the weighted average number of common shares outstanding and potential common shares. 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 SEPTEMBER 30,		NINE MONTHS EN SEPTEMBER 3
	2002	2001	2002
Net income (numerator)	$ 1,219,879	$ 805,465	$3,639,543
Shares for basic EPS (denominator)	2,835,947	2,814,347	2,835,634
Dilutive effect of stock options	25,343	14,482	20,449
Shares for diluted EPS (denominator)	2,861,290	2,828,829	2,856,083

For the period ended September 30, 2002 and 2001, there were 14,204 options outstanding that were antidilutive since the exercise price exceeds the average market price. These options have been omitted from the calculation of the dilutive effect of stock options.

4. Comprehensive Income: 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 and nine months ended September 30:

	THREE MONTHS ENDED SEPTEMBER 30,		NINE MONTHS ENDED SEPTEMBER 30,	
	2002	2001	2002	2001
Net income	$ 1,219,879	$ 805,465	$ 3,639,543	$ 2,082,721
Other comprehensive income:				
Reclassification adjustment for realized gains on available for sale securities	--	(98,086)	(135,182)	(110,485
Unrealized gains on available for sale securities arising during the period	346,469	555,432	507,536	662,560
Income tax expense	(135,123)	(178,365)	(145,218)	(215,309
Other comprehensive income	211,346	278,981	227,136	336,766
Comprehensive income	$ 1,431,225	$ 1,084,446	$ 3,866,679	$ 2,419,487

5. New Accounting Pronouncements: On January 1, 2001, the Company adopted SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities". The Statement is effective for fiscal years beginning after June 15, 2000, with earlier adoption permitted, as amended by SFAS No. 137. SFAS No. 133 establishes accounting and reporting standards for derivative instruments and for hedging activities. The Statement requires an entity to recognize all derivatives as either assets or liabilities in the statement of financial position and measure those instruments at fair value. On January 1, 2001, the Company transferred held-to-maturity investment securities with an amortized cost of approximately $5,978,000 to the available-for-sale category at fair value as allowed by SFAS No. 133. The unrealized loss at the time of transfer of approximately $32,000 before tax has been included in other comprehensive income, net of tax. Such transfers from the held-to-maturity category at the date of initial adoption shall not call into question the Company's intent to hold other debt securities to maturity in the future.

The Company does not engage in hedging activities except for the buy and sell commitments for loans held for sale, which are deemed immaterial due to the fact the Company issues a rate lock commitment to a customer and concurrently "locks in" the loan with a secondary market investor under a best efforts delivery mechanism. Therefore, market 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. Other than the aforementioned transfer of securities, the adoption of the Statement had no material impact on the Company.

On July 1, 2001, the Company adopted SFAS No. 141, "Business Combinations". This Statement improves the transparency of the accounting and reporting for business combinations by requiring that all business combinations be accounted for under a single method - the purchase method. Use of the pooling-of-interests method is no longer permitted. SFAS No. 141 requires that the purchase method be used for business combinations initiated after June 30, 2001. The purchase method was used in recording the acquisition of Lumina Mortgage Company.

On January 1, 2002, the Company adopted SFAS No. 142 "Goodwill and Other Intangible Assets". This Statement requires that goodwill no longer be amortized to earnings, but instead be reviewed for impairment. The Company did not have any goodwill until the purchase of Lumina Mortgage Company. This purchase has created goodwill in the amount of $661,543. In accordance with Statement No. 142, this goodwill will not be amortized but instead will be tested for impairment at least annually.

6. Real Estate Sale: During February 2002, the Bank sold a parking lot for $500,000. A gain of $464,977 was realized on the sale.

7. Loans Held for Sale: As a part of the normal business operations, the Company originates mortgage loans that have been approved by secondary investors. The Company issues a rate lock commitment to a customer and concurrently "locks in" with a secondary market investor under a best efforts delivery mechanism. The terms of the loan are set by the secondary investors and are transferred within several weeks of the Company initially funding the loan. The Company receives origination fees from borrowers and servicing release premiums from the investors that are recognized on the Statement of Operations in the line item "net gains on sale of loans". Between the initial funding of the loans by the Company and the subsequent purchase by the investor, the Company carries the loans on its balance sheet at cost.

8. Acquisition: On May 31, 2002, the Bank acquired the operating assets of Wilmington-based Lumina Mortgage Company. The combined resources of these two companies enable the Bank to offer a wider range of products to a larger customer base. Lumina has offices in Wilmington, North Carolina, North Myrtle Beach, South Carolina and Virginia Beach, Virginia. Their 2001 loan originations totaled $118 million. The purchase price was $740,000 in cash with two future contingent payments based on loan origination volume and meeting certain profitability goals of Lumina in the two subsequent years after the purchase. Due to the uncertainties surrounding the determination of the contingent payments, such payments have not been recorded. The two contingent payments are estimated to be approximately $300,000 each and will be recorded as additional purchase price. The goodwill created by this transaction was $661,543.

Lumina borrows money on a short-term basis principally from another financial institution to fund its loans that are held for sale. At September 30, 2002 the balance of this borrowing was $17.7 million at a rate of 4.06%. This borrowing is collateralized by mortgage loans held for sale. When a loan is sold, the proceeds are used to repay the borrowing. Loans are usually sold within 60 days. This borrowing agreement provides for a maximum line of credit up to $10 million, which has been temporarily increased to $25 million due to the large volume increase caused by the current low interest rate environment.

The following table summarizes the estimated fair value of assets acquired and liabilities assumed at May 31, 2002, excluding $33,127 of professional fees that were included in goodwill as part of this transaction:

Premises and equipment	$ 71,584
Goodwill	628,416
Other Assets	51,729
Total assets acquired	$ 751,729
Accrued expenses and other liabilities	11,668
Total liabilities assumed	11,668
Net assets acquired	$ 740,061

Presented below are the pro-forma consolidated condensed statements of operations, for the Company and Lumina Mortgage Company, for the three and nine month periods ended September 30, 2002 and 2001, assuming the acquisition was completed at the beginning of all periods presented. The unaudited pro-forma information presented below is not necessarily indicative of the results of operations that would have resulted had the merger been completed at the beginning of the applicable periods presented, nor is it necessarily indicative of the results of operations in future periods.

	THREE MONTHS ENDED SEPTEMBER 30,		NINE MONTHS ENDE SEPTEMBER 30,	
	2002	2001	2002	200
Interest income	$ 7,373,837	$ 7,982,862	$ 22,274,653	$ 23,9
Interest expense	3,380,697	4,851,488	10,738,757	14,8
Net interest income	3,993,140	3,131,374	11,535,896	9,0
Provision for loan losses	120,000	120,000	520,000	3
Net interest income after provision for loan losses	3,873,140	3,011,374	11,015,896	8,7
Noninterest income	1,288,742	1,371,552	4,501,167	3,9
Noninterest expense	3,291,548	3,047,480	9,786,038	9,2
Income before income taxes	1,870,334	1,335,446	5,731,025	3,5
Income tax expense	645,714	474,001	2,017,781	1,2
NET INCOME	$ 1,224,620	$ 861,445	$ 3,713,244	$ 2,2
NET INCOME PER SHARE:				
Basic	$ 0.43	$ 0.31	$ 1.31	$

Diluted	$ 0.43	$ 0.30	$ 1.30	$

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 for Savings, Inc., SSB ("Cooperative Bank" or the "Bank"), a North Carolina chartered savings 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. The Bank's subsidiary, 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. In October of 2002, the Bank changed the name of its subsidiary from CS&L Services, Inc. to Lumina Mortgage Company, Inc. Accordingly, the information set forth in this report, including financial statements and related data, relates primarily to Cooperative Bank.

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. The Bank's deposit accounts are insured up to applicable limits by 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. The Bank also offers a wide range of mortgage loan products through its subsidiary, Lumina. On May 31, 2002, the Bank acquired Wilmington-based Lumina Mortgage Company. Lumina has offices in Wilmington, North Carolina, North Myrtle Beach, South Carolina and Virginia Beach, Virginia. Their 2001 loan originations totaled $118 million. Management expects this acquisition to be accretive to earnings during the year ended 2002.

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 September 30, 2002, approximately $273 million, or 70%, of the Bank's loan portfolio, excluding loans held for sale, consisted of loans secured by residential properties which was reduced from 73% at December 31, 2001. The Bank originates adjustable rate and fixed rate loans. As of September 30, 2002, adjustable rate and fixed rate loans totaled approximately 63.4% and 36.6%, respectively, of the Bank's total loan portfolio.

The Bank has chosen to sell a larger percentage of its fixed rate mortgage loan originations 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 has received approval to build additional branches in Wilmington, N.C. and Morehead City, N. C.

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 September 30, 2002, Cooperative had a one-year cumulative gap position of a negative 2.4%. During a period of rising interest rates, a negative gap would tend to adversely affect net interest income, while a positive gap would tend to result in an increase in net interest income. During a period of falling interest rates, a negative gap would tend to result in an increase in net interest income while a positive 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.

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 September 30, 2002 (in thousands).

Contractual Obligations	Total	Less than 1 year	1-3 years	4-5 years	Over 5 years
	Payments Due by Period				
Borrowed Funds	$ 96,133	$ 53,039	$ 20,000	$ --	$ 23,094
Lease Obligations	1,582	204	363	153	862
Deposits	359,873	296,354	63,327	59	133
Total Contractual Obligations	$ 457,588	$ 349,597	$ 83,690	$ 212	$ 24,089

Off Balance Sheet Commitments	Total Amounts Committed	Less than 1 year	1-3 years	4-5 years	Over years
	Amount of Commitment Expiration Per Period				
Undisbursed portion of home equity loans collateralized primarily by junior liens on 1-4 family properties	$13,456	$ 1,323	$ 326	$ 298	$11,50
Other commitments and credit lines	10,518	6,759	1,636	15	2,10
Undisbursed portion of construction loans	31,248	31,248	--	--	--
Fixed-rate mortgage loan commitments	2,976	2,976	--	--	--
Adjustable-rate mortgage loan commitments	4,852	4,852	--	--	--
Commitments to sell loans	18,285	18,285	--	--	--
Letters of credit	1,699	1,668	31	--	--
Total Commitments	$83,034	$67,111	$ 1,993	$ 313	$13,61

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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 September 30, 2002, the Bank's borrowed funds from the FHLB equaled 15.7% of its total assets. Lumina has a borrowing agreement that provides funding for loans held for sale. This agreement has a maximum credit limit of $10 million, which has been temporarily increased to $25 million due to the large volume increase caused by the current low interest rate environment. At September 30, 2002, Lumina had borrowed $17.7 million on this line of credit. 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 September 30, 2002, the estimated market value of liquid assets (cash, cash equivalents, marketable securities and loans held for sale) was approximately $85.8 million, which represents 18.8% of deposits and borrowed funds as compared to $60.5 million or 14.3% of deposits and borrowed funds at December 31, 2001. The increase in liquid assets was primarily due to an increase in loans held for sale that was funded with short term borrowings.

The Company's primary uses of liquidity are to fund loans and to make investments. At September 30, 2002, outstanding off-balance sheet commitments to extend credit totaled $33.5 million, and the undisbursed portion of construction loans was $31.2 million. Management considers current liquidity levels adequate to meet the Company's cash flow requirements.

CAPITAL

Stockholders' equity at September 30, 2002, was $37.1 million, up 10.3% from $33.6 million at December 31, 2001. Stockholders' equity at September 30, 2002 and December 31, 2001, includes unrealized gains, net of tax, of $415,000 and $188,000, respectively, 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 September 30, 2002, the Bank's ratio of Tier I capital was 7.27%. 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 September 30, 2002, the Bank had a ratio of qualifying total capital to risk-weighted assets of 11.08%.

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 September 18, 2002, the Company's Board of Directors approved a quarterly cash dividend of $.05 per share. The dividend was paid on October 16, 2002 to stockholders of record as of October 1, 2002. 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 Company's only 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 Company's financial condition and results, and requires management's most difficult, subjective or complex judgments. What makes these judgments inherently difficult, subjective and/or 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 "Financial Condition" in Management's Discussion and Analysis and Note 3 of "Notes to Consolidated Financial Statements" included in the 2001 Annual Report.

FINANCIAL CONDITION AT SEPTEMBER 30, 2002, COMPARED TO DECEMBER 31, 2001

The Company's total assets increased 8.7% to $498.0 million at September 30, 2002, as compared to $458.1 million at December 31, 2001. There was an increase of $3.8 million (30.9%) in cash and cash equivalents, which was caused by an increase in deposits of $20.0 million (5.9%). The increase in deposits was primarily in the seven month certificates due to favorable pricing and the customers' desire to stay short in the current rate environment. The Bank also attracted an additional $7.1 million in internet deposits because the rates were competitive with the Bank's local markets. Internet deposits are primarily obtained from other financial institutions in increments of $99,000, 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 $13.7 million (3.6%) and securities held to maturity by $3.3 million (66.2%) 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 an increase of $18.3 million in loans held for sale, which was primarily funded by a short term borrowing at another financial institution. This loan is collateralized by the loans held for sale. Both the loans held for sale and the corresponding borrowing are a result of the May 2002 Lumina purchase. During the nine months ended September 30, 2002, the Bank purchased real estate in Southport, NC for $577,000 for possible branch expansion, which is the principal reason for the increase of $666,000 (10.3%) to premises and equipment. Other assets increased $847,000 (8.2%) since the beginning of the year, of which $662,000 was due to goodwill resulting from the purchase of Lumina Mortgage Company. Accrued expenses and other liabilities increased $3.0 million (280.2%) because of a reclassification made due to outstanding checks. At September 30, 2002, $53.0 million in borrowed funds mature in 1 year and $20.0 million of funds mature in 2 years. The remaining amount of borrowed funds matures in 2010 or 2011.

The Company's non-performing assets (loans 90 days or more delinquent and foreclosed real estate) were $1.1 million, or .23% of assets, at September 30, 2002, compared to $3.8 million, or 0.84% of assets, at December 31, 2001. The majority of this reduction was due to over $1.1 million of loans being paid off and $822,000 in loans foreclosed on during the current year that were classified as non-performing at December 31, 2001. Foreclosed real estate decreased to $600,000 at September 30, 2002, from $759,000 at December 31, 2001, with two properties making 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, interest bearing 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 in 2002 because of the action the Federal Reserve took to reduce interest rates throughout 2001 in hopes to spur the economy.

NET INCOME

Net income for the three and nine-month periods ended September 30, 2002, increased 51.5% to $1.2 million and 74.7% to $3.6 million, respectively, as compared to the same period last year. The increase in net income for the nine-month period ended September 30, 2002 can be attributed to increases in net interest income of $2.4 million and noninterest income of $1.7 million. These increases were partially offset by increases in the provision for loan losses of $220,000, noninterest expense of $1.5 million and income taxes of $813,000 during the same period.

INTEREST INCOME

For the three-month period ended September 30, 2002, interest income decreased 6.4% as compared to the same period a year ago. The average balance of interest-earning assets increased 7.8% while the average yield decreased 100 basis points as compared to the same period a year ago. Interest income decreased 6.3% for the nine-month period ended September 30, 2002, as compared to the same period a year ago. The decrease in interest income can be attributed to the yield on average interest-earning assets decreasing to 6.72% as compared to 7.70% for the same period a year ago. The average balance of interest-earning assets increased 7.3% for the nine month period ended September 30, 2002, as compared to 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.

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INTEREST EXPENSE

Interest expense decreased 28.8% for the three-month period ended September 30, 2002, as compared to the same period a year ago. This decrease was due to the average cost of interest-bearing liabilities decreasing 172 basis points as compared to the same period a year ago. In the nine-month period ended September 30, 2002, interest expense decreased 26.8% as compared to the same period a year ago. The average balance of interest-bearing liabilities increased 9.5% as compared to the same period a year ago. The cost of interest-bearing liabilities decreased to 3.45% as compared to 5.16% for the same period last year.

NET INTEREST INCOME

Net interest income for the three and nine-month periods ended September 30, 2002, as compared to the same period a year ago, increased 27.6% and 26.6%, respectively. 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 certificates of deposit continue to reprice at lower yields caused by the rate reductions in 2001. See "Average Yield/Cost Analysis" tables 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	
	SEPTEMBER 30, 2002	S
(DOLLARS IN THOUSANDS)	Average	

	Average Balance	Interest	Yield/ Cost	Average Balance
Interest-earning assets:				
Interest-bearing deposits in other banks	$ 3,512	$ 18	2.05%	$ 2,464
Securities:				
Available for sale	39,212	504	5.14%	42,420
Held to maturity	8,460	107	5.06%	8,000
FHLB stock	4,155	55	5.29%	3,755
Loan portfolio	394,554	6,682	6.77%	360,529
Total interest-earning assets	449,893	7,366	6.55%	417,168
Non-interest earning assets	27,670			16,704
Total assets	$477,563			$433,872
Interest-bearing liabilities:				
Deposits	$339,539	2,462	2.90%	$323,613
Borrowed funds	80,120	918	4.58%	60,860
Total interest-bearing liabilities	419,659	3,380	3.22%	384,473
Non-interest bearing liabilities	21,185			16,745
Total liabilities	440,844			401,218
Stockholders' equity	36,719			32,654
Total liabilities and stockholders' equity	$477,563			$433,872
Net interest income		$3,986		
Interest rate spread			3.33%	
Net yield on interest-earning assets			3.54%	
Percentage of average interest-earning assets to average interest-bearing liabilities			107.2%	

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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 nine months en			
	SEPTEMBER 30, 2002			
(DOLLARS IN THOUSANDS)	Average Balance	Interest	Average Yield/ Cost	Avera Balan

Interest-earning assets:				
Interest-bearing deposits in other banks	$ 3,150	$ 43	1.82%	$ 8,9
Securities:				
Available for sale	41,260	1,669	5.39%	35,9
Held to maturity	6,892	311	6.02%	8,0
FHLB stock	4,155	168	5.39%	3,7
Loan portfolio	383,306	19,931	6.93%	352,0
Total interest-earning assets	438,763	22,122	6.72%	408,7
Non-interest earning assets	26,855			13,8
Total assets	$465,618			$422,5
Interest-bearing liabilities:				
Deposits	$334,185	7,918	3.16%	$318,2
Borrowed funds	77,002	2,723	4.72%	57,4
Total interest-bearing liabilities	411,187	10,641	3.45%	375,6
Non-interest bearing liabilities	19,047			14,8
Total liabilities	430,234			390,5
Stockholders' equity	35,384			32,0
Total liabilities and stockholders' equity	$465,618			$422,5
Net interest income		$11,481		
Interest rate spread			3.27%	
Net yield on interest-earning assets			3.49%	
Percentage of average interest-earning assets to average interest-bearing liabilities			106.7%	

PROVISION AND ALLOWANCE FOR LOAN LOSSES

During the nine-month period ended September 30, 2002 the Bank had net charge-offs against the allowance for loan losses of $341,000 compared to $82,111 for the same period in 2001. This increase was due to one credit of $189,000 which previously had been placed in non-accrual status, being charged off and three loans that were written down to the fair value of the collateral at the time of foreclosure. The Bank recorded $520,000 as a provision for loan losses for the current nine-month period, as compared to a $300,000 provision for the same period last year. The increase in the provision was primarily caused by a continued emphasis to grow the Bank's commercial loan portfolio. Management considers the current level of the allowance for loan losses 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 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 additions 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 118.9% for the nine-month period ended September 30, 2002, as compared to the same period a year ago. The change in noninterest income can be attributed to a $465,000 gain on the sale of real estate and Bank-owned life insurance earnings of $285,000. No similar transactions occurred during the nine months ended September 30, 2001. During February 2002, the Bank sold a parking lot for $500,000 which caused the gain on the sale of premises and equipment. The Bank purchased Bank-owned life insurance at the end of September 2001. Also, net gains on sale of loans increased to $765,000 for the nine-month period ended September 30, 2002, as compared to $2,000 for the same period a year ago. This increase was primarily due to increased loan sale volume resulting from the purchase of Lumina. In addition, deposit-related fees increased $53,000 for the nine-month period ended September 30, 2002, as compared to the same period last year. This increase is primarily due to an increase in ATM revenues, which was caused by an increase in both the fee and the number of ATMs in operation. For the nine-month period ended September 30, 2002, as compared to the same period a year ago, other income increased $180,000 mainly due to an increase in commissions from annuity sales and mutual funds, through UVEST Investment Services.

In the three-month period ended September 30, 2002, noninterest income increased 139.1% as compared to the same period last year. The net gains on sale of loans, Bank-owned life insurance and other income, net increased $704,000, $86,000, and $84,000 respectively, for the three-month period ended September 30, 2002, as compared to the same period a year ago. The reasons for these increases are the same as stated above for the nine month period. During the same three-month period, service charges and fees on loans decreased 20.3% as compared to last year. This reduction was primarily caused by a reduction in loan settlement service fees, where the Bank acts as a broker, due to the large number of mortgage refinances made during the three-months ended September 30, 2001.

NONINTEREST EXPENSES

For the nine-month period ended September 30, 2002, noninterest expense increased 21.6% as compared to the same period last year. Compensation and related costs increased 33.4%. The increase was due to increases in incentive based pay, costs of benefits, staffing levels and normal increases in salaries, as well as higher personnel costs as a result of the purchase of Lumina. The increase in other noninterest expenses of $109,000 was mainly due to an increase in professional fees. The increases of $81,000 and $39,000 in occupancy and equipment expense and in advertising, respectively, can be primarily attributed to the purchase of Lumina.

In the three-month period ended September 30, 2002, noninterest expense increased 43.0% as compared to the same period last year. This increase can be principally attributed to compensation and fringe benefits increasing $860,000. The reasons for this increase are identical to the nine-month period ended September 30, 2002. The increases in occupancy and equipment expense, advertising and other noninterest expense of $79,000, $13,000 and $39,000, respectively, in the three-month period ended September 30, 2002, as compared to the same period last year, were mainly due to the purchase of Lumina.

INCOME TAXES

The effective tax rates for the nine-month periods ended September 30, 2002 and 2001, were 35.1% and 35.7% respectively. The effective tax rates for the three-month periods ended September 30, 2002 and 2001, were 34.5% and 35.2% respectively. The decreases were mainly due to the fact that the earnings on

Bank-owned life insurance are not taxable.

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, 2001.

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

Not applicable

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 October 23, 2002 to report third quarter earnings.

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.

COOPERATIVE BANKSHARES, INC.

Dated: November 13, 2002 /s/ Frederick Willetts, III

President and Chief Executive Officer

Dated: November 13, 2002 /s/ Todd L. Sammons

Senior Vice President and Chief Financial Officer

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 officers 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 officers 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 officers 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: November 13, 2002

/s/ Frederick Willetts

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 officers 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 officers 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 officers 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: November 13, 2002

/s/ Todd L. Sammons

Todd L. Sammons
Senior Vice President and Chief Financial Officer