COOPERATIVE BANKSHARES INC
Form 10-Q
May 15, 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 March 31, 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. 2,835,447 shares at April 30, 2002

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

	MARCH 31, 2002 (UNAUDITED)
ASSETS	
Cash and due from banks, noninterest-bearing	$ 11,109,267
Interest-bearing deposits in other banks	3,772,639
Total cash and cash equivalents	14,881,906
Securities:	
Available for sale (amortized cost of $43,066,181 in March 2002 and $42,661,527 in December 2001)	42,354,305
Held to maturity (estimated market value of $5,219,600 in March 2002 and $5,282,815 in December 2001)	5,000,000
FHLB stock	4,154,900
Loans	377,715,012
Less allowance for loan losses	2,589,572
Net loans	375,125,440
Other real estate owned	1,192,133
Accrued interest receivable	2,403,661
Premises and equipment, net	6,602,898
Other assets	11,130,277
Total assets	$462,845,520

LIABILITIES AND STOCKHOLDERS' EQUITY	
Deposits	$352,082,543
Short-term borrowings	31,199,036
Escrow deposits	476,972
Accrued interest payable	303,883
Accrued expenses and other liabilities	1,544,560
Long-term obligations	43,096,038
Total liabilities	428,703,032
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, 2,835,447 shares issued and outstanding	2,835,447
Additional paid-in capital	2,435,720
Accumulated other comprehensive income (loss)	(434,244)
Retained earnings	29,305,565
Total stockholders' equity	34,142,488
Total liabilities and stockholders' equity	$462,845,520
Book value per common share	$ 12.04

* Derived from audited consolidated financial statements.

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

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

	THREE M
	2002
INTEREST INCOME:	
Loans	$ 6,595,546
Securities	695,887
Other	12,293
Dividends on FHLB stock	58,909
Total interest income	7,362,635
INTEREST EXPENSE:	
Deposits	2,845,342
Borrowed funds	912,653
Total interest expense	3,757,995
NET INTEREST INCOME	3,604,640

Provision for loan losses	280,000
Net interest income after provision for loan losses	3,324,640
NONINTEREST INCOME:	
Net gains on sale of loans	18,279
Net gains on sale of securities	116,766
Service charges and fees on loans	201,382
Deposit-related fees	248,235
Gain on sale of premises and equipment	464,977
Bank-owned life insurance earnings	99,837
Other income, net	60,116
Total noninterest income	1,209,592
NONINTEREST EXPENSE:	
Compensation and fringe benefits	1,435,853
Occupancy and equipment	518,210
Advertising	70,503
Real estate owned	6,542
Other	518,962
Total noninterest expenses	2,550,070
Income before income taxes	1,984,162
Income tax expense	695,660
NET INCOME	$ 1,288,502
NET INCOME PER SHARE:	
Basic	$ 0.45
Diluted	$ 0.45
WEIGHTED AVERAGE COMMON SHARES OUTSTANDING:	
Basic	2,835,447
Diluted	2,843,398

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

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

	COMMON STOCK	ADDITIONAL PAID-IN CAPITAL	ACCUMULATED OTHER COMPREHENSIVE INCOME (LOSS), NET	RE EA
Balance, December 31, 2001	$ 2,835,447	$ 2,435,720	$ 188,278	$ 28

Other comprehensive loss, net of taxes	--	--	(622,522)	
Net income for period	--	--	--	1
Cash dividend ($.05 per share)	--	--	--	
Balance, March 31, 2002	$ 2,835,447	$ 2,435,720	$ (434,244)	$ 29

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)

	THR
	2002
OPERATING ACTIVITIES:	
Net income	$ 1,288,502
Adjustments to reconcile net income to net cash provided by operating activities:	
Net accretion, amortization, and depreciation	198,350
Net gain on sale securities	(116,766
Net gain on sale of loans	(18,279
Provision (benefit) from deferred income taxes	140,620
Loss (gain) on sale of premises and equipment	(464,977
Provision for loan losses	280,000
Originations of loans held for sale	(1,513,000
Proceeds from sales of loans held for sale	1,518,418
Changes in assets and liabilities:	
Accrued interest receivable	233,706
Prepaid expenses and other assets	(505,728
Accrued interest payable	39,492
Accrued expenses and other liabilities	461,318
Net cash provided by operating activities	1,541,656
INVESTING ACTIVITIES:	
Purchases of securities available for sale	(13,438,870
Proceeds from sale of securities available for sale	12,115,938
Proceeds from maturity of securities available for sale	1,016,356
Proceeds from maturity of securities held to maturity	--
Loan originations, net of principal repayments	(2,435,646
Proceeds from disposals of foreclosed real estate	68,096
Purchases of premises and equipment	(344,937
Proceeds from sale of premises and equipment	499,070
Net cash used in investing activities	(2,519,993
FINANCING ACTIVITIES:	
Net increase in deposits	12,252,491
Net change in short-term borrowings	(8,802,082
Proceeds from issuance of common stock	--

Dividends paid	(141,772
Net change in escrow deposits	256,028
Net cash provided by financing activities	3,564,665
INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	2,586,328
CASH AND CASH EQUIVALENTS:	
BEGINNING OF PERIOD	12,295,578
END OF PERIOD	$ 14,881,906

(Continued)

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

	THREE MONTHS MARCH 31
	2002
Cash paid for:	
Interest	$3,718,503
Income taxes	92,763
Summary of noncash investing and financing activities:	
Transfer from loans to foreclosed real estate	500,957
Unrealized gain (loss) on securities available for sale, net of taxes	(622,522)
Transfer of securities from held to maturity to available for sale at fair value	--

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-month period ended March 31, 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 and its wholly owned subsidiary, CS&L Services, Inc. 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 stock. 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, 2002	2001
Net income (numerator)	$1,288,502	$ 574,352
Shares for basic EPS (denominator)	2,835,447	2,747,512
Dilutive effect of stock options	7,951	68,556
Shares for diluted EPS (denominator)	2,843,398	2,816,068

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 months ended March 31:

	THREE MONTHS ENDED MARCH 31, 2002	2001
Net income	$ 1,288,502	$ 574,3
Other comprehensive income (loss):		
Reclassification to realized gains	116,766	
Unrealized gain (loss) arising during the period	(1,137,295)	201,4
Income tax (expense) benefit	398,007	(78,5
Other comprehensive income (loss)	(622,522)	122,8
Comprehensive income	$ 665,980	$ 697,2

5. Statement of Financial Accounting Standards No. 133: 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 any hedging activities, and, other than the aforementioned transfer of securities, the adoption of the statement had no impact on the Company.

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. Subsequent Event: During April 2002, the Bank signed a definitive agreement to acquire Wilmington-based Lumina Mortgage Company. Lumina Mortgage has offices in Wilmington, North Carolina, North Myrtle Beach, South Carolina and Virginia Beach, Virginia. Their 2001 loan originations totaled $118 million. This transaction is anticipated to be completed in the second quarter of 2002.

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 was formed for the purpose of serving as the holding company for Cooperative Bank for Savings, Inc., SSB ("Cooperative Bank" or the "Bank"), a North Carolina chartered savings bank. The Company's primary activities consist of holding the stock of Cooperative Bank and operating the business of the Bank. Accordingly, the information set forth in this report, including financial statements and related data, relates primarily to Cooperative Bank.

Cooperative Bank was chartered in 1898. The Bank's headquarters are located in Wilmington, North Carolina. Cooperative operates 17 financial centers throughout the coastal and inland communities of eastern North Carolina. These centers extend from Corolla, located on the Outer Banks of North Carolina, to Tabor City, located on the South Carolina border. The Bank's deposit accounts are insured up to applicable limits by the Federal Deposit Insurance Corporation ("FDIC").

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. 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.

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, 2002, approximately $269 million, or 71%, of the Bank's loan portfolio consisted of loans secured by residential properties. This was down from approximately $273 million, or 73% at December 31, 2001. The Bank originates adjustable rate and fixed rate loans. As of March 31, 2002, adjustable rate and fixed rate loans totaled approximately 64.2% and 35.8%, 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 broker dealer 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.

In April 2002, the Bank had signed a definitive agreement to acquire Wilmington-based Lumina Mortgage Company. Lumina Mortgage 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. This transaction is anticipated to be completed in the second quarter of 2002.

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, 2002, Cooperative had a one-year negative gap position of 11.4%. 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.

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, 2002, the Bank's borrowed funds equaled 16.0% 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, 2002, the estimated market value of liquid assets (cash, cash equivalents, and marketable securities) was approximately $62.5 million, which represents 14.6% 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 cash from an increase in deposits.

The Company's primary uses of liquidity are to fund loans and to make investments. At March 31, 2002, outstanding off-balance sheet commitments to extend credit totaled $28.5 million, and the undisbursed portion of construction loans was $27.4 million. Management considers current liquidity levels adequate to meet the Company's cash flow requirements.

CAPITAL

Stockholders' equity at March 31, 2002, was $34.1 million, up 1.6% from $33.6 million at December 31, 2001. Stockholders' equity at March 31, 2002, includes an unrealized loss net of tax, of $434,000 as compared to an unrealized gain net of tax at December 31, 2001, of $188,000 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 7.57%. 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, 2002, the Bank had a ratio of qualifying total capital to risk-weighted assets of 11.26%.

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 28, 2002, the Company's Board of Directors approved a quarterly cash dividend of $.05 per share. The dividend was paid on April 16, 2002 to stockholders of record as of April 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 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 or complex are due to 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 2001 Annual Report.

FINANCIAL CONDITION AT MARCH 31, 2002, COMPARED TO DECEMBER 31, 2001

The Company's total assets increased 1.0% to $462.8 million at March 31, 2002, as compared to $458.1 million at December 31, 2001. The major change in the assets is an increase of $2.6 million (21.0%) in cash and cash equivalents, which was caused by an increase in deposits of $12.3 million (3.6%). The increase in deposits was mainly 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 $3.3 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. The rise in deposits enabled the Bank to repay $9.0 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. At March 31, 2002, $31.2 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 $2.3 million, or 0.49% of assets, at March 31, 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 million of loans being paid off in the first quarter of 2002, that were classified as non-performing at December 31, 2001. In addition, over $200,000 in loans were charged off during this period. Foreclosed real estate increased to $1.2 million at March 31, 2002, from $800,000 at December 31, 2001, but only two 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.

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.

NET INCOME

Net income for the three-month period ended March 31, 2002, of $1,288,502 represents a 124.3% increase as compared to the same period last year. The increase in net income for the period ended March 31, 2002 can be attributed to increases in net interest income of $659 thousand and noninterest income of $795 thousand. These increases were partially offset by increases in the provision for loan losses of $190 thousand, noninterest expense of $177 thousand and income taxes of $373 thousand during the same period.

INTEREST INCOME

For the three-month period ended March 31, 2002, interest income decreased 7.0% as compared to the same period a year ago. The average balance of interest-earning assets increased 7.8% but the average yield decreased 109 basis points as compared to the same period a year ago. The yield on average interest-earning assets decreased to 6.80% as compared to 7.89% 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 24.4% for the three-month period ended March 31, 2002, as compared to the same period a year ago. This decrease was due to the average cost of interest-bearing liabilities decreasing 167 basis points as compared to the same

period a year ago. The average balance of interest-bearing liabilities increased 9.7% as compared to the same period a year ago. The cost of interest-bearing liabilities decreased to 3.71% as compared to 5.38% for the same period last year.

NET INTEREST INCOME

Net interest income for the three-month period ended March 31, 2002, as compared to the same period a year ago, increased 22.4%. 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.

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.

(DOLLARS IN THOUSANDS)	For the quarter ended March 31, 2002			
	Average Balance	Interest	Average Yield/ Cost	Averag Balanc
Interest-earning assets:				
Interest-bearing deposits in other banks	$ 2,810	$ 12	1.71%	$ 15,4
Securities:				
Available for sale	43,398	607	5.59%	27,4
Held to maturity	5,000	89	7.12%	8,1
FHLB stock	4,155	59	5.68%	3,7
Loan portfolio	377,481	6,596	6.99%	346,7
Total interest-earning assets	432,844	7,363	6.80%	401,5
Non-interest earning assets	23,648			12,1
Total assets	$456,492			$413,7
Interest-bearing liabilities:				
Deposits	326,812	2,845	3.48%	314,3
Borrowed funds	78,427	913	4.66%	55,1
Total interest-bearing liabilities	405,239	$3,758	3.71%	369,4
Non-interest bearing liabilities	16,859			12,9
Total liabilities	422,098			382,3
Stockholders' equity	34,394			31,4
Total liabilities and stockholders' equity	$456,492			$413,7
Net interest income		$3,605		
Interest rate spread			3.09%	
Net yield on interest-earning assets			3.33%	
Percentage of average interest-earning assets to average interest-bearing liabilities			106.8%	

RATE/VOLUME ANALYSIS

The table below provides information regarding changes in interest income and interest expense for the period indicated. For each category of interest-earning assets and interest-bearing liabilities, information is provided on changes attributable to (i) changes in volume (changes in volume multiplied by old rate) and (ii) changes in rates (change in rate multiplied by old volume). The change attributable to changes in rate-volume has been allocated to the two categories based on their relative values.

(DOLLARS IN THOUSANDS)	For the three months ended March 31, 2001 vs. March 31, 2002 Increase (Decrease) Due to		
	Volume	Rate	Total
Interest income:			
Interest-bearing deposits in other banks	$ (90)	$ (68)	$ (158)
Securities:			
Available for sale	229	(61)	168
Held to maturity	(45)	38	(7)
FHLB stock	7	(15)	(8)
Loan portfolio	598	(1,148)	(550)
Total interest-earning assets	699	(1,254)	(555)
Interest expense:			
Deposits	158	(1,438)	(1,280)
Borrowed funds	304	(238)	66
Total interest-bearing liabilities	462	(1,676)	(1,214)
Net interest income	$ 237	$ 422	$ 659

PROVISION AND RESERVE FOR LOAN LOSSES

During the three-month period ended March 31, 2002 the Bank had net charge-offs against the allowance for loan losses of $213,000 compared to $45,000 for the same period in 2001. This increase was due to one credit of $189,000, which previously had been placed in the non-accrual status, being charged off. The Bank added $280,000 to the allowance for loan losses for the current three-month period increasing the balance to $2.6 million at March 31, 2002. The increase in the provision was caused by continued restructuring of the loan portfolio to include a higher percentage of commercial loans. Management considers the current level of the provision 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 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 191.5% for the three-month period ended March 31, 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, a $117,000 gain on the sale of securities and Bank-owned life insurance earnings of $100,000, all of which occurred during the three-month period ended March 31, 2002. No similar transactions occurred during the three months ended March 31, 2001. During February 2002, the Bank sold a parking lot for $500,000 which caused the gain on the sale of real estate. The gain on securities was due to selling bonds and purchasing mortgage backed securities to give the Bank greater cash flow in the event of rising rates. The Bank-owned life insurance was purchased at the end of September 2001. In addition, for the three-month period ended March 31, 2002, as compared to the same period a year ago, service charges and fees on loans increased 26.9% and other income increased $43,000 in the current period. The increase in loan fees was mainly due to an increase in loan settlement service fees for loans processed for others due to a favorable rate environment. The increase in other income was mainly due to an increase in commissions from annuity sales and mutual funds, through UVEST Investment Services.

NONINTEREST EXPENSES

For the three-month period ended March 31, 2002, noninterest expense increased 7.4% as compared to the same period last year. Compensation and related costs increased 10.7%. The increase was due to increases in incentive based pay, costs of benefits, staffing levels and normal increases in salaries. The increase in other noninterest expenses of $33,000 was mainly due to an increase in professional fees. The increase of $24,000 in advertising can be attributed to a more progressive advertising and business development strategy. Occupancy and equipment expense was reduced by $26,000 due to a decrease in the cost of outside data processing services during the three-month period ended March 31, 2002 as compared to the same period last year.

INCOME TAXES

The effective tax rate for the three-month periods ended March 31, 2002 and 2001, was 35.1% and 36.0% respectively. The decrease was 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.

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

None

(b) Reports on Form 8-K

A Form 8-K was filed on January 22, 2002 reporting fourth quarter and full fiscal year 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: May 13, 2002	/s/ Frederick Willetts, III --------------------------------------- President and Chief Executive Officer
Dated: May 13, 2002	/s/ Todd Sammons --------------------------------------- Treasurer and Chief Financial Officer

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