COOPERATIVE BANKSHARES INC
Form 10-Q
August 12, 2003

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

FORM 10-Q

(Mark One)

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

For the quarterly period ended June 30, 2003

OR

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

For the transition period from to

Commission File Number: 0-24626

COOPERATIVE BANKSHARES, INC.

Exact name of registrant as specified in its charter)

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

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

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

N/A

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

[X] Yes [ ] No

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

[ ] Yes [X] No

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

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CONSOLIDATED STATEMENTS OF FINANCIAL CONDITION

	JUNE 30, 2003 (UNAUDITED)	December 31,
ASSETS		
Cash and due from banks, noninterest-bearing	$ 21,179,075	$ 11,85
Interest-bearing deposits in other banks	6,858,501	
Total cash and cash equivalents	28,037,576	11,85
Securities:		
Available for sale (amortized cost of $34,986,714 in June 2003 and $41,033,409 in December 2002)	35,741,698	42,07
Held to maturity (estimated market value of $6,779,302 in June 2003 and $8,009,087 in December 2002)	6,723,586	7,85
FHLB stock	4,004,600	4,05
Loans held for sale	27,502,596	25,65
Loans	397,656,444	393,81
Less allowance for loan losses	3,110,698	2,93
Net loans	394,545,746	390,87
Other real estate owned	898,800	61
Accrued interest receivable	2,119,579	2,23
Premises and equipment, net	8,319,300	7,01
Other assets	14,109,088	11,94
Total assets	$522,002,569	$504,20
LIABILITIES AND STOCKHOLDERS' EQUITY		
Deposits	$373,627,531	$357,25
Short-term borrowings	60,956,824	61,58
Escrow deposits	403,855	22
Accrued interest payable	248,681	28
Accrued expenses and other liabilities	2,653,813	3,32
Long-term obligations	43,090,214	43,09
Total liabilities	480,980,918	465,76
Stockholders' equity:		
Preferred stock, $1 par value, 3,000,000 shares authorized, no shares issued and outstanding	--	
Common stock, $1 par value, 7,000,000 shares authorized, 2,847,947 and 2,835,947 shares issued and outstanding	2,847,947	2,83
Additional paid-in capital	2,613,152	2,44
Accumulated other comprehensive income	498,289	63
Retained earnings	35,062,263	32,53
Total stockholders' equity	41,021,651	38,44
Total liabilities and stockholders' equity	$522,002,569	$504,20
Book value per common share	$ 14.40	$

*Derived from audited consolidated financial statements. 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 JUNE 30,		SIX M
	2003	2002	2003
INTEREST INCOME:			
Loans	$ 6,534,851	$ 6,653,357	$13,060,
Securities	528,897	673,851	1,131,
Other	14,185	11,625	23,
Dividends on FHLB stock	37,849	54,384	83,
Total interest income	7,115,782	7,393,217	14,299,
INTEREST EXPENSE:			
Deposits	1,904,065	2,610,028	3,942,
Borrowed funds	889,958	892,076	1,781,
Total interest expense	2,794,023	3,502,104	5,724,
NET INTEREST INCOME	4,321,759	3,891,113	8,575,
Provision for loan losses	180,000	120,000	380,
Net interest income after provision for loan losses	4,141,759	3,771,113	8,195,
NONINTEREST INCOME:			
Gain on sale of loans	1,232,322	79,388	2,259,
Net gain on sale of securities	--	18,417	
Service charges and fees on loans	114,886	136,374	253,
Deposit-related fees	376,644	262,693	633,
Gain on sale of real estate	--	--	
Bank-owned life insurance earnings	89,910	99,837	186,
Other income, net	41,879	42,858	94,
Total noninterest income	1,855,641	639,567	3,426,
NONINTEREST EXPENSE:			
Compensation and fringe benefits	2,485,805	1,570,690	4,760,
Occupancy and equipment	660,138	549,184	1,307,
Professional and examination fees	112,461	99,044	213,
Advertising	145,541	66,317	266,
Real estate owned	15,651	3,985	33,
Other	460,138	357,980	917,

Total noninterest expenses	3,879,734	2,647,200	7,498,
Income before income taxes	2,117,666	1,763,480	4,124,
Income tax expense	694,427	632,318	1,313,
NET INCOME	$ 1,423,239	$ 1,131,162	$ 2,810,
NET INCOME PER SHARE:			
Basic	$ 0.50	$ 0.40	$ 0.
Diluted	$ 0.49	$ 0.40	$ 0.
WEIGHTED AVERAGE COMMON SHARES OUTSTANDING:			
Basic	2,847,947	2,835,508	2,846,
Diluted	2,895,190	2,861,143	2,891,

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

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

	COMMON STOCK	ADDITIONAL PAID-IN CAPITAL	ACCUMULATED OTHER COMPREHENSIVE INCOME	RETAINED EARNINGS
Balance, December 31, 2002	$ 2,835,947	$ 2,440,645	$ 635,500	$ 32,536,1
Exercise of stock options	12,000	158,500	--	
Tax benefit of stock option exercise	--	14,007	--	
Other comprehensive loss, net of taxes	--	--	(137,211)	
Net income	--	--	--	2,810,8
Cash dividends ($.10 per share)	--	--	--	(284,7
Balance, June 30, 2003	$ 2,847,947	$ 2,613,152	$ 498,289	$ 35,062,2

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

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

(UNAUDITED)

	SIX MONTHS ENDED JUNE 30, 2003	SIX MONTHS ENDED JUNE 30, 2002
OPERATING ACTIVITIES:		
Net income	$ 2,810,889	$ 2,419,664
Adjustments to reconcile net income to net cash provided by operating activities:		
Net accretion, amortization, and depreciation	648,648	464,730
Net gain on sale of securities	--	(135,182)
Net gain on sale of loans	(2,259,078)	(97,668)
Provision for deferred income taxes	(151,752)	107,938
Gain on sale of premises and equipment	--	(464,977)
Gain on sales of foreclosed real estate	3,711	--
Valuation losses on foreclosed real estate	116,543	108,446
Provision for loan losses	380,000	400,000
Proceeds from sale of loans held for sale	136,366,033	5,826,611
Loan originations held for sale	(136,047,055)	(12,286,447)
Changes in assets and liabilities:		
Accrued interest receivable	120,247	248,450
Prepaid expenses and other assets	(1,060,909)	(311,859)
Accrued interest payable	(35,887)	3,052
Accrued expenses and other liabilities	(1,466,816)	184,102
Net cash provided (used) by operating activities	(575,426)	(3,533,140)
INVESTING ACTIVITIES:		
Purchases of securities available for sale	(800,000)	(21,882,903)
Purchase of Lumina Mortgage Company	--	(772,610)
Proceeds from sale of securities available for sale	--	19,058,014
Proceeds from maturity of securities available for sale	850,100	--
Repayments of mortgage-backed securities available for sale	5,926,289	2,131,132
Repayments of mortgage-backed securities held to maturity	1,052,741	304,379
Loan originations, net of principal repayments	(4,431,624)	(12,450,903)
Proceeds from disposals of foreclosed real estate	87,807	101,908
Additions to other real estate owned	(8,236)	(96,455)
Purchases of premises and equipment	(1,746,387)	(466,744)
Proceeds from sale of premises and equipment	1,691	499,070
Net cash used in investing activities	932,381	(13,575,112)
FINANCING ACTIVITIES:		
Net increase in deposits	16,373,435	20,705,686
Net change in short-term borrowings	(629,003)	(2,166,409)
Repayments on long-term obligations	(2,378)	(2,251)
Proceeds from issuance of common stock	184,508	5,424
Dividends paid	(284,795)	(283,544)
Net change in escrow deposits	180,251	427,323
Net cash provided by financing activities	15,822,018	18,686,229
INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	16,178,973	1,577,977
CASH AND CASH EQUIVALENTS:		
BEGINNING OF PERIOD	11,858,603	12,295,578
END OF PERIOD	$ 28,037,576	$ 13,873,555

(Continued)

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

	SIX MONTHS ENDED JUNE 30, 2003	SIX MONTHS ENDED JUNE 30, 2002
Cash paid for:		
Interest	$ 5,760,113	$ 7,257,047
Income taxes	1,537,652	1,192,763
Summary of noncash investing and financing activities:		
Transfer from loans to foreclosed real estate	479,462	637,668
Unrealized gain (loss) on securities available for sale, net of taxes	(137,211)	15,790
Reclassifications between long-term obligations and short-term borrowings	10,000,000	10,000,000

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

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. Accounting Policies: The significant accounting policies followed by Cooperative Bankshares, Inc. (the "Company") for interim financial reporting are consistent with the accounting policies followed for annual financial reporting. These unaudited consolidated financial statements have been prepared in accordance with Rule 10-01 of Regulation S-X, and, in management's opinion, all adjustments of a normal recurring nature necessary for a fair presentation have been included. The accompanying consolidated financial statements do not purport to contain all the necessary financial disclosures that might otherwise be necessary in the circumstances and should be read in conjunction with the consolidated financial statements and notes thereto in the Company's annual report for the year ended December 31, 2002 (the "Annual Report"). The results of operations for the six-month period ended June 30, 2003 are not necessarily indicative of the results to be expected for the full year.

2. Basis of Presentation: The accompanying unaudited consolidated financial statements include the accounts of Cooperative Bankshares, Inc., Cooperative Bank (the "Bank") and its wholly owned subsidiaries, Lumina Mortgage Company, Inc. ("Lumina") and CS&L Holdings, Inc. ("Holdings"), and Holdings' majority owned subsidiary, CS&L Real Estate Trust, Inc. (the "REIT"). All significant intercompany items have been eliminated. Certain

items for prior periods have been reclassified to conform to the current period presentation. These reclassifications have no effect on the net income or stockholders' equity as previously reported.

3. Earnings Per Share: Earnings per share (EPS) are calculated by dividing net income by the weighted average number of common shares outstanding (basic EPS) and the sum of the weighted average number of common shares outstanding and potential common stock (diluted EPS). Potential common stock consists of stock options issued and outstanding. In determining the number of shares 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 JUNE 30,		SIX MONTHS ENDED JUNE 30,	
	2003	2002	2003	2002
Net income (numerator)	$1,423,239	$1,131,162	$2,810,889	$2,419,664
Shares for basic EPS (denominator)	2,847,947	2,835,508	2,846,313	2,835,478
Dilutive effect of stock options	47,243	25,635	44,972	17,724
Shares for diluted EPS (denominator)	2,895,190	2,861,143	2,891,285	2,853,202

For the six months ended June 30, 2003 and 2002, there were 4,204 and 14,204 options outstanding respectively that were antidilutive since the exercise price exceeds the average market price. The options have been omitted from the calculation of the dilutive effect of stock options.

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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 six months ended June 30:

	THREE MONTHS ENDED JUNE 30,		
	2003	2002	2
Net income	$ 1,423,239	$ 1,131,162	$ 2,
Other comprehensive income			

Reclassification to realized gains	--	(18,417)	
Unrealized gain (losses) on available for sale securities	(114,400)	1,064,830	(
Income tax (expense) benefit	38,896	(408,101)	
Other comprehensive income (loss)	(75,504)	638,312	(
Comprehensive income	$ 1,347,735	$ 1,769,474	$ 2,

5. Stock-Based Compensation: On January 1, 1996 the Company adopted SFAS No. 123, "Accounting for Stock-Based Compensation". As permitted by SFAS No. 123, the Company has chosen to continue to apply APB Opinion No. 25, "Accounting for Stock Issued to Employees" and related interpretations. The option exercise price is the market price of the common stock on the date the option is granted. Accordingly, no compensation cost has been recognized for options granted under the Option Plan. Had compensation cost for the Company's Option Plan been determined based on the fair value at the grant dates for awards under the option plan consistent with the method of SFAS No. 123, the Company's net income and net income per share would have been reduced to the pro forma amounts indicated below.

	THREE MONTHS ENDED JUNE 30,		SIX MONTHS ENDED JUNE 30,	
	2003	2002	2003	2002
Net income, as reported	$ 1,423,239	$ 1,131,162	$ 2,810,889	$ 2,419,
Deduct: Total stock-based employee compensation expense determined under fair value based method for all awards, net of related tax effects	--	--	--	(60,
Pro forma net income	$ 1,423,239	$ 1,131,162	$ 2,810,889	$ 2,359,
Earnings per share:				
Basic-as reported	$ 0.50	$ 0.40	$ 0.99	$ 0
Basic-pro forma	$ 0.50	$ 0.40	$ 0.99	$ 0
Diluted-as reported	$ 0.49	$ 0.40	$ 0.97	$ 0
Diluted-pro forma	$ 0.49	$ 0.40	$ 0.97	$ 0

6. Acquisition: On May 31, 2002, the Bank acquired the operating assets of Wilmington-based Lumina Mortgage Company. 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. The agreement was subsequently amended to change the contingent payments into two payments of $400,000 each payable on July 31, 2003 and 2004. These payments are considered additional purchase price and accordingly, goodwill related to this acquisition was increased by $800,000.

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

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

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

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

GENERAL

Cooperative Bankshares, Inc. (the "Company") is a registered bank holding company incorporated in North Carolina in 1994. The Company is the parent company of Cooperative Bank (the "Bank"); a North Carolina chartered commercial bank. Cooperative Bank, headquartered in Wilmington, North Carolina, was chartered in 1898. The Bank provides financial services through 19 financial centers in Eastern North Carolina. One of the Bank's subsidiaries, Lumina Mortgage Company, Inc. ("Lumina") is a mortgage banking firm originating and selling residential mortgage loans through offices in Wilmington, North Carolina; North Myrtle Beach, South Carolina; and Virginia Beach, Virginia. The Bank's other subsidiary, CS&L Holdings, Inc. ("Holdings"), is a holding company for CS&L Real Estate Trust, Inc. (the "REIT"), which is a real estate investment trust.

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Through its financial centers, the Bank provides a wide range of banking products, including interest-bearing and non-interest-bearing checking accounts, certificates of deposit and individual retirement accounts, which are insured up to the applicable limits of the Federal Deposit Insurance Corporation ("FDIC"). It offers an array of loan products: overdraft protection, commercial, consumer, agricultural, real estate, residential mortgage and home equity loans. Also offered are safe deposit boxes, ATMs and Access24 Phone Banking. The bank began offering online banking and bill payment on July 1, 2003. In addition, the Bank offers discount brokerage services, annuity sales and mutual funds through a third party arrangement with UVEST Investment Services. Lumina delivers a wide range of mortgage loan products to its market area.

MISSION STATEMENT

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

MANAGEMENT STRATEGY

Cooperative Bank's lending activities have traditionally concentrated on the origination of loans for the purpose of constructing, financing or refinancing residential properties. In recent years however, the Bank has emphasized origination of nonresidential real estate loans and secured and unsecured consumer and business loans. As of June 30, 2003, approximately $268 million, or 68%, of the Bank's loan portfolio, which excludes loans held for sale, consisted of loans secured by residential properties. This compared to approximately $268 million, or 69% at December 31, 2002. The Bank originates adjustable rate and fixed rate loans. As of June 30, 2003, adjustable rate and fixed rate loans totaled approximately 65.9% and 34.1%, respectively, of the Bank's total loan portfolio.

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

The Bank opened additional branches in Wilmington, North Carolina on May 12, 2003 and Morehead City, North Carolina on July 1, 2003.

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 June 30, 2003, Cooperative had a one-year positive gap position of 1.8%. During a period of falling interest rates, a positive gap would tend to adversely affect net interest income, while a negative gap would tend to result in an increase in net interest income. During a period of rising interest rates, a positive gap would tend to result in an increase in net interest income while a negative gap would tend to adversely affect net interest income. It is important to note that certain shortcomings are inherent in using a 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 June 30, 2003 (in thousands).

	Payments Due by Period				
Contractual Obligations	Total	Less than 1 year	1-3 years	4-5 years	Over 5 years
Borrowed Funds	$ 104,047	$ 60,957	$ 10,000	$ 10,000	$ 23,0
Lease Obligations	2,885	305	410	253	1,9
Lumina Mortgage Company Purchase	800,000	400,000	400,000	--	
Deposits	373,628	325,302	47,644	182	5
Total Contractual Cash Obligations	$1,280,560	$ 786,564	$ 458,054	$ 10,435	$ 25,5

Amount of Commitment Expiration

Other Commitments	Total Amounts Committed	Less than 1 year	1-3 years	4-5 years	Over 5 years
	Per Period				
Undisbursed portion of home equity collateralized primarily by junior liens on 1-4 family properties	$15,175	$ 1,205	$ 798	$ 576	$12,596
Other commitments and credit lines	13,605	4,383	6,331	71	2,820
Undisbursed portion of construction loans	31,318	31,318	--	--	--
Available for sale mortgage loan commitments	6,430	6,430	--	--	--
Fixed-rate mortgage loan commitments	2,535	2,535	--	--	--
Adjustable-rate mortgage loan commitments	3,335	3,335	--	--	--
Total Commitments	$72,398	$49,206	$ 7,129	$ 647	$15,416

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 June 30, 2003, the Bank's borrowed funds from the FHLB 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 June 30, 2003, the estimated market value of liquid assets (cash, cash equivalents, marketable securities and loans held for sale) was approximately $98.1 million, which represents 20.5% of deposits and borrowed funds as compared to $87.6 million or 19.0% of deposits and borrowed funds at December 31, 2002. The increase in liquid assets was primarily due to an increase in cash and cash equivalents.

The Company's primary uses of liquidity are to fund loans and to make investments. At June 30, 2003, outstanding off-balance sheet commitments to extend credit totaled $41.1 million, and the undisbursed portion of construction loans was $31.3 million. Management considers current liquidity levels adequate to meet the Company's cash flow requirements.

CAPITAL

Stockholders' equity at June 30, 2003, was $41.0 million, up 6.7% from $38.4 million at December 31, 2002. Stockholders' equity at June 30, 2003, includes an unrealized gain net of tax, of $498,289 as compared to an unrealized gain net of tax at December 31, 2002, of $635,500 on securities available for sale marked to estimated fair market value.

Under the capital regulations of the FDIC, the Bank must satisfy minimum leverage ratio requirements and risk-based capital requirements. Banks supervised by the FDIC must maintain a minimum leverage ratio of core (Tier I) capital to average adjusted assets ranging from 3% to 5%. At June 30, 2003, the Bank's ratio of Tier I capital was 7.76%. 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 June 30, 2003, the Bank had a ratio of qualifying total capital to risk-weighted assets of 11.22%.

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 June 18, 2003, the Company's Board of Directors approved a quarterly cash dividend of $.05 per share. The dividend was paid on July 16, 2003 to stockholders of record as of July 1, 2003. This brings the total dividend for the year to $.10 per share. Any future payment of dividends is dependent on the financial condition and capital needs of the Company, requirements of regulatory agencies, and economic conditions in the marketplace.

CRITICAL ACCOUNTING POLICY

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

FINANCIAL CONDITION AT JUNE 30, 2003, COMPARED TO DECEMBER 31, 2002

The Company's total assets increased 3.5% to $522.0 million at June 30, 2003, as compared to $504.2 million at December 31, 2002. The major change in the assets is an increase of $16.2 million (136.4%) in cash and cash equivalents, which was caused by an increase in deposits of $16.4 million (4.6%). The increase in deposits was mainly in the six and fifteen month certificates, due to the customers' desire to stay short term in the current rate environment, and non-interest-bearing checking accounts due to the emphasis of the Bank on obtaining business accounts. The Bank also attracted an additional $7.9 million in internet deposits because the rates were competitive with the Bank's local markets. Internet deposits are usually obtained from other financial institutions with terms

primarily of one or two years. The decrease in available for sale securities of $6.3 million (15.1%) enabled the Bank to fund an increase in loans of $3.8 million (1.0%) and loans held for sale of $1.8 million (7.2%) as well as repay $1.0 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. Securities available for sale decreased during the first six months of 2003 due to payments of mortgage backed securities. The increase of $1.3 million in premises and equipment, during this same period, is primarily due to the building of two new branches. Other assets increased $2.2 million (18.1%) due to an increase of $1.2

million being held by attorneys to fund loan closings and an increase of $800,000 in goodwill. The increase of funds held by attorneys was the result of a backlog of loan closings created by high demand. The additional goodwill was created by amending the purchase agreement of Lumina Mortgage Company from two contingent payments into two payments of $400,000 each payable on July 31, 2003 and 2004.

The Company's non-performing assets (loans 90 days or more delinquent and foreclosed real estate) were $1.5 million, or .29% of assets, at June 30, 2003, compared to $1.2 million, or 0.24% of assets, at December 31, 2002. Foreclosed real estate increased to $898,800 at June 30, 2003, from $619,163 at December 31, 2002, but only 3 properties make up this balance. The Company assumes an aggressive position in collecting delinquent loans and disposing of foreclosed assets to minimize balances of non-performing assets and continues to evaluate the loan and real estate portfolios to provide loss reserves as considered necessary. For further information see "Comparison of Operating Results - Provision and Allowance 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 portfolio and interest-earning deposits and the cost of funds, consisting principally of the interest paid on deposits and borrowings. The Company's operations are materially affected by general economic conditions, the monetary and fiscal policies of the Federal government, and the policies of regulatory authorities. Yields and costs have declined because of the actions the Federal Reserve has taken since 2001 to reduce interest rates in hopes of spurring the economy.

NET INCOME

Net income for the three and six-month periods ended June 30, 2003, increased 25.8% to $1.4 million and 16.2% to $2.8 million respectively, as compared to the same periods last year. The increase in net income for the six-month period ended June 30, 2003 can be attributed to increases in net interest income of $1.1 million and non-interest income of $1.6 million. These changes were partially offset by an increase in non-interest expense of $2.3 million during the same period.

INTEREST INCOME

For the three-month period ended June 30, 2003, interest income decreased 3.8% as compared to the same period a year ago. The average balance of interest-earning assets increased 9.7% but the average yield decreased 84 basis points as compared to the same period a year ago. Interest income decreased 3.1% for the six-month period ended June 30, 2003, 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 6.00% as compared to 6.82% for the same period a year ago. The average balance of interest-earning assets increased 10.0% for the six month period ended June 30, 2003, 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.

INTEREST EXPENSE

Interest expense decreased 20.2% for the three-month period ended June 30, 2003, as compared to the same period a year ago. This decrease was due to the average cost of interest-bearing liabilities decreasing 88 basis points as compared to the same period a year ago. In the six-month period ended June 30, 2003, interest expense decreased 21.2% as compared to the same period a year ago. The average balance of interest-bearing liabilities increased 7.8% as compared to the same period a year ago. The cost of interest-bearing liabilities decreased to 2.61% as compared to 3.57% for the same period last year.

NET INTEREST INCOME

Net interest income for the three and six-month periods ended June 30, 2003, as compared to the same period a year ago, increased 11.1% and 14.4% respectively. The increase was due to interest-earning assets increasing faster than interest-bearing liabilities. In addition, there was a larger decrease in the cost of liabilities versus the yield on assets, which can be attributed to the fact that deposits continue to reprice at lower yields caused by the Federal Reserve's previous rate reductions and the increased use of low cost borrowings due to the Lumina purchase. See "Average Yield/Cost Analysis" table for further information on interest income and interest expense.

AVERAGE YIELD/COST ANALYSIS

The following tables contain 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 three months en			
	JUNE 30, 2003			
(DOLLARS IN THOUSANDS)	Average Balance	Interest	Average Yield/ Cost	Avera Balan
Interest-earning assets:				
Interest-bearing deposits in other banks	$ 4,983	$ 14	1.12%	$ 2,
Securities:				
Available for sale	37,715	436	4.62%	41,
Held to maturity	7,254	93	5.13%	7,
FHLB stock	3,798	38	4.00%	4,
Loan portfolio	424,247	6,535	6.16%	380,
Total interest-earning assets	477,997	7,116	5.95%	435,
Non-interest earning assets	27,861			27,
Total assets	$505,858			$462,
Interest-bearing liabilities:				
Deposits	348,301	1,904	2.19%	336,
Borrowed funds	90,803	890	3.92%	72,

Total interest-bearing liabilities	439,104	$ 2,794	2.55%	408,
Non-interest bearing liabilities	26,059			19,
Total liabilities	465,163			427,
Stockholders' equity	40,695			35,
Total liabilities and stockholders' equity	$505,858			$462,
Net interest income		$ 4,322		
Interest rate spread			3.40%	
Net yield on interest-earning assets			3.62%	
Percentage of average interest-earning assets to average interest-bearing liabilities			108.9%	

For the six months ende

(DOLLARS IN THOUSANDS)	JUNE 30, 2003 Average Balance	Interest	Average Yield/ Cost	Averag Balanc
Interest-earning assets:				
Interest-bearing deposits in other banks	$ 4,269	$ 24	1.12%	$ 2,7
Securities:				
Available for sale	39,027	929	4.76%	42,2
Held to maturity	7,519	202	5.37%	6,1
FHLB stock	3,961	84	4.24%	4,1
Loan portfolio	421,553	13,061	6.20%	377,6
Total interest-earning assets	476,329	14,300	6.00%	432,9
Non-interest earning assets	27,063			26,7
Total assets	$503,392			$459,6
Interest-bearing liabilities:				
Deposits	346,573	3,942	2.27%	331,5
Borrowed funds	92,138	1,782	3.87%	75,4
Total interest-bearing liabilities	438,711	$ 5,724	2.61%	406,9

Non-interest bearing liabilities	24,915			17,9
Total liabilities	463,626			424,9
Stockholders' equity	39,766			34,7
Total liabilities and stockholders' equity	$503,392			$459,6
Net interest income		$ 8,576		
Interest rate spread			3.39%	
Net yield on interest-earning assets			3.60%	
Percentage of average interest-earning assets to average interest-bearing liabilities			108.6%	

PROVISION AND ALLOWANCE FOR LOAN LOSSES

During the six-month period ended June 30, 2003 the Bank had net charge-offs against the allowance for loan losses of $206,097 compared to $330,945 for the same period in 2002. This decrease was primarily due to one larger credit being charged off during the first quarter of 2002. The Bank added $380,000 to the allowance for loan losses for the current six-month period increasing the balance to $3.1 million at June 30, 2003. Management considers the current level of the allowance to be appropriate based on loan composition, the current level of delinquencies and other non-performing assets, overall economic conditions and other factors. Future increases to the allowance may be necessary, however, due to changes in loan composition or loan volume, changes in economic or market area conditions and other factors. Additionally, various regulatory agencies, as an integral part of their examination process, periodically review the Company's allowance for loan losses. Such agencies may require the recognition of adjustments to the allowance for loan losses based on their judgments of information available to them at the time of their examination.

NONINTEREST INCOME

Noninterest income increased by 85.3% for the six-month period ended June 30, 2003, as compared to the same period a year ago. The change in noninterest income can be attributed to gain on sale of loans increasing over $2.2 million primarily as a result of the purchase of Lumina. The Bank has also started to sell a larger percentage of its fixed rate mortgage loan originations in the secondary market instead of through brokered arrangements. This change causes an increase in gain on sale of loans and a reduction to service charges and fees on loans. Deposit related fees increased 24.0% primarily due to a new service the Bank offered beginning in April 2003, for checking accounts with non-sufficient funds. During the first six months of 2002 the Bank sold a parking lot for $500,000, resulting in the gain on sale of real estate, and the gain of $135,182 on sale of securities was due to selling bonds and purchasing mortgage backed securities to give the Bank greater cash flow. No similar transactions occurred during the six months ended June 30, 2003.

In the three-month period ended June 30, 2003, noninterest income increased 190.1% as compared to the same period last year. The net gains on sale of loans and deposit-related fees increased $1.2 million and $113,951 respectively, for the three-month period ended June 30, 2003 as compared to the same period a year ago. The reasons for these increases are the same as stated above for the six month period.

NONINTEREST EXPENSE

For the six-month period ended June 30, 2003, noninterest expense increased 44.3% as compared to the same period last year. Compensation and related costs increased 58.3%. Higher personnel costs associated with the purchase of Lumina accounted for the majority of the increase. Also, in January 2003, the Company granted 117 shares of preferred stock in the REIT to officers, directors, and Bank employees with at least one month of service and certain other parties. Each individual that was granted the preferred stock received one share that had a $500 value, for an aggregate increase to compensation expense of $58,500. In addition, the increase was due to increases in costs of benefits, staffing levels including the staffing for two additional branches, and normal increases in salaries. Occupancy and equipment expense increased $240,174 primarily because of the Lumina purchase and an increase in depreciation expense due to the new branches and upgrades in hardware and software systems. The increase in advertising and other noninterest expenses of $129,277 and $170,663 respectively, was mainly due to the purchase of Lumina.

In the three-month period ended June 30, 2003, noninterest expense increased 46.6% as compared to the same period last year. This increase can be principally attributed to compensation and fringe benefits, occupancy and equipment expense, advertising and other expense increasing $915,115, $110,954, $79,224 and $102,158 respectively. The reasons for these changes are identical to the six month period ended June 30, 2003.

INCOME TAXES

The effective tax rate for the six-month periods ended June 30, 2003 and 2002, was 31.8% and 35.4% respectively. The effective tax rate for the three-month periods ended June 30, 2003 and 2002 was 32.8% and 35.9% respectively. The decreases resulted from the formation of Holdings and the REIT in December 2002.

NOTE REGARDING FORWARD-LOOKING STATEMENTS

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

ITEM 3 - MARKET RISK

The Company's primary market risk is interest rate risk. Interest rate risk is the result of differing maturities or repricing intervals of interest earning assets and interest bearing liabilities and the fact that rates on these financial instruments do not change uniformly. These conditions may impact the earnings generated by the Company's interest earning assets or the cost of its interest bearing liabilities, thus directly impacting the Company's overall earnings. The Company's management actively monitors and manages interest rate risk. One way this is accomplished is through the development of and adherence to the Company's asset/liability policy. This policy sets forth management's strategy for matching the risk characteristics of the Company's interest earning assets and liabilities so as to mitigate the effect of changes in the rate environment. The Company's market risk profile has not changed significantly since December 31, 2002.

ITEM 4 - CONTROLS AND PROCEDURES

The Company's Chief Executive Officer and Chief Financial Officer have evaluated the Company's disclosure controls and procedures (as such term is defined in Rule 13a-14(c) under the Exchange Act) as of the end of the period covered by 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 during the quarter ended June 30, 2003

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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

(1) Annual Meeting of Stockholders, April 25, 2003
(a) Election of Directors

	FOR		WITHHELD	
	NUMBER OF VOTES	PERCENTAGE OF VOTES	NUMBER OF VOTES	PERCENTAGE OF VOTES
Frederick Willetts, III	2,319,444.6	94.26	141,022.5	5.74
F. Peter Fensel, Jr.	2,451,109.6	99.62	9,357.5	0.38

ITEM 5. OTHER INFORMATION

None

ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K

(a) Exhibits

Exhibit 31.1 Section 302 Certification of the Chief Executive Officer

Exhibit 31.2 Section 302 Certification of the Chief Financial Officer

Exhibit 32 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 April 24, 2003 to report first quarter earnings and a current report on Form 8-K dated July 24, 2003 to report second 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.

Dated August 12, 2003

Cooperative Bankshares, Inc.

/s/ Frederick Willetts, III

Frederick Willetts, III
President/Chief Executive Officer

Dated: August 12, 2003

/s/ Todd L. Sammons

Todd L. Sammons
Senior Vice President/Chief
Financial Officer