COOPERATIVE BANKSHARES INC
Form 10-Q
November 09, 2001

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, 2001

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.
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. 2,823,271 shares at November 2, 2001

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

	SEPTEMBER 30, 2001 (UNAUDITED)
ASSETS	
Cash and due from banks, noninterest-bearing	$ 9,340,438
Interest-bearing deposits in other banks	101,620
Total cash and cash equivalents	9,442,058
Securities:	
Available for sale (amortized cost of $38,840,238 in September 2001 and $16,000,677 in December 2000)	39,441,013
Held to maturity (estimated market value of $8,232,190 in September 2001 and $18,553,526 in December 2000)	8,000,000
FHLB stock	3,755,300
Loans	366,683,985
Less allowance for loan losses	2,377,552

Net loans	364,306,433
Other real estate owned	1,080,372
Accrued interest receivable	2,668,046
Premises and equipment, net	6,212,917
Other assets	8,874,889
Total assets	$443,781,028
LIABILITIES AND STOCKHOLDERS' EQUITY	
Deposits	$340,615,280
Borrowed funds	68,098,259
Escrow deposits	712,043
Accrued interest payable	320,687
Accrued expenses and other liabilities	1,024,765
Total liabilities	410,771,034
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, 2,823,271 and 2,714,610 shares issued and outstanding	2,823,271
Additional paid-in capital	2,325,864
Accumulated other comprehensive income	366,473
Retained earnings	27,494,386
Total stockholders' equity	33,009,994
Total liabilities and stockholders' equity	$443,781,028
Book value per common share	$ 11.69

*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 SEPTEMBER 30, 2001	2000	NINE MONTHS ENDE SEPTEMBER 30, 2001	2
INTEREST INCOME:				
Loans	$7,034,182	$7,332,808	$21,186,198	$21,3
Securities	748,095	572,311	1,980,307	1,7
Other	23,640	81,305	251,975	2
Dividends on FHLB stock	63,892	73,156	194,221	2
Total interest income	7,869,809	8,059,580	23,612,701	23,6
INTEREST EXPENSE:				
Deposits	3,857,524	3,922,804	11,950,354	10,9
Borrowed funds	889,419	1,081,857	2,591,290	3,2

Total interest expense	4,746,943	5,004,661	14,541,644	14,2
NET INTEREST INCOME	3,122,866	3,054,919	9,071,057	9,4
Provision for loan losses	120,000	90,000	300,000	8
Net interest income after provision for loan losses	3,002,866	2,964,919	8,771,057	8,5
NONINTEREST INCOME:				
Net gains on sale of loans	--	--	2,420	
Net gains (losses) on sale of securities	98,086	--	110,485	(2
Service charges and fees on loans	176,025	105,956	511,240	3
Deposit-related fees	257,946	228,342	781,840	6
Gain on sale of branch	--	--	--	5
Other income, net	813	363	3,984	
Total noninterest income	532,870	334,661	1,409,969	1,2
NONINTEREST EXPENSE:				
Compensation and fringe benefits	1,223,555	1,211,660	3,789,730	4,0
Occupancy and equipment	540,116	480,646	1,605,919	1,4
Advertising	89,984	84,105	200,929	2
Real estate owned	5,594	5,248	4,957	(
Other	432,811	379,937	1,339,461	1,3
Total noninterest expenses	2,292,060	2,161,596	6,940,996	7,1
Income before income taxes	1,243,676	1,137,984	3,240,030	2,6
Income tax expense	438,211	410,306	1,157,309	9
NET INCOME	$ 805,465	$ 727,678	$ 2,082,721	$ 1,6
NET INCOME PER SHARE:				
Basic	$ 0.29	$ 0.27	$ 0.75	$
Diluted	$ 0.28	$ 0.26	$ 0.74	$
WEIGHTED AVERAGE COMMON SHARES OUTSTANDING:				
Basic	2,814,347	2,714,519	2,787,611	2,7
Diluted	2,828,829	2,800,564	2,820,185	2,8

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

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

	COMMON STOCK	ADDITIONAL PAID-IN CAPITAL	ACCUMULATED OTHER COMPREHENSIVE INCOME	RETAI EARNI

Balance, December 31, 2000	$2,714,610	2,234,936	29,707	25,832
Exercise of stock options	128,059	328,428	--	
Stock traded to exercise options (19,398 shares)	(19,398)	(237,500)	--	
Other comprehensive income, net of taxes	--	--	336,766	
Net income for period	--	--	--	2,082
Cash dividends ($.15 per share)	--	--	--	(421
Balance, September 30, 2001	$2,823,271	2,325,864	366,473	27,494

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)

	NIN
	2001
OPERATING ACTIVITIES:	
Net income	$ 2,082,721
Adjustments to reconcile net income to net cash provided by (used in) operating activities:	
Net accretion, amortization, and depreciation	525,593
Net (gain) loss on sale securities	(110,485
Gain on sale of loans	(2,420
Benefit from deferred income taxes	(168,527
Loss on sale of premises and equipment	3,318
Loss (gain) on sales of foreclosed real estate	(6,956
Valuation losses on foreclosed real estate	2,807
Gain on sale of branch office	--
Provision for loan losses	300,000
Proceeds from sale of loans	27,115
Changes in assets and liabilities:	
Accrued interest receivable	108,358
Other assets	(7,661,439
Accrued interest payable	20,291
Accrued expenses and other liabilities	151,136
Net cash provided by (used in) operating activities	(4,728,488
INVESTING ACTIVITIES:	
Purchases of securities available for sale	(62,517,100
Purchases of securities held to maturity	--
Proceeds from sale of securities available for sale	28,092,663
Proceeds from maturity of securities available for sale	17,645,964
Proceeds from maturity of securities held to maturity	5,000,000
Loan originations, net of principal repayments	(18,225,565
Proceeds from disposals of foreclosed real estate	238,860
Purchases of premises and equipment	(453,464
Proceeds from sale of premises and equipment	11,418
Net cash paid related to sale of branch office	--

Net cash used in investing activities	(30,207,224
FINANCING ACTIVITIES:	
Net increase in deposits	13,302,956
Proceeds from borrowed funds	13,000,000
Principal payments on borrowed funds	(3,218
Proceeds from issuance of common stock, net	199,589
Purchase and retirement of common stock	--
Dividends	(421,261
Net change in escrow deposits	151,268
Net cash provided by financing activities	26,229,334
DECREASE IN CASH AND CASH EQUIVALENTS	(8,706,378
CASH AND CASH EQUIVALENTS:	
BEGINNING OF PERIOD	18,148,436
END OF PERIOD	$ 9,442,058

(Continued)

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

	NINE MONTHS EN SEPTEMBER 30 2001
Cash paid for:	
Interest	$14,521,353
Income taxes	1,254,583
Summary of noncash investing and financing activities:	
Transfer from loans to foreclosed real estate	1,080,372
Unrealized gain on securities available for sale, net of taxes	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.

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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 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, 2000. The results of operations for the three and nine-month periods ended September 30, 2001 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 the dilutive common equivalent shares outstanding. Common equivalent shares consist of stock options issued and outstanding. In determining the number of equivalent shares outstanding, 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 average 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.

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, 2001 and 2000:

	THREE MONTHS ENDED SEPTEMBER 30,		NINE SEP
	2001	2000	2001
Net income	$ 805,465	$ 727,678	$2,082,721
Other comprehensive income			
Realized (gains) losses on available for sale securities	(98,086)	--	(110,485
Unrealized gains (losses) on available for sale securities	555,432	162,684	662,560
Income tax expense	(178,365)	(63,447)	(215,309
Other comprehensive income	278,981	99,237	336,766
Comprehensive income	$1,084,446	$ 826,915	$2,419,487

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. Statement of Financial Accounting Standards No. 141: 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 not longer permitted. Statement 141 requires that the purchase method be used for business combination initiated after June 30, 2001. Management of the Company anticipates that SFAS No. 141 will not have a material effect on the Company's results of operations or its financial position.

7. Statement of Financial Accounting Standards No. 142: This statement requires that goodwill no longer be amortized to earnings, but instead be reviewed for impairment. This change provides investors with greater transparency regarding the economic value of goodwill and its impact on earnings. The amortization of goodwill ceases upon adoption of the Statement, which will be January 1, 2002. Management of the company anticipates that due to the fact that it does not have goodwill or other intangible assets, the adoption of SFAS No. 142 will not have a material effect on the company's results of operations or its financial position.

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 Federal Deposit Insurance Corporation ("FDIC") insures the Bank's deposit accounts up to applicable limits.

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, home equity lines of credit loans, and secured and unsecured consumer and business loans. As of September 30, 2001, approximately $279.6 million, or 76.0%, of the Bank's loan portfolio consisted of loans secured by residential properties. This was down from approximately $291 million, or 82.9% at December 31, 2000. The Bank originates adjustable rate and fixed rate loans. As of September 30, 2001, adjustable rate and fixed rate loans totaled approximately 62.0% and 38.0%, respectively, of the Bank's total loan portfolio.

The Bank has chosen to begin selling a larger percentage of its fixed rate mortgage loan originations through broker dealer arrangements. This enables the Bank to invest its funds in higher yielding 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.

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, 2001, Cooperative had a one-year negative gap position of 1.9%. 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 declining 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 large 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 in an amount of up to 25% of the Bank's total assets. At September 30, 2001, the Bank's borrowed funds equaled 15.3% 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 September 30, 2001, the estimated market value of liquid assets (cash, cash equivalents, and marketable securities) was approximately $57.1 million, which represents 14.0% of deposits and borrowed funds as compared to $52.8 million or 13.8% of deposits and borrowed funds at December 31, 2000. The increase in liquid assets was primarily due to the investment of cash from increased retail deposits and borrowed funds.

The Company's primary uses of liquidity are to fund loans and to make investments. At September 30, 2001, outstanding off-balance sheet commitments to extend credit totaled $28.7 million, and the undisbursed portion of construction loans was $27.7 million. Management considers current liquidity levels adequate to meet the Company's cash flow requirements.

CAPITAL

Stockholders' equity at September 30, 2001, was $33.0 million, up 7.1% from $30.8 million at December 31, 2000. Stockholders' equity at September 30, 2001 and December 31, 2000, includes unrealized gains, net of tax, of $366,473 and $29,707, 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, 2001, the Bank's leverage ratio of Tier I capital to average adjusted assets was 7.5%. 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, 2001, the Bank had a ratio of qualifying total capital to risk-weighted assets of 11.4%.

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 20, 2001, the Company's Board of Directors approved a quarterly cash dividend of $.05 per share. The dividend was paid on October 16, 2001 to stockholders of record as of October 1, 2001. 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.

FINANCIAL CONDITION AT SEPTEMBER 30, 2001, COMPARED TO DECEMBER 31, 2000

The Company's total assets increased 6.9% to $443.8 million at September 30, 2001, as compared to $415.0 million at December 31, 2000. The major changes in the assets are as follows: a decrease of $8.7 million (48.0%) in cash and cash equivalents, an increase of $23.4 million (145.7%) in securities available for sale, a decrease of $11.0 million (57.8%) in securities held to maturity, an increase of $17.0 million (4.9%) in loans and an increase of 7.6 million (604.2%) in other assets.

The increase in other assets was due to the cash surrender value of bank owned life insurance that was purchased during the quarter. Although the Company has concentrated its lending activities on the origination of loans for the purpose of the constructing, financing or refinancing of residential properties, it is becoming more active in the origination of small loans secured by commercial properties. At September 30, 2001, approximately 24.0% of the Company's loan portfolio were loans secured by collateral other than residential properties, compared to 17.1% at December 31, 2000.

The Bank funded the increase in loans, securities and other assets with a $13.3 million (4.1%) increase in retail deposits, a $13.0 million (23.6%) increase in borrowed funds and other available liquid assets. The increase in retail deposits was in certificates with terms no greater than 7 months which management priced aggressively to meet its funding needs. 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 September 30, 2001, $20.0 million in borrowed funds mature in 1 year and $25.0 million of funds mature in 2 to 5 years. The remaining amount of borrowed funds mature in 2010 or 2011.

The Company's non-performing assets (nonaccrual loans, loans 90 days or more delinquent and still accruing interest and foreclosed real estate) were $3.1 million or 0.70% of assets, at September 30, 2001, compared to $925 thousand, or 0.22% of assets, at December 31, 2000. Foreclosed real estate increased to $1,080,372 at September 30, 2001, from $234,711 at December 31, 2000, but only two properties make up this balance. The Company assumes an aggressive position in collecting delinquent loans and disposing of foreclosed assets and continues to evaluate the loan and real estate portfolios to provide loss reserves as considered necessary. While there can be no guarantee, in the opinion of management, the allowance for loan losses of $2.4 million at September 30, 2001, is adequate to cover probable losses inherent in the loan portfolio.

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 and nine-month periods ended September 30, 2001, increased 10.7% to $805,465 and 22.7% to $2.1 million, respectively, as compared to the same periods last year. The increase in net income for the nine-month period ended September 30, 2001 can be attributed to decreases of $580 thousand and $235 thousand in provision for loan losses and noninterest expense, respectively and an increase of $150 thousand in noninterest income. These changes were partially offset by a reduction in net interest income of $356 thousand and an increase in income tax expense of $224 thousand.

INTEREST INCOME

For the three-month period ended September 30, 2001, interest income decreased 2.4% as compared to the same period a year ago. The average balance of interest-earning assets increased 3.9% but the average yield decreased 48 basis points as compared to the same period a year ago. Interest income decreased 0.1%, for the nine-month period ended September 30, 2001, as compared to the same period a year ago. The average balance of interest-earning assets increased 2.2%, while the average yield decreased 18 basis points to 7.70% as compared to 7.88%, 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 5.1% for the three-month period ended September 30, 2001, as compared to the same period a year ago. This decrease was due to the average cost of interest-bearing liabilities decreasing 48 basis points as compared to the same period a year ago. In the nine-month period ended September 30, 2001, interest expense increased 2.3% as compared to the same period a year ago. The 1.8% increase in the average balance of interest-bearing liabilities and their subsequent increase in cost of funds principally contributed to the increase in interest expense. The average cost of interest-bearing liabilities increased 3 basis points to 5.16% as compared to 5.13% for the same period last year.

NET INTEREST INCOME

Net interest income for the three and nine-month periods ended September 30, 2001, as compared to the same periods a year ago, increased 2.2% and decreased 3.8%, respectively. During these same periods, the yield on average interest-earning assets decreased 48 basis points and 18 basis points, respectively. For the same periods, the cost of average interest-bearing liabilities decreased 48 basis points and increased 3 basis points, respectively. The nine-month difference can be attributed to the fact that more assets reprice within 30 days as compared to liabilities as a result of the rapidly declining interest rate environment during the entire nine-month period ended September 30, 2001. Once interest rates stabilize, management expects the spread between the average yield on interest-earning assets and the average cost on interest-bearing liabilities to improve.

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, 2001			SEPTEMBER 30, 2	
(DOLLARS IN THOUSANDS)	Average Balance	Interest	Average Yield/ Cost	Average Balance	Interest
Interest-earning assets:					
Interest-bearing deposits in other banks	$ 2,464	$ 24	3.90%	$ 8,208	$ 81
Securities:					
Available for sale	42,420	634	5.98%	21,001	313
Held to maturity	8,000	114	5.70%	18,501	260
FHLB stock	3,755	64	6.82%	3,755	73
Loan portfolio	360,529	7,034	7.80%	350,078	7,333
Total interest-earning assets	417,168	7,870	7.55%	401,543	8,060
Non-interest earning assets	16,704			11,956	
Total assets	$433,872			$413,499	
Interest-bearing liabilities:					
Deposits	323,613	3,858	4.77%	304,774	3,923
Borrowed funds	60,860	889	5.84%	64,831	1,082
Total interest-bearing liabilities	384,473	$4,747	4.94%	369,605	$5,005
Non-interest bearing liabilities	16,745			13,329	
Total liabilities	401,218			382,934	
Stockholders' equity	32,654			30,565	
Total liabilities and stockholders' equity	$433,872			$413,499	
Net interest income		$3,123			$3,055
Interest rate spread			2.61%		
Net yield on interest-earning assets			2.99%		
Percentage of average interest-earning assets to average interest-bearing liabilities			108.5%		

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 ended SEPTEMBER 30, 2001			SEPTEMBER 30	
(DOLLARS IN THOUSANDS)	Average Balance	Interest	Average Yield/ Cost	Average Balance	Inte
Interest-earning assets:					
Interest-bearing deposits in other banks	$8,947	$ 252	3.76%	$ 9,317	$
Securities:					
Available for sale	35,927	1,669	6.19%	22,333	
Held to maturity	8,041	312	5.17%	18,182	
FHLB stock	3,755	194	6.89%	3,755	
Loan portfolio	352,094	21,186	8.02%	346,514	21,
Total interest-earning assets	408,764	$23,613	7.70%	400,101	$23,
Non-interest earning assets	13,829			11,584	
Total assets	$422,593			$411,685	
Interest-bearing liabilities:					
Deposits	318,209	11,951	5.01%	301,499	10,
Borrowed funds	57,457	2,591	6.01%	67,676	3,
Total interest-bearing liabilities	375,666	$14,542	5.16%	369,175	$14,
Non-interest bearing liabilities	14,887			12,359	
Total liabilities	390,553			381,534	
Stockholders' equity	32,040			30,151	
Total liabilities and stockholders' equity	$422,593			$411,685	
Net interest income		$ 9,071			$ 9,
Interest rate spread			2.53%		
Net yield on interest-earning assets			2.96%		
Percentage of average interest-earning assets to average interest-bearing liabilities			108.8%		

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.

	For the nine months ended September 30, 2000 vs. September 30, Increase (Decrease) Due to		
(DOLLARS IN THOUSANDS)	Volume	Rate	Tota
Interest income:			
Interest-bearing deposits in other banks	$ (11)	$ (17)	$ (2
Securities:			
Available for sale	629	52	68
Held to maturity	(401)	(73)	(47
FHLB stock	--	(24)	(2
Loan portfolio	341	(527)	(18
Total interest-earning assets	558	(589)	(3
Interest expense:			
Deposits	620	385	1,00
Borrowed funds	(472)	(208)	(68
Total interest-bearing liabilities	148	177	32
Net interest income	$ 410	$ (766)	$ (35

PROVISION AND RESERVE FOR LOAN LOSSES

During the nine-month period ended September 30, 2001 the Bank had net charge-offs against the allowance for loan losses of $82,111 compared to $92,801 for the same period in 2000. The Bank added $300,000 to the allowance for loan losses for the current nine-month period, increasing the balance to $2.4 million at September 30, 2001. The $880,000 provision in the nine-month period ended September 30, 2000 included an increase of approximately $625,000 made in response to a detailed review of the Bank's loan portfolio and was considered appropriate in light of the successful expansion in the commercial loan portfolio. The 2001 provision for loan losses of $300,000 represents an increase of $45,000 when compared to the 2000 provision, excluding the effect of the $625,000 special provision made in the nine months ended September 30, 2000. This increase is attributable to the growth in loans as well as current economic conditions. The increase in non-performing loans did not have a significant effect on the provision for loan losses in 2001 since these loans are considered to be both well secured and in the process of collection. 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 59.2% for the three-month period ended September 30, 2001, as compared to the same period a year ago. This increase can be attributed to deposit-related fees increasing 13.0%, fees and service charges on loans increasing 66.1% and gains on sale of securities of $98,086. The increase in deposit-related fees was due to an increase in the number of accounts and an increase in checking related fees. The increase in service charges and fees on loans was mainly due to an increase in loan settlement service fees for loans processed for others. This program began in May 2000 and the volume has

increased due to the favorable rate environment. There were no gains on sales of securities for the three-month period ended September 30, 2000.

In the nine-month period ended September 30, 2001, noninterest income increased 11.9% as compared to the same period a year ago. The change in noninterest income can be attributed to the increase in deposit-related fees of 18.3% and the 69.0% increase in service charges and fees on loans. In addition, there was an $110,485 gain on sale of securities during the nine-month period ended September 30, 2001 as compared to a $287,282 loss on sale of securities during the same period a year ago. The company realized a $582,583 gain on the sale of a branch during the nine months ended September 30, 2000. No similar transaction occurred during the nine months ended September 30, 2001.

NONINTEREST EXPENSES

For the nine-month period ended September 30, 2001, noninterest expense decreased 3.3% as compared to the same period last year. Compensation and related costs decreased 7.0%. The decrease can be principally attributed to a modification to the defined benefit plan in 2000 and the early retirement of certain employees at December 31, 2000. Occupancy and equipment expense increased by 9.9%. This increase can be attributed to additional maintenance necessary to keep the buildings and equipment in good repair, rental increases, opening a new branch, property tax increases, increases in the cost of data processing services and normal increases in utility expenses. The reduction of $97 thousand in advertising can be attributed to a more conservative advertising policy. Noninterest expense for the three-month period ended September 30, 2001 as compared to the same period last year increased $130 thousand, of which $59 thousand can be attributed to an increase in occupancy & equipment expense.

INCOME TAXES

The effective tax rate for both the three and nine-month periods ended September 30, 2001 was 35.2% and 35.7% respectively, as compared to 36.1% and 35.5% for the same periods last year.

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 the continued availability of commercial lending opportunities in the Company's market area, a change in the ability of the Company to sell fixed rate loan originations, an increase in nonperforming assets, changes in the economy and interest rates generally, changes in regulations affecting the Company or the Bank or changes in the economic conditions in the Company's market area.

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

(c) Not applicable

(d) Not applicable

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

(a) Not applicable

(b) Not applicable

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

None

ITEM 5. OTHER INFORMATION

None

ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K

(a) Exhibits
Exhibit 11. Computation of Earnings Per Share

(b) Not applicable

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 9, 2001

/s/ Frederick Willetts, III

President and Chief Executive Officer

Dated: November 9, 2001

/s/ Todd L. Sammons

Treasurer and Chief Financial Officer