COOPERATIVE BANKSHARES INC
Form 10-Q
May 12, 2004

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, 2004

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. 2,860,764 shares at April 23, 2004

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Exhibits

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

	MARCH 31, 2004
	(UNAUDITED)
ASSETS	
Cash and due from banks, noninterest-bearing	$ 13,418,492
Interest-bearing deposits in other banks	4,750,786
Total cash and cash equivalents	18,169,278
Securities:	
Available for sale (amortized cost of $47,884,134 in March 2004 and $43,180,913 in December 2003)	48,712,704
Held to maturity (estimated market value of $3,606,844 in March 2004 and $3,889,736 in December 2003)	3,508,140
FHLB stock	4,354,400
Loans held for sale	8,304,744
Loans	415,258,023
Less allowance for loan losses	3,638,961
Net loans	411,619,062
Accrued interest receivable	1,986,214
Premises and equipment, net	8,586,347
Goodwill	1,461,543
Other assets	12,179,366
Total assets	$ 518,881,798
LIABILITIES AND STOCKHOLDERS' EQUITY	
Deposits	$ 376,450,494
Short-term borrowings	32,048,351
Escrow deposits	296,599
Accrued interest payable	195,851
Accrued expenses and other liabilities	2,577,038
Long-term obligations	63,086,523
Total liabilities	474,654,856
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,	

2,860,764 and 2,849,447 shares issued and outstanding	2,860,764
Additional paid-in capital	2,673,233
Accumulated other comprehensive income	546,856
Retained earnings	38,146,089
Total stockholders' equity	44,226,942
Total liabilities and stockholders' equity	$ 518,881,798
Book value per common share	$ 15.46

* 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 Months Ended March 31, 2004	2003
INTEREST INCOME:		
Loans	$ 5,944,835	$ 6,564,
Securities	562,083	603,
Other	9,880	9,
Dividends on FHLB stock	35,736	45,
Total interest income	6,552,534	7,222,
INTEREST EXPENSE:		
Deposits	1,506,825	2,038,
Borrowed funds	672,009	891,
Total interest expense	2,178,834	2,930,
NET INTEREST INCOME	4,373,700	4,292,
Provision for loan losses	220,000	200,
Net interest income after provision for loan losses	4,153,700	4,092,
NONINTEREST INCOME:		
Gain on sale of loans	580,169	977,
Service charges and fees on loans	69,713	149,
Deposit-related fees	364,091	256,
Bank-owned life insurance earnings	86,608	97,
Other income, net	44,910	52,
Total noninterest income	1,145,491	1,533,
NONINTEREST EXPENSE:		
Compensation and fringe benefits	2,296,407	2,268,

Occupancy and equipment	824,305	647,
Professional and examination fees	131,221	101,
Advertising	124,981	120,
Real estate owned	432	17,
Other	523,099	462,
Total noninterest expenses	3,900,445	3,618,
Income before income taxes	1,398,746	2,006,
Income tax expense	480,276	619,
Net Income	$ 918,470	$ 1,387,
Net Income Per Share:		
Basic	$ 0.32	$ 0
Diluted	$ 0.32	$ 0
WEIGHTED AVERAGE COMMON SHARES OUTSTANDING:		
Basic	2,855,539	2,844,
Diluted	2,913,184	2,887,

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	
Balance, December 31, 2003	$ 2,849,447	$ 2,638,044	$ 285,251	$
Exercise of stock options	14,000	104,625	--	
Stock traded to exercise options (2,683 shares)	(2,683)	(69,436)		
Other comprehensive loss, net of taxes	--	--	261,605	
Net income	--	--	--	
Cash dividends ($.05 per share)	--	--	--	
Balance, March 31, 2004	$ 2,860,764	$ 2,673,233	$ 546,856	$

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

COOPERATIVE BANKSHARES, INC. AND SUBSIDIARY

CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited)

	Thre
	2004
OPERATING ACTIVITIES:	
Net income	$ 918,470
Adjustments to reconcile net income to net cash provided by operating activities:	
Net accretion, amortization, and depreciation	254,546
Net gain on sale of loans	(580,169
Provision (benefit) from deferred income taxes	(85,420
Loss on sales of foreclosed real estate	--
Valuation losses on foreclosed real estate	--
Provision for loan losses	220,000
Originations of loans held for sale	(34,758,191
Proceeds from sales of loans held for sale	33,410,564
Changes in assets and liabilities:	
Accrued interest receivable	(133,848
Prepaid expenses and other assets	521,329
Accrued interest payable	15,784
Accrued expenses and other liabilities	370,035
Net cash provided by operating activities	153,100
INVESTING ACTIVITIES:	
Purchases of securities available for sale	(5,293,578
Repayments of mortgage-backed securities available for sale	570,274
Repayments of mortgage-backed securities held to maturity	298,353
Loan originations, net of principal repayments	(10,476,022
Proceeds from disposals of foreclosed real estate	--
Net expenditures on foreclosed real estate	--
Net sales (purchases) of FHLB stock	(200,000
Purchases of premises and equipment	(155,229
Net cash used in investing activities	(15,256,202
FINANCING ACTIVITIES:	
Net increase in deposits	9,248,061
Net proceeds (repayments) on short-term borrowings	631,566
Repayments on long-term obligations	(1,247
Proceeds on long-term borrowings	5,000,000
Proceeds from issuance of common stock	46,506
Dividends paid	(143,037
Net change in escrow deposits	97,166
Net cash provided by financing activities	14,879,015
INCREASE IN CASH AND CASH EQUIVALENTS	(224,087
CASH AND CASH EQUIVALENTS:	
BEGINNING OF PERIOD	18,393,365
END OF PERIOD	$ 18,169,278

(Continued)

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

	THREE MONTHS EN MARCH 31,	
	2004	
Cash paid for:		
Interest	$ 2,163,050	$
Income taxes	25,900	
Summary of noncash investing and financing activities:		
Transfer from loans to foreclosed real estate	120,372	
Loans to facilitate the sale of foreclosed real estate	111,725	
Unrealized loss on securities available for sale, net of taxes	261,605	
Reclassifications between long-term obligations and short-term borrowings	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, 2003 (the "Annual Report"). The results of operations for the three-month period ended March 31, 2004 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) is 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 MARCH 31, 2004	2003
Net income (numerator)	$ 918,470	$ 1,387,650
Shares for basic EPS (denominator)	2,855,539	2,844,678
Dilutive effect of stock options	57,645	42,418
Shares for diluted EPS (denominator)	2,913,184	2,887,096

For the periods ended March 31, 2004 and 2003, there were 0 and 4,204 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 months ended March 31.

	THREE MONTHS ENDED MARCH 31, 2004	2003
Net income	$ 918,470	$ 1,387,6
Other comprehensive income (loss):		

Unrealized gain (loss) arising during the period	396,371	(172,4
Income tax benefit (expense)	(134,766)	110,7
Other comprehensive income (loss)	261,605	(61,7
Comprehensive income	$ 1,180,075	$ 1,325,9

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 MARCH 31, 2004	2003
Net income, as reported	$ 918,470	$ 1,387,650
Deduct: Total stock-based employee compensation expense determined under fair value based method for all awards, net of related tax effects	(23,054)	--
Proforma net income	$ 895,416	$ 1,387,650
Earnings per share:		
Basic-as reported	$ 0.32	$ 0.49
Basic-proforma	$ 0.31	$ 0.49
Diluted-as reported	$ 0.32	$ 0.48
Diluted-proforma	$ 0.31	$ 0.48

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 21 offices 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 Virginia corporation and the holding company for CS&L Real Estate Trust, Inc. (the "REIT"), which is a real estate investment trust.

Through its financial centers, the Bank provides a wide range of banking products, including interest-bearing and noninterest-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. The Bank began offering Online Banking and Bill Payment in July 2003. In addition, the Bank also 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

The 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, 2004, approximately $274 million, or 66%, of the Bank's loan portfolio, which excludes loans held for sale, consisted of loans secured by residential properties. This compared to approximately $267 million, or 66% at December 31, 2003. The Bank originates adjustable rate and fixed rate loans. As of March 31, 2004, adjustable rate and fixed rate loans totaled approximately 68 % and 32%, respectively, of the Bank's total loan portfolio.

The Bank has chosen to sell a large 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.

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 exceeds the amount of interest rate sensitive liabilities. Gap is considered negative when the amount of interest rate sensitive liabilities exceeds the amount of interest rate sensitive assets. At March 31, 2004, Cooperative had a one-year positive gap position of 3.1%. During a period of falling interest rates, a positive gap would tend to adversely affect net interest income, while a negative gap would tend to result in an increase in net interest income. During a period of rising interest rates, a positive gap would tend to result in an increase in net interest income while a negative gap would tend to adversely affect net interest income. It is important to note that certain shortcomings are inherent in static gap analysis. Although certain assets and liabilities may have similar maturities or periods of repricing, they may react in different degrees to changes in market interest rates. For example, a part of the Company's adjustable-

rate mortgage loans are indexed to the National Monthly Median Cost of Funds to SAIF-insured institutions. This index is considered a lagging index that may lag behind changes in market rates. The one-year or less interest-bearing liabilities also include checking, savings, and money market deposit accounts. Experience has shown that the Company sees relatively modest repricing on these types of 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 commitment 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.

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, 2004, the Bank's borrowed funds from the FHLB equaled 16.8% of its total assets. Scheduled loan repayments are a relatively predictable source of funds, unlike deposits and loan prepayments that are significantly influenced by general interest rates, economic conditions and competition.

At March 31, 2004, the estimated market value of liquid assets (cash, cash equivalents, marketable securities and loans held for sale) was approximately $78.8 million, which represents 16.7% of deposits and borrowed funds as compared to $71.8 million or 15.7% of deposits and borrowed funds at December 31, 2003. The increase in liquid assets was due to an increase in available for sale securities and loans held for sale.

The Company's primary uses of liquidity are to fund loans and to make investments. At March 31, 2004, outstanding off-balance sheet commitments to extend credit totaled $39.7 million, and the undisbursed portion of construction loans was $45.0 million. Management considers current liquidity levels adequate to meet the Company's cash flow requirements.

CAPITAL

Stockholders' equity at March 31, 2004, was $44.2 million, up 2.5% from $43.1 million at December 31, 2003. Stockholders' equity at March 31, 2004, includes an unrealized gain net of tax of $546,856 as compared to an unrealized gain net of tax at December 31, 2003, of $285,251 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, 2004, the Bank's ratio of Tier I capital was 8.47%. 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, 2004, the Bank had a ratio of qualifying total capital to risk-weighted assets of 11.93%.

The Company, as a bank holding company, is also subject, on a consolidated basis, to the capital adequacy guidelines of the Board of Governors of the Federal Reserve (the "Federal Reserve Board"). The capital requirements of the Federal Reserve Board are similar to those of the FDIC governing the Bank. The Company currently exceeds all of its capital requirements. Management expects the Company to continue to exceed these capital requirements without altering current operations or strategies. On March 14, 2004, the Company's Board of Directors approved a quarterly cash dividend of $.05 per share. The dividend was paid on April 16, 2004 to stockholders of record as of April 1, 2004. 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 policies are those that govern accounting for loans and its allowance for loan losses and goodwill. A critical accounting policy is one that is both very important to the portrayal of the Company's financial condition and results, and requires a difficult, subjective or complex judgment by management. 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 "Critical Accounting Policy" and the "Financial Condition" in Management's Discussion and Analysis and Note 3 of "Notes to Consolidated Financial Statements" included in the Annual Report. For further information on goodwill, see the "Critical Accounting Policy" in Management's Discussion and Analysis and Note 13 of "Notes to Consolidated Financial Statements" included in the Annual Report.

FINANCIAL CONDITION AT MARCH 31, 2004 COMPARED TO DECEMBER 31, 2003

The Company's total assets increased 3.3% to $518.9 million at March 31, 2004, as compared to $502.4 million at December 31, 2003. The major change in the assets was an increase of $10.4 million (2.6%) in loans, which was funded primarily by an increase in deposits of $9.2 million (2.5%). The increase in loans and deposits was a result of opening new branches. The Bank increased securities available for sale by $5.1 million (11.7%) and loans held for sale by $1.9 million (30.3%). The security purchase was funded by an advance 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. Loans held for sale are funded by a short-term borrowing at another financial institution. This loan increased $1.5 million since December 31, 2003 and is collateralized by the loans held for sale.

The Company's nonperforming assets (loans 90 days or more delinquent and foreclosed real estate) were $220,000, or 0.04% of assets, at March 31, 2004, compared to $267,000, or 0.05% of assets, at December 31, 2003. The Bank did not own any foreclosed real estate at March 31, 2004, or December 31, 2003. The Company assumes an aggressive position in collecting delinquent loans and disposing of foreclosed assets to minimize balances of nonperforming assets and continues to evaluate the loan and real estate portfolios to provide loss reserves as considered necessary. For further information see "Comparison of Operating Results - Provision and Reserve for Loan Losses".

COMPARISON OF OPERATING RESULTS

OVERVIEW

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

NET INCOME

Net income for the three-month period ended March 31, 2004, of $918,000 represents a 33.8% decrease as compared to the same period last year. The decrease in net income for the period ended March 31, 2004 can be attributed to a decrease in noninterest income of $388,000 and an increase in noninterest expense of $282,000.

INTEREST INCOME

For the three-month period ended March 31, 2004, interest income decreased 9.3% as compared to the same period a year ago. The average balance of interest-earning assets increased 0.1% but the average yield decreased 58 basis points as compared to the same period a year ago. The yield on average interest-earning assets decreased to 5.51% as compared to 6.09% for the same period a year ago which caused the negative impact on interest income.

INTEREST EXPENSE

Interest expense decreased 25.6% for the three-month period ended March 31, 2004, as compared to the same period a year ago. This decrease was due to the average cost of interest-bearing liabilities decreasing 64 basis points as compared to the same period a year ago. In addition, the average balance of interest-bearing liabilities decreased

1.9% as compared to the same period a year ago. The cost of interest-bearing liabilities decreased to 2.03% as compared to 2.67% for the same period last year.

NET INTEREST INCOME

Net interest income for the three-month period ended March 31, 2004, as compared to the same period a year ago, increased 1.9%. The increase was due to a decrease in interest-bearing liabilities versus an increase in interest-earning assets. There was also a larger decrease in the cost of liabilities, versus the yield on assets. This can be attributed to the Bank's success in obtaining both low and no cost deposits. See "Average Yield/Cost Analysis" table for further information on interest income and interest expense.

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 end			
	March 31, 2004			
(Dollars in thousands)	Average Balance	Interest	Average Yield/ Cost	Averag Balanc
Interest-earning assets:				
Interest-bearing deposits in other banks	$4,432	$ 10	0.90%	$ 3,55
Securities:				
Available for sale	46,512	512	4.40%	40,33
Held to maturity	3,749	50	5.33%	7,78
FHLB stock	4,133	36	3.48%	4,12
Loan portfolio	416,469	5,945	5.71%	418,89
Total interest-earning assets	475,295	6,553	5.51%	474,69
Non-interest earning assets	25,629			26,26
Total assets	$500,924			$500,96
Interest-bearing liabilities:				
Deposits	344,086	1,507	1.75%	344,87
Borrowed funds	86,052	672	3.12%	93,47
Total interest-bearing liabilities	430,138	$2,179	2.03%	438,35
Non-interest bearing liabilities	29,868			23,77
Total liabilities	460,006			462,12
Stockholders' equity	40,918			38,83
Total liabilities and stockholders' equity	$500,924			$500,96
Net interest income		$4,374		
Interest rate spread			3.48%	
Net yield on interest-earning assets			3.68%	
Percentage of average interest-earning assets to average interest-bearing liabilities			110.50%	

PROVISION AND RESERVE FOR LOAN LOSSES

During the three-month period ended March 31, 2004 the Bank had net charge-offs against the allowance for loan losses of $28,000 compared to $140,000 for the same period in 2003. This decrease was primarily due to one credit relationship being charged off during the first quarter of 2003. The Bank added $220,000 to the allowance for loan

losses for the current three-month period increasing the balance to $3.6 million at March 31, 2004. This brings the ratio of allowance for loan losses to total loans up to .86% at March 31, 2004 as compared to .84% at December 31, 2003. This percentage continues to rise because of the increase in retail banking loans in the Bank's portfolio. Management considers the current level of the allowance to be appropriate based on loan composition, the current level of delinquencies and other nonperforming 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 decreased by 25.3% for the three-month period ended March 31, 2004, as compared to the same period a year ago. The change in noninterest income can be attributed to gain on sale of loans and service charges and fees on loans decreasing $397,000 and $79,000 respectively. These changes were primarily caused by a reduction in mortgage banking activities caused by lower refinancing activities. Deposit related fees increased $107,000 primarily due to a new service the Bank offered beginning in April 2003 for checking accounts with non-sufficient funds.

NONINTEREST EXPENSE

For the three-month period ended March 31, 2004, noninterest expense increased 7.8% as compared to the same period last year. Occupancy and equipment and other expense increased $176,000 and $61,000 respectively, which was primarily caused by the opening of four new branches since May of 2003.

INCOME TAXES

The effective tax rate for the three-month periods ended March 31, 2004 and 2003, was 34.3% and 30.9% respectively. The lower rate in 2003 was the result of the formation of Holdings and the REIT in December 2002, which caused an adjustment to taxes.

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, 2003.

ITEM 4 - CONTROLS AND PROCEDURES

As of the end of the period covered by this report, management of the Company carried out an evaluation, under the supervision and with the participation of the Company's principal executive officer and principal financial officer, of the effectiveness of the Company's disclosure controls and procedures. Based on this evaluation, the Company's principal executive officer and principal financial officer concluded that the Company's disclosure controls and procedures are effective in ensuring that information required to be disclosed by the Company in reports that it files or submits under the Securities Exchange Act of 1934, as amended, is recorded, processed, summarized and reported, within the time periods specified in the Securities and Exchange Commission's rules and forms. It should be noted that the design of the Company's disclosure controls and procedures is based in part upon certain

reasonable assumptions about the likelihood of future events, and there can be no reasonable assurance that any design of disclosure controls and procedures will succeed in achieving its stated goals under all potential future conditions, regardless of how remote, but the Company's principal executive and financial officers have concluded that the Company's disclosure controls and procedures are, in fact, effective at a reasonable assurance level.

There have been no changes in the Company's internal control over financial reporting (to the extent that elements of internal control over financial reporting are subsumed within disclosure controls and procedures) identified in connection with the evaluation described in the above paragraph that occurred during the Company's last fiscal quarter, that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting.

PART II - OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

Not applicable

ITEM 2. CHANGES IN SECURITIES, USE OF PROCEEDS AND ISSUER PURCHASES OF EQUITY SECURITIES

(a) Not applicable

(b) Not applicable

(c) Not applicable

(d) Not applicable

(e) 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 31.1 Rule 13a-14(a) Certification of Chief Executive Officer

Exhibit 31.2 Rule 13a-14(a) Certification of Chief Financial Officer

Exhibit 32 Certificate Pursuant to 18 U.S.C. Section 1350

(b) Reports on Form 8-K

The Company filed a Current Report on Form 8-K dated January 28, 2004 to report fiscal year 2003 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: May 12, 2004

Cooperative Bankshares, Inc.

/s/ Frederick Willetts, III

Frederick Willetts, III
President/Chief Executive Officer

Dated: May 12, 2004

/s/ Todd L. Sammons

Todd L. Sammons
Senior Vice President/Chief
Financial Officer