CORNERSTONE BANK

2002 Annual Report

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Cornerstone Bank Web Address: www.thecornerstonebank.com

For stock transfers and change of address on shares owned please contact our Stock Transfer Agent

First-Citizens Bank & Trust
Corporate Trust Dept.
100 East Tryon Road
Raleigh, NC 27603
1-877-685-0576

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Dear Stockholders,

Despite bad news from various economic fronts, we are able to report a remarkable year of growth for your bank.

First, the environment in which we competed, followed by some reasons for our success:

- The past year featured a third straight year of stock market declines, and some of the most distressing economic news since 1941.
- Major corporations, such as Enron and WorldCom, were exposed for fraud.
- Interest rates were cut again, and again, shrinking profit margins for banks.
- Consumer confidence hit lows not seen within the past decade.

And yet...

- We completed five consecutive quarters of profitability.
- Cornerstone Bank rewarded stockholders with a 10% stock dividend early last year.
- The bank successfully completed a secondary stock offering in the middle of the year to enhance its capital position and to be in a sound position for growth within the market.
- We grew our market share in Wilson County 66%, gaining to 7.74%. The significance of those numbers are this: every bank in our market either lost market share or stayed flat, except Cornerstone, and overall deposits in the market grew 2.99%.
- We know where it went.
    - Our assets are now at $80 million ($75.5 million at year-end).
    - We closed $52 million in real estate mortgage transactions.
    - We beat our original three-year business plan at 106% above in profits, 33% above in loans, 22% above in deposits, and 28% above in assets.

Above all, we met the promise of being Wilson's hometown bank...with hometown bankers and the same familiar faces each day, being confident, experienced, and knowledgeable about the banking needs of the area. It is a bank where humans answer phone calls, where customers are called by name, and where decisions are made promptly and fairly, with no out-of-town second-guessing.

No longer is Cornerstone Bank a start-up bank. It is an established bank, and well respected among its peers. While most new banks see profitability in three years, Cornerstone accomplished that in half the time. While stocks nationwide are down, Cornerstone's is up. While area banks lost market share, Cornerstone gained. While consumer confidence nationwide is down, the future of Cornerstone is especially bright.

We say that because after completing the original three-year business plan, we now are putting together a new long-term strategic plan, one that focuses on being a shareholder rewarding, locally owned and locally managed community bank. While growth will be obvious, there are no great aspirations for becoming a regional bank, a mega bank, or an international bank. We believe that rewarding shareholder trust on a meaningful and continuing basis in the future will allow us to continue providing our markets with a valuable asset.

The reason for the bank's success, backed up by the numbers that follow in this report, is quite simple that the bank and its customers are in touch. They speak the same language. Bank officers anticipate financial needs (rather than reacting to needs), and work hard, everyday, at doing the little things that were lost by other companies. Instead, this bank does things right (you expect that from a bank) and this bank does the right things. That is evident in a pricing structure that is fair to our customers...and the bank.

Besides the one-to-one banking inside the office, Cornerstone provides customer access around the clock, around the world. Toll-free phone lines and user-friendly Internet banking options are constantly available. Customers and the bank are in touch.

Does that matter? The growing list of transactions each day indicates that it does. The employees who opened this bank three years ago are still here, and that also proves that things are right. Plus, the directors who had the foresight to build this bank are still very much visible in the foundation.

There are many uncertainties in the world these days, with the economy stalled and the threat of war and terrorism. But we remain optimistic about the future. Your bank is stronger than ever and we are excited about the future. Aren't you glad you can count on your bank? Come share our optimism, and visit our bank. You can see for yourself.

Sincerely,

Thomas E. Brown III
Chairman of the Board of Directors

Norman B. Osborn
President & CEO

The selected financial information and other data presented below has been derived, in part, from the audited financial statements of the Bank. The selected financial information and other data should be read in conjunction with the financial statements and notes thereto presented elsewhere herein.

	At or for the Periods Ended December 31,		
	2002	2001	2000
	(Dollars in thousands, except per share data)		
Operating Data:			
Total interest income	$ 3,640	$ 2,792	$ 999
Total interest expense	1,534	1,557	512
Net interest income	2,106	1,235	487
Provision for loan losses	391	367	244
Net interest income after provision for loan losses	1,715	868	243
Total non-interest income	782	305	147
Total non-interest expense	1,969	1,542	1,116
Net income (loss)	$ 528	$ (369)	$ (726)
Per Common Share Data:			
Earnings per share - basic and diluted	$ 0.73	$ (0.56)	$ (1.10)
Book value	9.07	7.69	8.30
Selected Year-End Balance Sheet Data:			
Loans	$ 58,649	$ 38,292	$ 16,359
Allowance for loan losses	845	523	244
Other earning assets	13,229	11,761	10,448
Total assets	74,974	54,173	29,235
Deposits	65,519	48,885	23,610
Borrowings	1,250	-	-
Shareholders' equity	7,909	5,078	5,485
Selected Average Balances:			
Total assets	$ 65,526	$ 41,068	$ 17,542
Loans	48,896	28,668	8,098
Total interest-earning assets	62,098	38,256	16,198
Deposits	58,210	35,397	11,736
Total interest-bearing liabilities	54,503	32,998	10,415
Shareholders' equity	6,014	5,485	5,740
Selected Performance Ratios:			
Return on average assets	0.81%	(0.90%)	(1.34%)
Return on average equity	8.78%	(6.73%)	(4.39%)
Net interest margin	3.39%	3.23%	4.72%
Non-interest expense to average assets	3.00%	3.77%	6.23%
Asset Quality Ratios:			
Allowance for loan losses to period-end loans	1.44%	1.37%	1.49%
Net loan charge-offs to average loans	0.14%	0.31%	-%
Capital Ratios:			
Total risk-based capital	14.63%	13.62%	29.00%
Tier 1 risk-based capital	13.39%	12.37%	27.70%
Leverage ratio	10.63%	10.00%	19.90%
Equity to assets	10.55%	9.37%	18.76%
Average equity to average assets	9.18%	13.36%	32.72%

The following discussion and analysis is presented to assist readers in understanding Cornerstone Bank's financial condition and results of operations for the years ended December 31, 2002 and 2001. You should read this discussion and the related financial data in conjunction with the audited financial statements and the related footnotes, which are included elsewhere in this Annual Report. All references in this Annual Report to net income per share, price per share, book value per share and weighted average common and common equivalent shares outstanding have been adjusted to reflect an eleven-for-ten stock split effected in the form of a 10% stock dividend issued in 2002.

DESCRIPTION OF BUSINESS

Cornerstone Bank ("Cornerstone" or the "Bank"), a North Carolina chartered banking corporation, opened for business on March 15, 2000. Cornerstone presently operates one full-service banking office located at 3710 Nash Street North, Wilson, North Carolina. The Bank's lending activities are oriented to the consumer/retail customer as well as to the small-to-medium sized businesses located in Wilson County. The Bank offers the standard complement of commercial, consumer, and mortgage lending products, as well as the ability to structure products to fit specialized needs. The deposit services offered by the Bank include business and personal checking, savings account and certificates of deposit. The Bank intends to focus on customer relationships in building its deposit base and to compete aggressively for transaction accounts.

FINANCIAL CONDITION
December 31, 2002 and 2001

During 2002 the Bank achieved very strong growth, ending the year with total assets of $75.0 million, an increase of $20.8 million or 38% from the beginning of year total assets of $54.2 million. The growth in total assets was funded primarily by inflows of customer deposits, which increased by $16.6 million or 34% to $65.5 million, up from $48.9 million at December 31, 2001. Other sources of funding for asset growth included net proceeds from a successful secondary stock offering of $2.2 million, borrowings of $1.3 million and net income. Total loans receivable grew by $20.3 million and closed the year at $58.6 million, an increase of 53% from total loans receivable at December 31, 2001. Liquid investments, consisting of cash and due from banks, interest-earning deposits in other banks, federal funds sold, time deposits and investment securities available for sale, totaled $15.0 million, or 20% of total assets, at December 31, 2002, representing an increase of $600,000 over the beginning of year total of $14.4 million. Total stockholders' equity increased from $5.1 million at December 31, 2001 to $7.9 million at December 31, 2002 as a result of retention of net income of $528,000 and the sale of 211,044 shares of common stock, which generated net proceeds of $2.2 million. At December 31, 2002, the Bank's capital exceeds the levels that are deemed to be "well-capitalized" under applicable regulatory capital requirements.

RESULTS OF OPERATIONS
For the Years Ended December 31, 2002 and 2001

Overview. The Bank earned net income of $528,000 or $.73 per share for the year ended December 31, 2002, as compared with a net loss of $369,000 or $.56 per share for 2001. This improvement of $897,000 or $1.29 per share in net operating results was principally attributable to an increase in net interest income that resulted from asset growth from period to period and to a much higher level of non-interest income. Net interest income after the provision for loan losses increased by $846,000, from $868,000 for the year ended December 31, 2001 to $1.7 million for the year ended December 31, 2002. Non-interest income for the same year grew by $478,000, from $305,000 to $783,000, more than offsetting an increase of $427,000 in non-interest expenses from $1.5 million for 2001 to $2.0 million for the year ended December 31, 2002.

Net Interest Income. Like most financial institutions, the primary component of earnings for the Bank is net interest income. Net interest income is the difference between interest income, principally from loan and investment securities portfolios, and interest expense, principally on customer deposits and borrowings. Changes in net interest income result from changes in volume, spread and margin. For this purpose, volume refers to the average dollar level of interest-earning assets and interest-bearing liabilities, spread refers to the difference between the average yield on interest-earning assets and the average cost of interest-bearing liabilities, and margin refers to net interest income divided by average interest-earning assets. Margin is influenced by the level and relative mix of interest-earning assets and interest-bearing liabilities, as well as by levels of non-interest bearing liabilities and capital. The rates earned on a significant portion of the Bank's loans adjust immediately when index rates such as the prime rate change. Conversely, most interest-bearing liabilities, including certificates of deposit and borrowings, have rates fixed until maturity. As a result, interest rate reductions will generally result in an immediate drop in the Bank's interest income on loans, with a more delayed impact on interest expense because reductions in interest costs will only occur upon renewals of certificates of deposit or borrowings.

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Net interest income increased to $2.1 million for the year ended December 31, 2002, an $871,000 or 71% increase from the $1.2 million earned in 2001. Total interest income benefited from strong growth in the level of average earning assets, which offset lower asset yields caused by the dramatic trend of declining interest rates throughout the period. The reduced level of interest rate yields resulted from the dramatically declining trend in interest rates that occurred during 2001, with a slower declining trend in 2002. Rates paid by the Bank on deposits have continuously declined, while many of the Bank's adjustable rate loans have interest rate floors that limit downward adjustment. As a result, the decrease in the average rate paid on interest-bearing deposits during 2002 was greater than the decrease in the average rate earned on interest-earning assets. Average total interest-earning assets increased by $23.8 million or 62% during the year ended December 31, 2002 as compared to the year ended December 31, 2001, while the average interest rate earned dropped by 144 basis points from 7.30% to 5.86%. Average total interest-bearing liabilities increased by $21.5 million, consistent with the increase in interest-earning assets, and yielded a 191 basis point decrease in average cost, from 4.72 % during 2001 to 2.81% in for 2002. For the year ended December 31, 2002, the interest rate spread was 3.05%, a 47 basis point improvement from the year ended December 31, 2001 interest rate spread of 2.58%.

Provision for Loan Losses. The Bank recorded a $391,000 provision for loan losses in 2002, representing an increase of $24,000 over the $367,000 provision made in 2001. Provisions for loan losses are charged to income to bring the allowance for loan losses to a level deemed appropriate by management. In evaluating the allowance for loan losses, management considers factors that include growth, composition and industry diversification of the portfolio, historical loan loss experience, current delinquency levels, adverse situations that may affect a borrower's ability to repay, estimated value of any underlying collateral, prevailing economic conditions and other relevant factors. In both 2002 and 2001, the provision for loan losses was made principally in response to growth in loans, as total loans outstanding increased by $20.3 million in 2002 and by $21.9 million in 2001. Net loan charge-offs were $69,000 in 2002 and $88,000 in 2001. At December 31, the allowance for loan losses was $845,000 for 2002 and $523,000 for 2001, representing 1.44% and 1.37%, respectively, of loans outstanding. At December 31, 2002, loans delinquent more than 90 days amounted to $25,000. Interest income that would have been recorded on nonaccrual loans totaled $1,000 for the year ended December 31, 2002. There were no nonperforming loans at December 31, 2001.

Non-Interest Income. Non-interest income grew by $478,000, from $305,000 for 2001 to $783,000 for 2002. Service fees and charges, which represent a relatively stable and predictable source of non-interest income, totaled $170,000 for 2002 as compared with $101,000 of service fees and charges earned in 2001. The most significant source of the increase in non-interest income in 2002 was from the Bank's mortgage operations. Through associations with certain mortgage lending companies, the Bank originates a full range of competitively priced residential and commercial long-term mortgages, at both fixed and variable rates, earning fees for loans originated. Because the Bank originates these mortgages, the Bank's customers receive personal face-to-face service from the Bank's employees, rather than dealing with third parties. Mortgage loan originations have increased substantially because of the favorable interest rate market. As a result, the Bank had income from mortgage operations of $586,000 during 2002, an increase of $403,000 from the $183,000 earned during the year ended December 31, 2001. The Bank's management will continue efforts to develop sources of additional non-interest income.

Non-Interest Expenses. Non-interest expenses totaled $2.0 million for the year ended December 31, 2002, an increase of $427,000 from the total of $1.5 million for the year ended December 31, 2001. Approximately $150,000 of this increase in non-interest expenses was attributable to the addition of personnel to support the Bank's mortgage operations. The balance of this increase is attributable to the Bank's growth from period to period. The Bank's total assets averaged $65.5 million during 2002, an increase of $24.4 million, or 59%, over the 2001 average of $41.1 million. Net interest income increased by 71% and non-interest income increased by 157% - in both instances higher than the rate of growth in total assets. In comparison, total non-interest expenses for the year ended December 31, 2002 increased by 28%, a significantly lower percentage increase than those applicable to asset growth and revenues. The Bank's plan for 2003 calls for continued asset growth, and management expects that growth in revenues will continue to exceed increases in non-interest costs and expenses until the Bank adds one or more new branches.

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Income Taxes. The Bank recorded no income tax expense for the year ended December 31, 2002, despite having income before income taxes, because of recognition of previously generated deferred tax assets.

NET INTEREST INCOME

Like most financial institutions, the primary component of earnings for the Bank is net interest income. Net interest income is the difference between interest income, principally from loan and investment securities portfolios, and interest expense, principally on customer deposits and borrowings. Changes in net interest income result from changes in volume, spread and margin. For this purpose, volume refers to the average dollar level of interest-earning assets and interest-bearing liabilities, spread refers to the difference between the average yield on interest-earning assets and the average cost of interest-bearing liabilities, and margin refers to net interest income divided by average interest-earning assets and is influenced by the level and relative mix of interest-earning assets and interest-bearing liabilities, as well as levels of noninterest-bearing liabilities. The following table sets forth, for the periods indicated, information with regard to average balances of assets and liabilities, as well as the total dollar amounts of interest income from interest-earning assets and interest expense on interest-bearing liabilities, resultant yields or costs, net interest income, net interest spread, net interest margin and ratio of average interest-earning assets to average interest-bearing liabilities. Nonaccrual loans have been included in determining average loans.

	Year Ended December 31, 2002			Year Ended December 31, 2001		
	Average balance	Interest Income/ Expense	Yield/ Cost	Average balance	Interest Income/ Expense	Yield/ Cost
			(Dollars in thousands)			
Interest-earning assets:						
Loans	$ 48,896	$ 3,159	6.46%	$ 28,668	$ 2,298	8.02%
Investment securities [1]	9,737	437	4.49%	4,951	328	6.62%
Other interest-earning assets	3,465	44	1.27%	4,637	166	3.58%
Total interest-earning assets	62,098	3,640	5.86%	38,256	2,792	7.30%
Other assets	3,428			2,812		
Total assets	$ 65,526			$ 41,068		
Interest-bearing liabilities:						
Deposits:						
Savings, NOW and money market	$ 28,454	589	2.07%	$ 13,951	441	3.16%
Time deposits over $100,000	10,466	383	3.66%	4,560	253	5.55%
Other time deposits	15,004	540	3.60%	14,458	862	5.96%
Borrowings	579	22	3.80%	29	1	3.45%
Total interest-bearing liabilities	54,503	1,534	2.81%	32,998	1,557	4.72%
Noninterest-bearing deposits	4,286			2,428		
Other liabilities	723			157		
Stockholders' equity	6,014			5,485		
Total liabilities and stockholders' equity	$ 65,526			$ 41,068		
Net interest income/interest rate spread		$ 2,106	3.05%		$ 1,235	2.58%
Net interest margin			3.39%			3.23%
Ratio of interest-earning assets to interest-bearing liabilities	113.94%			115.93%		

[1] Includes time deposits, investment securities available for sale and stock in FHLB.

RATE/VOLUME ANALYSIS

The following table analyzes the dollar amount of changes in interest income and interest expense for major components of interest-earning assets and interest-bearing liabilities. The table distinguishes between (i) changes attributable to volume (changes in volume multiplied by the prior period's rate), (ii) changes attributable to rate (changes in rate multiplied by the prior period's volume), and (iii) net change (the sum of the previous columns). The change attributable to both rate and volume (changes in rate multiplied by changes in volume) has been allocated equally to both the changes attributable to volume and the changes attributable to rate.

	Years Ended December 31, 2002 vs. 2001		
	Increase (Decrease) Due to		
	Volume	Rate	Total
	(Dollars in thousands)		
Interest income:			
Loans	$ 1,464	$ (603)	$ 861
Investment securities	266	(157)	109
Other interest-earning assets	(28)	(94)	(122)
Total interest income	1,702	(854)	848
Interest expense:			
Deposits			
Savings, NOW and money market	379	(231)	148
Time deposits over $100,000	272	(142)	130
Other time deposits	26	(348)	(322)
Borrowings	20	1	21
Total interest expense	697	(720)	(23)
Net interest income increase (decrease)	$ 1,005	$ (134)	$ 871

LOAN PORTFOLIO

The Bank's primary source of revenue is interest and fee income from its lending activities. These lending activities consist principally of originating commercial operating and working capital loans, residential mortgage loans, home equity lines of credit, other consumer loans and loans secured by commercial real estate. The Bank's current lending strategy is to fully serve its deposit customers, including all market segments, and to establish greater market share throughout Wilson County.

Total loans, net of the allowance for loan losses and net deferred loan origination fees, at December 31, 2002, were $57.8 million compared to $37.8 million at December 31, 2001, an increase of 53%. The Bank has a diversified loan portfolio with no significant concentrations to any one borrower or industry. The amounts of loans outstanding at December 31, 2002, by category, are shown in Note D to the financial statements included elsewhere herein.

LIQUIDITY

"Liquidity" refers to the ability of the Bank to fund loans, withdrawals and maturities of deposits, and other cash outflows in a cost effective manner. The Bank's principal sources of liquidity are deposits, scheduled payments and prepayments of loan principal, maturities of investment securities, access to liquid deposits, and funds provided by operations. While scheduled loan payments and maturing investments are relatively predictable sources of funds, deposit flows and loan prepayments are greatly influenced by general interest rates, economic conditions and competition.

Liquid assets (consisting of cash and due from banks, interest-earning deposits with other banks, federal funds sold, time deposits and investment securities classified as available for sale) comprised 20% and 27% of the Bank's total assets at December 31, 2002 and 2001, respectively.

The Bank has been a net seller of federal funds, as its liquidity has exceeded its need to fund new loan demand. Should the need arise, the Bank would have the capability to sell securities classified as available for sale or to borrow funds as necessary. The Bank has established credit lines with other financial institutions to purchase up to $4.0 million in federal funds. As a member of the Federal Home Loan Bank of Atlanta, Cornerstone may obtain longer-term advances up to 10% of its assets. As of December 31, 2002, there was $1.3 million outstanding under this line of credit.

Total deposits were $65.5 million and $48.9 million at December 31, 2002 and 2001, respectively. Time deposits, which are the only deposit accounts that have stated maturity dates, are generally considered to be rate sensitive. Time deposits represented 47% and 43%, respectively, of total deposits at December 31, 2002 and 2001. Time deposits of $100,000 or more represented 19% and 18%, respectively, of the Bank's total deposits at December 31, 2002 and 2001. At December 31, 2002, the Bank had $3.0 million in brokered time deposits. Management believes most other time deposits are relationship-oriented. While the Bank will need to pay competitive rates to retain these deposits at their maturities, there are other subjective factors that will determine their continued retention. Based upon prior experience, the Bank anticipates that a substantial portion of outstanding certificates of deposit will renew upon maturity.

At December 31, 2002 (and at all times during the years presented in this report), the Bank's management believes that its liquidity sources, including unused lines of credit, were at an acceptable level and remained adequate to meet its operating needs.

CAPITAL

A significant measure of the strength of a financial institution is its capital base. Federal regulators have classified and defined capital into the following components: (1) Tier I capital, which includes common stockholders' equity and qualifying preferred equity, and (2) Tier II capital, which includes a portion of the allowance for loan losses, certain qualifying long-term debt and preferred stock which does not qualify as Tier I capital. Minimum capital levels are regulated by risk-based capital adequacy guidelines which require a financial institution to maintain capital as a percent of its assets and certain off-balance sheet items adjusted for predefined credit risk factors (risk-adjusted assets). A financial institution is required to maintain, at a minimum, Tier I capital as a percentage of risk-adjusted assets of 4.0% and combined Tier I and Tier II capital as a percentage of risk-adjusted assets of 8.0%. In addition to the risk-based guidelines, federal regulations require that we maintain a minimum leverage ratio (Tier I capital as a percentage of tangible assets) of 4.0%. The Bank had an equity to assets ratio of 10.55 % at December 31, 2002. As the following table indicates, at December 31, 2002, the Bank exceeded regulatory capital requirements.

	At December 31, 2002		
	Actual Ratio	Minimum Requirement	Well-Capitalized Requirement
Total risk-based capital ratio	14.63%	8.00%	10.00%
Tier 1 risk-based capital ratio	13.39%	4.00%	6.00%
Leverage ratio	10.63%	4.00%	5.00%

Management expects that the Bank will remain "well-capitalized" for regulatory purposes, although there can be no assurance that additional capital will not be required in the near future due to greater-than-expected growth, or otherwise.

CRITICAL ACCOUNTING POLICY

The Bank's discussion and analysis of its financial condition and results of operations are based upon its financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States. The preparation of these financial statements requires the Bank to make estimates and judgments regarding uncertainties that affect the reported amount of assets, liabilities, revenues and expenses. On an ongoing basis, the Bank evaluates its estimates that are based upon historical experience and other assumptions believed to be reasonable under the circumstances. Actual results may differ from these estimates under different assumptions or conditions.

The Bank's most significant accounting policy is the determination of its allowance for loan losses. Cornerstone records provisions for loan losses based upon known problem loans and estimated deficiencies in the existing loan portfolio. The Bank's methodology for determining the level of its allowance for loan losses consists of two key components, which are a specific allowance for identified problem or impaired loans and a formula allowance for the remainder of the portfolio.

Identified problem and impaired loans are measured for impairment based on the present value of expected future cash flows discounted at the loan's effective interest rate, the loan's observable market price or the fair value of the collateral, if the loan is collateral dependent. This evaluation is inherently subjective as it requires material estimates that may be susceptible to significant change. The adequacy of the allowance is also reviewed by management based upon its evaluation of then-existing economic and business conditions affecting the key lending areas of the Bank and other conditions, such as new loan products, collateral values, loan concentrations, changes in the mix and volume of the loan portfolio; trends in portfolio credit quality, including delinquency and charge-off rates; and current economic conditions that may affect a borrower's ability to repay. Although management believes it has established and maintained the allowance for loan losses at appropriate levels, future adjustments may be necessary if economic and other conditions differ substantially from the current operating environment.

A summary of the Bank's significant accounting policies is set forth in Note B to the financial statements.

RECENT ACCOUNTING PRONOUNCEMENTS

In June 2002, the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standards ("SFAS") No. 146, Accounting for Costs Associated with Exit or Disposal Activities. This statement addresses financial accounting and reporting for costs associated with exit or disposal activities and supersedes Emerging Issues Task Force ("EITF") Issue No. 94-3, Liability Recognition for Certain Employee Termination Benefits and Other Costs to Exit an Activity (including Certain Costs Incurred in a Restructuring). A liability for a cost associated with an exit or disposal activity shall be recognized and measured initially at its fair value in the period in which the liability is incurred, except for certain qualifying employee termination benefits. SFAS No. 146 will be effective for exit or disposal activities initiated by the Bank after December 31, 2002. This statement is not expected to have a material impact on the Bank's financial statements upon adoption.

ASSET/LIABILITY MANAGEMENT

The Bank's results of operations depend substantially on its net interest income. Like most financial institutions, the Bank's interest income and cost of funds are affected by general economic conditions and by competition in the market place.

The purpose of asset/liability management is to provide stable net interest income growth by protecting the Bank's earnings from undue interest rate risk, which arises from volatile interest rates and changes in the balance sheet mix, and by managing the risk/return relationships between liquidity, interest rate risk, market risk, and capital adequacy. The Bank maintains, and has complied with, a Board approved asset/liability management policy that provides guidelines for controlling exposure to interest rate risk by utilizing the following ratios and trend analysis: liquidity, equity, volatile liability dependence, portfolio maturities, maturing assets and maturing liabilities. The Bank's policy is to control the exposure of its earnings to changing interest rates by generally endeavoring to maintain a position within a narrow range around an "earnings neutral position," which is defined as the mix of assets and liabilities that generate a net interest margin that is least affected by interest rate changes.

When suitable lending opportunities are not sufficient to utilize available funds, the Bank has generally invested such funds in securities, primarily U.S. Treasury securities, securities issued by governmental agencies, mortgage-backed securities and corporate obligations. The securities portfolio contributes to the Bank's profits and plays an important part in the overall interest rate management. However, management of the securities portfolio alone cannot balance overall interest rate risk. The securities portfolio must be used in combination with other asset/liability techniques to actively manage the balance sheet. The primary objectives in the overall management of the securities portfolio are liquidity, safety yield, asset/liability management (interest rate risk), and investing in securities that can be pledged for public deposits.

In reviewing the needs of the Bank with regard to proper management of its asset/liability program, the Bank's management estimates its future needs, taking into consideration historical periods of high loan demand and low deposit balances, estimated loan and deposit increases (due to increased demand through marketing), and forecasted interest rate changes.

The analysis of an institution's interest rate gap (the difference between the repricing of interest-earning assets and interest-bearing liabilities during a given period of time) is a standard tool for the measurement of exposure to interest rate risk. The following table sets forth the amounts of interest-earning assets and interest-bearing liabilities outstanding at December 31, 2002, which are projected to reprice or mature in each of the future time periods shown. Except as stated below, the amounts of assets and liabilities shown that reprice or mature within a particular period were determined in accordance with the contractual terms of the assets or liabilities. Loans with adjustable rates are shown as being due at the end of the next upcoming adjustment period. Money market deposit accounts and negotiable order of withdrawal or other transaction accounts are assumed to be subject to immediate repricing and depositor availability and have been placed in the shortest period. In making the gap computations, none of the assumptions sometimes made regarding prepayment rates and demand deposit retention rates have been used for any interest-earning assets or interest-bearing liabilities. In addition, the table does not reflect scheduled principal payments which will be received throughout the lives of the loans. The interest rate sensitivity of the Bank's assets and liabilities illustrated in the following table would vary substantially if different assumptions were used or if actual experience differs from that indicated by such assumptions.

	Terms to Repricing at December 31, 2002				
	1 Year or Less	More Than 1 Year to 3 Years	More Than 3 Years to 5 Years	More Than 5 Years	Total
	(Dollars in thousands)				
Interest-earning assets:					
Loans:					
Variable rate	$ 44,536	$ -	$ -	$ -	$ 44,536
Fixed rate	3,527	2,173	8,160	253	14,113
Securities available for sale	1,534	2,077	1,009	5,570	10,190
Other interest-earning assets	3,039	-	-	146	3,185
Total interest-earning assets	$ 52,636	$ 4,250	$ 9,169	$ 5,969	$ 72,024
Interest-bearing liabilities:					
Deposits:					
Savings, NOW and money market	$ 31,797	$ -	$ -	$ -	$ 31,797
Time over $100,000	7,594	2,339	2,044	211	12,188
Other time	7,725	7,164	2,548	-	17,437
Borrowings	-	-	-	1,250	1,250
Total interest-bearing liabilities	$ 47,116	$ 9,503	$ 4,592	$ 1,461	$ 62,672
Interest sensitivity gap per period	$ 5,520	$ (5,253)	$ 4,577	$ 4,508	$ 9,352
Cumulative interest sensitivity gap	$ 5,520	$ 267	$ 4,844	$ 9,352	$ 9,352
Cumulative gap as a percentage of total interest-earning assets	7.66%	0.37%	6.73%	12.98%	12.98%
Cumulative interest-earning assets as a percentage of interest-bearing liabilities	111.72%	100.47%	107.91%	114.92%	114.92%

ASSET QUALITY AND THE ALLOWANCE FOR LOAN LOSSES

The financial statements are prepared on the accrual basis of accounting, including the recognition of interest income on its loan portfolio, unless a loan is placed on a nonaccrual basis. Loans are placed on a nonaccrual basis when there are serious doubts about the collectibility of principal or interest. Amounts received on nonaccrual loans generally are applied first to principal and then to interest only after all principal has been collected. Restructured loans are those for which concessions, including the reduction of interest rates below a rate otherwise available to that borrower or the deferral of interest or principal, have been granted due to the borrower's weakened financial condition. Interest on restructured loans is accrued at the restructured rates when it is anticipated that no loss of original principal will occur. The Bank had $25,000 in nonaccrual loans, but no restructured or impaired loans at December 31, 2002. The Bank had no nonaccrual, restructured or impaired loans at December 31, 2001.

The allowance for loan losses is maintained at a level considered adequate by management to provide for anticipated loan losses based on management's assessment of various factors affecting the loan portfolio, including a review of problem loans, business conditions and loss experience and an overall evaluation of the quality of the underlying collateral. The allowance is increased by provisions charged to operations and reduced by loans charged off, net of recoveries. While management believes that it uses the best information available to determine the allowance for loan losses, unforeseen market conditions could result in adjustments to the allowance for loan losses, and net income could be significantly affected, if circumstances differ substantially from the assumptions used in making the final determination. Additional information regarding the Bank's allowance for loan losses and loan loss experience are presented in Note D to the accompanying financial statements.

CONTRACTUAL OBLIGATIONS AND COMMITMENTS

In the normal course of business there are various outstanding contractual obligations of the Bank that will require future cash outflows. In addition, there are commitments and contingent liabilities, such as commitments to extend credit that may or may not require future cash outflows. The following table reflects contractual obligations of the Bank outstanding as of December 31, 2002.

	Payments Due by Period				
Contractual Obligations	Total	On Demand or Within 1 Year	2-3 Years	4-5 Years	After 5 Years
			(In thousands)		
Borrowings	$ 1,250	$ -	$ -	$ -	$ 1,250
Deposits	65,519	51,213	9,503	4,592	211
Total contractual cash obligations	$ 66,769	$ 51,213	$ 9,503	$ 4,592	$ 1,461

The following table reflects other commitments of the Bank outstanding as of December 31, 2002.

	Amount of Commitment Expiration Per Period				
Other Commitments	Total Amounts Committed	Within 1 Year	2-3 Years	4-5 Years	After 5 Years
			(In thousands)		
Undisbursed portion of home equity lines	$ 4,468	$ -	$ -	$ -	$ 4,468
Other commitments and credit lines	5,610	5,164	109	337	-
Standby letters of credit	183	183	-	-	-
Undisbursed portion of construction loans	3,522	3,522	-	-	-
Total other commitments	$ 13,783	$ 8,869	$ 109	$ 337	$ 4,468

FORWARD-LOOKING INFORMATION

This report contains certain forward-looking statements with respect to the financial condition, results of operations and business of the Bank. These forward-looking statements involve risks and uncertainties and are based on the beliefs and assumptions of management of the Bank and on the information available to management at the time that these disclosures were prepared. These statements can be identified by the use of words like "expect," "anticipate," "estimate" and "believe," variations of these words and other similar expressions. Readers should not place undue reliance on forward-looking statements as a number of important factors could cause actual results to differ materially from those in the forward-looking statements. Factors that could cause actual results to differ materially include, but are not limited to, (1) competition in the Bank's markets, (2) changes in the interest rate environment, (3) general national, regional or local economic conditions may be less favorable than expected, resulting in, among other things, a deterioration in credit quality and the possible impairment of collectibility of loans, (4) legislative or regulatory changes, including changes in accounting standards, (5) significant changes in the federal and state legal and regulatory environment and tax laws, (6) the impact of changes in monetary and fiscal policies, laws, rules and regulations and (7)other risks and factors identified in the Bank's other filings with the Federal Deposit Insurance Corporation. The Bank undertakes no obligation to update any forward-looking statements.

DIXON ODOM PLLC
Certified Public Accountants and Consultants

INDEPENDENT AUDITORS' REPORT

To the Stockholders and the Board of Directors
Cornerstone Bank
Wilson, North Carolina

We have audited the accompanying balance sheets of Cornerstone Bank as of December 31, 2002 and 2001, and the related statements of operations, comprehensive income, changes in stockholders' equity and cash flows for the years then ended. These financial statements are the responsibility of the Bank's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Cornerstone Bank at December 31, 2002 and 2001 and the results of its operations and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

Dixon Odom PLLC

Sanford, North Carolina
February 27, 2003

CORNERSTONE BANK
BALANCE SHEETS
December 31, 2002 and 2001

	2002	2001
ASSETS		
Cash and due from banks	$ 1,771,290	$ 2,619,947
Interest-earning deposits in banks	700,831	785,535
Federal funds sold	1,643,000	3,186,000
Time deposits	695,000	-
Investment securities available for sale, at fair value (Note C)	10,189,644	7,790,530
Loans (Note D)	58,649,219	38,292,309
Allowance for loan losses	(844,961)	(522,718)
NET LOANS	57,804,258	37,769,591
Accrued interest receivable	305,803	216,733
Stock in Federal Home Loan Bank of Atlanta, at cost	146,200	56,800
Bank premises and equipment (Note E)	1,638,497	1,699,417
Other assets	79,644	48,485
TOTAL ASSETS	$ 74,974,167	$ 54,173,038
LIABILITIES AND STOCKHOLDERS' EQUITY		
Deposits:		
Demand	$ 4,097,801	$ 4,622,842
Savings	696,505	391,259
Money market and NOW	31,100,124	22,772,926
Time over $100,000 (Note F)	12,188,136	8,845,475
Time (Note F)	17,436,708	12,252,062
TOTAL DEPOSITS	65,519,274	48,884,564
Advances from Federal Home Loan Bank	1,250,000	-
Accrued interest payable	81,386	59,760
Accrued expenses and other liabilities	214,762	150,487
TOTAL LIABILITIES	67,065,422	49,094,811
Commitments (Notes K and M)		
Stockholders' equity (Notes J and M):		
Common stock, $5 par value, 20,000,000 shares authorized; 871,540 and 600,451 shares issued and outstanding at December 31, 2002 and 2001, respectively	4,357,700	3,002,255
Additional paid-in capital	4,055,777	3,167,844
Accumulated deficit	(566,503)	(1,094,991)
Accumulated other comprehensive income	61,771	3,119
TOTAL STOCKHOLDERS' EQUITY	7,908,745	5,078,227
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	$ 74,974,167	$ 54,173,038

See accompanying notes.

CORNERSTONE BANK
STATEMENTS OF OPERATIONS
Years Ended December 31, 2002 and 2001

	2002	2001
INTEREST INCOME		
Loans	$ 3,159,112	$ 2,298,560
Federal funds sold	43,513	165,892
Investments	437,382	327,915
TOTAL INTEREST INCOME	3,640,007	2,792,367
INTEREST EXPENSE		
Money market, NOW and savings deposits	588,853	440,502
Time deposits	922,945	1,115,711
Borrowings	22,517	839
TOTAL INTEREST EXPENSE	1,534,315	1,557,052
NET INTEREST INCOME	2,105,692	1,235,315
PROVISION FOR LOAN LOSSES (Note D)	391,258	367,275
NET INTEREST INCOME AFTER PROVISION FOR LOAN LOSSES	1,714,434	868,040
NON-INTEREST INCOME		
Service charges on deposit accounts	169,504	100,807
Mortgage operations	585,870	183,496
Gain (loss) on sale of investment securities	(2,553)	8,435
Other income	29,945	12,103
TOTAL NON-INTEREST INCOME	782,766	304,841
NON-INTEREST EXPENSE		
Salaries and employee benefits	1,229,626	922,269
Occupancy and equipment	148,523	138,222
Data processing expenses	217,502	170,454
Other (Note I)	373,061	311,375
TOTAL NON-INTEREST EXPENSE	1,968,712	1,542,320
INCOME (LOSS) BEFORE INCOME TAXES	528,488	(369,439)
INCOME TAXES (Note H)	-	-
NET INCOME (LOSS)	$ 528,488	$ (369,439)
BASIC AND DILUTED NET INCOME (LOSS) PER COMMON SHARE	$ 0.73	$ (0.56)
BASIC AND DILUTED WEIGHTED AVERAGE COMMON SHARES OUTSTANDING	720,052	660,496

See accompanying notes.

CORNERSTONE BANK
STATEMENTS OF COMPREHENSIVE INCOME
Years Ended December 31, 2002 and 2001

	2002	2001
NET INCOME (LOSS)	$ 528,488	$ (369,439)
OTHER COMPREHENSIVE INCOME:		
Securities available for sale:		
Unrealized holding gains (losses) on available-for-sale securities	87,920	(28,718)
Tax effect	(30,923)	-
Reclassification of (gains) losses recognized in net income	2,553	(8,435)
Tax effect	(898)	-
TOTAL OTHER COMPREHENSIVE INCOME (LOSS)	58,652	(37,153)
COMPREHENSIVE INCOME (LOSS)	$ 587,140	$ (406,592)

See accompanying notes.

CORNERSTONE BANK
STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY
Years Ended December 31, 2002 and 2001

	Common stock		Additional paid-in capital	Accumulated deficit	Accumulated other comprehensive income (loss)	Total equity
	Shares	Amount				
Balance at December 31, 2000	600,451	$ 3,002,255	$ 3,167,844	$ (725,552)	$ 40,272	$ 5,484,819
Net loss	-	-	-	(369,439)	-	(369,439)
Other comprehensive loss	-	-	-	-	(37,153)	(37,153)
Balance at December 31, 2001	600,451	3,002,255	3,167,844	(1,094,991)	3,119	5,078,227
Net income	-	-	-	528,488	-	528,488
Other comprehensive income	-	-	-	-	58,652	58,652
Eleven-for-ten stock split	60,045	300,225	(300,225)	-	-	-
Issuance of common stock	211,044	1,055,220	1,188,158	-	-	2,243,378
Balance at December 31, 2002	871,540	$ 4,357,700	$ 4,055,777	$ (566,503)	$ 61,771	$ 7,908,745

See accompanying notes.

CORNERSTONE BANK
STATEMENTS OF CASH FLOWS
Years Ended December 31, 2002 and 2001

	2002	2001
CASH FLOWS FROM OPERATING ACTIVITIES		
Net income (loss)	$ 528,488	$ (369,439)
Adjustments to reconcile net income (loss) to net cash provided by operating activities:		
Depreciation and amortization	187,696	132,599
Realized (gain) loss on available-for-sale securities	2,553	(8,435)
Provision for loan losses	391,258	367,275
Change in assets and liabilities:		
Increase in accrued interest receivable	(89,070)	(95,809)
(Increase) decrease in other assets	(31,159)	25,190
Increase (decrease) in accrued interest payable	21,626	(12,664)
Increase in accrued expenses and other liabilities	32,454	82,819
NET CASH PROVIDED BY OPERATING ACTIVITIES	1,043,846	121,536
CASH FLOWS FROM INVESTING ACTIVITIES		
Net purchases of time deposits	(695,000)	-
Purchase of available-for-sale securities	(9,550,788)	(7,554,032)
Sales of available for sale investments	5,895,000	4,008,435
Maturities and calls of available for sale investments	1,276,387	218,043
Net increase in loans	(20,425,925)	(22,022,227)
Purchase of Federal Home Loan Bank stock	(89,400)	(56,300)
Purchases of bank premises and equipment	(58,569)	(58,278)
NET CASH USED BY INVESTING ACTIVITIES	(23,648,295)	(25,464,359)
CASH FLOWS FROM FINANCING ACTIVITIES		
Increase in deposits	16,634,710	25,274,532
Net increase in FHLB advances	1,250,000	-
Proceeds from issuance of common stock	2,243,378	-
NET CASH PROVIDED BY FINANCING ACTIVITIES	20,128,088	25,274,532
NET DECREASE IN CASH AND CASH EQUIVALENTS	(2,476,361)	(68,291)
CASH AND CASH EQUIVALENTS, BEGINNING	6,591,482	6,659,773
CASH AND CASH EQUIVALENTS, ENDING	$ 4,115,121	$ 6,591,482
CASH AND CASH EQUIVALENTS:		
Cash and due from banks	$ 1,771,290	$ 2,619,947
Interest-earning deposits in banks	700,831	785,535
Federal funds sold	1,643,000	3,186,000
	$ 4,115,121	$ 6,591,482
SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION		
Interest paid on deposits and borrowings	$ 1,512,689	$ 1,569,716
Unrealized gain (loss) on investment securities available for sale, net	58,652	(37,153)

See accompanying notes.

NOTE A - ORGANIZATION AND OPERATIONS

Cornerstone Bank (the "Bank") was incorporated March 14, 2000 and began banking operations on March 15, 2000. The Bank is engaged in general commercial and retail banking in eastern North Carolina, principally Wilson County, and operates under the banking laws of North Carolina and the rules and regulations of the Federal Deposit Insurance Corporation and the North Carolina Commissioner of Banks. The Bank undergoes periodic examinations by those regulatory authorities.

NOTE B - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect (i) the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the financial statements and (ii) the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. Material estimates that are particularly susceptible to significant change relate to management's determination of the allowance for loan losses.

Cash and Cash Equivalents

For the purpose of presentation in the statement of cash flows, cash and cash equivalents are defined as those amounts included in the balance sheet captions "Cash and due from banks", "Interest-earning deposits in banks" and "Federal funds sold."

Investment Securities Available for Sale

Investment securities available for sale are reported at fair value and consist of debt instruments that are not classified as either trading securities or as held to maturity securities. Unrealized holding gains and losses, net of deferred income tax, on available for sale securities are reported as a net amount in other comprehensive income. Gains and losses on the sale of investment securities available for sale are determined using the specific-identification method. Declines in the fair value of individual investment securities available for sale below their cost that are other than temporary would result in write-downs of the individual securities to their fair value. Such write-downs would be included in earnings as realized losses. Premiums and discounts are recognized in interest income using the interest method over the period to maturity.

Loans

Loans that management has the intent and ability to hold for the foreseeable future or until maturity are reported at their outstanding principal adjusted for any charge-offs, the allowance for loan losses, and any deferred fees or costs on originated loans and unamortized premiums or discounts on purchased loans. Loan origination fees and certain direct origination costs are capitalized and recognized as an adjustment of the yield of the related loan. The accrual of interest on impaired loans is discontinued when, in management's opinion, the borrower may be unable to meet payments as they become due. When interest accrual is discontinued, all unpaid accrued interest is reversed. Interest income is subsequently recognized only to the extent cash payments are received.

NOTE B - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Allowance for Loan Losses

The provision for loan losses is based upon management's estimate of the amount needed to maintain the allowance for loan losses at an adequate level. In making the evaluation of the adequacy of the allowance for loan losses, management gives consideration to current economic conditions, statutory examinations of the loan portfolio by regulatory agencies, delinquency information and management's internal review of the loan portfolio. Loans are considered impaired when it is probable that all amounts due under the contractual terms of the loan will not be collected. The measurement of impaired loans is generally based on the present value of expected future cash flows discounted at the historical effective interest rate, or upon the fair value of the collateral if the loan is collateral dependent. If the recorded investment in the loan exceeds the measure of fair value, a valuation allowance is established as a component of the allowance for loan losses. While management uses the best information available to make evaluations, future adjustments to the allowance may be necessary if conditions differ substantially from the assumptions used in making the evaluations. In addition, regulatory examiners may require the Bank to recognize changes to the allowance for loan losses based on their judgments about information available to them at the time of their examination.

Mortgage Operations

The Bank originates single family, residential first mortgage loans on a presold basis. The Bank recognizes certain origination and service release fees upon the sale, which are included in non-interest income on the statements of operations under the caption "Mortgage operations."

Bank Premises and Equipment

Bank premises and equipment are stated at cost less accumulated depreciation. Depreciation is calculated on the straight-line method over the estimated useful lives of the assets. Estimated useful lives are 35 years for buildings, 3 to 15 years for furniture, fixtures and equipment and 2 to 5 years for computers and related equipment. Repairs and maintenance costs are charged to operations as incurred and additions and improvements to premises and equipment are capitalized. Upon sale or retirement, the cost and related accumulated depreciation are removed from the accounts and any gains or losses are reflected in current operations.

Stock in Federal Home Loan Bank of Atlanta

As a requirement for membership, the Bank invests in stock of the Federal Home Loan Bank of Atlanta ("FHLB"). This investment is carried at cost.

Income Taxes

Deferred tax assets and liabilities are recognized for the estimated future tax consequences attributable to differences between the tax bases of assets and liabilities and their carrying amounts for financial reporting purposes. Deferred tax assets are also recognized for operating loss carryforwards. Deferred tax assets and liabilities are measured using enacted tax rates in effect for the year in which the temporary differences are expected to be recovered or settled. Deferred tax assets are reduced by a valuation allowance if it is more likely than not that the tax benefits will not be realized.

NOTE B - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Comprehensive Income

The Bank reports as comprehensive income all changes in shareholders' equity during the year from sources other than shareholders. Other comprehensive income refers to all components (revenues, expenses, gains, and losses) of comprehensive income that are excluded from net income. The Bank's only component of other comprehensive income is unrealized gains and losses on investment securities available for sale.

Stock Compensation Plans

Statement of Financial Accounting Standards ("SFAS") No. 123, *Accounting for Stock-Based Compensation*, encourages all entities to adopt a fair value based method of accounting for employee stock compensation plans, whereby compensation cost is measured at the grant date based on the value of the award and is recognized over the service period, which is usually the vesting period. However, it also allows an entity to measure compensation cost for those plans using the intrinsic value based method of accounting prescribed by Accounting Principles Board ("APB") Opinion No. 25, *Accounting for Stock Issued to Employees,* whereby compensation cost is the excess, if any, of the quoted market price of the stock at the grant date (or other measurement date) over the amount an employee must pay to acquire the stock. Stock options to be issued under the Bank's stock option plans are expected to have no intrinsic value at the grant date and, under APB Opinion No. 25, no compensation cost will be recognized for them. Upon the grant of options, the Bank expects to apply the accounting methodology in APB Opinion No. 25 and, as a result, will provide pro forma disclosures of net income and earnings per share and other disclosures as if the fair value based method of accounting were being applied.

Earnings Per Common Share

Basic earnings per share represents income available to common stockholders divided by the weighted-average number of common shares outstanding during the period. Diluted earnings per share reflect additional common shares that would have been outstanding if dilutive potential common shares had been issued, as well as any adjustment to income that would result from the assumed issuance. Potential common shares that may be issued by the Bank relate to stock options. No options had been granted by the Bank as of December 31, 2002.

All references in these financial statements to net income per share and weighted average common and common equivalent shares outstanding have been adjusted to reflect an eleven-for-ten stock split effected in the form of a 10% stock dividend in 2002.

NOTE B - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Recent Accounting Pronouncements

In November 2002, the Financial Accounting Standards Board ("FASB") issued FASB Interpretation No. 45, *Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others* ("FIN 45"). FIN 45 requires a liability to be recognized at the time a bank issues a guarantee for the fair value of the obligations assumed under certain guarantee agreements. Additional disclosures about guarantee agreements are also required in the interim and annual financial statements. The disclosure provisions of FIN 45 are effective for the Bank on December 31, 2002. The provisions for initial recognition and measurement of guarantee agreements are effective on a prospective basis for guarantees that are issued or modified after December 31, 2002. The Bank is in the process of assessing the impact of FIN 45 on its financial statements.

Reclassifications

Certain amounts in the 2001 financial statements have been reclassified to conform to the 2002 presentation. The reclassifications had no effect on net income (loss) or stockholders' equity as previously reported.

NOTE C - INVESTMENT SECURITIES

The amortized cost and fair value of securities available for sale, with gross unrealized gains and losses, are as follows:

	December 31, 2002			
	Amortized cost	Gross unrealized gains	Gross unrealized losses	Fair value
Securities available for sale:				
U.S. government securities and obligations of U.S. government agencies	$ 4,597,826	$ 42,079	$ -	$ 4,639,905
Corporate bonds	504,222	3,419	-	507,641
Mortgage-backed securities	4,994,004	95,899	(47,805)	5,042,098
	$ 10,096,052	$ 141,397	$ (47,805)	$ 10,189,644

	December 31, 2001			
	Amortized cost	Gross unrealized gains	Gross unrealized losses	Fair value
Securities available for sale:				
U.S. government securities and obligations of U.S. government agencies	$ 4,544,448	$ 18,861	$ (9,090)	$ 4,554,219
Corporate bonds	513,488	5,201	-	518,689
Mortgage-backed securities	2,729,476	31,854	(43,708)	2,717,622
	$ 7,787,412	$ 55,916	$ (52,798)	$ 7,790,530

NOTE C - INVESTMENT SECURITIES (Continued)

Securities with a carrying value of $2,540,313 and $1,523,438 at December 31, 2002 and 2001, respectively, were pledged to secure borrowings.

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For the years ended December 31, 2002 and 2001, proceeds from sales of securities available for sale amounted to $5,895,000 and $4,008,435, respectively. Gross realized losses amounted to $2,553 and gross realized gains amounted to $8,435 for the years ended December 31, 2002 and 2001, respectively.

The amortized cost, fair value and weighted average yield of the Bank's investment securities at December 31, 2002, by contractual maturity, are shown below. Expected maturities will differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

	Amortized Cost	Fair Value	Weighted Average/ Yield
		(Dollars in thousands)	
Securities available for sale:			
U.S. government agency securities			
Due within one year	$ 1,011	$ 1,026	4.59%
Due after one but within five years	3,060	3,086	4.36%
Due after five but within ten years	527	528	5.99%
	4,598	4,640	4.60%
Mortgage-backed securities			
Due after five but within ten years	395	419	6.83%
Due after ten years	4,599	4,623	5.70%
	4,994	5,042	5.79%
Corporate bonds			
Due within one year	504	508	7.45%
Total securities available for sale			
Due within one year	1,515	1,534	5.54%
Due after one but within five years	3,060	3,086	4.36%
Due after five but within ten years	922	947	6.36%
Due after ten years	4,599	4,623	5.70%
	$ 10,096	$ 10,190	5.33%

For purposes of the maturity table, mortgage-backed securities, which are not due at a single maturity date, have been allocated over maturity groupings based on the weighted-average contractual maturities of underlying collateral. The mortgage-backed securities may mature earlier than their weighted-average contractual maturities because of principal prepayments.

NOTE D - LOANS

Following is a summary of loans at December 31, 2002 and 2001:

	2002		2001	
	Amount	Percent of total	Amount	Percent of total
	(Dollars in thousands)			
Residential mortgage	$ 4,978	8.48%	$ 5,059	13.21%
Residential construction	2,950	5.03%	1,291	3.37%
Home equity lines of credit	4,098	6.99%	1,881	4.91%
Commercial and industrial loans	43,861	74.75%	26,747	69.82%
Loans to individuals	2,787	4.75%	3,328	8.69%
Total loans	58,674	100.00%	38,306	100.00%
Less:				
Allowance for loan losses	(845)		(523)	
Deferred loan fees and costs, net	(25)		(13)	
Net loans receivable	$ 57,804		$ 37,770	

Loans are primarily made in Wilson County, North Carolina. Real estate loans can be affected by the condition of the local real estate market. Commercial and installment loans can be affected by local economic conditions.

As of December 31, 2002, impaired loans consisted of nonaccrual loans totaling $25,000. Interest income that would have been recorded on nonaccrual loans totaled $1,000 for the year ended December 31, 2002. There were no restructured loans at December 31, 2002 and no nonaccrual, restructured or impaired loans at December 31, 2001.

Following is a summary of activity in the allowance for loan losses for the years indicated:

	At or for the Years Ended December 31,	
	2002	2001
	(Dollars in thousands)	
Allowance for loan losses at beginning of year	$ 523	$ 244
Provision for loan losses	391	367
	914	611
Loans charged-off:		
Commercial and industrial	(38)	(82)
Loans to individuals	(33)	(6)
Total charge-offs	(71)	(88)
Recoveries of loans previously charged off:		
Loans to individuals	2	-
Total recoveries	2	-
Net charge-offs	(69)	(88)
Allowance for loan losses at end of year	$ 845	$ 523
Net charge-offs as a percent of average loans outstanding during the period	0.14%	0.31%
Allowance for loan losses as a percent of loans at period end	1.44%	1.37%

NOTE D - LOANS (Continued)

Following is a summary of allocation of the allowance for loan losses to the indicated categories of loans and the percentage that all loans in each category bears to total loans outstanding:

	At December 31,			
	2002		2001	
	Amount	% of Total Loans	Amount	% of Total Loans
	(Dollars in thousands)			
Residential mortgage	$ 52	8.48%	$ 20	13.21%
Residential construction	72	5.03%	15	3.37%
Home equity lines of credit	68	6.99%	10	4.91%
Commercial and industrial loans	496	74.75%	361	69.82%
Loans to individuals	41	4.75%	45	8.69%
Total allocated	729	100.00%	451	100.00%
Unallocated	116		72	
Total	$ 845		$ 523	

At December 31, 2002, the Bank had loan commitments outstanding of $250,000, pre-approved but unused lines of credit totaling $13.4 million and commercial and standby letters of credit of $183,000. In management's opinion, these commitments represent no more than normal lending risk to the Bank and will be funded from normal sources of liquidity.

The Bank has had loan transactions with its directors and executive officers. Such loans were made in the ordinary course of business and on substantially the same terms and collateral as those for comparable transactions prevailing at the time. Such loans did not involve more than the normal risk of collectibility or present other unfavorable features. A summary of related party loan transactions is as follows:

	2002	2001
Balance at beginning of year	$ 1,580,464	$ 1,298,652
Borrowings	718,359	857,500
Repayments	(730,610)	(575,688)
Balance at end of year	$ 1,568,213	$ 1,580,464

NOTE E - BANK PREMISES AND EQUIPMENT

Following is a summary of the Bank's premises and equipment at December 31, 2002 and 2001:

	2002	2001
Land	$ 251,037	$ 251,037
Buildings	1,237,990	1,236,372
Furniture and equipment	445,690	388,739
	1,934,717	1,876,148
Less accumulated depreciation	(296,220)	(176,731)
Total	$ 1,638,497	$ 1,699,417

Depreciation and amortization amounting to $119,489 and $117,969 for the years ended December 31, 2002 and 2001, respectively, is included in occupancy and equipment expense and data processing expense.

NOTE F - DEPOSITS

At December 31, 2002, the scheduled maturities of time deposit (dollars in thousands) are as follows:

2003	$ 15,319
2004	7,410
2005	2,093
2006	1,106
2007	3,486
Thereafter	211
Total	$ 29,625

The above table includes certificates of deposit of $100,000 and over, which at December 31, 2002, totaled $12,188,000. Of that total, $1,041,000 had scheduled maturities within three months; and $6,553,000 after three but within twelve months.

NOTE G - BORROWINGS

The Bank may purchase federal funds through unsecured federal funds lines of credit totaling $4.0 million. These lines are intended for short-term borrowings and are subject to restrictions limiting the frequency and term of advances. These lines of credit are payable on demand and bear interest based upon the daily federal funds rate. There were no advances outstanding under these lines of credit at December 31, 2002 and 2001.

The Bank has an available line of credit with the FHLB equal to 10% of total assets. Advances under this line are secured by eligible securities and qualifying first mortgage loans. The balance of qualifying pledged first mortgage loans as of December 31, 2002 was approximately $1.6 million. An advance of $1,250,000 was outstanding under this line of credit at December 31, 2002. This advance matures in 2012 and bears interest at 3.90%. No advances were outstanding at December 31, 2001.

NOTE H - INCOME TAXES

The significant components of the provision for income taxes for 2002 and 2001 are as follows:

	2002	2001
Current tax expense	$ -	$ -
Deferred tax expense (benefit)	190,000	(126,000)
Provision for income tax expense (benefit) before adjustment to deferred tax asset valuation allowance	190,000	(126,000)
Increase (decrease) in valuation allowance	(190,000)	126,000
Net provision for income taxes	$ -	$ -

The difference between the provision for income taxes and the amounts computed by applying the statutory federal income tax rate of 34% to income (loss) before income taxes is summarized below:

	2002	2001
Tax expense (benefit) computed at the statutory federal rate	$ 180,000	$ (126,000)
Increase (decrease) resulting from:		
State income taxes, net of federal tax effect	22,000	(10,000)
Adjustment to deferred tax asset valuation allowance	(190,000)	126,000
Other permanent differences	(12,000)	10,000
Provision for income taxes	$ -	$ -

Deferred income taxes reflect the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes. Significant components of deferred taxes at December 31, 2002 and 2001 are as follows:

	2002	2001
Deferred tax assets relating to:		
Allowance for loan losses	$ 249,000	$ 154,000
Pre-opening costs and expenses	73,000	104,000
Net operating loss carryforwards	83,000	314,000
Other	1,000	-
Total deferred tax assets	406,000	572,000
Less valuation allowance	(377,000)	(567,000)
Deferred tax assets net of valuation allowance	29,000	5,000
Deferred tax liabilities relating to:		
Fixed asset differences	(29,000)	(5,000)
Investment securities available for sale	(31,821)	-
Total deferred tax liabilities	(60,821)	(5,000)
Net recorded deferred tax asset (liabilities)	$ (31,821)	$ -

NOTE H - INCOME TAXES (Continued)

The Bank has net operating loss carryforwards of approximately $217,000, expiring at various dates through 2021, which are available to offset future taxable income.

NOTE I - OTHER NON-INTEREST EXPENSE

The major components of other non-interest expense for the years ended December 31, 2002 and 2001 are as follows:

	2002	2001
Postage, printing and office supplies	$ 61,895	$ 40,336
Advertising and promotion	64,742	53,326
Professional services	93,699	85,031
Other	152,725	132,682
Total	$ 373,061	$ 311,375

NOTE J - REGULATORY MATTERS

The Bank, as a North Carolina banking corporation, may pay cash dividends only out of undivided profits as determined pursuant to North Carolina General Statutes. However, regulatory authorities may further limit the payment of dividends by any bank when it is determined that such limitation is in the public interest and is necessary to ensure financial soundness of the bank. The payment of cash dividends by a newly organized bank is prohibited by regulation for three years unless special exceptions are made.

The Bank is subject to various regulatory capital requirements administered by federal and state banking agencies. Failure to meet minimum capital requirements can initiate certain mandatory - and possibly additional discretionary - actions by regulators that, if undertaken, could have a direct material effect on the Bank's financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, the Bank must meet specific capital guidelines that involve quantitative measures of the Bank's assets, liabilities, and certain off-balance-sheet items as calculated under regulatory accounting practices. The Bank's capital amounts and classifications are also subject to qualitative judgments by the regulators about components, risk weightings, and other factors.

NOTE J - REGULATORY MATTERS (Continued)

Quantitative measures established by regulation to ensure capital adequacy require the Bank to maintain minimum amounts and ratios, as prescribed by regulations, of total and Tier I capital to risk-weighted assets and of Tier I capital to average assets. Management believes that, as of December 31, 2002 and 2001, the Bank meets all capital adequacy requirements to which it is subject, as set forth below:

	For the Bank		Minimum Requirements	
	Capital Amount	Capital Ratio	For Capital Adequacy	To Be Well Capitalized
As of December 31, 2002				
Tier I capital (to risk-weighted assets)	$ 7,847	13.4%	4.0%	6.0%
Total capital - Tier II capital (to risk-weighted assets)	8,580	14.6	8.0	10.0
Leverage - Tier I capital (to average assets)	7,847	10.6	4.0	5.0
As of December 31, 2001				
Tier I capital (to risk-weighted assets)	$ 5,075	12.4%	4.0%	6.0%
Total capital - Tier II capital (to risk-weighted assets)	5,588	13.6	8.0	10.0
Leverage - Tier I capital (to average assets)	5,075	10.0	4.0	5.0

NOTE K - OFF-BALANCE SHEET RISK

The Bank is a party to financial instruments with off-balance sheet risk in the normal course of business to meet the financing needs of its customers. These financial instruments include commitments to extend credit, undisbursed lines of credit, and standby letters of credit. Those instruments involve, to varying degrees, elements of credit and interest rate risk in excess of the amount recognized in the balance sheets. The contract or notional amounts of those instruments reflect the extent of involvement the Bank has in particular classes of financial instruments. The Bank uses the same credit policies in making commitments and conditional obligations as it does for on-balance-sheet instruments.

Commitments to extend credit are agreements to lend to a customer as long as there is no violation of conditions established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. Since some of the commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. The Bank evaluates each customer's creditworthiness on a case-by-case basis. The amount of collateral obtained, if deemed necessary by the Bank, upon extension of credit is based on management's credit evaluation of the borrower. Collateral obtained varies but may include real estate, stocks, bonds, and certificates of deposit.

A summary of the contract amount of the Bank's exposure to off-balance sheet credit risk as of December 31, 2002 is as follows:

Financial instruments whose contract amounts represent credit risk:	
Commitments to extend credit	$ 250,000
Undisbursed lines of credit	13,350,000
Commercial and standby letters of credit	183,000

NOTE L - DISCLOSURES ABOUT FAIR VALUES OF FINANCIAL INSTRUMENTS

Financial instruments include cash and due from banks, interest-bearing deposits in banks, federal funds sold, time deposits, investments, loans, stock in Federal Home Loan Bank of Atlanta, deposit accounts and borrowings. Fair value estimates are made at a specific moment in time, based on relevant market information and information about the financial instrument. These estimates do not reflect any premium or discount that could result from offering for sale at one time the Bank's entire holdings of a particular financial instrument. Because no active market readily exists for a portion of the Bank's financial instruments, fair value estimates are based on judgments regarding future expected loss experience, current economic conditions, risk characteristics of various financial instruments, and other factors. These estimates are subjective in nature and involve uncertainties and matters of significant judgment and, therefore, cannot be determined with precision. Changes in assumptions could significantly affect the estimates.

The following methods and assumptions were used to estimate the fair value of each class of financial instruments for which it is practicable to estimate that value:

Cash and Due from Banks, Interest-Earning Deposits In Banks and Federal Funds Sold

The carrying amounts for cash and due from banks, interest-earning deposits in banks and federal funds sold approximate fair value because of the short maturities of those instruments.

Time Deposits

The fair value of time deposits is estimated using rates currently offered for instruments of similar maturity.

Investment Securities

Fair value for investment securities equals quoted market price if such information is available. If a quoted market price is not available, fair value is estimated using quoted market prices for similar securities.

Loans

For certain homogenous categories of loans, such as residential mortgages, fair value is estimated using the quoted market prices for securities backed by similar loans, adjusted for differences in loan characteristics. The fair value of other types of loans is estimated by discounting the future cash flows using the current rates at which similar loans would be made to borrowers with similar credit ratings and for the same remaining maturities.

Stock in Federal Home Loan Bank of Atlanta

The fair value for FHLB stock approximates carrying value, based on the redemption provisions of the Federal Home Loan Bank.

NOTE L - DISCLOSURES ABOUT FAIR VALUES OF FINANCIAL INSTRUMENTS (Continued)

Deposits and Borrowings

The fair value of demand, savings, money market and NOW deposits is the amount payable on demand at the reporting date. The fair value of time deposits and borrowings is estimated based on discounting cash flows using the rates currently offered for instruments of similar remaining maturities.

Financial Instruments with Off-Balance Sheet Risk

With regard to financial instruments with off-balance sheet risk discussed in Note K, it is not practicable to estimate the fair value of future financing commitments.

The carrying amounts and estimated fair values of the Bank's financial instruments, none of which are held for trading purposes, are as follows at December 31, 2002 and 2001:

	2002		2001	
	Carrying amount	Estimated fair value	Carrying amount	Estimated fair value
	(In thousands)			
Financial assets:				
Cash and due from banks	$ 1,771	$ 1,771	$ 2,620	$ 2,620
Interest-earning deposits in banks	701	701	786	786
Federal funds sold	1,643	1,643	3,186	3,186
Time deposits	695	694	-	-
Investment securities	10,190	10,190	7,791	7,791
Federal Home Loan Bank stock	146	146	57	57
Loans	57,804	58,801	37,770	38,081
Financial liabilities:				
Deposits	65,519	65,707	48,885	47,395
Borrowings	1,250	1,250	-	-

NOTE M - EMPLOYEE AND DIRECTOR BENEFIT PLANS

401(k) Plan

The Bank has a 401(k) Plan (the "Plan") whereby substantially all employees participate in the Plan. The Bank makes matching contributions equal to 100 percent of the first 6 percent of an employee's compensation contributed to the Plan. Matching contributions vest to the employee equally over a four-year period. For the years ended December 31, 2002 and 2001, expense attributable to the Plan amounted to $46,210 and $35,403, respectively.

NOTE M - EMPLOYEE AND DIRECTOR BENEFIT PLANS (Continued)

Stock Option Plans

During 2000, the Bank adopted, with shareholder approval, an Employee Stock Option Plan (the "Employee Plan") and a Director Stock Option Plan (the "Director Plan"). Each plan makes available options to purchase 60,045 shares of the Bank's common stock for an aggregate number of common shares reserved for options equal to 120,090. No options have been granted under either the Employee Plan or the Director Plan through December 31, 2002.

Employment Agreements

The Bank has entered into an employment agreement with its chief executive officer to ensure a stable and competent management base. This agreement provides for benefits as spelled out in the contract and cannot be terminated by the Board of Directors, except for cause, without prejudicing the officer's right to receive certain vested rights, including compensation. In the event of a change in control of the Bank, as outlined in the agreement, the acquirer will be bound to the terms of this contract.

The Bank also has entered into agreements with three executive officers which provide for severance pay benefits in the event of a change in control of the Bank resulting in the termination of such executive officers or diminished compensation, duties or benefits.

DIRECTORS

John C. Anthony
Partner: Anthony, Moore and Tabb CPA's

Thomas E. Brown III
Chairman of the Board
Owner/Manager of Brown Oil Company

Robert E. Kirkland III
Owner/Manager of Barnes Motor & Parts Co., Inc.

Judy A. Muirhead
Owner/ Manager of JAM Properties, JAM Rentals and JAM Investments

W. Coalter Paxton III
President of Paxton Mini Storages, Inc. and PBS Storage, Inc. and Manager of Paxton Bonded Warehouse, Inc.

Norman B. Osborn
President and CEO
Cornerstone Bank

Gregory A. Turnage
Owner and President of PLT Construction Inc. and President of T. & H. Electric, Inc.

S. Christopher Williford
Vice President and Owner of Southern Piping Company, Inc.

David W. Woodard
Secretary for Cornerstone Bank
Law Partner, Connor, Bunn, Rogerson & Woodard

EXECUTIVE OFFICERS

Norman B. Osborn
President and CEO

G. Brooks Batchelor
Executive Vice President, Sr. Business Development Officer

Robert K. Ladd III
Executive Vice President, Chief Lending Officer

Robert W. Kernodle
Executive Vice President, Chief Information and Systems Officer

Office Location

3710 Nash Street North
Wilson, NC 27896
www.thecornerstonebank.com

Regulatory and Securities Counsel

Brooks, Pierce, McLendon
Humphrey & Leonard, L.L.P.
P. O. Box 26000
Greensboro, NC 27401

Stock Transfer Agent

First-Citizens Bank & Trust
Corporate Trust Dept.
100 East Tryon Road
Raleigh, NC 27603

Independent Auditors

Dixon Odom PLLC
P.O. Box 70
Sanford, NC 27331-0070

Common Stock

The Bank had 871,540 shares of Common Stock outstanding which were held by approximately 1,367 holders of record (excluding shares held in street name) as of December 31, 2002. The North Carolina Commissioner of Bank's approval of the Bank's organization was conditioned on the requirement that for a period of three years following commencement of its operations, the Bank not pay any cash dividend. Thereafter, the Commissioner's prior approval is required for the payment of any cash dividend by the Bank. To date, the Bank has not paid any cash dividend.

Market for the Common Stock

There is no public trading market for the Bank's common stock. Certain sales have been facilitated by the Bank in 2002 and 2001, all of which were, to the knowledge of management, at a price of $11.00 to $11.25 per share.

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Annual Shareholders Meeting

The 2003 Annual Meeting of shareholders of Cornerstone Bank will be held at 10:00 a.m. on May 22, 2003 at the Del Mastro Auditorium on the campus of Wilson Technical Community College at 902 Herring Avenue, Wilson, North Carolina.

Annual Report on Form 10-KSB

A copy of Cornerstone Bank's 2002 Annual Report on Form 10-KSB, as filed with the Federal Deposit Insurance Corporation, is available without charge to shareholders upon written request to Norman B. Osborn, President and CEO, Cornerstone Bank, 3710 Nash Street North, Wilson, North Carolina 27896.

This Annual Report serves as the annual financial disclosure statement furnished pursuant to the Federal Deposit Insurance Corporation's rules and regulations. This statement has not been reviewed or confirmed for accuracy or relevance by the Federal Deposit Insurance Corporation.