2001 Annual Report

First South Bancorp

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MISSION STATEMENT

"Our mission is to become the premier community bank in eastern North Carolina. We will enhance shareholder value by serving the personal and business needs of our markets, providing superior customer service, investing in the communities that we serve, and enriching the lives of our employees."

LETTER TO STOCKHOLDERS

To Our Stockholders:

It is a pleasure to present the 2001 operating results for First South Bancorp ("First South"). It was another excellent year with earnings setting a new record. We are pleased that the market value of First South's common stock reflected this superior performance, increasing 38.3% from year-end 2000. The appreciation in market value, combined with a 45.7% increase in the annual cash dividend, resulted in a total return of 41.2% to First South stockholders in 2001.

For the year ended September 30, 2001, we reported record earnings of $5.8 million representing a 64.3% increase over the $3.5 million earned for the year ended September 30, 2000. Diluted earnings per share increased 72.6% to $1.95 per share, compared to $1.13 per share for fiscal 2000. Our 2001 earnings produced a return on average assets of 1.1% and a return on average stockholders' equity of 12.3%. Our financial position remains strong.

The year ended September 30, 2001 was an eventful one for First South and First South Bank (the "Bank"). The Bank was recognized as the number one Small Business Administration lender among community banks in the state of North Carolina. We opened two new full service banking offices located in Washington and Kinston and we opened a new Operations Center, also located in Washington. We have created a new leasing division called First South Leasing, LLC that will offer general equipment leases to the commercial markets of eastern North Carolina and the Piedmont, parts of South Carolina and Virginia, as well as to the existing commercial accounts and business clients of the Bank. The Bank will open its twentieth branch during the last quarter of 2001 and plans to continue its expansion into additional outer markets, including areas in eastern, southeastern and northeastern North Carolina.

Our primary strategy is to focus on enhancing the franchise value of First South. We are committed to building a high performance bank, which provides superior returns to its stockholders. We are continuing to restructure the assets and liabilities of the Bank in order to achieve a higher net interest margin. We will continue to look for acquisition opportunities and will expand our branch operations into new markets. The consolidation of our industry will continue and this will create significant opportunities for First South. There will be a greater emphasis on increasing our level of efficiency and customer service.

This year has been a difficult year for Americans both economically and personally. The challenges America has been presented this year can not be understated. The events of September 11th have changed each of us forever and it is difficult to express the shock, grief and compassion we feel for our country. Our sympathies go out to all those who suffered a personal loss and to those who were injured in the attack on our country.

As we work through these difficult times, it is apparent that our employees are our greatest asset. Our employees are held to high standards and they meet the challenges placed before them. I want to thank them for their efforts and commitment in making First South so successful.

Each member of your Board of Directors along with our officers and employees join me in thanking you for supporting First South Bancorp. As always, your comments or suggestions are welcomed and we look forward to your continued support.

Sincerely,

Tom Vann
President and
Chief Executive Officer

SELECTED CONSOLIDATED FINANCIAL INFORMATION AND OTHER DATA

	At or For the Year Ended September 30,				
	2001	2000	1999	1998	1997
	(dollars in thousands, except per share data)				
Selected Financial Condition Data					
Total assets	$ 541,195	$ 559,719	$ 292,305	$ 281,479	$ 249,281
Loans receivable, net	374,087	366,210	212,054	224,999	197,785
Cash and investment securities	95,191	59,927	12,435	20,119	18,856
Mortgage-backed securities	48,603	108,519	56,326	27,017	24,818
Deposits	471,939	471,942	234,618	204,635	175,116
Borrowings	4,909	30,388	1,318	11,933	12,621
Stockholders' equity	50,769	44,835	48,763	56,714	57,856
Selected Operations Data					
Interest income	$ 42,159	$ 36,865	$ 23,129	$ 21,867	$ 18,515
Interest expense	22,168	19,013	9,979	9,240	8,346
Net interest income	19,991	17,852	13,150	12,627	10,169
Provision for loan losses	830	977	120	310	931
Noninterest income	6,776	3,432	2,874	2,646	1,685
Noninterest expenses	16,047	14,100	10,255	9,940	6,941
Income before income taxes	9,890	6,207	5,649	5,023	3,982
Income taxes	4,060	2,658	2,453	1,900	1,719
Net income	$ 5,830	$ 3,549	$ 3,196	$ 3,123	$ 2,263
Earnings per share - basic (1)(2)	$ 2.01	$ 1.14	$ 0.91	$ 0.80	$ 0.35
Earnings per share - diluted (1)(2)	1.95	1.13	0.91	0.80	0.35
Dividends per share (2)	0.67	0.46	0.31	0.27	0.13
Selected Financial Ratios and Other Data					
Performance Ratios:					
Return on average assets	1.06 %	0.76 %	1.09 %	1.19 %	1.00 %
Return on average equity	12.31	7.71	6.03	5.40	6.57
Interest rate spread	3.67	3.73	3.95	4.03	4.10
Net interest margin	3.90	4.05	4.69	5.05	4.67
Average earning assets/average interest bearing liabilities	114.06	115.51	131.01	127.57	115.00
Noninterest expense/average assets	2.92	3.03	3.50	3.80	3.06
Efficiency ratio	59.95	66.25	63.99	65.08	58.55
Dividend payout ratio	33.33	40.35	34.07	33.75	37.14
Quality Ratios:					
Nonperforming assets/total assets	0.29 %	0.33 %	0.40 %	0.43 %	0.65 %
Nonperforming loans/total loans	0.28	0.45	0.27	0.36	0.64
Loan loss reserves/total loans	1.42	1.39	1.53	1.50	1.64
Provision for loan losses/total loans	0.22	0.27	0.06	0.14	0.47
Capital Ratios:					
Equity/total assets, end of period	9.38 %	8.02 %	16.69 %	19.95 %	23.23 %
Average equity/average assets	8.62	9.89	18.09	22.14	15.17
Other Data:					
Full service offices	19	17	9	8	8
Loans serviced for others	$ 295,216	$ 300,006	$ 275,255	$ 250,202	$ 253,647

(1) Applies to net income of $1,395,900 earned for the period April 8, 1997 to September 30, 1997.

(2) Adjusted for three-for-two stock split on August 19, 1998.

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

General

First South Bancorp, Inc. (the "Company") was formed for the purpose of issuing common stock, owning 100% of the stock of First South Bank (the "Bank") and operating through the Bank a commercial banking business. The Company has engaged in no activities other than holding the stock of the Bank, therefore, this discussion of consolidated financial condition and results of operations relates principally to the Bank. The business of the Bank consists principally of attracting deposits from the general public and using them to originate secured and unsecured commercial and consumer loans, permanent mortgage and construction loans secured by single-family residences, credit cards and other loans. The Bank's earnings depend primarily on its net interest income, which is the difference between interest earned on interest earning assets and interest paid on interest-bearing liabilities. The level of its noninterest income and expenses also affects the Bank's earnings.

Prevailing economic conditions, as well as federal and state regulations, affect the operations of the Bank. The Bank's cost of funds is influenced by interest rates paid on competing investments, rates offered on deposits by other financial institutions in the Bank's market area and by general market interest rates. Lending activities are affected by the demand for financing of real estate and various types of commercial and consumer loans, influenced by interest rates at which such financing may be offered.

The Bank's business emphasis is to operate as a well-capitalized, profitable and independent community oriented financial institution dedicated to providing quality customer service and meeting the financial needs of the communities it serves. Management believes the Bank can be more effective in serving its customers than many larger competitors, because of its ability to respond quickly and effectively to customer needs and inquiries. The Bank's ability to provide these services is enhanced by the stability of the Bank's senior management team.

Significant Activities and Events

On November 30, 1999, the Company consummated the acquisition of Green Street Financial Corp ("Green Street"), the parent holding company of Home Federal Savings and Loan Association of Fayetteville, North Carolina ("Home Federal"), with full service offices located in Fayetteville and Lumberton, North Carolina. The acquisition was accounted for using the purchase method of accounting for a cash purchase price of $59.2 million, representing $15.25 per share of Green Street common stock. Summary financial information related to Green Street acquisition was as follows (unaudited): assets - $162.2 million; loans receivable - $125.4 million; deposits - $101.7 million; and goodwill - $288,000.

On February 18, 2000, the Bank completed the purchase of six Triangle Bank ("Triangle") branch offices located in Rocky Mount and Tarboro, North Carolina. This acquisition was accounted for using the purchase method of accounting and the Bank assumed the deposits of the six Triangle branch offices for a premium of approximately 4.0% of the assumed deposits. Summary financial information related to the Triangle branches purchase was as follows (unaudited): deposits - $147.5 million; cash and other assets - $113.4 million; loans receivable - $26.3 million; deposit premium - $5.0 million; and premises and equipment - $2.8 million.

Concurrent with the Green Street acquisition, the Bank changed its name to First South Bank. These acquisitions enabled the Company to leverage its capital base, represent a significant growth in the Bank's branch office network and have benefited the Company's earnings.

Liquidity and Capital Resources

As a state chartered commercial bank, the Bank must meet liquidity requirements established by the North Carolina Office of the Commissioner of Banks (the "Commissioner"). Savings banks, which convert to commercial banks, are required to maintain 15% liquidity pursuant to the conversion guidelines adopted by the Commissioner. The Bank's liquidity ratio, as computed under these guidelines, was 24.0% at September 30, 2001 compared to 27.9% at September 30, 2000.

The Bank's primary sources of funds are deposits, principal and interest payments on loans, proceeds from loan and securities sales, and advances from the Federal Home Loan Bank of Atlanta (the "FHLB"). While maturities and scheduled amortization of loans are predictable sources of funds, deposit flows and mortgage prepayments are greatly influenced by interest rates, economic conditions and local competition. The Bank's primary investing activity is the origination of commercial, consumer and mortgage loans. During the years ended September 30, 2001 and 2000, the Bank had loan originations of $204.6 million and $176.5 million, respectively. The Bank's primary financing activities are the attraction of checking, certificate and savings deposits, and obtaining FHLB advances.

The levels of cash and cash equivalents is dependent on the Bank's operating, financing, lending and investing activities during any given period. At September 30, 2001 and 2000, cash and cash equivalents totaled $40.4 million and $14.7 million, respectively. The Bank has other sources of liquidity if a need for additional funds arises. During the years ended September 30, 2001 and 2000, the Bank sold or exchanged real estate loans totaling $49.3 million and $62.8 million, respectively. Borrowing's consisting of FHLB advances and retail repurchase agreements were $4.9 million at September 30, 2001 compared to $30.4 million at September 30, 2000. Other sources of liquidity include investment and mortgage-backed securities designated as available for sale, which totaled $103.3 million at September 30, 2001 and $153.7 million at September 30, 2000.

At September 30, 2001 stockholders' equity was $50.8 million compared to $44.8 million at September 30, 2000. At September 30, 2001 there were 3,016,546 shares of common stock outstanding, net of 1,347,498 treasury shares. Net income for fiscal 2001 was $5.8 million, compared to $3.5 million for fiscal 2000.

As a North Carolina chartered commercial bank and a Federal Deposit Insurance Corporation (the "FDIC") insured institution, the Bank is required to meet various state and federal regulatory capital standards. The Bank's stand-alone equity was $49.2 million at September 30, 2001, compared to $43.7 million at September 30, 2000, substantially in excess of all such regulatory requirements. The Commissioner requires the Bank to maintain a capital surplus of not less than 50% of common capital stock. The FDIC requires the Bank to meet a minimum leverage capital requirement of Tier I capital (consisting of retained earnings and common stockholders' equity, less any intangible assets) to assets ratio of at least 4% and a total capital to risk-weighted assets ratio of 8%, of which 4% must be in the form of Tier I capital. The Bank was in compliance with all capital requirements of both the Commissioner and the FDIC at September 30, 2001 and 2000.

Asset/Liability Management

The Bank strives to maintain consistent net interest income and reduce its exposure to adverse changes in interest rates by matching the terms to repricing of its interest-sensitive assets and liabilities. Factors beyond the Bank's control, such as market interest rates and competition, may also impact interest income and interest expense. The overall yield on the Bank's earning assets will generally increase when interest rates rise over an extended period of time, and conversely, yields will decrease when interest rates decline. In general, interest expense will increase when interest rates rise over an extended period of time, and conversely interest expense will decrease when interest rates decline. The Bank can significantly influence its net interest income by controlling the increases and decreases in its interest income and interest expense, which are caused by changes in market interest rates.

The President of the Bank reports interest rate risk and trends to the Board of Directors on a regular basis, as well as liquidity and capital ratio requirements. The Board of Directors reviews the maturities of the Bank's assets and liabilities and establishes policies and strategies designed to regulate the flow of funds and to coordinate the sources, uses and pricing of such funds. The first priority in structuring and pricing assets and liabilities is to maintain an acceptable interest rate spread while reducing the net effects of changes in interest rates. The Bank's management is responsible for administering the policies and determinations of the Board of Directors with respect to the Bank's asset and liability goals and strategies.

A principal strategy in managing the Bank's interest rate risk has been to increase interest sensitive assets such as commercial and consumer loans. At September 30, 2001, the Bank had $178.9 million of commercial loans and $78.2 million of consumer loans compared to $137.9 million and $75.0 million, respectively, at September 30, 2000. The Bank had $20.5 million of loans held for sale at September 30, 2001, compared to $32.4 million at September 30, 2000. Depending on conditions existing at a given time, the Bank may sell fixed-rate residential mortgage loans in the secondary market. In managing its portfolio of investment securities, the Bank has emphasized that all purchases of securities are held as available for sale, allowing the Bank to sell a security in a timely manner should an immediate liquidity need arise. The Bank had $103.3 million of investment and mortgage-backed securities classified as available for sale at September 30, 2001, compared to $153.7 million at September 30, 2000.

Market Risk

Market risk reflects the risk of economic loss resulting from changes in market prices and interest rates. The risk of loss can be reflected in diminished current market values and/or reduced potential net interest income in future periods. Market risk arises primarily from interest rate risk inherent in lending and deposit taking activities. The Bank does not maintain a trading account for any class of financial instruments, nor does it engage in hedging activities or purchase high-risk derivative instruments. Furthermore, the Bank is not subject to foreign currency exchange risk or commodity price risk.

The Bank measures interest rate risk by computing estimated changes in net interest income and the net portfolio value ("NPV") of its cash flows from assets, liabilities and off-balance sheet items in the event of a range of assumed changes in market interest rates. The Bank's exposure to interest rates is reviewed on a quarterly basis by management and the Board of Directors. Exposure to interest rate risk is measured with the use of interest rate sensitivity analysis to determine the change in NPV in the event of hypothetical changes in interest rates, while interest rate sensitivity gap analysis is used to determine the repricing characteristics of assets and liabilities. If estimated changes to NPV and net interest income are not within the limits established by the Board, the Board may direct management to adjust the Bank's asset and liability mix to bring interest rate risk within Board approved limits.

NPV represents the market value of portfolio equity and is equal to the market value of assets minus the market value of liabilities, with adjustments made for off-balance sheet items. This analysis assesses the potential loss in risk sensitive instruments in the event of sudden and sustained 1% to 3% increases and decreases in market interest rates.

The Bank's Board of Directors has adopted an interest rate risk policy that establishes maximum increases in NPV of 17%, 36% and 56% and decreases in NPV of 15%, 36% and 61% in the event of sudden and sustained 1% to 3% increases or decreases in market interest rates. Table 1 below presents the Bank's projected changes in NPV and net interest income in the event of sudden and sustained increases or decreases in market interest rates for the various rate shock levels at September 30, 2001. At September 30, 2001, the Bank's estimated changes in NPV and net interest income were within the targets established by the Board of Directors.

Table 1 - Projected Change in NPV and Net Interest Income

Change in Rates	Net Portfolio Value $ Amount	$ Change	% Change	Net Interest Income $ Amount	$ Change	% Change
			(Dollars in thousands)			
+ 300 bp	$ 59,269	$(16,018)	(21.3)%	$ 23,091	$ (765)	(3.2)%
+ 200 bp	65,350	(9,937)	(13.2)	23,203	(653)	(2.7)
+ 100 bp	70,809	(4,478)	(5.9)	23,529	(327)	(1.4)
Base	75,287	—	—	23,856	—	—
- 100 bp	78,681	3,394	4.5	23,935	79	.3
- 200 bp	83,865	8,578	11.4	23,947	91	.4
- 300 bp	88,524	13,237	17.6	23,121	(735)	(3.1)

Computations of prospective effects of hypothetical interest rate changes are based on numerous assumptions, including relative levels of market interest rates, loan prepayments and deposit decay rates, and should not be relied upon as indicative of actual results. Further, the computations do not contemplate any actions the Bank may undertake in response to changes in interest rates. The NPV calculation is based on the net present value of discounted cash flows utilizing market prepayment assumptions.

Certain shortcomings are inherent in the method of analysis presented in Table 1. For example, although certain assets and liabilities may have similar maturities to repricing, they may react in differing degrees to changes in market interest rates. The interest rates on certain types of assets and liabilities may fluctuate in advance of changes in market interest rates, while interest rates on other types may lag behind changes in market rates. Certain assets such as adjustable-rate loans have features that restrict changes in interest rates on a short-term basis and over the life of the asset. In addition, the proportion of adjustable-rate loans in the Bank's portfolio could decrease in future periods if market interest rates remain at or decrease below current levels due to refinance activity. Further, in the event of a change in interest rates, prepayment and early withdrawal levels would likely deviate from those assumed in the table. Also, the ability of many borrowers to repay their adjustable-rate debt may decrease in the event of an increase in interest rates.

In addition, the Bank uses interest sensitivity gap analysis to monitor the relationship between the maturity and repricing of its interest-earning assets and interest-bearing liabilities, while maintaining an acceptable interest rate spread. Interest sensitivity gap is defined as the difference between the amount of interest-earning assets maturing or repricing within a specific time period and the amount of interest-bearing liabilities maturing or repricing within that time period. A gap is considered positive when the amount of interest-sensitive assets exceeds the amount of interest-sensitive liabilities, and is considered negative when the amount of interest-rate-sensitive liabilities exceeds the amount of interest-rate-sensitive assets. Generally, during a period of rising interest rates, a negative gap would adversely affect net interest income, while a positive gap would result in an increase in net interest income. Conversely, during a period of falling interest rates, a negative gap would result in an increase in net interest income, while a positive gap would negatively affect net interest income. The Bank's goal is to maintain a reasonable balance between exposure to interest rate fluctuations and earnings.

Rate/Volume Analysis

Net interest income can also be analyzed in terms of the impact of changing interest rates on average interest-earning assets and average interest-bearing liabilities and the changing volume or amount of these assets and liabilities. Table 2 below represents the extent to which changes in interest rates and changes in the volume of average interest-earning assets and average interest-bearing liabilities have affected the Bank's interest income and interest expense during the periods indicated. For each category of average interest-earning asset and average interest-bearing liability, information is provided on changes attributable to: (i) changes in volume (changes in volume multiplied by old rate); (ii) changes in rate (change in rate multiplied by old volume); (iii) changes in rate-volume (changes in rate multiplied by the changes in volume); and (iv) net change (total of the previous columns).

Table 2 - Rate/Volume Analysis

	Year Ended September 30,							
	2001 vs. 2000				2000 vs. 1999			
	Increase (Decrease) Due to				Increase (Decrease) Due to			
	Volume	Rate	Rate/ Volume	Total	Volume	Rate	Rate/ Volume	Total
	(In thousands)							
Interest income:								
Loans receivable	$4,103	$ 145	$ 21	$ 4,269	$ 9,019	$ 143	$ 67	$ 9,229
Investment securities	2,285	(39)	(69)	2,177	994	(7)	(22)	965
Mortgage-backed securities	(439)	(344)	24	(759)	2,598	88	71	2,757
Other interest-earning assets	(63)	(350)	20	(393)	215	342	228	785
Total interest-earning assets	5,886	(588)	(4)	5,294	12,826	566	344	13,736
Interest expense:								
Deposits	3,363	(437)	(81)	2,845	7,584	744	601	8,929
FHLB advances	131	108	25	264	8	1	—	9
Other interest-bearing liabilities	82	(23)	(13)	46	46	26	24	96
Total interest-bearing liabilities	3,576	(352)	(69)	3,155	7,638	771	625	9,034
Change in net interest income	$2,310	$ (236)	$ 65	$ 2,139	$ 5,188	$ (205)	$ (281)	$ 4,702

Table 3 - Yield/Cost Analysis

	Year Ended September 30,						
	2001			2000			
	Average Balance	Interest	Average Yield/ Cost	Average Balance	Interest	Average Yield/ Cost	Average Balance
Interest earning assets:							
Loans receivable (1)	$369,735	$32,760	8.86 %	$323,178	$28,491	8.81 %	$220,12
Investment securities	51,386	3,461	6.74	18,487	1,284	6.95	4,48
Mortgage-backed securities	77,422	5,223	6.75	83,535	5,982	7.16	46,27
Other Interest-earning assets	14,547	715	4.92	15,409	1,108	7.19	9,24
Total earning assets	513,090	42,159	8.22	440,609	36,865	8.37	280,13
Nonearning assets	36,225			25,194			13,02
Total assets	$549,315			$465,803			$293,16
Interest bearing liabilities:							
Time deposits	$323,037	18,496	5.72	$282,159	16,048	5.69	$160,68
Demand deposits	87,309	2,396	2.74	66,015	1,987	3.01	33,47
Savings	20,450	262	1.28	18,771	274	1.46	6,97
FHLB advances	13,638	822	6.03	11,046	558	5.05	10,88
Repurchase agreements	5,419	192	3.54	3,471	146	4.21	1,81
Total interest-bearing liabilities	449,853	22,168	4.93	381,462	19,013	4.98	213,82
Noninterest bearing demand deposits	37,383	0	0.00	28,530	0	0.00	17,61
Total sources of funds	487,236	22,168	4.55	409,992	19,013	4.64	231,44
Other liabilities and stockholders'equity							
Other liabilities	14,707			9,753			8,68
Stockholders' equity	47,372			46,058			53,03
Total liabilities and stockholders' equity	$549,315			$465,803			$293,16
Net interest income		$19,991			$17,852		
Interest rate spread (2)			3.67 %			3.73 %	
Net yield on earning assets (3)			3.90 %			4.05 %	
Ratio of earning assets to interest bearing liabilities			114.06 %			115.51 %	

(1) Includes classified loans.
(2) Represents the difference between the yield on earning assets and the average cost of funds.
(3) Represents the net interest income divided by average earning assets.

Analysis of Net Interest Income

Net interest income primarily represents the difference between income derived from interest-earning assets and interest expense on interest-bearing liabilities. Net interest income is affected by both the difference between the yield on earning assets and the average cost of funds ("interest rate spread") and the relative volume of interest-earning assets, interest-bearing liabilities and noninterest-bearing deposits.

Table 3 above sets forth certain information relating to the Bank's statements of financial condition and statements of operations for the three years ended September 30, 2001, 2000, and 1999 and reflects the yield on average earning assets and the average cost of funds for the periods indicated. Average balances are derived from month end balances. The Bank does not believe that the use of month end balances instead of average daily balances has caused any material difference in the information presented.

Results of Operations

Comparison of Financial Condition at September 30, 2001 and 2000

Total assets were $541.2 million at September 30, 2001 compared to $559.7 million at September 30, 2000. Earning assets declined to $501.7 million at September 30, 2001 from $524.2 million at September 30, 2000, reflecting the sales of certain mortgage loans and mortgage-backed securities. Earning assets were 92.7% of total assets at September 30, 2001 compared to 93.8% a September 30, 2000.

The Bank has implemented various strategies to sell certain loans and securities during favorable interest rate cycles, and the securitization of certain mortgage loans held for sale into mortgage-backed securities. The year ended September 30, 2001 was an advantageous period to execute these strategies due to declining interest rates.

Loans receivable, net of loan loss reserves and deferred loan fees, increased to $374.1 million at September 30, 2001, from $366.2 million at September 30, 2000. The Bank continues to emphasize the origination of both secured and unsecured commercial and consumer loans in order to take advantage of generally higher yields as well as shorter terms to maturity. From time to time, the Bank sells selected mortgage loans in the secondary market in order to reduce interest rate and credit risk, while retaining servicing to generate additional fee income.

Commercial loans increased 29.7% to $178.9 million at September 30, 2001, from $137.9 million at September 30, 2000. Consumer loans increased 4.2% to $78.2 million at September 30, 2001 from $75.0 million at September 30, 2000. This growth reflects the Bank's emphasis of structuring itself as a commercial banking entity. Commercial and consumer loan originations increased to $144.1 million during fiscal 2001, from $122.4 million during fiscal 2000.

Residential real estate mortgage loans declined 22.7% to $123.2 million at September 30, 2001, from $159.3 million at September 30, 2000, reflecting the sales and exchanges of loans, net of origination volume. The Bank sold or exchanged $49.4 million of mortgage loans during fiscal 2001, compared to $62.8 million during fiscal 2000. Loans serviced for others were $295.2 million at September 30, 2000 compared to $300.0 million at September 30, 2000. During fiscal 2001, the Bank originated $60.4 million of residential mortgage loans, compared to $54.1 million during fiscal 2000.

Investment securities and mortgage-backed securities declined 32.8% to $103.3 million at September 30, 2001, from $153.7 million at September 30, 2000. During the year ended September 30, 2001, the Bank increased its investment securities portfolio (primarily U. S. Government and Agency securities) to $54.7 million from $45.2 million at September 30, 2000. Due to declining interest rates during fiscal 2001 and 2000, the Bank has executed its aforementioned strategies of securitizing loans into mortgage-backed securities and selling certain mortgage-backed securities. During the years ended September 30, 2001 and 2000, the Bank exchanged $12.3 million and $62.8 million of mortgage loans previously held for sale into mortgage-backed securities. The Bank sold $63.2 million of mortgage-backed securities during the year ended September 30, 2001, compared to no sales during the year ended September 30, 2000. Net of sales, securitizations and principal repayments, the mortgage-backed securities portfolio declined to $48.6 million at September 30, 2001 from $108.5 million at September 30, 2000.

Deposits were $471.9 million at September 30, 2001 and 2000, respectively. Certificates of deposit declined to $312.7 million at September 30, 2000, from $339.3 million at September 30, 2000. The Bank continued to emphasize attracting lower cost core deposits, as checking accounts increased 26.7% to $140.1 million at September 30, 2001, from $110.6 million at September 30, 2000. During fiscal 2001, the Bank implemented a strategy of managing its cost of deposits by allowing certain high rate certificates of deposit to mature amid increasingly competitive market interest rates, offset by the growth in checking accounts. The Bank is also repricing higher costing certificates of deposits at lower rates, and combined with the growth of lower costing core checking accounts, has been an effective tool in managing its deposit cost.

Total borrowings declined to $4.9 million at September 30, 2001, from $30.4 million at September 30, 2000. During fiscal 2001, the Bank used proceeds from the mortgage-backed securities sales to repay $24.0 million of FHLB advances. Borrowings in the form of repurchase agreements were $4.9 million at September 30, 2001 compared to $6.4 million at September 30, 2000, representing funds held in cash management accounts for commercial banking customers.

Stockholders' equity was $50.8 million at September 30, 2001, compared to $44.8 million at September 30, 2000. The ratio of equity to total assets increased to 9.4% at September 30, 2001, from 8.0% at September 30, 2000, reflecting current fiscal year earnings and a significant increase in unrealized gains on available for sale securities, due primarily to the recent decline in market rates. Accumulated other comprehensive income was $3.5 million at September 30, 2001 compared to other comprehensive loss of $1.3 million at September 30, 2000.

During the years ended September 30, 2001 and 2000, the Company declared four quarterly cash dividends each, totaling $0.67 and $0.46 per share respectively. These cash dividend payments reflect dividend payout ratios on basic earnings of 33.3% and 40.4% respectively. Future quarterly dividends will be determined at the discretion of the Board of Directors based upon earnings, the capital and financial condition of the Company and general economic conditions.

The Company's note receivable from the Employee Stock Ownership Plan ("ESOP") declined to $1.4 million at September 30, 2001, from $1.8 million at September 30, 2000, reflecting the release of 45,932 shares to ESOP participants. The note is reported as a reduction of stockholders' equity and requires an annual $349,000 principal payment plus interest at prime plus one percent. Although shares of common stock of the Company secure the ESOP note, the Bank expects to make discretionary contributions to the ESOP in amounts at least equal to the required principal and interest payments. At September 30, 2000, 135,926 unallocated shares remained in the ESOP, compared to 181,858 at September 30, 2000.

Pursuant to stock repurchase programs adopted by the Company during fiscal years 2001 and 2000, the Company acquired 143,929 and 390,066 shares of its common stock, respectively, through open market and private purchases. Shares acquired under the repurchase program are being held as treasury stock, at cost. At September 30, 2001, treasury shares were 1,347,498 totaling $26.9 million, compared to 1,203,569 shares totaling $23.0 million at September 30, 2000. The Company believes the repurchase of its outstanding common stock will increase per share earnings and book value, provide an attractive investment for the Company's excess funds and decrease the potential dilutive effect caused by the future exercise of stock options.

Comparison of Operating Results for the Years Ended September 30, 2001 and 2000

Net Income. Net income increased to $5.8 million for the year ended September 30, 2001, from $3.5 million for the year ended September 30, 2000. Basic and diluted earnings per share increased to $2.01 and $1.95 per share, respectively, for the year ended September 30, 2001, compared to $1.14 and $1.13 per share, respectively, for the year ended September 30, 2000. The average number of basic shares outstanding (net of unearned ESOP and treasury shares) was 2,899,846 and 3,115,768, respectively, for the years ended September 30, 2001 and 2000, reflecting the impact of the stock repurchase program.

Interest Income. Interest income increased 14.4% to $42.2 million for fiscal 2001, from $36.9 million for fiscal 2000. The increase in interest income on loans and investments during 2001 results from the growth in earning assets from internal growth and the completion of two prior year acquisitions. The average balance of interest-earning assets increased 16.5% to $513.1 million for fiscal 2001, from $440.6 million for fiscal 2000. The yield on average interest-earning assets was 8.2% for 2001 compared to 8.4% for 2000, reflecting the decline in interest rates during 2001.

Interest Expense. Interest expense increased 16.6% to $22.2 million for fiscal 2001, from $19.0 million for fiscal 2000. The increase in interest expense on deposits and borrowings during 2001 also results from the increased volume of average interest-bearing liabilities resulting from internal growth and the completion of the prior year acquisitions. The average balance of interest-bearing liabilities increased 17.9% to $449.9 million for fiscal 2001, from $381.5 million for fiscal 2000. The average cost of funds was 4.5% for 2001 compared to 4.6% for 2000, reflecting the decline in interest rates during 2001.

Net Interest Income. Net interest income increased 12.0% to $20.0 million for fiscal 2001, from $17.9 million for fiscal 2000. The increase in net interest income is primarily due to an increase in both the volume of average interest-earning assets, offset by an increase in interest bearing liabilities and a decline in interest rates during 2001. The net yield on interest-earning assets was 4.1% for fiscal 2001 and 2000, respectively. See Table 2 (Rate/Volume Analysis) and Table 3 (Yield/Cost Analysis) above for additional information on interest income, interest expense, net interest income, average balances and yield/cost ratios.

Provision for Loan Losses. The Bank maintains an allowance for losses on loans based upon management's evaluation of existing risks in the loan portfolio, the Bank's past loan loss experience, and current economic conditions. The Bank provided $830,000 for loan losses during fiscal 2001, compared to $977,000 for fiscal 2000. These provisions were necessary to support the risks associated with the growth of the commercial and consumer loan portfolios and the volume of loans acquired in the prior year acquisitions. The allowance for loan losses was $5.4 million at September 30, 2001, compared to $5.2 million at September 30, 2000, which the Bank believes is adequate to absorb probable losses in its loan portfolio. The ratio of the allowance for loan losses to total loans, net of loans-in-process and deferred loan fees, was 1.4% at September 30, 2001 and 2000.

The Bank uses an analytical approach in determining the adequacy of its loan loss allowance and the necessary provision for loan losses, through a classification of assets program. On a quarterly basis, the loan portfolio is generally reviewed, and delinquent loans are individually analyzed. Consideration is given to the loan status, payment history, repayment ability, probability of repayment, and loan-to-value percentages. As a result of this review and analysis, loans are classified in appropriate categories applicable to their circumstances. After reviewing current economic conditions, changes in delinquency status, and actual loan losses incurred by the Bank, management establishes an appropriate reserve percentage applicable to each category of assets, and provision for loan losses is recorded when necessary to bring the allowance to a level consistent with this analysis. The ratio of non-performing loans to total loans was .3% at September 30, 2001, compared to .5% at September 30, 2000.

Other Income. Other income increased 97.4% to $6.8 million for fiscal 2001, from $3.4 million for fiscal 2000. Other income consists of fees and service charges earned on loans, service charges on deposit accounts, gains from sales of loans, and other miscellaneous income. Loan fees and service charges increased 78.3% to $3.4 million for fiscal 2001, from $1.9 million for fiscal 2000, reflecting the growth of the commercial and consumer loan portfolios, the growth in checking accounts and the impact of the prior year acquisitions. Gains from sales of loans and mortgage-backed securities increased to $1.8 million for fiscal 2001 from $2,000 for fiscal 2000. The volume of loans and mortgage-backed securities sold or exchanged during 2001 was $112.6 million, compared to $62.8 million for 2000, reflecting an increased volume of sales or exchanges due to declining interest rates and more favorable pricing in the secondary mortgage market. Servicing fee income on loans serviced for others was $766,000 for 2001 compared to $771,000 for 2000, as loans serviced for others declined to $295.2 million at September 30, 2001, from $300.0 million at September 30, 2000.

General and Administrative Expenses. General and administrative expenses increased 13.8% to $16.0 million for fiscal 2001, from $14.1 million in fiscal 2000. The Company's efficiency ratio (noninterest expenses divided by net interest income plus noninterest income) improved to 59.9% for fiscal 2001 from 66.3% for fiscal 2000. The largest single component of these expenses, compensation and fringe benefits, increased 12.4% to $9.7 million for fiscal 2001, from $8.6 million for fiscal 2000. This increase is principally attributable to growth in personnel resulting from two new full-service branch offices opened during the year ended September 30, 2001 and the prior year acquisitions. In addition, compensation expense related to the ESOP increased to $1.2 million for fiscal 2001 from $835,000 for fiscal 2000, resulting from a continuing increase in the market value of the Company's outstanding common stock.

Data processing expense has grown proportionately with the growth in customer accounts and transaction activity primarily attributable to the growth in earning assets and deposits from the prior year acquisitions. The increase in amortization of intangible assets is directly related to a full year of amortizing the intangible assets associated with the prior year acquisitions. Other noninterest expenses including advertising, deposit insurance, premises and equipment, repairs and maintenance, and office expenses have also grown proportionately from period to period with the growth in earning assets and checking accounts.

Income Taxes. The provision for income taxes increased to $4.1 million for fiscal 2001 from $2.7 million for fiscal 2000. The increase in provision for income taxes is the result of the increased pretax earnings of $9.9 million for fiscal 2001, from $6.2 million for fiscal 2000 and the effective income tax rates for each period.

Comparison of Financial Condition at September 30, 2000 and 1999

Total assets increased to $559.7 million at September 30, 2000, from $292.3 million at September 30, 1999, reflecting the Green Street and Triangle acquisitions. Loans receivable increased 72.7% to $366.2 million at September 30, 2000, from $212.1 million at September 30, 1999, also reflecting the Green Street and Triangle acquisitions.

Commercial loans increased 55.3% to $137.9 million at September 30, 2000, from $88.8 million at September 30, 1999. Consumer loans increased 47.5% to $75.0 million at September 30, 2000 from $50.8 million at September 30, 1999. This growth reflects both the Green Street and Triangle acquisitions as well as the Bank's emphasis on commercial banking. Commercial and consumer loan originations increased to $122.4 million for fiscal 2000, from $86.3 million for fiscal 1999.

Residential real estate mortgage loans increased 109.1% to $159.3 million at September 30, 2000, from $76.2 million at September 30, 1999, reflecting the Green Street acquisition and the Bank's origination volume. During fiscal 2000, the Bank originated $54.1 million of real estate mortgage loans, compared to $91.2 million during fiscal 1999. The Bank sold or exchanged $62.8 million of real estate loans during fiscal 1999, compared to $86.1 million during fiscal 1999. Loans serviced for others were $300.0 million at September 30, 2000 compared to $275.3 million at September 30, 1999.

Investment securities and mortgage-backed securities increased to $153.7 million at September 30, 2000, from $59.4 million at September 30, 1999. To support its acquisition growth, the Bank implemented various investment strategies for increasing required regulatory levels. During the year ended September 30, 2000, the Bank increased its investment securities portfolio (primarily U. S. Government and Agency securities) to $45.2 million, compared to $3.0 million at September 30, 1999. In addition, during 2000 the Bank securitized certain mortgage loans previously held for sale into mortgage-backed securities, resulting in a mortgage-backed securities portfolio of $108.5 million at September 30, 2000, compared to $56.3 million at September 30, 1999.

Deposits increased to $471.9 million at September 30, 2000, from $234.6 million at September 30, 1999, reflecting the Green Street and Triangle acquisitions and the Bank's annual internal growth. Certificates of deposit increased 95.1% to $339.3 million at September 30, 2000, from $173.9 million at September 30, 1999, while checking accounts increased 106.6% to $110.6 million at September 30, 2000, from $53.5 million at September 30, 1999.

Total borrowings increased to $30.4 million at September 30, 2000, from $1.3 million at September 30, 1999. Due to the volatility of short-term interest rates during fiscal 2000, the Bank relied more on FHLB advances as a funding source to help control its exposure to interest rate risk, and to support its operations and liquidity requirements.

Stockholders' equity was $44.8 million at September 30, 2000, compared to $48.8 million at September 30, 1999. The ratio of equity to total assets decreased to 8.0% at September 30, 2000, from 16.7% at September 30, 1999, reflecting the leveraging effect of the Green Street and Triangle acquisitions. During the years ended September 30, 2000 and 1999, the Company declared four quarterly cash dividends each, totaling $0.46 and $0.31 per share respectively. These cash dividend payments reflect dividend payout ratios on basic earnings of 40.4% and 34.1% respectively.

The Company's note receivable from the ESOP declined to $1.8 million at September 30, 2000, from $2.3 million at September 30, 1999, reflecting the release of 44,492 shares to ESOP participants. At September 30, 2000, 181,858 unallocated shares remained in the ESOP, compared to 226,350 at September 30, 1999.

During fiscal 2000, the Management Recognition Plan ("MRP"), a deferred stock awards plan established for the benefit of directors and officers of the Company and the Bank, was terminated upon distribution of all remaining plan shares. On April 8, 2000, the remaining 58,187 of awarded plan shares were vested and distributed to participants. At September 30, 1999, the 58,187 of awarded shares were held in trust for future vesting, and reported as a reduction in stockholders' equity as deferred stock awards.

Pursuant to stock repurchase programs adopted by the Company during fiscal years 2000 and 1999, the Company acquired 390,066 and 595,301 shares of its common stock, respectively, and are being held as treasury stock, at cost. At September 30, 2000, treasury shares were 1,203,569 totaling $23.0 million, compared to 813,503 shares totaling $15.8 million at September 30, 1999.

Comparison of Operating Results for the Years Ended September 30, 2000 and 1999

Net Income. Net income increased to $3.5 million for the year ended September 30, 2000, from $3.2 million for the year ended September 30, 1999. Basic and diluted earnings per share increased to $1.14 and $1.13 per share, respectively, for the year ended September 30, 2000, compared to $0.91 per share, respectively, for the year ended September 30, 1999. The average number of basic shares outstanding (net of unearned ESOP, MRP and treasury shares) was 3,115,768 and 3,530,811, respectively, for the years ended September 30, 2000 and 1999.

Interest Income. Interest income increased 59.4% to $36.9 million for fiscal 2000, from $23.1 million for fiscal 1999. The increase in interest income on loans and investments during 2000 results principally from the growth in volume of average interest-earning assets attributable to the Green Street and Triangle acquisitions. The average balance of interest-earning assets increased 57.2% to $440.6 million for fiscal 2000, from $280.1 million for fiscal 1999. The yield on average interest-earning assets increased to 8.4% for 2000, from 8.3% for 1999, reflecting an increase in interest rates during 2000.

Interest Expense. Interest expense increased 90.5% to $19.0 million for fiscal 2000, from $10.0 million for fiscal 1999. The increase in interest expense on deposits and borrowings during 2000 results principally from the increased volume of average interest-bearing liabilities attributable to the Green Street Triangle acquisitions and rising interest rates. The average balance of interest-bearing liabilities increased 78.4% to $381.50 million for fiscal 2000, from $213.8 million for fiscal 1999. The average cost of funds increased to 4.6% for 2000, from 4.3% for 1999, reflecting an increase in interest rates during 2000.

Net Interest Income. Net interest income increased 35.8% to $17.9 million for fiscal 2000, from $13.2 million for fiscal 1999. See Table 2 (Rate/Volume Analysis) and Table 3 (Yield/Cost Analysis) above for additional information on interest income, interest expense, net interest income, average balances and yield/cost ratios.

Provision for Loan Losses. The Bank provided $977,000 for loan losses during fiscal 2000, compared to $120,000 for fiscal 1999. These provisions were necessary to support the volume of loans acquired in the Green Street and Triangle transactions, and the risks associated with the growth of the commercial and consumer loan portfolio. The allowance for loan losses was $5.2 million at September 30, 2000, compared to $3.3 million at September 30, 1999. The ratio of the allowance for loan losses to total loans was 1.4% at September 30, 2000, compared to 1.5% at September 30, 1999. The ratio of non-performing loans to total loans was .5% at September 30, 2000 and .3% at September 30, 1999.

Other Income. Other income increased 19.4% to $3.4 million for fiscal 2000, from $2.9 million for fiscal 1999. Loan fees and service charges increased 48.8% to $1.9 million for fiscal 2000, from $1.3 million for fiscal 1999, reflecting the impact of the Green Street and Triangle acquisitions on the growth of the commercial and consumer loan portfolios and checking accounts. Gains from sales of loans and mortgage-backed securities declined to $2,000 for fiscal 2000 from $566,000 for fiscal 1999. The volume of loans and mortgage-backed securities sold or exchanged during 2000 was $62.8 million, compared to $86.1 million for 1999, reflecting less sales or exchanges due to the competitive pricing in the secondary mortgage market. Servicing fee income on loans serviced for others increased to $771,000 for 2000 from $762,000 for 1999, as loans serviced for others increased to $300.0 million at September 30, 2000, from $275.3 million at September 30, 1999.

General and Administrative Expenses. General and administrative expenses increased 37.5% to $14.1 million for fiscal 2000, from $10.3 million in fiscal 1999. The Company's efficiency ratio was 66.2% for fiscal 2000, compared to 63.9% for fiscal 1999. Compensation and fringe benefits, increased 24.3% to $8.6 million for fiscal 2000, from $6.9 million for fiscal 1999, reflecting a 50.0% growth in personnel resulting from the Green Street and Triangle acquisitions, as full time equivalent employees increased to 198 at September 30, 2000 from 132 at September 30, 1999.

Other noninterest expenses including data processing, deposit insurance, premises and equipment, repairs, advertising and office expenses sustained proportionate incremental increases from 1999 to 2000, supporting the 91.5% growth in assets from September 30, 1999 to September 30, 2000. During fiscal 2000, the Bank recorded amortization of intangible assets and certain other noninterest expenses in connection with the completion of the Green Street and Triangle acquisitions, as well as completing its name change to First South Bank.

Income Taxes. The provision for income taxes increased to $2.7 million for fiscal 2000 from $2.5 million for fiscal 1999. The increase in provision for income taxes is the result of the increased pretax earnings of $6.2 million for fiscal 2000, from $5.6 million for fiscal 1999 and the effective income tax rates for each period.

Impact of Inflation and Changing Prices

The financial statements of the Bank and accompanying footnotes have been prepared in accordance with generally accepted accounting principles. They require the measurement of financial position and operating results in terms of historical dollars without considering the change in the relative purchasing power of money over time and due to inflation. The impact of inflation is reflected in the increased cost of the Bank's operations. Unlike most industrial companies, nearly all the assets and liabilities of the Bank are monetary. As a result, interest rates have a greater impact on the Bank's performance than do the effects of general levels of inflation. Interest rates do not necessarily move in the same direction or to the same extent as the price of goods and services.

Forward Looking Statements

The Private Securities Litigation Reform Act of 1995 states that the disclosure of forward looking information is desirable for investors and encourages such disclosure by providing a safe harbor for forward looking statements by corporate management. This Annual Report, including the Letter to Stockholders and Management's Discussion and Analysis of Financial Condition and Results of Operations, contains forward looking statements that involve risk and uncertainty. In order to comply with the terms of the safe harbor, the Company notes that a variety of risks and uncertainties could cause its actual results and experience to differ materially from the anticipated results or other expectations expressed in the Company's forward looking statements. There are risks and uncertainties that may affect the operations, performance, development, growth projections and results of the Company's business. They include, but are not limited to, economic growth, interest rate movements, timely development of technology enhancements for products, services and operating systems, the impact of competitive products, services and pricing, customer requirements, regulatory changes and similar matters. Readers of this report are cautioned not to place undue reliance on forward looking statements that are subject to influence by these risk factors and unanticipated events. Accordingly, actual results may differ materially from management's expectations.

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Report of Independent Accountants

To the Board of Directors
First South Bancorp, Inc.
Washington, North Carolina

In our opinion, the accompanying consolidated statements of financial condition and the related consolidated statements of operations, of stockholders' equity and of cash flows present fairly, in all material respects, the financial position of First South Bancorp, Inc. and Subsidiary (the "Company") at September 30, 2001 and 2000, and the results of their operations and their cash flows for each of the three years in the period ended September 30, 2001, in conformity with accounting principles generally accepted in the United States of America. These financial statements are the responsibility of the Company's management; our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits of these statements in accordance with auditing standards generally accepted in the United States of America, which 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, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for the opinion expressed above.

PricewaterhouseCoopers LLP

November 2, 2001

First South Bancorp, Inc. and Subsidiary
Consolidated Statements of Financial Condition
September 30, 2001 and 2000

Assets	2001	2000
Cash and due from banks	$ 18,789,868	$ 13,124,356
Interest-bearing deposits in financial institutions	21,659,575	1,617,084
Investment securities - available for sale	54,741,784	45,186,391
Mortgage-backed securities - available for sale	48,603,336	108,518,700
Loans receivable, net:		
Held for sale	20,450,602	32,443,106
Held for investment	353,636,343	333,766,510
Premises and equipment, net	7,925,610	7,022,819
Deferred income taxes	108,631	2,882,886
Real estate owned	529,666	220,004
Federal Home Loan Bank of Atlanta stock, at cost which approximates market	2,712,500	2,651,300
Accrued interest receivable	3,602,088	3,784,177
Intangible assets	5,273,172	5,044,421
Prepaid expenses and other assets	1,791,020	2,060,842
Note receivable	1,371,006	1,396,051
Total assets	$ 541,195,201	$ 559,718,647
Liabilities and Stockholders' Equity		
Deposits:		
Demand	$ 140,107,605	$ 110,592,166
Savings	19,174,806	22,069,124
Large denomination certificates of deposit	61,416,796	56,336,303
Other time	251,239,701	282,944,074
Total deposits	471,938,908	471,941,667
Borrowed money	4,909,497	30,387,551
Other liabilities	13,578,178	12,554,694
Total liabilities	490,426,583	514,883,912
Commitments and contingencies (Notes 10 and 14)		
Common stock, $.01 par value, 8,000,000 shares authorized, 4,364,044 shares issued and outstanding	43,640	43,640
Additional paid-in capital	45,303,405	44,583,318
Retained earnings, substantially restricted	30,222,064	26,327,863
Treasury stock at cost, 1,347,498 and 1,203,569 shares at September 30, 2001 and 2000, respectively	(26,905,629)	(23,039,101)
Unearned ESOP shares, 135,926 and 181,858 shares at September 30, 2001 and 2000, respectively	(1,359,259)	(1,818,578)
Accumulated other comprehensive income (loss), net	3,464,397	(1,262,407)
Total stockholders' equity	50,768,618	44,834,735
Total liabilities and stockholders' equity	$ 541,195,201	$ 559,718,647

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

First South Bancorp, Inc. and Subsidiary
Consolidated Statements of Operations
Years ended September 30, 2001, 2000 and 1999

	2001	2000	1999
Interest income:			
Interest and fees on loans	$ 32,759,752	$ 28,491,128	$ 19,261,766
Interest and dividends on investments and deposits	9,399,416	8,373,756	3,867,259
Total interest income	42,159,168	36,864,884	23,129,025
Interest expense:			
Interest on deposits	21,154,382	18,309,033	9,379,641
Interest on borrowings	1,013,660	703,647	599,422
Total interest expense	22,168,042	19,012,680	9,979,063
Net interest income before provision for loan losses	19,991,126	17,852,204	13,149,962
Provision for loan losses	830,000	977,000	120,000
Net interest income	19,161,126	16,875,204	13,029,962
Other income:			
Loan fees and service charges	3,357,623	1,883,646	1,265,974
Loan servicing fees	766,301	771,093	762,125
Gain on sale of real estate, net	261,031	119,331	61,027
Gain on sale of mortgage loans and mortgage-backed securities	1,800,429	1,706	560,469
Other income	590,218	656,363	224,118
Total other income	6,775,602	3,432,139	2,873,713
General and administrative expenses:			
Compensation and fringe benefits	9,667,115	8,602,946	6,924,085
Federal insurance premiums	91,074	95,382	123,431
Premises and equipment	1,021,167	1,299,158	501,270
Advertising	208,950	204,735	137,806
Payroll and other taxes	737,267	709,909	520,656
Data processing	1,526,827	1,155,713	806,306
Amortization of intangibles	580,078	344,959	-
Other	2,214,423	1,687,683	1,241,262
Total general and administrative expenses	16,046,901	14,100,485	10,254,816
Income before income taxes	9,889,827	6,206,858	5,648,859
Income taxes	4,059,535	2,657,826	2,452,713
Net income	5,830,292	3,549,032	3,196,146
Other comprehensive income (loss), net	4,726,804	(369,877)	(1,378,776)
Comprehensive income	$ 10,557,096	$ 3,179,155	$ 1,817,370
Net income per common share:			
Basic	$ 2.01	$ 1.14	$ .91
Diluted	$ 1.95	$ 1.13	$ .91

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

First South Bancorp, Inc. and Subsidiary
Consolidated Statements of Stockholders' Equity
Years ended September 30, 2001, 2000 and 1999

	Common Stock	Additional Paid-in Capital	Retained Earnings, Substantially Restricted	Treasury Stock	Unearned ESOP Shares	Deferred Stock Awards	Acc Com Inco
Balance, October 1, 1998	$ 43,640	$ 43,801,987	$ 22,091,243	$ (4,895,754)	$ (2,687,093)	$ (2,126,299)	$
Net income	-	-	3,196,146	-	-	-	
Other comprehensive loss, net of taxes	-	-	-	-	-	-	
MRP amortization	-	-	-	-	-	1,342,907	
Acquisition of treasury shares	-	-	-	(10,875,208)	-	-	
Dividends ($.31 per share)	-	-	(1,089,622)	-	-	-	
Release of ESOP shares	-	430,023	-	-	423,593	-	
Balance, September 30, 1999	43,640	44,232,010	24,197,767	(15,770,962)	(2,263,500)	(783,392)	
Net income	-	-	3,549,032	-	-	-	
Other comprehensive loss, net of taxes	-	-	-	-	-	-	
MRP amortization	-	(57,700)	-	-	-	783,392	
Acquisition of treasury shares	-	-	-	(7,268,139)	-	-	
Dividends ($.46 per share)	-	-	(1,418,936)	-	-	-	
Release of ESOP shares	-	409,008	-	-	444,922	-	
Balance, September 30, 2000	43,640	44,583,318	26,327,863	(23,039,101)	(1,818,578)	-	
Net income	-	-	5,830,292	-	-	-	
Other comprehensive income, net of taxes	-	-	-	-	-	-	
Exercise of stock options	-	(25,823)	-	386,687	-	-	
Acquisition of treasury shares	-	-	-	(4,253,215)	-	-	
Dividends ($.67 per share)	-	-	(1,936,091)	-	-	-	
Release of ESOP shares	-	745,910	-	-	459,319	-	
Balance, September 30, 2001	$ 43,640	$ 45,303,405	$ 30,222,064	$ (26,905,629)	$ (1,359,259)	$ -	$

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

First South Bancorp, Inc. and Subsidiary
Consolidated Statements of Cash Flows
Years ended September 30, 2001, 2000 and 1999

	2001	2000	1999
Operating activities:			
Net income	$ 5,830,292	$ 3,549,032	$ 3,196,146
Adjustments to reconcile net income to net cash used in operating activities:			
Provision for loan losses	830,000	977,000	120,000
Depreciation	486,194	421,233	289,150
ESOP compensation	1,205,229	853,930	853,616
MRP compensation	-	725,692	1,342,907
Accretion of (premium) discounts on securities	(103,388)	692,235	371
Benefit from deferred income taxes	(376,950)	(321,370)	(825,748)
Gain on disposal of premises and equipment and real estate acquired in settlement of loans	(261,031)	(119,331)	(64,373)
Gain on sale of mortgage loans and mortgage-backed securities	(1,800,429)	(1,706)	(560,469)
Originations of loans held for sale, net	(36,102,872)	(46,229,695)	(60,777,625)
Proceeds from sale of loans held for sale	37,087,531	-	40,597,010
Other operating activities	1,517,679	2,415,094	(337,366)
Net cash provided by (used in) operating activities	8,312,255	(37,037,886)	(16,166,381)
Investing activities:			
Proceeds from maturities of investment securities available for sale	-	3,000,000	-
Purchases of investment securities	(5,000,000)	(46,050,000)	-
Proceeds from principal repayments and sales of mortgage-backed securities available for sale	76,061,309	10,175,821	14,141,098
Originations of loans held for investment, net of principal repayments	(21,529,591)	(20,480,237)	(12,863,836)
Proceeds from disposal of premises and equipment and real estate acquired in settlement of loans	705,310	911,869	655,821
Purchases of FHLB stock	(61,200)	(43,600)	(96,400)
Purchases of premises and equipment	(1,224,834)	(1,614,712)	(312,919)
Repayment of note receivable	25,045	3,949	-
Net cash to purchase Green Street Financial Corp.	-	(26,530,907)	-
Acquisition of Triangle Bancorp, Inc. branches	-	113,760,993	-
Net cash provided by investing activities	48,976,039	33,133,176	1,523,764
Financing activities:			
Net increase in deposit accounts	(2,759)	(8,461,007)	29,982,910
Proceeds from FHLB borrowings	72,200,000	125,200,000	61,000,000
Repayments of FHLB borrowings	(96,200,000)	(101,200,000)	(70,500,000)
Purchase of treasury shares	(4,253,215)	(7,268,139)	(10,875,208)
Proceeds from exercise of stock options	360,863	-	-
Cash dividends paid	(1,936,091)	(1,418,936)	(1,089,622)
Net change in escrow accounts	(271,035)	(4,442)	(362,793)
Net change in repurchase agreements	(1,478,054)	2,388,742	(1,114,579)
Net cash (used in) provided by financing activities	(31,580,291)	9,236,218	7,040,708
Increase (decrease) in cash and cash equivalents	25,708,003	5,331,508	(7,601,909)
Cash and cash equivalents, beginning of year	14,741,440	9,409,932	17,011,841
Cash and cash equivalents, end of year	$ 40,449,443	$ 14,741,440	$ 9,409,932

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

1. Basis of Presentation and Accounting Policies

Organization and Nature of Operations

First South Bancorp, Inc. (the "Company") is a bank holding company incorporated under the laws of the State of Virginia. First South Bank (the "Bank"), the wholly owned subsidiary of the Company, is organized and incorporated under the laws of the state of North Carolina. The Federal Reserve Board regulates the company and the Federal Deposit Insurance Corporation and the North Carolina Office of the Commissioner of Banks regulate the Bank.

The consolidated financial statements include the accounts of the Company, the Bank, and the Bank's wholly owned subsidiary, First South Leasing, LLC. All significant intercompany balances and transactions have been eliminated in consolidation.

The Company follows accounting principles generally accepted in the United States of America and general practices within the financial services industry as summarized below.

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 the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Cash and Cash Equivalents

Cash and cash equivalents include demand and time deposits (with remaining maturities of ninety days or less at time of purchase) at other financial institutions and federal funds sold. Generally, federal funds are purchased and sold for one-day periods.

Investments and Mortgage-Backed Securities

Investments in certain securities are classified into three categories and accounted for as follows: (1) debt securities that the entity has the positive intent and the ability to hold to maturity are classified as held-to-maturity and reported at amortized cost; (2) debt and equity securities that are bought and held principally for the purpose of selling them in the near term are classified as trading securities and reported at fair value, with unrealized gains and losses included in earnings; (3) debt and equity securities not classified as either held-to-maturity securities or trading securities are classified as available for sale securities and reported at fair value, with unrealized gains and losses excluded from earnings and reported as accumulated other comprehensive income, a separate component of equity. As of September 30, 2001, the Bank has classified all investments as available for sale.

Premiums and discounts on debt securities are recognized in interest income using the interest method over the period to maturity.

Mortgage-backed securities represent participating interests in pools of long-term first mortgage loans. Premiums and discounts are amortized using the interest method over the remaining period to contractual maturity, adjusted for anticipated prepayments.

Gains and losses on the sale of securities are determined by using the specific identification method.

Loans Receivable and Allowance for Loan Losses

Loans receivable held for investment are stated at the amount of unpaid principal, reduced by an allowance for probable loan losses and net deferred origination fees. Interest on loans is accrued based on the principal amount outstanding and is recognized using the interest method. The accrual of interest is discontinued, and accrued but unpaid interest is reversed when, in management's judgment, it is determined that the collectibility of interest, but not necessarily principal, is doubtful. Generally, this occurs when payment is delinquent in excess of ninety days.

Loan origination fees, as well as certain direct loan origination costs, are deferred. Such costs and fees are recognized as an adjustment to yield over the contractual lives of the related loans utilizing the interest method.

Commitment fees to originate or purchase loans are deferred, and if the commitment is exercised, recognized over the life of the loan as an adjustment of yield. If the commitment expires unexercised, commitment fees are recognized in income upon expiration of the commitment. Fees for originating loans for other financial institutions are recognized as loan fee income.

A loan is considered impaired, based on current information and events, if it is probable that the Bank will be unable to collect the scheduled payments of principal or interest when due according to the contractual terms of the loan agreement. Uncollateralized loans are measured for impairment based on the present value of expected future cash flows discounted at the historical effective interest rate, while all collateral-dependent loans are measured for impairment based on the fair value of the collateral. At September 30, 2001 and 2000, and during the three years ended September 30, 2001, there were no individual loans material to the consolidated financial statements which were defined as impaired.

The Bank uses several factors in determining if a loan is impaired. The internal asset classification procedures include a thorough review of significant loans and lending relationships and include the accumulation of related data. This data includes loan payment status, borrowers' financial data and borrowers' operating factors such as cash flows, operating income or loss, etc.

The allowance for loan losses is increased by charges to income and decreased by charge-offs (net of recoveries). Management's periodic evaluation of the adequacy of the allowance is based on the Bank's past loan loss experience, known and inherent risks in the portfolio, adverse situations that may affect the borrower's ability to repay, the estimated value of any underlying collateral, and current economic conditions. While management believes that it has established the allowance in accordance with accounting principles generally accepted in the United States of America and has taken into account the views of its regulators and the current economic environment, there can be no assurance that in the future the Bank's regulators or risks in its portfolio will not require further increases in the allowance.

Loans Held for Sale

Loans originated and intended for sale are carried at the lower of cost or aggregate estimated market value. Net unrealized losses are recognized in a valuation allowance by charges to income. Gains and losses on sales of whole or participating interests in real estate loans are recognized at the time of sale and are determined by the difference between net sales proceeds and the Bank's basis of the loans sold, adjusted for the recognition of any servicing assets retained.

Income Recognition on Impaired and Nonaccrual Loans

Loans, including impaired loans, are generally classified as nonaccrual if they are past due as to maturity or payment of principal or interest for a period of more than 90 days, unless such loans are well-secured and in the process of collection. If a loan or a portion of a loan is classified as doubtful or is partially charged off, the loan is generally classified as nonaccrual. Loans that are on a current payment status or past due less than 90 days may also be classified as nonaccrual if repayment in full of principal and/or interest is in doubt.

Loans may be returned to accrual status when all principal and interest amounts contractually due (including arrearages) are reasonably assured of repayment within an acceptable period of time, and there is a sustained period of repayment performance (generally a minimum of six months) by the borrower, in accordance with the contractual terms of interest and principal.

While a loan is classified as nonaccrual and the future collectibility of the recorded loan balance is doubtful, collections of interest and principal are generally applied as a reduction to principal outstanding, except in the case of loans with scheduled amortization where the payment is generally applied to the oldest payment due. When the future collectibility of the recorded loan balance is expected, interest income may be recognized on a cash basis limited to that which would have been recognized on the recorded loan balance at the contractual interest rate. Receipts in excess of that amount are recorded as recoveries to the allowance for loan losses until prior charge-offs have been fully recovered.

Mortgage Servicing Rights

In September 2000, the FASB issued SFAS No. 140, "Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities, a replacement of SFAS No. 125." It revises the standards for accounting for securitizations and other transfers of financial assets and collateral and requires certain disclosures, but it carries over most of the provisions of SFAS No. 125 without reconsideration. SFAS 140 requires a debtor to reclassify financial assets pledged as collateral and report these assets separately in the statement of financial position. It also requires a secured party to disclose information, including fair value, about collateral that it has accepted and is permitted by contract or custom to sell or repledge. SFAS 140 includes specific disclosure requirements for entities with securitized financial assets and entities that securitize assets. SFAS 140 is effective for transfers and servicing of financial assets and extinguishments of liabilities occurring after March 31, 2000, and is effective for recognition and reclassification of collateral and for disclosures relating to securitization transactions and collateral for fiscal years ending after December 15, 2000. The adoption of SFAS 140 did not have a material effect on financial condition or results of operation.

When mortgage loans, or mortgage-backed securities, are sold, the proceeds are allocated between the related loans and the retained mortgage servicing rights based on their relative fair values

Servicing assets and liabilities are amortized in proportion to and over the period of estimated net servicing income (if servicing revenue exceed servicing costs) or net servicing loss (if servicing costs exceed servicing revenues). All servicing assets or liabilities are assessed for impairment or increased obligation based on their fair value.

During the year ended September 30, 2001, the Company recorded additional servicing assets of $803,679 as a result of sales of loans or mortgage-backed securities. Amortization of servicing assets during the year ended September 30, 2001 aggregated $62,668. The fair value of recognized servicing assets amounted to $925,239 as of September 30, 2001. The Company's significant assumptions used to estimate their fair value include weighted average life, prepayment speeds, and expected costs to transfer servicing to a third party.

There was no valuation allowance for impairment of recognized servicing assets during the year ended September 30, 2001.

Premises and Equipment

Premises and equipment are stated at cost less accumulated depreciation and amortization. Depreciation and amortization are computed by the straight-line and accelerated methods based on estimated service lives of assets. Useful lives range from 10 to 40 years for substantially all premises and from 3 to 20 years for equipment and fixtures.

Real Estate Owned

Assets acquired through loan foreclosure are recorded as real estate owned ("REO") at the lower of the estimated fair value of the property less estimated costs to sell at the date of foreclosure or the carrying amount of the loan plus unpaid accrued interest. The carrying amount is subsequently reduced by additional allowances which are charged to earnings if the estimated fair value declines below its initial value plus any capitalized costs. Costs related to the improvement of the property are capitalized, whereas costs related to holding the property are expensed.

Investment in Federal Home Loan Bank Stock

The Bank is required to invest in stock of the Federal Home Loan Bank of Atlanta ("FHLB") in the amount of 1% of its outstanding home loans or 5% of its outstanding advances from the FHLB, whichever is greater. At September 30, 2001 and 2000, respectively, the Bank owned 27,125 and 26,513 shares of the FHLB's $100 par value capital stock.

Intangible Assets

Intangible assets consist of goodwill and deposit premiums and are being amortized over ten years using the straight-line method.

Income Taxes

Deferred tax asset and liability balances are determined by application to temporary differences of the tax rate expected to be in effect when taxes will become payable or receivable. Temporary differences are differences between the tax basis of assets and liabilities and their reported amounts in the financial statements that will result in taxable or deductible amounts in future years. The effect on deferred taxes of a change in tax rates is recognized in income in the period that includes the enactment date.

Comprehensive Income

The Company's other comprehensive income relates to unrealized gains (losses) on available for sale securities. Information concerning the Company's other comprehensive income (loss) for the years ended September 30, 2001, 2000 and 1999, is as follows:

	2001	2000	1999
Unrealized (losses) gains on securities available for sale	$ 8,299,802	$ (616,463)	$ (2,159,473)
Reclassification of net gains recognized in net income	(421,792)	-	(138,881)
Income tax benefit (expense) relating to unrealized gains (losses) on available for sale securities	(3,151,206)	246,586	919,578
Other comprehensive (loss) income, net	$ 4,726,804	$ (369,877)	$ (1,378,776)

Segment Information

The Company follows the provisions of SFAS No. 131, "Disclosure About Segments of an Enterprise and Related Information," which specifies guidelines for determining an entity's operating segments and the type and level of financial information to be disclosed. Based on these guidelines management has determined that the Bank operates in one business segment, the providing of general commercial financial services to customers located in its market areas. The various products are those generally offered by community banks. The allocation of Bank resources is based on overall performance of the Bank, rather than individual branches or products.

New Accounting Pronouncements

On July 20, 2001 the FASB issued SFAS No. 141, Business Combinations (SFAS 141), and No. 142, Goodwill and Other Intangible Assets (SFAS 142). SFAS Nos. 141 and 142 will change the accounting for business combinations and goodwill in two significant ways. First, SFAS No. 141 requires that the purchase method of accounting be used for all business combinations initiated after June 30, 2001. Use of the pooling-of-interests method is prohibited. Second, SFAS No. 142 changes the accounting for goodwill from an amortization method to an impairment-only approach. Upon adoption of SFAS No. 142, the Company will cease to amortization of goodwill recorded in past business transactions. Goodwill presently recorded on the books of the Company amounted to $232,162 at September 30, 2001. Amortization of goodwill amounted to $23,258 during the year ended September 30, 2001.

The goodwill will be assigned to the related reporting unit in the Company and tested for impairment at least annually. The tests will initially involve the comparison of the reporting units fair value to its carrying value, including goodwill. If necessary, the implied fair value of the goodwill will be compared to the carrying value to determine if an allowance is necessary. The provisions of SFAS No. 142 are effective for fiscal years beginning after December 15, 2001.

In June 2001, the FASB issued SFAS No. 143, Accounting for Asset Retirement Obligations (SFAS 143), and in July 2001, the FASB issued SFAS No. 144, Accounting for the Impairment or Disposal of Long-Lived Assets (SFAS 144).

SFAS 143 requires that obligations associated with the retirement of tangible long-lived assets be recorded as a liability when those obligations are incurred, with the amount of liability initially measured at fair value. SFAS 143 will be effective for financial statements beginning after June 15, 2002, though early adoption is encouraged. The application of this statement is not expected to have a material impact on the Company’s financial statements.

SFAS 144 supersedes SFAS 121, Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to be Disposed Of. SFAS 144 applies to all long-lived assets including discontinued operations, and amends Accounting Principle Board Opinion No 30, Reporting the Effect of Disposal of a Segment of a Business, and Extraordinary, Unusual and Infrequently Occurring Events and Transactions. SFAS 144 requires that long-lived assets that are to be disposed of by sale be measured at the lower of book or fair value less cost to sell. SFAS 144 is effective for financial statements issued for fiscal years beginning after December 15, 2001 and its provisions are generally expected to be applied prospectively. The application of this statement is not expected to have a material impact of the Company’s financial statements.

2. Significant Activities

On November 30, 1999, the Company consummated the acquisition of Green Street Financial Corp. (“Green Street”), the parent holding company of Home Federal Savings and Loan Association of Fayetteville, North Carolina (“Home Federal”), with full service offices located in Fayetteville and Lumberton, North Carolina. The acquisition was accounted for using the purchase method of accounting for a cash purchase price of $59.2 million, representing $15.25 per share of Green Street common stock.

Concurrently with the Green Street acquisition, the Company changed its name to First South Bancorp, Inc.

The following table reflects the unaudited pro forma combined results of operations, assuming the acquisition had occurred at the beginning of fiscal 2000 and 1999:

	2000	**1999**
Net interest income	$ 17,409,204	$ 16,235,962
Net income	3,580,032	3,384,146
Net earnings per diluted share	1.14	.96

In management's opinion, these unaudited pro forma amounts are not necessarily indicative of what the actual combined results of operations might have been if the acquisitions had been effective at the beginning of fiscal 1998.

On February 18, 2000, the Bank completed the acquisition of six Triangle Bank ("Triangle") branch offices located in Rocky Mount and Tarboro, North Carolina. This acquisition was accounted for using the purchase method of accounting and the Bank assumed the deposits of the six Triangle branch offices for a premium of approximately 4.0% of the assumed deposits.

The fair values of assets, including goodwill, and liabilities assumed were as follows (in thousands):

	Green Street	**Triangle**
Loans receivable	$ 125,459,235	$ 26,162,062
Premises and equipment	1,245,957	2,407,409
Intangible assets	287,832	4,898,652
Other assets	4,548,219	277,790
Deposits	(101,648,952)	(144,135,727)
Other liabilities	(3,361,384)	(3,371,179)
Net cash paid (received) for acquisitions	$ 26,530,907	$ (113,760,993)

3. Investment Securities

Investment securities at September 30, 2001 and 2000, are classified as available for sale according to management's intent and summarized as follows:

	Amortized Cost	**Gross Unrealized Gains**	**Gross Unrealized Losses**	**Estimated Market Value**
2001:				
U.S. Treasury and Agency Notes	$50,461,308	$ 4,280,476	$ -	$54,741,784
2000:				
U.S. Treasury and Agency Notes	$45,357,920	$ 230,003	$ 401,532	$45,186,391

U.S. Treasury and Agency notes at September 30, 2001, are contractually scheduled to mature as follows:

	Amortized Cost	Estimated Market Value
Due after one year through five years	$ 45,446,788	$ 49,080,078
Due after five years through ten years	5,014,520	5,661,706
	$ 50,461,308	$ 54,741,784

4. Mortgage-Backed Securities

Mortgage-backed securities at September 30, 2001 and 2000, are classified as available for sale according to management's intent and summarized as follows:

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Market Value
2001:				
FHLMC participation certificates, maturing from years 2003 to 2028	$ 47,120,820	$1,482,516	$ -	$ 48,603,336
2000:				
FHLMC participation certificates, maturing from years 2003 to 2030	$110,462,189	$ 166,593	$(2,110,082)	$108,518,700

Mortgage-backed securities at September 30, 2001, are contractually scheduled to mature as follows:

	Amortized Cost	Estimated Market Value
Due after one year through five years	$ 533,840	$ 551,389
Due after five years through ten years	3,457,138	3,551,121
Due after ten years	43,129,842	44,500,826
	$ 47,120,820	$ 48,603,336

Expected maturities may differ from contractual maturities because borrowers have the right to call or prepay obligations with or without call or prepayment penalties.

Mortgage-backed securities with a carrying value of $63,181,244, $0, and $5,520,194 were sold during the years ended September 30, 2001, 2000 and 1999, respectively. Gross realized gains on the sales of mortgage-backed securities were $421,792, $0, and $138,881 during 2001, 2000 and 1999, respectively. There were no gross realized losses during 2001, 2000 and 1999.

Mortgage-backed securities with an amortized cost of approximately $5,492,322 and $5,437,740 were pledged as collateral for deposits from public entities at September 30, 2001 and 2000, respectively.

5. Loans Receivable

Loans receivable at September 30, 2001 and 2000, are summarized as follows:

	2001	2000
Mortgage loans	$ 123,196,766	$ 159,328,698
Consumer loans	78,184,965	75,001,720
Commercial loans	178,856,021	137,941,182
Total	380,237,752	372,271,600
Less:		
Allowance for loan losses	(5,401,358)	(5,159,353)
Deferred loan fees	(749,449)	(902,631)
Loans receivable, net	$ 374,086,945	$ 366,209,616

The Bank has pledged its eligible real estate loans to collateralize actual or potential borrowings from the Federal Home Loan Bank of Atlanta (See Note 10).

During 2001, 2000 and 1999, the Bank exchanged loans with outstanding principal balances of

$12,298,139, $62,789,209, and $45,527,117, respectively, with the Federal Home Loan Mortgage Corporation ("FHLMC") for mortgage-backed securities of equal value.

The Bank originates mortgage loans for portfolio investment or sale in the secondary market. During the period of origination, mortgage loans are designated as either held for sale or for investment purposes. Transfers of loans held for sale to the investment portfolio are recorded at the lower of cost or market value on the transfer date. Loans receivable held for sale at September 30, 2001 and 2000, are fixed rate mortgage loans with an estimated market value of approximately $20,500,000 and $32,400,000, respectively.

Net gains on sales of loans receivable held for sale amounted to $1,378,637, $1,706, and $303,324 during the years ended September 30, 2001, 2000 and 1999, respectively.

The changes in the allowance for loan losses for the years ended September 30, 2001, 2000 and 1999, are as follows:

	2001	2000	1999
Balance at beginning of year	$ 5,159,353	$ 3,297,256	$ 3,364,588
Provisions for loan losses	830,000	977,000	120,000
Balance transferred in acquisition	-	962,999	-
Loans charged off	(655,506)	(157,092)	(265,384)
Recoveries	67,511	79,190	78,052
Balance at end of year	$ 5,401,358	$ 5,159,353	$ 3,297,256

The following is a summary of the principal balances of loans on nonaccrual status and loans past due ninety days or more:

	2001	2000
Loans contractually past due 90 days or more and/or on nonaccrual status:		
Residential	$ 570,704	$ 1,365,949
Consumer and commercial	491,676	279,826
	$ 1,062,380	$ 1,645,775

During the years ended September 30, 2001, 2000 and 1999, interest income of approximately

$43,000, $40,000, and $9,000, respectively, was not recorded related to loans accounted for on a nonaccrual basis.

6. Premises and Equipment

Premises and equipment at September 30, 2001 and 2000, consist of the following:

	2001	2000
Land	$ 2,566,219	$ 2,566,219
Office buildings	5,793,501	5,009,762
Furniture, fixtures and equipment	3,083,963	2,566,530
Vehicles	323,205	290,031
	11,766,888	10,432,542
Less accumulated depreciation	3,841,278	3,409,723
Total	$ 7,925,610	$ 7,022,819

7. Employee Benefit Plans

The Company participates in a multi-employer defined benefit pension plan which covers substantially all employees. Expenses of the plan for the years ended September 30, 2001, 2000 and 1999, were $69,017, $258,600, and $133,000, respectively.

The Company participates in a multi-employer defined contribution plan which covers substantially all employees. Under the plan, employees may contribute from 1% to 15% of compensation, subject to an annual maximum as determined by the Internal Revenue Code. The Company makes matching contributions of 50% of employees' contributions up to 6% of the employees' salaries. The plan provides that employees' contributions are 100% vested at all times and the Bank's contributions vest 25% for each year of service. The expenses related to the Company's contributions to this plan for the years ended September 30, 2001, 2000 and 1999, were $115,174, $84,924, and $76,985, respectively.

Directors and certain officers participate in deferred compensation plans. These plans generally provide for fixed payments beginning at retirement. These payments are earned over service periods of up to ten years, and can include provisions for deferral of current payments. The expense related to these plans during the years ended September 30, 2001, 2000 and 1999, aggregated $617,127, $544,327, and $516,985, respectively. The plans generally include provisions for forfeitures of unvested portions of payments, and vesting in the event of death or disability.

On April 8, 1998, the Company's Stockholders approved a Management Recognition Plan ("MRP") for directors and key employees. The Company was authorized to fund the acquisition of and award up to 174,570 shares (4% of shares issued in the stock conversion) to be awarded by a committee of the Board of Directors. The Company completed the acquisition of MRP shares during fiscal 1998. On April 8, 1998, 174,570 shares (market value of $4,029,258 and aggregate cost of $3,275,299) were awarded to certain officers and employees. The vesting schedule provided that 33-1/3% of the shares were earned and became non-forfeitable on April 8, 1998, 1999 and 2000.

The shares issued to the MRP plan were recorded as outstanding shares, and the unvested portion was recorded as unearned compensation through a contra equity account. The consolidated statements of operations for the years ended September 30, 2001, 2000 and 1999, include compensation expense of $0, $725,692, and $1,342,907, respectively, relating to the scheduled vesting of MRP shares.

8. Employee Stock Ownership Plan

The Company's Board of Directors adopted an Employee Stock Ownership Plan ("ESOP"), effective October 1, 1996. Employees of the Company and its subsidiaries who have attained age 21 and completed one year of service are eligible to participate in the ESOP, provided that any employee who was employed full-time on the closing date of the Stock Conversion automatically became a participant on October 1, 1996. The ESOP is to be funded by contributions made by the Company or the Bank in cash or shares of Common Stock. Allocations to participants' accounts occur annually on September 30. Shares are committed to be released for financial statement purposes when the Bank makes scheduled payments on the ESOP note payable and will be allocated to employees for services rendered in the current accounting period. Employees vest in their allocated ESOP shares over three years. The number of shares legally released and allocated is based on the ratio of the actual principal payments amount to the remaining total principal payments for the ESOP note payable. The Bank expects to contribute sufficient funds to the ESOP to repay the note payable over a ten-year period, plus such other amounts as the Company's Board of Directors may determine in its discretion.

Initially, the ESOP acquired 349,140 shares of the Company's common stock financed by $3,491,400 in borrowings by the ESOP from the Company. This loan is secured by the shares of Common Stock purchased and earnings thereon. At September 30, 2001 and 2000, 213,213 and 167,282 shares, respectively, have been allocated to participants' accounts and 135,927 and 181,858 shares, with an estimated market value of $4,322,479 and $4,182,734, respectively, remain unallocated. All allocated shares are considered outstanding for earnings per share purposes, while the unallocated shares are not included in the calculation.

The principal balance of the ESOP loan was $1,359,259 and $1,818,578 at September 30, 2001 and 2000, respectively. The Bank is using the dividends declared on shares held by the ESOP to reduce the outstanding debt. Dividends on allocated shares are treated as a reduction of retained earnings. Dividends on unallocated shares are treated only as debt service, and there is no reduction of retained earnings. Compensation expense related to the ESOP is based on the average fair market value of shares during the period since the prior allocation date through the dates shares are committed to be released. The financial statements for the years ended September 30, 2001, 2000 and 1999, include compensation expense of $1,205,230, $835,135, and $853,616, respectively, related to the ESOP.

9. Stock Option Plan

On April 8, 1998, the Shareholders of the Company approved the First South Bancorp, Inc. 1997 Stock Option Plan (the "Plan"). The purpose of this Plan is to advance the interests of the Company through providing selected key employees and Directors of the Bank and the Company with the opportunity to purchase shares. The Plan reserves 436,425 shares for grant within ten years of the effective date. The option price is required to be 100% of the stock's fair market value as defined, with an exception for any shareholder with more than a 10% ownership interest in the Company. The exercise price is required to be 110% of the stock's fair market value for these options holders. Vesting is determined on the date of the grant. Options have a 10-year life; however, there are additional limitations for shareholders with more than a 10% ownership interest in the Company. The Plan also has a change of control provision under which all options immediately vest if a change of control, as defined, occurs.

The Company has adopted SFAS No. 123, "Accounting for Stock Based Compensation." As permitted by SFAS No. 123, the Company has chosen to apply APB Opinion No. 25, "Accounting for Stock Issued to Employees," and related interpretations. 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 methods 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:

	For the year ended					
	September 30, 2001		September 30, 2000		September 30, 1999	
	As Reported	Pro Forma	As Reported	Pro Forma	As Reported	Pro Forma
Net income	$ 5,830,292	$ 5,742,412	$ 3,549,032	$ 3,464,965	$ 3,196,146	$ 3,138,174
Earnings per common share - basic	2.01	1.95	1.14	1.11	.91	.89
Earnings per common share - diluted	1.95	1.92	1.13	1.11	.91	.89

The fair value of each option grant is estimated on the date of grant using the Black-Scholes option-pricing model with the following weighted-average assumptions used for grants in 2001, 2000 and 1999, respectively: dividend growth rate of 22%, 17%, and 15%; expected volatility of 18.9%, 18.6% and 20.8%; risk-free interest rates of 5.84%, 5.78%, and 5.05% in 2001; 6.0% in 2000 and 7.1% in 1999; and expected lives of 7 years.

A summary of the status of the Plan as of September 30, 2001, 2000 and 1999, and changes during the years then ended, including weighted-average exercise price ("Price"), is presented below:

	2001		2000		1999	
	Shares	Price	Shares	Price	Shares	Price
Outstanding at beginning of year	413,303	$ 18.25	404,303	$ 18.24	398,303	$ 18.25
Granted	19,000	25.63	21,000	18.26	6,000	17.75
Cancellations	(23,400)	18.35	(12,000)	18.25		
Outstanding at year end	408,903	18.54	413,303	18.25	404,303	18.24
Weighted-average fair value of options granted during the year		$ 5.14		$ 4.02		$ 5.04

The following table summarizes additional information about the Option Plan at September 30, 2001, including weighted-average remaining contractual life ("Life") and Price:

	Options Outstanding			Options Exercisable	
	Shares	Life	Price	Shares	Price
$ 17.75 - 27.23	408,903	6.8 years	$ 18.54	389,903	$ 18.37

10. Borrowed Money

Borrowed money represents advances from the FHLB and repurchase agreements. There were no advances outstanding from the FHLB at September 30, 2001. Advances from the FHLB had a weighed average rate of 6.94% and totaled $24,000,000 at September 30, 2000.

At September 30, 2001 and 2000, repurchase agreements outstanding had average rates of 1.93% and 4.38%, and totaled $4,909,497 and $6,387,552, respectively.

At September 30, 2001, repurchase agreements were collateralized by U.S. government agency obligations with a principal balance of $7,000,000. The Company has pledged all of its stock in the FHLB and certain loans secured by one to four family residential mortgages as collateral for actual or potential borrowings from the FHLB. At September 30, 2001, the Company had an additional $115,000,000 of credit available with the FHLB.

11. Income Taxes

The components of income tax expense for the years ended September 30, 2001, 2000 and 1999, are as follows:

	2001	2000	1999
Current:			
Federal	$ 3,877,218	$ 2,665,596	$ 2,712,909
State	559,267	313,600	565,552
	4,436,485	2,979,196	3,278,461
Deferred:			
Federal	(310,782)	(287,542)	(719,993)
State	(66,168)	(33,828)	(105,755)
	(376,950)	(321,370)	(825,748)
Total	$ 4,059,535	$ 2,657,826	$ 2,452,713

Reconciliations of the expected income tax expense at statutory tax rates with income tax expense reported in the statements of operations for the years ended September 30, 2001, 2000 and 1999, are as follows:

	2001	2000	1999
Expected income tax expense at 34%	$ 3,362,541	$ 2,110,332	$ 1,920,612
State income taxes, net of federal income tax	325,445	296,998	270,298
Non-deductible ESOP, other expenses and other adjustments	371,549	250,496	261,803
	$ 4,059,535	$ 2,657,826	$ 2,452,713

The components of deferred income tax assets and liabilities are as follows:

	2001	2000
Deferred income tax assets:		
Deferred directors' fees	$ 578,037	$ 548,288
Allowance for loan losses	1,752,708	1,490,452
Employee benefits	740,189	747,790
Unrealized losses on securities available for sale	-	852,611
Loans mark-to-market	315,198	123,823
Other	363,408	180,154
	3,749,540	3,943,118
Deferred income tax liabilities:		
Unrealized gains on securities available for sale	2,298,594	-
Depreciation and amortization	347,515	315,426
Carrying value - land	386,200	386,200
Mortgage servicing rights	357,327	71,149
Deferred loan origination fees and costs	55,472	91,656
FHLB stock	195,801	195,801
	3,640,909	1,060,232
Net deferred income tax asset	$ 108,631	$ 2,882,886

Retained earnings at September 30, 2001, include approximately $1,850,000 for which no deferred income tax liability has been recognized. This amount represents an allocation of income to bad debt deductions for income tax purposes only. Reductions of the amount so allocated for purposes other than for tax bad debt losses or adjustments arising from carryback of net operating losses could create taxable income, in certain remote instances, which would be subject to the then current corporate income tax rate.

12. Regulatory Capital Requirements

Dividend payments made by the Company are subject to regulatory restrictions under Federal Reserve Board policy as well as to limitations under applicable provisions of Virginia corporate law. The Federal Reserve Board may prohibit a bank holding company from paying any dividends if the holding company's bank subsidiary is classified as "undercapitalized." Under Virginia law, dividends may be paid out of surplus or, if there is no surplus, out of net profits for the fiscal year in which the dividend is declared and for the preceding fiscal year. Furthermore, under FDIC regulations, the Bank is prohibited from making any capital distributions if, after making the distribution, the Bank would have: (i) a total risk-based capital ratio of less than 8.0%; (ii) a Tier 1 risk-based capital ratio of less than 4.0%; or (iii) a leverage ratio of less than 4.0%.

The Bank is subject to various regulatory capital requirements administered by the 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. Quantitative measures established by regulation to ensure capital adequacy require the Bank to maintain minimum amounts and ratios, as set forth in the table below. Management believes, as of September 30, 2001, that the Bank meets all capital adequacy requirements to which it is subject.

As of September 30, 2001, the most recent notification from the FDIC categorized the Bank as well capitalized under the regulatory framework for prompt corrective action. To be categorized as well capitalized the Bank must maintain minimum amounts and ratios, as set forth in the table below. There are no conditions or events since that notification that management believes have changed the Bank's category.

The Bank's actual regulatory capital amounts and ratios as of September 30, 2001 and 2000, are presented in the table below (dollars in thousands):

	Actual		For Capital Adequacy Purpose		To Be Well Capitalized Under Prompt Action Provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
2001:						
Total Capital (to Risk Weighted Assets)	$ 47,627	12.8%	$ 29,835	8.0%	$ 37,294	10.0%
Tier I Capital (to Risk Weighted Assets)	42,956	11.5%	14,917	4.0%	22,376	6.0%
Tier I Capital (to Average Assets)	42,956	8.1%	21,246	4.0%	26,557	5.0%
2000:						
Total Capital (to Risk Weighted Assets)	$ 45,655	13.0%	$ 28,214	8.0%	$ 35,268	10.0%
Tier I Capital (to Risk Weighted Assets)	41,237	11.7%	14,107	4.0%	21,161	6.0%
Tier I Capital (to Average Assets)	41,237	7.7%	21,523	4.0%	26,904	5.0%

13. Earnings Per Share

The following table provides a reconciliation of income available to common stockholders and the average number of shares outstanding (less unearned ESOP shares, unearned deferred stock awards and treasury shares) for the years ended September 30, 2001, 2000 and 1999. Options to purchase 408,903, 413,303 and 404,303 shares of common stock were outstanding at September 30, 2001, 2000, and 1999, respectively. For the year ended September 30, 1999, no options were included in the computation of diluted EPS because the options' exercise price was greater than the average market price of common shares for each of the years.

	2001	2000	1999
Net income (numerator)	$ 5,830,292	$ 3,549,032	$ 3,196,146
Weighted average shares outstanding for basic EPS (denominator)	2,899,846	3,115,768	3,530,811
Dilutive effect of stock options	85,580	11,104	-
Adjusted shares for diluted EPS	2,985,426	3,126,872	3,530,811

14. Mortgage Banking Activities

Mortgage loans serviced for others are not included in the accompanying consolidated statements of financial condition. The unpaid principal balances of mortgage loans serviced for others were

$295,216,089 and $286,238,000 at September 30, 2001 and 2000, respectively. Servicing loans for others generally consists of collecting mortgage payments, maintaining escrow accounts, disbursing payment to investors and foreclosure processing. Loan servicing income is recorded on the accrual basis and includes servicing fees from investors and certain charges collected from borrowers, such as late payment fees.

At September 30, 2001 and 2000, mortgage servicing rights reported in the consolidated statements of financial condition, net of amortization, were $925,239 and $184,228, respectively.

15. Financial Instrument with Off-Balance Sheet Risk and Significant Group Concentration of Credit Risk:

The Company 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 and to reduce its own exposure to fluctuations in interest rates. These financial instruments include commitments to extend credit and involve, to varying degrees, elements of credit and interest rate risk in excess of the amount recognized in the balance sheet.

The Company's exposure to credit loss in the event of non-performance by the other party to the financial instrument for commitments to extend credit is represented by the contractual amount of those instruments. The Company 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 any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. The Company evaluates each customer's creditworthiness on a case-by-case basis. The amount of collateral obtained, if deemed necessary by the Company upon extension of credit, is based on management's credit evaluation of the borrower.

A summary of the contractual amounts of the Company's exposure to off-balance sheet risk as of September 30, 2001 and 2000, is as follows:

	2001	2000
Commitments to extend credit:		
Commitments to originate loans	$ 57,413,601	$ 44,052,960
Undrawn balances on lines of credit and undrawn balances on credit reserves (overdraft protection)	48,197,325	43,864,361
	$ 105,610,926	$ 87,917,321

Included in the commitments to originate loans as of September 30, 2001 and 2000, are fixed interest rate loan commitments of $7,758,283 and $6,917,438, respectively. The shorter duration of interest-sensitive liabilities, to the extent they are used to fund these fixed-rate loans, indicates that the Company is exposed to interest rate risk because, in a rising rate environment, liabilities will be repricing faster at higher interest rates, thereby reducing the market value of fixed-rate long-term assets and net interest income.

The Company's lending is concentrated primarily in Beaufort, Craven, Cumberland, Edgecombe, Fayetteville, Lenoir, Lumberton, Nash, Pasquotank, Pitt, Robeson, Tarboro and surrounding counties in North Carolina. Credit has been extended to certain of the Company's customers through multiple lending transactions.

Since many of the commitments are expected to expire without being drawn upon, amounts reported do not necessarily represent future cash requirements.

16. Parent Company Financial Information

The Company's principal asset is its investment in the Bank. Condensed financial statements of the parent company as of September 30, 2001 and 2000, and for the three years ended September 30, 2001, are as follows:

	2001	2000	1999
Condensed Balance Sheets			
Cash	$ 1,902,285	$ 1,055,374	$ 1,151,744
Due from subsidiary	931,535	477,287	5,368,089
Investment in wholly-owned subsidiary	49,203,538	43,692,079	42,563,204
Other assets	8,856	8,747	12,115
Total assets	$ 52,046,214	$ 45,233,487	$ 49,095,152
Other liabilities	$ 1,277,596	$ 398,752	$ 332,119
Stockholders' equity	50,768,618	44,834,735	48,763,033
Total liabilities and stockholders' equity	$ 52,046,214	$ 45,233,487	$ 49,095,152

	2001	2000	1999
Condensed Statements of Income			
Interest income, net	$ 166,623	$ 204,090	$ 234,242
Equity in earnings of subsidiary	5,772,653	3,471,752	3,121,370
Miscellaneous expenses	108,984	126,810	159,466
Net income	$ 5,830,292	$ 3,549,032	$ 3,196,146

	2001	2000	1999
Condensed Statements of Cash Flows			
Operating activities:			
Net income	$ 5,830,292	$ 3,549,032	$ 3,196,146
Adjustments to reconcile net income to net cash provided by operating activities:			
Equity in undistributed earnings of subsidiary	(5,772,653)	(3,471,752)	(3,121,370)
ESOP compensation	1,205,229	853,930	853,616
MRP compensation	-	725,692	1,342,907
Other operating activities	878,733	70,001	628,213
Net cash provided by operating activities	2,141,601	1,726,903	2,899,512
Investing activities:			
Repayments of advances to subsidiary	4,533,752	6,863,802	9,257,445
Net cash provided by investing activities	4,533,752	6,863,802	9,257,445
Financing activities:			
Proceeds from exercise of stock options	360,864	-	-
Purchase of treasury shares	(4,253,215)	(7,268,139)	(10,875,208)
Dividends paid	(1,936,091)	(1,418,936)	(1,089,622)
Net cash used in financing activities	(5,828,442)	(8,687,075)	(11,964,830)
Net (decrease) increase in cash	846,911	(96,370)	192,127
Cash at beginning of year	1,055,374	1,151,744	959,617
Cash at end of year	$ 1,902,285	$ 1,055,374	$ 1,151,744

17. Quarterly Financial Data (Unaudited)

Summarized unaudited quarterly financial data for the years ended September 30, 2001 and 2000, is as follows (in thousands):

	Fourth	Third	Second	First
2001:				
Interest income	$ 9,794	$ 10,231	$ 10,863	$ 11,271
Interest expense	4,560	5,298	5,967	6,343
Provision for loan losses	50	-	540	240
Noninterest income	1,933	1,690	1,853	1,299
Noninterest expense	4,498	3,949	3,898	3,701
Income tax expense	1,082	1,090	946	941
Net income	$ 1,537	$ 1,584	$ 1,365	$ 1,345
Net income per common share:				
Basic	$ .54	$ .55	$ .47	$ .46
Diluted	$ .52	$ .53	$ .46	$ .45

	Fourth	Third	Second	First
2000:				
Interest income	$ 10,783	$ 10,099	$ 9,178	$ 6,805
Interest expense	5,921	5,241	4,680	3,171
Provision for loan losses	300	250	200	227
Noninterest income	950	1,052	815	615
Noninterest expense	3,768	4,058	3,631	2,643
Income tax expense	762	699	628	569
Net income	$ 982	$ 903	$ 854	$ 810
Net income per common share:				
Basic and diluted	$ .32	$ .30	$ .27	$ .25

18. Fair Values of Financial Instruments

Statement of Financial Accounting Standards No. 107, "Disclosures about Fair Value of Financial Instruments" ("SFAS No. 107"), requires the disclosure of estimated fair values for financial instruments. Quoted market prices, if available, are utilized as an estimate of the fair value of financial instruments. Because no quoted market prices exist for a significant part of the Company's financial instruments, the fair value of such instruments has been derived based on management's assumptions with respect to future economic conditions, the amount and timing of future cash flows and estimated discount rates with respect to future economic conditions, the amount and timing of future cash flows and estimated discount rates. Different assumptions could significantly affect these estimates. Accordingly, the net realizable value could be materially different from the estimates presented below. In addition, the estimates are only indicative of individual financial instruments' values and should not be considered an indication of the fair value of the Company taken as a whole.

Fair values have been estimated using data which management considers as the best available, and estimation methodologies deemed suitable for the pertinent category of financial instrument. The estimation methodologies, resulting fair values, and recorded carrying amounts at September 30, 2001 and 2000, were as follows:

Cash and cash equivalents are by definition short-term and do not present any unanticipated credit issues. Therefore, the carrying amount is a reasonable estimate of fair value. The estimated fair values of investment securities and mortgage backed securities are provided in Notes 3 and 4 to the financial statements. These are based on quoted market prices, when available. If a quoted market price is not available, fair value is estimated using quoted market prices for similar securities.

The fair value of the net loan portfolio has been estimated using the present value of expected cash flows, discounted at an interest rate adjusted for servicing costs and giving consideration to estimated prepayment risk and credit loss factors, as follows:

	2001		2000	
	Estimated Fair Value	**Carrying Amount**	**Estimated Fair Value**	**Carrying Amount**
1 - 4 family mortgages	$ 123,737,283	$ 121,735,028	$ 157,985,659	$ 157,650,137
Consumer	77,088,028	77,193,937	73,079,204	74,100,552
Non-residential	175,157,980	175,157,980	134,458,927	134,458,927
	$ 375,983,291	$ 374,086,945	$ 365,523,790	$ 366,209,616

The fair value of deposit liabilities with no stated maturities has been estimated to equal the carrying amount (the amount payable on demand), totaling $159,282,411 and $132,661,290 at September 30, 2001 and 2000, respectively. The fair value estimates for these products do not reflect the benefits that the Bank receives from the low-cost, long-term funding they provide. These benefits are considered significant.

The fair value of certificates of deposits and advances from the FHLB is estimated by discounting the future cash flows using the current rates offered for similar deposits and advances with the same remaining maturities. The carrying value and estimated fair values of certificates of deposit and FHLB advances at September 30, 2001 and 2000, are as follows:

	2001	**2000**
Certificates of deposits:		
Carrying amount	$ 312,656,497	$ 339,280,377
Estimated fair value	317,751,119	340,318,757
Advances for Federal Home Loan Bank:		
Carrying amount	$ -	$ 24,000,000
Estimated fair value	-	24,000,000

The carrying amount of repurchase agreements approximates the fair value. The interest rate on these agreements is a floating rate based on the federal fund's daily rate.

There is no material difference between the carrying amount and estimated fair value of off-balance sheet items totaling $105,610,926 in 2001 and $87,917,321 in 2000, which are primarily comprised of unfunded loan commitments.

The Company's remaining assets and liabilities are not considered financial instruments.

19. Supplemental Cash Flow Information

Supplemental cash flow information for the years ended September 30, 2001, 2000 and 1999, is as follows:

	2001	2000	1999
Real estate acquired in settlement of loans	$ 918,091	$ 411,040	$ 764,023
Exchange of loans for mortgage-backed securities	12,298,139	62,789,209	45,527,117
Cash paid for interest	22,391,730	19,012,680	9,960,689
Cash paid for income taxes	3,350,211	2,769,000	2,787,000
Dividends declared, not paid	518,511	387,220	332,119

BOARD OF DIRECTORS

Linley H. Gibbs, Jr.
Chairman
Retired
Washington, NC

Frederick N. Holscher
Vice Chairman
Partner
Rodman, Holscher, Francisco & Peck
Washington, NC

Edmund T. Buckman, Jr.
Retired
Washington, NC

Dr. Frederick H. Howdy
President
Drs. Freshwater and Howdy, P.A.
Washington, NC

Charles E. Parker, Jr.
Vice President
Robinson Insurance Agency
New Bern, NC

H. D. Reaves, Jr.
Former President and Chief Executive Officer
Home Federal Savings & Loan
Fayetteville, NC

Marshall T. Singleton
Co-Owner
B. E. Singleton & Sons
Washington, NC

Thomas A. Vann
President and Chief Executive Officer
First South Bank
Washington, NC

EXECUTIVE OFFICERS

Thomas A. Vann
President and
Chief Executive Officer

Jack L. Ashley
Executive Vice President
Chief Operating Officer

Gary J. Brock
Executive Vice President
Credit Administration

Walter P. House
Executive Vice President
Mortgage Operations

William L. Wall
Executive Vice President
Chief Financial Officer and
Secretary

Mary R. Boyd
Senior Vice President
Loan Servicing

Sherry L. Correll
Senior Vice President
Deposit Administration

Kristie W. Hawkins
Treasurer
Controller

William R. Outland
Senior Vice President
Consumer Lending

AREA AND CITY EXECUTIVES

James F. Buckman, IV
Senior Vice President
Area Executive
Washington
Chocowinity

George R. Hamilton
Senior Vice President
Area Executive
Rocky Mount
Tarboro

Michael L. Hardin
Senior Vice President
City Executive
Lumberton

William L. Hedgepeth, II
Senior Vice President
City Executive
Fayetteville

Russell A. Lay
Senior Vice President
Area Executive
Elizabeth City Kinston

David M. Pope
Vice President
City Executive

James R. Rose, Jr.
Senior Vice President
Area Executive
Greenville

James L. Thompson
Vice President
City Executive
Tarboro

Guy P. Williams, Jr.
Senior Vice President
City Executive
New Bern

FIRST SOUTH BANK OFFICE LOCATIONS

Chocowinity
2999 Highway 17 South
252-940-4970

Elizabeth City
604 East Ehringhaus Street
252-335-0848

Greenville
301 East Arlington Blvd
252-321-2600

Fayetteville
241 Green Street
910-438-3681

3107 Raeford Road
910-484-2116

Kinston
827 Hardee Road
252-522-9466

2430 Heritage Street
252-523-9449

Lumberton
600 North Chestnut Street
910-739-3274

3000 North Elm Street
910-608-5031

New Bern
202 Craven Street
252-636-2997

1725 Glenburnie Road
252-636-2997

Tarboro
100 East Hope Lodge Street
252-823-0157

Rocky Mount
300 Sunset Avenue
252-972-9661

2901 Sunset Avenue
252-451-1259

1378 Benvenue Road
252-442-8375

450 North Winstead Avenue
252-937-1900

3635 North Halifax Road
252-451-8700
(in Smith's Red & White/ Dortches)

Washington
1311 Carolina Avenue
252-946-4178

300 North Market Street
252-940-4945

1328 John Small Avenue
252-940-5000

Credit Administration
239 West Main Street
252-946-4178

Operations Center
220 Creekside Drive
252-946-4178

FIRST SOUTH BANK ATM* LOCATIONS

Chocowinity
2999 Highway 17 South

Elizabeth City
604 East Ehringhaus Street

Fayetteville
241 Green Street
3107 Raeford Road

Greenville
301 East Arlington Blvd

Kinston
2430 Heritage Street

Lumberton
3000 North Elm Street
3551 Fayetteville Road

New Bern
1725 Glenburnie Road

Tarboro
1202 Western Blvd

Rocky Mount
300 Sunset Avenue
2901 Sunset Avenue
1378 Benvenue Road
450 North Winstead Avenue
3635 North Halifax Road

Washington
1311 Carolina Avenue
300 North Market Street
1328 John Small Avenue

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*Member of Star and Cirrus ATM networks

Member FDIC

FIRST SOUTH BANK PRODUCTS AND SERVICES

Personal Banking Services

Checking Accounts:

Free Basic Checking
Free Senior Checking (age 50 and over)
Executive Checking
Preferred Checking
Money Market Checking

Lending Services:

Consumer Loans
Home Equity Loans
Mortgage Loans
FHA/VA Financing
Reserve Lines
VISA and MasterCard Credit Cards

Savings Accounts:

Regular Savings
Custodial Savings

Other Personal Banking Services:

AccessLine 24 Hour Telephone Banking
Automated Teller Machines (ATMs)
24-Hour Banking Cards (ATM)
Certificates of Deposit
Individual Retirement Accounts
VISA CheckCards
Drive-Thru Windows
Night Depository
Safe Deposit Boxes
Wire Transfers

Commercial Banking Services

Checking Accounts:

Commercial Checking
Commercial Money Market Checking
Business Interest Checking
Simple Business Checking
Simple Business Plus Checking

Lending Services:

Commercial Real Estate Loans
Commercial Business Loans
SBA Loans
Lines-of-Credit

Other Commercial Banking Services

Cash Management Sweep Products
Total Treasury Manager
VISA and MasterCard Merchant Services
Night Depository

Wire Transfers

Cash Services (Coin and Currency)

STOCKHOLDER INFORMATION

Corporate Headquarters

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Washington, NC 27889

Telephone: 252-946-4178
Fax: 252-946-3873
E-mail: info@firstsouthnc.com
Website: www.firstsouthnc.com

Stock Listing Information

The Company's common stock trades on the Nasdaq Stock Market under the symbol FSBK.

Stock Price Information

The following table sets forth the high and low trade price information and dividends declared per share for the periods indicated.

Quarter Ended	High	Low	Dividends
December 31, 1999	$18.875	$17.125	$.10
March 31, 2000	18.875	17.375	.10
June 30, 2000	20.00	18.375	.13
September 30, 2000	23.25	19.25	.13
December 31, 2000	24.78	21.75	.13
March 31, 2001	25.00	23.0625	.18
June 30, 2001	27.50	24.6875	.18
September 30, 2001	36.25	26.50	.18

Registrar and Transfer Agent

Inquiries regarding stock transfer, registration, lost certificates or changes in name and address should be directed to the stock registrar and transfer agent:

Registrar and Transfer Company
10 Commerce Drive
Cranford, New Jersey 07016
(800) 866-1340

Form 10-K

The Company's annual report on Form 10-K, filed with the Securities and Exchange Commission, is available to shareholders without charge by writing: William L. Wall, Chief Financial Officer, First South Bancorp, Inc., P. O. Box 2047, Washington, NC 27889.

Investor Information

Shareholders, investors, and analysts interested in additional information may contact William L. Wall, Chief Financial Officer, First South Bancorp, Inc.

Annual Meeting

The Annual Meeting of Stockholders of First South Bancorp, Inc. will be held Thursday, February 21, 2002 at 11:00 a.m., at the main office of First South Bank, 1311 Carolina Avenue, Washington, North Carolina.

General Counsel

Rodman, Holscher, Francisco &
Peck, P.A.
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Washington, NC 27889

Special Counsel

Stradley Ronon Stevens
& Young, LLP
Suite 700
1220 19th Street, N.W.

Independent Accountants

PricewaterhouseCoopers LLP
Suite 2300
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Raleigh, NC 27601

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