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BERKSHIRE BANCORP INC /DE/  
Form 10-Q  
May 12, 2004

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

FORM 10-Q

(Mark One)

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

For the quarterly period ended March 31, 2004

or

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission file number: 0-13649

BERKSHIRE BANCORP INC.  
(Exact name of registrant as specified in its charter)

Delaware  
(State or other jurisdiction of  
incorporation or organization)

94-2563513  
(I.R.S. Employer  
Identification No.)

160 Broadway, New York, New York  
(Address of principal executive offices)

10038  
(Zip Code)

Registrant's telephone number, including area code: (212) 791-5362

N/A  
(Former name, former address and former fiscal year,  
if changed since last report)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15 (d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes  No

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act). Yes  No

As of May 10, 2004, there were 2,212,173 outstanding shares of the issuers Common Stock, \$.10 par value.

BERKSHIRE BANCORP INC. AND SUBSIDIARIES

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## FORWARD-LOOKING STATEMENTS

Statements in this Quarterly Report on Form 10-Q that are not based on historical fact may be "forward-looking statements" within the meaning of the Private Securities Litigation Reform Act of 1995. Words such as "believe", "may", "will", "expect", "estimate", "anticipate", "continue" or similar terms identify forward-looking statements. A wide variety of factors could cause the Company's actual results and experiences to differ materially from the results expressed or implied by the Company's forward-looking statements. Some of the risks and uncertainties that may affect operations, performance, results of the Company's business, the interest rate sensitivity of its assets and liabilities, and the adequacy of its loan loss allowance, include, but are not limited to: (i) deterioration in local, regional, national or global economic conditions which could result, among other things, in an increase in loan delinquencies, a decrease in property values, or a change in the housing turnover rate; (ii) changes in market interest rates or changes in the speed at which market interest rates change; (iii) changes in laws and regulations affecting the financial services industry; (iv) changes in competition; (v) changes in consumer preferences, (vi) changes in banking technology; (vii) ability to maintain key members of management, (viii) possible disruptions in the Company's operations at its banking facilities, and other factors referred to in the sections of this Quarterly Report entitled "Management's Discussion and Analysis of Financial Condition and Results of Operations."

Certain information customarily disclosed by financial institutions, such as estimates of interest rate sensitivity and the adequacy of the loan loss allowance, are inherently forward-looking statements because, by their nature, they represent attempts to estimate what will occur in the future.

The Company cautions readers not to place undue reliance upon any forward-looking statement contained in this Quarterly Report. Forward-looking statements speak only as of the date they were made and the Company assumes no obligation to update or revise any such statements upon any change in applicable circumstances.

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## BERKSHIRE BANCORP INC. AND SUBSIDIARIES QUARTERLY REPORT ON FORM 10-Q

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### BERKSHIRE BANCORP INC. AND SUBSIDIARIES CONSOLIDATED BALANCE SHEETS (Dollars in Thousands) (unaudited)

|  | March 31,<br>2004 | December 31,<br>2003 |
|--|-------------------|----------------------|
|  | -----             | -----                |
| <b>ASSETS</b>                          |                   |                      |
| Cash and due from banks                | \$ 5,499          | \$ 7,478             |
| Interest bearing deposits              | 359               | 1,832                |
| <b>Total cash and cash equivalents</b> | <b>5,858</b>      | <b>9,310</b>         |
| <b>Investment Securities:</b>          |                   |                      |
| Available-for-sale                     | 613,564           | 569,137              |
| Held-to-maturity                       | 690               | 711                  |
| <b>Total investment securities</b>     | <b>614,254</b>    | <b>569,848</b>       |
| Loans, net of unearned income          | 295,336           | 294,756              |
| Less: allowance for loan losses        | (2,661)           | (2,593)              |
| <b>Net loans</b>                       | <b>292,675</b>    | <b>292,163</b>       |
| Accrued interest receivable            | 5,780             | 5,298                |

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|  |           |           |
|--|-----------|-----------|
| Premises and equipment, net                    | 8,553     | 8,665     |
| Other assets                                   | 991       | 1,836     |
| Goodwill, net                                  | 18,549    | 18,549    |
|  | -----     | -----     |
| Total assets                                   | \$946,660 | \$905,669 |
|  | =====     | =====     |
| LIABILITIES AND STOCKHOLDERS' EQUITY           |           |           |
| Deposits:                                      |           |           |
| Non-interest bearing                           | \$ 38,371 | \$ 38,422 |
| Interest bearing                               | 584,148   | 565,833   |
|  | -----     | -----     |
| Total deposits                                 | 622,519   | 604,255   |
| Securities sold under agreements to repurchase | 129,476   | 114,391   |
| Long term borrowings                           | 79,692    | 77,745    |
| Accrued interest payable                       | 2,154     | 2,208     |
| Other liabilities                              | 4,737     | 3,580     |
|  | -----     | -----     |
| Total liabilities                              | 838,578   | 802,179   |
|  | -----     | -----     |
| Stockholders' equity                           |           |           |
| Preferred stock - \$.10 Par value:             | --        | --        |
| 2,000,000 shares authorized - none issued      |           |           |
| Common stock - \$.10 par value                 |           |           |
| Authorized -- 10,000,000 shares                |           |           |
| Issued -- 2,566,095 shares                     |           |           |
| Outstanding --                                 |           |           |
| March 31, 2004, 2,207,800 shares               |           |           |
| December 31, 2003, 2,207,080 shares            | 256       | 256       |
| Additional paid-in capital                     | 89,869    | 89,866    |
| Retained earnings                              | 24,911    | 22,960    |
| Accumulated other comprehensive                |           |           |
| income, net                                    | 3,420     | 775       |
| Common stock in treasury - at cost:            |           |           |
| March 31, 2004, 354,670 shares                 |           |           |
| December 31, 2003, 359,015 shares              | (10,374)  | (10,367)  |
|  | -----     | -----     |
| Total stockholders' equity                     | 108,082   | 103,490   |
|  | -----     | -----     |
|  | \$946,660 | \$905,669 |
|  | =====     | =====     |

The accompanying notes are an integral part of these statements.

BERKSHIRE BANCORP INC. AND SUBSIDIARIES  
CONSOLIDATED STATEMENTS OF INCOME  
(In Thousands, Except Per Share Data)  
(unaudited)

For The  
Three Months Ended

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|  | March 31, |         |
|--|-----------|---------|
|  | 2004      | 2003    |
|  | -----     | -----   |
| INTEREST INCOME  |           |         |
| Loans  | \$4,849   | \$4,757 |
| Investment securities                                  | 4,786     | 3,610   |
| Federal funds sold and<br>interest bearing deposits    | 3         | 11      |
|  | -----     | -----   |
| Total interest income                                  | 9,638     | 8,378   |
|  | -----     | -----   |
| INTEREST EXPENSE                                       |           |         |
| Deposits   | 2,455     | 2,582   |
| Short-term borrowings                                  | 497       | 149     |
| Long-term borrowings                                   | 768       | 657     |
|  | -----     | -----   |
| Total interest expense                                 | 3,720     | 3,388   |
|  | -----     | -----   |
| Net interest income                                    | 5,918     | 4,990   |
| PROVISION FOR LOAN LOSSES                              | 45        | 105     |
|  | -----     | -----   |
| Net interest income after provision<br>for loan losses | 5,873     | 4,885   |
|  | -----     | -----   |
| NON-INTEREST INCOME                                    |           |         |
| Service charges on deposit accounts                    | 127       | 96      |
| Investment securities gains                            | 93        | 628     |
| Other income   | 198       | 268     |
|  | -----     | -----   |
| Total non-interest income                              | 418       | 992     |
|  | -----     | -----   |
| NON-INTEREST EXPENSE                                   |           |         |
| Salaries and employee benefits                         | 1,667     | 1,331   |
| Net occupancy expense                                  | 274       | 405     |
| Equipment expense                                      | 86        | 109     |
| FDIC assessment  | 22        | 19      |
| Data processing expense                                | 32        | 59      |
| Other  | 881       | 789     |
|  | -----     | -----   |
| Total non-interest expense                             | 2,962     | 2,712   |
|  | -----     | -----   |
| Income before provision for taxes                      | 3,329     | 3,165   |
| Provision for income taxes                             | 1,378     | 1,423   |
|  | -----     | -----   |
| Net income   | \$1,951   | \$1,742 |
|  | =====     | =====   |
| Net income per share:                                  |           |         |
| Basic  | \$ .88    | \$ .78  |
|  | =====     | =====   |
| Diluted  | \$ .85    | \$ .78  |
|  | =====     | =====   |

The accompanying notes are an integral part of these statements.

BERKSHIRE BANCORP INC. AND SUBSIDIARIES  
CONSOLIDATED STATEMENT OF STOCKHOLDERS' EQUITY

For The Three Months Ended March 31, 2004  
(In Thousands)

|   | Common<br>Shares | Stock<br>Par<br>value | Additional<br>paid-in<br>capital | Accumulated<br>other<br>comprehensive<br>income<br>net | Retained<br>earnings | Treasury<br>stock |
|---|------------------|-----------------------|----------------------------------|--|----------------------|-------------------|
|   | -----            | -----                 | -----                            | -----  | -----                | -----             |
| Balance at December 31, 2003  | 2,566            | \$256                 | \$89,866                         | \$ 775   | \$22,960             | \$(10,367)        |
| Net income  |                  |                       |                                  |  | 1,951                |                   |
| Exercise of stock options   |                  |                       | 3                                |  |                      | 62                |
| Acquisition of treasury shares  |                  |                       |                                  |  |                      | (69)              |
| Other comprehensive income net<br>of reclassification adjustment<br>and taxes |                  |                       |                                  | 2,645  |                      |                   |
| Comprehensive income  |                  |                       |                                  |  |                      |                   |
| Balance at March 31, 2004<br>(Unaudited)                                      | 2,566            | \$256                 | \$89,869                         | \$3,420  | \$24,911             | \$(10,374)        |
|   | =====            | =====                 | =====                            | =====  | =====                | =====             |

The accompanying notes are an integral part of this statement.

BERKSHIRE BANCORP INC. AND SUBSIDIARIES  
CONSOLIDATED STATEMENTS OF CASH FLOWS  
(in thousands)  
(unaudited)

For The Three Months Ended  
March 31,  
-----  
2004                      2003  
-----

Cash flows from operating activities:

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|   |           |           |
|---|-----------|-----------|
| Net income  | \$ 1,951  | \$ 1,742  |
| Adjustments to reconcile net income to net cash provided by operating activities: |           |           |
| Realized gain on investment securities  | (93)      | (628)     |
| Net amortization of securities  | 813       | 276       |
| Depreciation and amortization   | 145       | 163       |
| Provision for loan losses   | 45        | 105       |
| (Increase) decrease in accrued interest receivable                                | (482)     | 159       |
| Decrease (increase) in other assets   | 845       | (889)     |
| (Decrease) increase in accrued interest payable and other liabilities             | (599)     | 231       |
| Net cash provided by operating activities   | 2,625     | 1,159     |
| Cash flows from investing activities:   |           |           |
| Investment securities available for sale  |           |           |
| Purchases   | (407,636) | (518,852) |
| Sales, maturities and calls   | 366,836   | 490,973   |
| Investment securities held to maturity  |           |           |
| Maturities  | 21        | 31        |
| Net (increase) decrease in loans  | (557)     | 4,582     |
| Acquisition of premises and equipment   | (33)      | (23)      |
| Net cash (used in) investing activities   | (41,369)  | (23,289)  |

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BERKSHIRE BANCORP INC. AND SUBSIDIARIES  
CONSOLIDATED STATEMENTS OF CASH FLOWS  
(in thousands)  
(unaudited)

For The Three Months Ended  
March 31,

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|   | 2004     | 2003      |
|---|----------|-----------|
|   | -----    | -----     |
| Cash flows from financing activities:                                 |          |           |
| Net (decrease) in non interest bearing deposits                       | (51)     | (392)     |
| Net increase in interest bearing deposits                             | 18,315   | 42,304    |
| Increase (decrease) in securities sold under agreements to repurchase | 15,085   | (10,520)  |
| Proceeds from long term debt  | 1,947    | 5,000     |
| Repayment of long term debt   | --       | (2,520)   |
| Proceeds from exercise of common stock options                        | 65       | --        |
| Acquisition of treasury stock   | (69)     | (978)     |
|   | -----    | -----     |
| Net cash provided by financing activities                             | 35,292   | 32,894    |
|   | -----    | -----     |
| Net (decrease) increase in cash                                       | (3,452)  | 10,764    |
|   | -----    | -----     |
| Cash - beginning of period  | 9,310    | 6,310     |
|   | -----    | -----     |
| Cash - end of period  | \$ 5,858 | \$ 17,074 |
|   | =====    | =====     |
| Supplemental disclosures of cash flow information:                    |          |           |
| Cash used to pay interest   | \$ 3,774 | \$ 3,491  |
| Cash used to pay taxes, net of refunds                                | \$ 945   | \$ 399    |

The accompanying notes are an integral part of these statements.

BERKSHIRE BANCORP INC. AND SUBSIDIARIES  
Notes to Consolidated Financial Statements  
March 31, 2004 and 2003

NOTE 1. General

Berkshire Bancorp Inc. ("Berkshire" or the "Company" or "we" and similar pronouns), a Delaware corporation, is a bank holding company registered under the Bank Holding Company Act of 1956. Berkshire's principal activity is the ownership and management of its wholly owned subsidiary, The Berkshire Bank (the "Bank"), a New York State chartered commercial bank.

The accompanying financial statements of Berkshire Bancorp Inc. and subsidiaries includes the accounts of the parent company, Berkshire Bancorp Inc., and its wholly-owned subsidiaries: The Berkshire Bank and Greater American Finance Group, Inc.



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During interim periods, the Company follows the accounting policies set forth in its Annual Report on Form 10-K filed with the Securities and Exchange Commission. Readers are encouraged to refer to the Company's Form 10-K for the fiscal year ended December 31, 2003 when reviewing this Form 10-Q. Quarterly results reported herein are not necessarily indicative of results to be expected for other quarters.

In the opinion of management, the accompanying unaudited consolidated financial statements contain all adjustments (consisting of normal recurring adjustments) considered necessary to present fairly the Company's consolidated financial position as of March 31, 2004 and December 31, 2003 and the consolidated results of its operations for the three month periods ended March 31, 2004 and 2003, and its consolidated stockholders' equity for the three month period ended March 31, 2004, and its consolidated cash flows for the three month periods ended March 31, 2004 and 2003. Operating results for the three months ended March 31, 2004 are not necessarily indicative of the results that may be expected for a full fiscal year.

### NOTE 2. Earnings Per Share

Basic earnings per share is calculated by dividing income available to common stockholders by the weighted average common shares outstanding, excluding stock options from the calculation. In calculating diluted earnings per share, the dilutive effect of stock options is calculated using the average market price for the Company's common stock during the period. The following table presents the calculation of earnings per share for the periods indicated:

|  | For The Three Months Ended            |                         |                        |                       |                         |
|--|---------------------------------------|-------------------------|------------------------|-----------------------|-------------------------|
|  | March 31, 2004                        |                         |                        | March 31, 2003        |                         |
|  | Income<br>(numerator)                 | Shares<br>(denominator) | Per<br>share<br>amount | Income<br>(numerator) | Shares<br>(denominator) |
|  | (In thousands, except per share data) |                         |                        |                       |                         |
| Basic earnings per share   |                                       |                         |                        |                       |                         |
| Net income available to<br>common stockholders                             | \$1,951                               | 2,208                   | \$ .88                 | \$1,742               | 2,221                   |
| Effect of dilutive securities  |                                       |                         |                        |                       |                         |
| Options  | --                                    | 73                      | (.03)                  | --                    | 21                      |
| Diluted earnings per share   |                                       |                         |                        |                       |                         |
| Net income available to<br>common stockholders plus<br>assumed conversions | \$1,951                               | 2,281                   | \$ .85                 | \$1,742               | 2,242                   |

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BERKSHIRE BANCORP INC. AND SUBSIDIARIES  
Notes to Consolidated Financial Statements (continued)

NOTE 2. - (continued)

Options to purchase 40,375 shares of common stock for \$38.00 per share were outstanding during the three month periods ended March 31, 2003. These options were not included in the computation of diluted earnings per share because the option exercise price was greater than the average market price for the Company's common stock during this period.

NOTE 3. Investment Securities

The following tables summarize held to maturity and available-for-sale investment securities as of March 31, 2004 and December 31, 2003:

|   | March 31, 2004    |                              |                               |               |
|---|-------------------|------------------------------|-------------------------------|---------------|
|   | Amortized<br>Cost | Gross<br>unrealized<br>gains | Gross<br>unrealized<br>losses | Fair<br>value |
|   | -----             | -----                        | -----                         | -----         |
|   | (In thousands)    |                              |                               |               |
| Held To Maturity<br>Investment Securities |                   |                              |                               |               |
| U.S. Government Agencies                  | \$690             | \$4                          | \$(1)                         | \$693         |
|   | ----              | --                           | ---                           | ----          |
| Totals                                    | \$690             | \$4                          | \$(1)                         | \$693         |
|   | ====              | ==                           | ===                           | ====          |

|   | December 31, 2003 |                              |                               |               |
|---|-------------------|------------------------------|-------------------------------|---------------|
|   | Amortized<br>Cost | Gross<br>unrealized<br>gains | Gross<br>unrealized<br>losses | Fair<br>value |
|   | -----             | -----                        | -----                         | -----         |
|   | (In thousands)    |                              |                               |               |
| Held To Maturity<br>Investment Securities |                   |                              |                               |               |
| U.S. Government Agencies                  | \$711             | \$4                          | \$--                          | \$715         |
|   | ----              | --                           | ---                           | ----          |
| Totals                                    | \$711             | \$4                          | \$--                          | \$715         |
|   | ====              | ==                           | ===                           | ====          |

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BERKSHIRE BANCORP INC. AND SUBSIDIARIES  
Notes to Consolidated Financial Statements (continued)

NOTE 3. - (continued)

| March 31, 2004                            |                   |                              |                               |               |
|---|-------------------|------------------------------|-------------------------------|---------------|
|   | Amortized<br>Cost | Gross<br>unrealized<br>gains | Gross<br>unrealized<br>losses | Fair<br>value |
| (In thousands)                            |                   |                              |                               |               |
| Available-For-Sale                        |                   |                              |                               |               |
| Investment Securities                     |                   |                              |                               |               |
| U.S. Treasury and Notes                   | \$ 14,975         | \$ 31                        | \$ --                         | \$ 15,006     |
| U.S. Government Agencies                  | 479,398           | 2,212                        | (675)                         | 480,935       |
| Mortgage-backed securities                | 101,775           | 3,707                        | (260)                         | 105,222       |
| Corporate notes                           | 1,571             | 409                          | (123)                         | 1,857         |
| Municipal Securities                      | 1,609             | 163                          | --                            | 1,772         |
| Marketable equity<br>securities and other | 8,609             | 246                          | (83)                          | 8,772         |
| Totals                                    | \$607,937         | \$6,768                      | \$(1,141)                     | \$613,564     |

| December 31, 2003                         |                   |                              |                               |               |
|---|-------------------|------------------------------|-------------------------------|---------------|
|   | Amortized<br>Cost | Gross<br>unrealized<br>gains | Gross<br>unrealized<br>losses | Fair<br>value |
| (In thousands)                            |                   |                              |                               |               |
| Available-For-Sale                        |                   |                              |                               |               |
| Investment securities                     |                   |                              |                               |               |
| U.S. Treasury and Notes                   | \$ 39,941         | \$ --                        | \$ (94)                       | \$ 39,847     |
| U.S. Government Agencies                  | 419,175           | 637                          | (3,059)                       | 416,753       |
| Mortgage-backed securities                | 93,875            | 3,838                        | (265)                         | 97,448        |
| Corporate Notes                           | 1,570             | 214                          | (122)                         | 1,662         |
| Municipal securities                      | 991               | 70                           | --                            | 1,061         |
| Marketable equity<br>securities and other | 12,305            | 177                          | (116)                         | 12,366        |
| Totals                                    | \$567,857         | \$4,936                      | \$(3,656)                     | \$569,137     |

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### BERKSHIRE BANCORP INC. AND SUBSIDIARIES Notes to Consolidated Financial Statements (continued)

#### NOTE 4. Loan Portfolio

The following table sets forth information concerning the Company's loan portfolio by type of loan at the dates indicated:

|                                   | March 31, 2004         |               | December 31, 2003 |               |
|-----------------------------------|------------------------|---------------|-------------------|---------------|
|                                   | Amount                 | % of<br>Total | Amount            | % of<br>Total |
|                                   | (Dollars in thousands) |               |                   |               |
| Commercial and professional loans | \$ 18,669              | 6.3%          | \$ 22,228         | 7.5%          |
| Secured by real estate            |                        |               |                   |               |
| 1-4 family                        | 166,198                | 56.1          | 169,589           | 57.4          |
| Multi family                      | 6,277                  | 2.2           | 6,608             | 2.2           |
| Non-residential (commercial)      | 99,646                 | 33.6          | 94,956            | 32.1          |
| Consumer                          | 5,402                  | 1.8           | 2,239             | 0.8           |
| Total loans                       | 296,192                | 100.0%        | 295,620           | 100.0%        |
|                                   |                        | =====         |                   | =====         |
| Deferred loan fees                | (856)                  |               | (864)             |               |
| Allowance for loan losses         | (2,661)                |               | (2,593)           |               |
| Loans, net                        | \$292,675              |               | \$292,163         |               |

#### NOTE 5. Deposits

The following table summarizes the composition of the average balances of major deposit categories:

|                      | March 31, 2004         |                  | December 31, 2003 |                  |
|----------------------|------------------------|------------------|-------------------|------------------|
|                      | Average<br>Amount      | Average<br>Yield | Average<br>Amount | Average<br>Yield |
|                      | (Dollars in thousands) |                  |                   |                  |
| Demand deposits      | \$ 37,199              | --               | \$ 32,592         | --               |
| NOW and money market | 49,523                 | 0.75%            | 58,723            | 1.02%            |
| Savings deposits     | 209,672                | 1.54             | 143,094           | 1.95             |
| Time deposits        | 320,081                | 1.95             | 333,112           | 2.26             |
| Total deposits       | \$616,475              | 1.60%            | \$567,521         | 1.78%            |

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BERKSHIRE BANCORP INC. AND SUBSIDIARIES  
Notes to Consolidated Financial Statements (continued)

NOTE 6. Comprehensive Income

The following table presents the components of comprehensive income, based on the provisions of SFAS No. 130.:

|  | For The Three Months Ended |                       |                   |                   |                       |
|--|----------------------------|-----------------------|-------------------|-------------------|-----------------------|
|  | March 31, 2004             |                       |                   | March 31, 2003    |                       |
|  | Before tax amount          | Tax (expense) benefit | Net of tax Amount | Before tax amount | Tax (expense) benefit |
|  | (In thousands)             |                       |                   |                   |                       |
| Unrealized (losses) gains on investment securities:                        |                            |                       |                   |                   |                       |
| Unrealized holding gains (losses) arising during period                    | \$4,440                    | \$ (1,739)            | \$2,589           | \$ (291)          | \$ 117                |
| Less reclassification adjustment for (losses) gains realized in net income | 93                         | (37)                  | 56                | 628               | (251)                 |
| Other comprehensive (loss) income, net                                     | \$4,347                    | \$ (1,702)            | \$2,645           | \$ (919)          | \$ 368                |

NOTE 7. Accounting For Stock Based Compensation

SFAS No. 148 "Accounting for Stock Based Compensation-Transition and Disclosure", which amends the disclosure and certain provisions of SFAS No. 123, was issued in December 2002. SFAS No. 148 requires all entities with stock based employee compensation arrangements to provide additional disclosures in their summary of significant accounting policies note. The Company has one stock-based employee compensation plan. The Company accounts for that plan under the recognition and measurement principles of APB No. 25, "Accounting for Stock Issued to Employees," and related interpretations. Stock-based employee compensation costs are not reflected in net income, as all options granted under the plan had an exercise price equal to the market value of the underlying common stock on the date of the grant. The following table illustrates the effect on net income and earnings per share if the Company had applied the fair value recognition provisions of SFAS No. 123, "Accounting for Stock-Based Compensation," to stock-based employee compensation.

For The  
Three Months Ended  
March 31,

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|   |              | -----  |         |
|---|--------------|--|---------|
|   |              | 2004   | 2003    |
|   |              | -----  | -----   |
|   |              | (In thousands,<br>except per<br>share amounts) |         |
| Net income  | As Reported: | \$1,951  | \$1,742 |
| Less: Stock based compensation<br>costs determined under fair<br>value methods for all awards |              | --   | (32)    |
|   | Pro Forma:   | \$1,951  | \$1,710 |
|   |              | =====  | =====   |
| Basic earnings per share  | As Reported: | \$ .88   | \$ .78  |
|   | Pro Forma:   | .88  | .77     |
| Diluted earnings per share  | As Reported: | \$ .85   | \$ .78  |
|   | Pro Forma:   | .85  | .76     |

The Company did not grant options during the three months ended March 31, 2004 and 2003.

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BERKSHIRE BANCORP INC. AND SUBSIDIARIES  
Notes to Consolidated Financial Statements (continued)

NOTE 7. - (continued)

On March 31, 2004, the Financial Accounting Standards Board (FASB) issued a proposed Statement, Share-Based Payment an Amendment of FASB Statements No. 123 and APB No. 95, that addresses the accounting for share-based payment transactions in which an enterprise receives employee services in exchange for (a) equity instruments of the enterprise or (b) liabilities that are based on the fair value of the enterprise's equity instruments or that may be settled by the issuance of such equity instruments. Under the FASB's proposal, all forms of share-based payments to employees, including employee stock options, would be treated the same as other forms of compensation by recognizing the related cost in the income statement. The expense of the award would generally be measured at fair value at the grant date. Current accounting guidance requires that the expense relating to so-called fixed plan employee stock options only be disclosed in the footnotes to the financial statements. The proposed Statement would eliminate the ability to account for share-based compensation transactions using APB Opinion No. 25, Accounting for Stock Issued to Employees. The Company is currently evaluating this proposed statement and its effects on its results of operations.

Note 8. Employee Benefit Plans

The Company has a Retirement Income Plan (the "Plan"), a noncontributory plan covering substantially all full-time, non-union United States employees of

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the Company. The following interim-period information is being provided in accordance with FASB Statement 132(R). See Note 9, Employers' Disclosure About Pensions and Other Postretirement Benefits, below.

|                                | For The<br>Three Months Ended<br>March 31, |           |
|--------------------------------|--|-----------|
|                                | 2004                                       | 2003      |
| Service cost                   | \$ 56,000                                  | \$ 48,791 |
| Interest cost                  | 28,750                                     | 26,803    |
| Expected return on plan assets | (37,500)                                   | (30,871)  |
| Amortization and Deferral:     |  |           |
| Transition amount              | --   | --        |
| Prior service cost             | 4,500                                      | 4,593     |
| (Gain)/loss                    | 3,000                                      | 6,210     |
| Net periodic pension cost      | 54,750                                     | 55,526    |

During the fiscal year ending December 31, 2004, we expect to contribute approximately \$110,000 to the Plan. We are, however, evaluating the impact of the Pension Funding Equity Act enacted in April 2004 on our projected funding. We did not make any contributions, required or otherwise, to the Plan in the three months ended March 31, 2004.

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BERKSHIRE BANCORP INC. AND SUBSIDIARIES  
Notes to Consolidated Financial Statements (continued)

NOTE 9. New Accounting Pronouncements

Loan Commitments Accounted for as Derivative Instruments

The Securities and Exchange Commission staff recently released Staff Accounting Bulletin (SAB) 105, "Loan Commitments Accounted for as Derivative Instruments." SAB 105 provides guidance about the measurement of loan commitments recognized at fair value under FASB Statement No. 133, Accounting for Derivative Instruments and Hedging Activities. SAB 105 also requires companies to disclose their accounting policy for those loan commitments including methods and assumptions used to estimate fair value and associated hedging strategies. SAB 105 is effective for all loan commitments accounted for as derivatives that are entered into after March 31, 2004. The adoption of SAB 105 is not expected to have a material effect on our consolidated financial statements.

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

The following discussion and analysis is intended to provide a better understanding of the consolidated financial condition and results of operations of Berkshire Bancorp Inc., a Delaware corporation. References herein to

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"Berkshire", the "Company" or "we" and similar pronouns, shall be deemed to refer to the Company and its consolidated subsidiaries unless the context otherwise requires. References to per share amounts refer to diluted shares. References to Notes herein are references to the "Notes to Consolidated Financial Statements" of the Company located in Item 1 herein.

### Critical Accounting Policies, Judgments and Estimates

The accounting and reporting policies of the Company conform with accounting principles generally accepted in the United States of America and general practices within the financial services industry. The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and the assumptions that affect the amounts reported in the financial statements and the accompanying notes. Actual results could differ from those estimates.

The Company considers that the determination of the allowance for loan losses involves a higher degree of judgment and complexity than any of its other significant accounting policies. The allowance for loan losses is calculated with the objective of maintaining a reserve level believed by management to be sufficient to absorb estimated credit losses. Management's determination of the adequacy of the allowance is based on periodic evaluations of the loan portfolio and other relevant factors. However, this evaluation is inherently subjective as it requires material estimates, including, among others, expected default probabilities, loss given default, the amounts and timing of expected future cash flows on impaired loans, mortgages, and general amounts for historical loss experience. The process also considers economic conditions, uncertainties in estimating losses and inherent risks in the loan portfolio. All of these factors may be susceptible to significant change. To the extent actual outcomes differ from management estimates, additional provisions for loan losses may be required that would adversely impact earnings in future periods.

With the adoption of SFAS No. 142 on January 1, 2002, the Company discontinued the amortization of goodwill resulting from acquisitions. Goodwill is now subject to impairment testing at least annually to determine whether write-downs of the recorded balances are necessary. The Company tests for impairment based on the goodwill maintained at each defined reporting unit. A

fair value is determined for each reporting unit based on at least one of three various market valuation methodologies. If the fair values of the reporting units exceed their book values, no write-down of recorded goodwill is necessary. If the fair value of the reporting unit is less, an expense may be required on the Company's books to write down the related goodwill to the proper carrying value. As of December 31, 2003, the Company completed its transitional testing, which determined that no impairment write-offs were necessary.

The Company recognizes deferred tax assets and liabilities for the future tax effects of temporary differences, net operating loss carryforwards and tax credits. Deferred tax assets are subject to management's judgment based upon available evidence that future realization is more likely than not. If management determines that the Company may be unable to realize all or part of net deferred tax assets in the future, a direct charge to income tax expense may be required to reduce the recorded value of the net deferred tax asset to the expected realizable amount.



The following table presents the total dollar amount of interest income from average interest-earning assets and the resultant yields, as well as the interest expense on average interest-bearing liabilities, expressed in both dollars and rates.

|  | For The Three Months Ended March 31, |                              |                       |                    |                              |    |
|--|--------------------------------------|------------------------------|-----------------------|--------------------|------------------------------|----|
|  | 2004                                 |                              |                       | 2003               |                              |    |
|  | Average<br>Balance                   | Interest<br>and<br>Dividends | Average<br>Yield/Rate | Average<br>Balance | Interest<br>and<br>Dividends | Yi |
|  | (Dollars in Thousands)               |                              |                       |                    |                              |    |
| <b>INTEREST-EARNING ASSETS:</b>            |                                      |                              |                       |                    |                              |    |
| Loans (1)                                  | \$293,441                            | \$4,849                      | 6.61%                 | \$274,929          | \$4,757                      |    |
| Investment securities                      | 589,961                              | 4,786                        | 3.24                  | 389,726            | 3,610                        |    |
| Other (2) (5)                              | 2,081                                | 3                            | 0.58                  | 6,100              | 11                           |    |
| Total interest-earning assets              | 885,483                              | 9,638                        | 4.35                  | 670,755            | 8,378                        |    |
| Noninterest-earning assets                 | 37,710                               |                              |                       | 36,464             |                              |    |
| Total Assets                               | \$923,193                            |                              |                       | \$707,219          |                              |    |
| <b>INTEREST-BEARING LIABILITIES:</b>       |                                      |                              |                       |                    |                              |    |
| Interest bearing deposits                  | 259,195                              | 898                          | 1.39%                 | 144,683            | 472                          |    |
| Time deposits                              | 320,081                              | 1,557                        | 1.95                  | 317,443            | 2,110                        |    |
| Other borrowings                           | 194,709                              | 1,265                        | 2.60                  | 106,232            | 806                          |    |
| Total interest-bearing liabilities         | 773,985                              | 3,720                        | 1.92                  | 568,357            | 3,388                        |    |
| Demand deposits                            | 37,199                               |                              |                       | 30,911             |                              |    |
| Noninterest-bearing liabilities            | 7,348                                |                              |                       | 8,366              |                              |    |
| Stockholders' equity (5)                   | 104,661                              |                              |                       | 99,585             |                              |    |
| Total liabilities and stockholders' equity | \$923,193                            |                              |                       | \$707,219          |                              |    |
| Net interest income                        |                                      | 5,918                        |                       |                    | 4,990                        |    |
| Interest-rate spread (3)                   |                                      |                              | 2.43%                 |                    |                              |    |

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|  |       |       |
|--|-------|-------|
| Net interest margin (4)  | 2.67% | ===== |
|  |       |       |
| Ratio of average interest-earning assets to average interest bearing liabilities | 1.14  | 1.18  |
|  | ===== | ===== |

- 
- (1) Includes nonaccrual loans.
  - (2) Includes interest-bearing deposits, federal funds sold and securities purchased under agreements to resell.
  - (3) Interest-rate spread represents the difference between the average yield on interest-earning assets and the average cost of interest bearing liabilities.
  - (4) Net interest margin is net interest income as a percentage of average interest-earning assets.
  - (5) Average balances are daily average balances except for the parent company which have been calculated on a monthly basis.

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### Results of Operations

Results of Operations for the Three Months Ended March 31, 2004 Compared to the Three Months Ended March 31, 2003.

General. Berkshire Bancorp Inc., a bank holding company registered under the Bank Holding Company Act of 1956, has one wholly-owned banking subsidiary, The Berkshire Bank, a New York State chartered commercial bank (the "Bank"). The Bank is headquartered in Manhattan and has nine branch locations, five branches in New York City and four branches in Orange and Sullivan counties. We opened two new branches in Brooklyn, New York in April and June of 2003.

Net Income. Net income for the three-month period ended March 31, 2004 was \$1.95 million, or \$.85 per share, as compared to \$1.74 million, or \$.78 per share, for the three-month period ended March 31, 2003. Our net income is largely dependent on interest rate levels, demand for our loan and deposit products and the strategies we employ to manage the interest rate risk and other risks inherent in the banking business. From June 2003 to date, interest rates, as measured by the prime rate, have remained at 4.0%, declining 25 basis points since March 31, 2003.

Net Interest Income. The Company's primary source of revenue is net interest income, or the difference between interest income on earning assets, such as loans and investment securities, and interest expense on interest-bearing liabilities, typically deposits and borrowings.

For the quarter ended March 31, 2004, net interest income increased by \$928,000, or 18.60%, to \$5.92 million from \$4.99 million for the quarter ended March 31, 2003. The quarter over quarter increase in net interest income was the

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result of the 32.01% growth in average interest-earning assets to \$885.48 million in 2004 from \$670.76 million in 2003 and the 20.34% increase in average non interest-bearing demand deposits to \$37.20 million from \$30.91 million. These two factors were partially offset by the 36.18% increase in the average amount of interest-bearing liabilities to \$773.99 million in 2004 from \$568.36 million in 2003 and by difference between the yield on assets compared to the cost of liabilities.

For the quarter ended March 31, 2004, the average yield on interest-earning assets declined by 65 basis points to 4.35% from 5.00% for the quarter ended March 31, 2003, whereas the average rates paid on interest-bearing liabilities declined by 46 basis points to 1.92% in 2004 from 2.38% in 2003. The interest-rate spread, the difference between the average yield on interest-earning assets and the average cost of interest-bearing liabilities, which has a direct bearing on net interest income, eased by 19 basis points to 2.43% from 2.62%.

With interest rates stabilized at historic lows, though a rate increase appears to be on the horizon, we expect to see minimal pressure on the Company's interest-rate spread and net interest income during the next several quarters. Investment securities in our portfolio that have been sold, matured or called by the issuer have been replaced with securities carrying somewhat lower yields and by design, shorter maturities to hedge against a rising interest rate environment. Rates paid on deposit accounts, particularly time deposits, are more likely to trend up rather than down for the remainder of the year.

Net Interest Margin. Net interest margin, or annualized net interest income as a percentage of average interest-earning assets, declined by 31 basis points to 2.67% in the first quarter of fiscal 2004 from 2.98% in the first quarter of fiscal 2003. We seek to secure and retain customer deposits with competitive products and rates, while making strategic use of the prevailing interest rate environment to borrow funds at what we believe to be attractive rates. We invest such borrowed funds, along with other available funds, in a prudent mix of loans and investment securities which provided an average yield of 6.61% and 3.24%, respectively, during the first three months of fiscal 2004 compared to an average yield of 6.92% and 3.71%, respectively during the comparable period in 2003.

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The average amounts of loans and investment securities increased by \$18.51 million and \$200.24 million, respectively, to \$293.44 million and \$589.96 million, respectively, in the quarter ended March 31, 2004, from \$274.93 million and \$389.73 million, respectively, in the quarter ended March 31, 2003. Total average interest-earning assets increased to \$885.48 million in the 2004 quarter, yielding 4.35% on average, from \$670.76 million in the 2003 quarter, yielding 5.00% on average, a decline of 65 basis points.

The average amounts of interest bearing deposits and time deposits increased by \$114.51 million and \$2.64 million, respectively, to \$259.20 million and \$320.08 million, respectively, during the quarter ended March 31, 2004 from \$144.68 million and \$317.44 million, respectively, during the quarter ended March 31, 2003. Borrowed funds increased by \$88.48 million to \$194.71 million in the 2004 quarter from \$106.23 million in the 2003 quarter. Total average interest-bearing liabilities increased by \$205.63 million to \$773.99 million in the 2004 quarter from \$568.36 million in the 2003 quarter. The average rates

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paid on such amounts decreased to 1.92% in 2004 from 2.38% in 2003, a decline of 46 basis points.

**Interest Income.** Total interest income for the quarter ended March 31, 2004 increased by \$1.26 million, or 15.04%, to \$9.64 million from \$8.38 million for the quarter ended March 31, 2003. The increase was the result of a 32.01% increase in the average amount of total interest-earning assets to \$885.48 million in the 2004 quarter from \$670.76 million in 2003 quarter, partially offset by the 13.0% decrease in the average yield earned of such amounts. Loans and investment securities contributed \$4.85 million and \$4.79 million, respectively, to interest income during the first three months of fiscal year 2004, compared to \$4.76 million and \$3.61 million, respectively, for the comparable period in fiscal year 2003.

**Interest Expense.** Total interest expense for the quarter ended March 31, 2004 increased by \$332,000 to \$3.72 million from \$3.39 million for the quarter ended March 31, 2003. The increase in interest expense was due primarily to higher average balances of interest bearing deposits, time deposits and other borrowings during the 2004 fiscal quarter, partially offset by the 19.33% decrease in the average rates paid on total interest-bearing balances during the 2004 fiscal quarter from the 2003 fiscal quarter. If interest rates increase over the next several months, we expect competitive pressure in our markets will push up the rates paid on interest bearing deposits and time deposits, resulting in an increase in interest expense.

**Non-Interest Income.** Non-interest income consists primarily of realized gains on sales of marketable securities and service fee income. For the three months ended March 31, 2004, total non-interest income decreased by \$574,000, to \$418,000 from \$992,000 for the three months ended March 31, 2003. The decrease is largely due to the \$535,000 decrease in gains on sales of investment securities.

**Non-Interest Expense.** Non-interest expense includes salaries and employee benefits, occupancy and equipment expenses, legal and professional fees and other operating expenses associated with the day-to-day operations of the Company. Total non-interest expense for the three months ended March 31, 2004 was \$2.96 million compared to \$2.71 million for the three months ended March 31, 2003. The \$250,000 increase was primarily due to costs associated with the expansion of our business.

**Provision for Income Tax.** We recorded income tax expense of \$1.38 million and \$1.42 million for the three-month periods ended March 31, 2004 and 2003, respectively. The tax provisions for federal, state and local taxes represent effective tax rates of 41.39% and 44.96%, respectively.

### Common Stock Repurchases

On May 15, 2003, The Company's Board of Directors authorized the purchase of up to an additional 150,000 shares of its Common Stock in the open market, from time to time, depending upon prevailing market conditions, thereby increasing the maximum number of shares which may be purchased by the Company from 650,000 shares of Common Stock to 800,000 shares of Common Stock. Since 1990 through December 31, 2003, the Company has purchased a total of 614,882 shares of its Common Stock. At March 31, 2004, there were 183,697 shares of

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Common Stock which may yet be purchased under our stock repurchase plan. The following table sets forth information with respect to such purchases during the periods indicated.

Fiscal Year 2004

|          | Number of<br>Shares<br>Purchased<br>----- | Average Price<br>Paid Per<br>Share<br>----- |
|----------|---|---|
| January  | 1,421                                     | \$49.00                                     |
| February | --  | --  |
| March    | --  | --  |

### ITEM 3 - QUANTITATIVE AND QUALITATIVE DISCLOSURE ABOUT MARKET RISK

Interest Rate Risk. Fluctuations in market interest rates can have a material effect on the Company's net interest income because the yields earned on loans and investments may not adjust to market rates of interest with the same frequency, or with the same speed, as the rates paid by the Bank on its deposits.

Most of the Bank's deposits are either interest-bearing demand deposits or short term certificates of deposit and other interest-bearing deposits with interest rates that fluctuate as market rates change. Management of the Bank seeks to reduce the risk of interest rate fluctuations by concentrating on loans and securities investments with either short terms to maturity or with adjustable rates or other features that cause yields to adjust based upon interest rate fluctuations. In addition, to cushion itself against the potential adverse effects of a substantial and sustained increase in market interest rates, the Bank has purchased off balance sheet interest rate cap contracts which generally provide that the Bank will be entitled to receive payments from the other party to the contract if interest rates exceed specified levels. These contracts are entered into with major financial institutions.

The Company seeks to maximize its net interest margin within an acceptable level of interest rate risk. Interest rate risk can be defined as the amount of the forecasted net interest income that may be gained or lost due to favorable or unfavorable movements in interest rates. Interest rate risk, or sensitivity, arises when the maturity or repricing characteristics of assets differ significantly from the maturity or repricing characteristics of liabilities.

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In the banking industry, a traditional measure of interest rate sensitivity is known as "gap" analysis, which measures the cumulative differences between the amounts of assets and liabilities maturing or repricing at various time intervals. The following table sets forth the Company's interest rate repricing gaps for selected maturity periods:

Berkshire Bancorp Inc.

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Interest Rate Sensitivity Gap at March 31, 2004  
(in thousands, except for percentages)

|   | 3 Months<br>or Less | 3 Through<br>12 Months | 1 Through<br>3 Years | Over<br>3 Years | Total   |
|---|---------------------|------------------------|----------------------|-----------------|---------|
| Interest bearing deposits in banks            | 359                 | --                     | --                   | --              | 359.0   |
| (Rate)  | 0.28%               |                        |                      |                 | 0.2     |
| Loans (1) (2)                                 |                     |                        |                      |                 |         |
| Adjustable rate loans                         | 46,484              | 18,347                 | 10,038               | 15,575          | 90,444  |
| (Rate)  | 5.60%               | 4.34%                  | 6.65%                | 6.94%           | 5.6     |
| Fixed rate loans                              | 1,419               | 8,447                  | 10,601               | 185,281         | 205,748 |
| (Rate)  | 7.19%               | 7.90%                  | 6.71%                | 6.42%           | 6.5     |
| Total loans                                   | 47,903              | 26,794                 | 20,639               | 200,856         | 296,192 |
| Investments (3) (4)                           | 205,610             | 88,487                 | 78,189               | 241,968         | 614,254 |
| (Rate)  | 3.71%               | 4.88%                  | 3.10%                | 4.13%           | 3.9     |
| Total rate-sensitive assets                   | 253,872             | 115,281                | 98,828               | 442,824         | 910,805 |
| Deposit accounts (5)                          |                     |                        |                      |                 |         |
| Savings and NOW                               | 228,906             | --                     | --                   | --              | 228,906 |
| (Rate)  | 1.48%               |                        |                      |                 | 1.4     |
| Money market                                  | 27,290              | --                     | --                   | --              | 27,290  |
| (Rate)  | 0.82%               |                        |                      |                 | 0.8     |
| Time Deposits                                 | 117,586             | 183,699                | 24,676               | 1,991           | 327,952 |
| (Rate)  | 1.79%               | 1.93%                  | 2.45%                | 1.98%           | 1.9     |
| Total deposit accounts                        | 373,782             | 183,699                | 24,676               | 1,991           | 584,148 |
| Repurchase Agreements                         | 57,515              | 33,961                 | 35,000               | 3,000           | 129,476 |
| (Rate)  | 1.09%               | 1.34%                  | 2.77%                | 3.52%           | 1.6     |
| Other borrowings                              |                     |                        | 23,866               | 55,826          | 79,692  |
| (Rate)  | %                   |                        | 3.59%                | 3.86%           | 3.8     |
| Total rate-sensitive liabilities              | 431,297             | 217,660                | 83,542               | 60,817          | 793,316 |
| Interest rate caps                            | 30,000              | (10,000)               |                      | (20,000)        |         |
| Gap (repricing differences)                   | (207,425)           | (92,379)               | 15,286               | 362,007         | 77,489  |
| Cumulative Gap                                | (207,425)           | (299,804)              | (284,518)            | 77,489          |         |
| Cumulative Gap to Total Rate Sensitive Assets | (22.77)%            | (32.92)%               | (31.24)%             | 8.51%           |         |

(1) Adjustable-rate loans are included in the period in which the interest rates are next scheduled to adjust rather than in the period in which the loans mature. Fixed-rate loans are scheduled according to their maturity dates.

(2) Includes nonaccrual loans.

(3) Investments are scheduled according to their respective repricing (variable rate loans) and maturity (fixed rate securities) dates.

(4) Investments are stated at book value.

- (5) NOW accounts and savings accounts are regarded as readily accessible withdrawal accounts. The balances in such accounts have been allocated among maturity/repricing periods based upon The Berkshire Bank's historical experience. All other time accounts are scheduled according to their respective maturity dates.

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Provision for Loan Losses. The Company maintains an allowance for loan losses at a level deemed sufficient to absorb losses, which are inherent in the loan portfolio at each balance sheet date. Management reviews the adequacy of the allowance on at least a quarterly basis to ensure that the provision for loan losses has been charged against earnings in an amount necessary to maintain the allowance at a level that is appropriate based on management's assessment of probable estimated losses. The Company's methodology for assessing the appropriateness of the allowance for loan losses consists of several key elements. These elements include a specific allowance for loan watch list classified loans, an allowance based on historical trends, an additional allowance for special circumstances, and an unallocated portion. The Company consistently applies the following comprehensive methodology.

The allowance for loan watch list classified loans addresses those loans maintained on the Company's loan watch list, which are assigned a rating of substandard, doubtful, or loss. Substandard loans are those with a well-defined weakness or a weakness, which jeopardizes the repayment of the debt. A loan may be classified as substandard as a result of impairment of the borrower's financial condition and repayment capacity. Loans for which repayment plans have not been met or collateral equity margins do not protect the Company may also be classified as substandard. Doubtful loans have the characteristics of substandard loans with the added characteristic that collection or liquidation in full, on the basis of presently existing facts and conditions, is highly improbable. Although the possibility of loss is extremely high for doubtful loans, the classification of loss is deferred until pending factors, which might improve the loan, have been determined. Loans rated as doubtful in whole or in part are placed in nonaccrual status. Loans, which are classified as loss, are considered uncollectible and are charged to the allowance for loan losses. There were no loans classified as loss as of March 31, 2004.

For the three months ended March 31, 2004, we did not charge-off any loans and we recovered loans totaling \$23,000, which amount was returned to the provision for loan loss reserves. For the three months ended March 31, 2003, we charged-off \$1,000 of loans and recovered \$2,000.

Loans on the loan watch list may also be impaired loans, which are defined as nonaccrual loans or troubled debt restructurings, which are not in compliance with their restructured terms. Each of the classified loans on the loan watch list is individually analyzed to determine the level of the potential loss in the loan under the current circumstances. The specific reserve established for these criticized and impaired loans is based on careful analysis of the loan's performance, the related collateral value, cash flow considerations and the financial capability of any guarantor. The allowance for loan watch list classified loans is equal to the total amount of potential unconfirmed losses for the individual classified loans on the watch list. Loan watch list loans are managed and monitored by assigned Senior Management.

The allowance based on historical trends uses charge-off experience of the

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Company to estimate potential unconfirmed losses in the balances of the loan and lease portfolios. The historical loss experience percentage is based on the charge-off history. Historical loss experience percentages are applied to all non-classified loans to obtain the portion of the allowance for loan losses which is based on historical trends. Before applying the historical loss experience percentages, loan balances are reduced by the portion of the loan balances, which are subject to guarantees, by a government agency. Loan balances are also adjusted for unearned discount on installment loans.

The Company also maintains an unallocated allowance. The unallocated allowance is used to cover any factors or conditions, which may cause a potential loan loss but are not specifically identifiable. It is prudent to maintain an unallocated portion of the allowance because no matter how detailed an analysis of potential loan losses is performed these estimates by definition lack precision. Management must make estimates using assumptions and information, which is often subjective and changing rapidly.

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Since all identified losses are immediately charged off, no portion of the allowance for loan losses is restricted to any individual loan or groups of loans, and the entire allowance is available to absorb any and all loan losses.

A loan is placed in a nonaccrual status at the time when ultimate collectibility of principal or interest, wholly or partially, is in doubt. Past due loans are those loans which were contractually past due 90 days or more as to interest or principal payments but are well secured and in the process of collection. Renegotiated loans are those loans which terms have been renegotiated to provide a reduction or deferral of principal or interest as a result of the deteriorating financial position of the borrower.

At March 31, 2004 and 2003, we had a total of \$328,000 and \$109,000, respectively, of non-accrual loans, and no loans past due more than 90 days and still accruing interest at either date. Based upon management's evaluations of the overall analysis of the Bank's allowance for loan losses and the year over year increase in total loans to \$295.34 million from \$272.30 million, the provision for the three months ended March 31, 2004 was increased to \$2.66 million from \$2.42 million in the year ago period.

Management believes that the allowance for loan losses and nonperforming loans remains safely within acceptable levels.

The following table sets forth information with respect to activity in the Company's allowance for loan losses during the periods indicated (in thousands, except percentages):

|                           | Three Months Ended<br>March 31, |           |
|---------------------------|---------------------------------|-----------|
|                           | 2004                            | 2003      |
| Average loans outstanding | \$293,441                       | \$274,929 |



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|                                       |           |           |
|---------------------------------------|-----------|-----------|
| Allowance at beginning of period      | 2,593     | 2,315     |
| Charge-offs:                          |           |           |
| Commercial and other loans            | --        | 1         |
|                                       | -----     | -----     |
| Total loans charged-off               | --        | 1         |
|                                       | -----     | -----     |
| Recoveries:                           |           |           |
| Commercial and other loans            | 23        | 2         |
|                                       | -----     | -----     |
| Total loans recovered                 | 23        | 2         |
|                                       | -----     | -----     |
| Net (charge-offs) recoveries          | 23        | 1         |
|                                       | -----     | -----     |
| Provision for loan losses             |           |           |
| charged to operating expenses         | 45        | 105       |
|                                       | -----     | -----     |
| Allowance at end of period            | \$ 2,661  | \$ 2,421  |
|                                       | -----     | -----     |
| Ratio of net recoveries (charge-offs) |           |           |
| to average loans outstanding          | 0.00%     | 0.00%     |
|                                       | =====     | =====     |
| Allowance as a percent of total loans | 0.90%     | 0.89%     |
|                                       | =====     | =====     |
| Total loans at end of period          | \$295,336 | \$272,298 |
|                                       | =====     | =====     |

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Loan Portfolio.

Loan Portfolio Composition. The Company's loans consist primarily of mortgage loans secured by residential and non-residential properties as well as commercial loans which are either unsecured or secured by personal property collateral. Most of the Company's commercial loans are either made to individuals or personally guaranteed by the principals of the business to which the loan is made. At March 31, 2004, we had total gross loans of \$296.19 million, deferred loan fees of \$856,000 and an allowance for loan losses of \$2.66 million. From time to time, the Bank may originate residential mortgage loans and then sell them on the secondary market, normally recognizing fee income in connection with the sale. During the three-month period ended March 31, 2004, the Bank sold approximately \$3.63 million of such loans and recorded in other income a gain of \$62,000 on such sales.

The following tables set forth information concerning the Company's loan portfolio by type of loan at the dates indicated:

| March 31,<br>2004 | December 31,<br>2003 |
|-------------------|----------------------|
| -----             | -----                |
| Amount            | Amount               |
| -----             | -----                |
| (in thousands)    |                      |

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|                                   |           |           |
|-----------------------------------|-----------|-----------|
| Commercial and professional loans | \$ 18,669 | \$ 22,228 |
| Secured by real estate            |           |           |
| 1-4 family                        | 166,198   | 169,589   |
| Multi family                      | 6,277     | 6,608     |
| Non-residential (commercial)      | 99,646    | 94,956    |
| Consumer                          | 5,402     | 2,239     |
|                                   | -----     | -----     |
| Total loans                       | 296,192   | 295,620   |
| Less:                             |           |           |
| Deferred loan fees                | (856)     | (864)     |
| Allowance for loan losses         | (2,661)   | (2,593)   |
|                                   | -----     | -----     |
| Loans, net                        | \$292,675 | \$292,163 |
|                                   | =====     | =====     |

It is the Bank's policy to discontinue accruing interest on a loan when it is 90 days past due or if management believes that continued interest accruals are unjustified. The Bank may continue interest accruals if a loan is more than 90 days past due if the Bank determines that the nature of the delinquency and the collateral are such that collection of the principal and interest on the loan in full is reasonably assured. When the accrual of interest is discontinued, all accrued but unpaid interest is charged against current period income. Once the accrual of interest is discontinued, the Bank records interest as and when received until the loan is restored to accruing status. If the Bank determines that collection of the loan in full is in reasonable doubt, then amounts received are recorded as a reduction of principal until the loan is returned to accruing status. At March 31, 2004 and 2003, we did not have any loans past due more than 90 days and still accruing interest.

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Capital Adequacy

Quantitative measures established by regulation to ensure capital adequacy require the Company and the Bank to maintain minimum amounts and ratios of total and Tier I capital (as defined in the regulations) to risk-weighted assets (as defined), and Tier I capital (as defined) to average assets (as defined). As of March 31, 2004, 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 certain Total risk-based, Tier I risk-based, and Tier I leverage ratios. There are no conditions or events since the notification that management believes have changed the Bank's category.

The following tables set forth the actual and required regulatory capital amounts and ratios of the Company and the Bank as of March 31, 2004 and December 31, 2003 (dollars in thousands):

| Actual | For capital<br>adequacy purposes | To be well<br>capitalized under<br>prompt corrective<br>action provisions |
|--------|----------------------------------|---|
| -----  | -----                            | -----   |



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The Company maintains financial instruments with off-balance sheet risk in the normal course of business to meet the financing needs of its customers. These financial instruments include commitments to extend credit and stand-by letters of credit.

At March 31, 2004, the Company had outstanding commitments of approximately \$46.08 million. These commitments include \$17.87 million that mature or renew within one year, \$6.13 million that mature or renew after one year and within three years, \$20.09 million that mature or renew after three years and within five years and \$1.20 million that mature or renew after five years.

The Company currently does not have any unconsolidated subsidiaries or special purpose entities.

### Impact of Inflation and Changing Prices

The Company's financial statements measure financial position and operating results in terms of historical dollars without considering the changes in the relative purchasing power of money over time due to inflation. The impact of inflation is reflected in the increasing cost of the Company's operations. The assets and liabilities of the Company are largely monetary. As a result, interest rates have a greater impact on the Company's performance than do the effects of general levels of inflation. In addition, interest rates do not necessarily move in the direction, or to the same extent, as the price of goods and services. However, in general, high inflation rates are accompanied by higher interest rates, and vice versa.

### ITEM 4 - CONTROLS AND PROCEDURES

Evaluation of the Company's Disclosure Controls and Internal Control. As of the end of the period covered by this Quarterly Report on Form 10-Q, the Company evaluated the effectiveness of the design and operation of its "disclosure controls and procedures" as defined in Rule 13a-15(e) of the Securities Exchange Act of 1934 ("Disclosure Controls"). This evaluation ("Controls Evaluation") was done under the supervision and with the participation of management, including the Chief Executive Officer ("CEO") who is also the Chief Financial Officer ("CFO").

Limitations on the Effectiveness of Controls. The Company's management, including the CEO/CFO, does not expect that its Disclosure Controls and/or its "internal control over financial reporting" as defined in Rule 13(a)-15(f) of the Securities Exchange Act of 1934 ("Internal Control") will prevent all error and all fraud. A control system, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met. Further, the design of a control system must reflect the

fact that there are resource constraints, and the benefits of controls must be considered relative to their costs. Because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, within the Company have been detected. These inherent limitations include the realities that judgments in decision-making can be faulty, and that breakdowns can occur because of simple error or mistake. Additionally, controls can be circumvented by the individual acts of some persons, by collusion of two or more people, or by management

override of the control. The design of any system of controls also is based in part upon certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions; over time, control may become inadequate because of changes in conditions, or the degree of compliance with the policies or procedures may deteriorate. Because of the inherent limitations in a cost-effective control system, misstatements due to error or fraud may occur and not be detected.

Conclusions. Based upon the Controls Evaluation, the CEO/CFO has concluded that, subject to the limitations noted above, the Disclosure Controls are effective in reaching a reasonable level of assurance that information required to be disclosed by the Company is recorded, processed, summarized and reported within the time period specified in the Securities and Exchange Commission's rules and forms.

In accordance with SEC requirements, the CEO/CFO notes that, except as described in the following paragraph, during the fiscal quarter ended March 31, 2004, no changes in internal controls have occurred that have materially affected Internal Control.

During the fiscal quarter ended March 31, 2004, in response to certain concerns raised by the Company's external auditors, Grant Thornton LLP, the Company, upon the recommendation of a Special Committee of the Audit Committee of the Board of Directors, adopted and began to implement a Remedial Action Plan for accounting and financial reporting that was designed to improve the Company's internal control over financial reporting. See Item 9A of the Company's Annual Report on Form 10-K for the year ended December 31, 2003 for details relating to the Remedial Action Plan.

## PART II. OTHER INFORMATION

### Item 5. Other Information

a. The following supersedes the information set forth in the Company's Proxy Statement dated April 26, 2004 relating to its Annual Meeting of Stockholders to be held on May 18, 2004 with respect to submission of stockholder proposals for the Company's 2005 Annual Meeting of Stockholders.

A stockholder proposal that complies with all of the applicable requirements under Rule 14a-8 of the Securities Exchange Act of 1934 and any other applicable regulation or statute must be received by the Company on or prior to December 27, 2004 at the address of the Company set forth on the first page of this Proxy Statement in order to be eligible for inclusion in the Company's proxy statement for the 2005 Annual Meeting of Stockholders. Any such proposal should be directed to the Secretary or Assistant Secretary of the Company.

In accordance with Rules 14a-4(c) and 14a-5(e) promulgated under the Exchange Act, the Company hereby notifies its stockholders that it did not receive notice of any proposed matter to be submitted for stockholder vote at the Annual Meeting and, therefore, any proxies received in respect of the Annual Meeting will be voted in the discretion of the Company's management on any other

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matters which may properly come before the Annual Meeting. The Company further notifies its stockholders that if the Company does not receive notice by March 14, 2005 of a proposed matter to be submitted by a stockholder for stockholders vote at the 2005 Annual Meeting of Stockholders, then any proxies held by persons designated as proxies by the Company's Board of Directors in respect of such Annual Meeting may be voted at the discretion of such persons on such matter if it shall properly come before such Annual Meeting.

Item 6. Exhibits and Reports on Form 8-K

- a. Exhibits
- b. Reports on Form 8-K  
None

| Exhibit<br>Number | Description   |
|-------------------|---|
| -----             | -----   |
| 31                | Certification of Principal Executive and Financial Officer pursuant to Section 302 Of The Sarbanes-Oxley Act of 2002. |
| 32                | Certification of Principal Executive and Financial Officer pursuant to Section 906 Of The Sarbanes-Oxley Act of 2002. |

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

BERKSHIRE BANCORP INC.  
(Registrant)

Date: May 10, 2004

By: /s/ Steven Rosenberg

-----  
 Steven Rosenberg  
 President and Chief  
 Financial Officer

EXHIBIT INDEX

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| Exhibit<br>Number<br>----- | Description<br>-----  | Sequential<br>Page Number<br>----- |
|----------------------------|---|------------------------------------|
| 31                         | Certification of Principal Executive and Financial Officer pursuant to Section 302 Of The Sarbanes-Oxley Act of 2002. | 31                                 |
| 32                         | Certification of Principal Executive and Financial Officer pursuant to Section 906 Of The Sarbanes-Oxley Act of 2002. | 32                                 |

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STATEMENT OF DIFFERENCES

The greater-than-or-equal sign shall be expressed as.....>=