BERKSHIRE BANCORP INC /DE/
Form 10-K
March 30, 2004

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

FORM 10-K

[X] ANNUAL REPORT PURSUANT TO SECTION 13 or 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the fiscal year ended December 31, 2003

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 number)
160 Broadway, New York, New York (Address of principal executive offices)	10038 (Zip Code)

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

Securities registered pursuant to Section 12(b) of the Act: None

Securities registered pursuant to Section 12(g) of the Act:

Common Stock, par value $.10 per share
(Title of Class)

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 [X] No [_]

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of the Registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. [X]

Indicate by check mark whether the Registrant is an accelerated filer (as defined in Rule 12b-2 of the Act. Yes [_] No [X]

Aggregate market value of voting and non-voting common stock held by non-affiliates of the Registrant as of June 30, 2003: $39,576,260.

Number of shares of Common Stock outstanding as of March 25, 2004: 2,207,080.

DOCUMENTS INCORPORATED BY REFERENCE:

None

Forward-Looking Statements. Statements in this Annual Report on Form 10-K 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 Annual Report entitled "Business" and "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 Annual 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.

PART I

ITEM 1. Business

General. Berkshire Bancorp Inc., a Delaware corporation , is a bank holding company registered under the Bank Holding Company Act of 1956. As used in this Annual Report on Form 10-K, the term "Berkshire", the "Company" or "we" and similar pronouns shall mean Berkshire Bancorp Inc. and its consolidated subsidiaries unless the context otherwise requires. Berkshire's principal activity is the ownership and management of our wholly-owned banking subsidiary, The Berkshire Bank (the "Bank"), a New York State chartered commercial bank.

We file annual, quarterly and current reports, proxy statements and other information with the Securities and Exchange Commission (the "SEC"). You may read and copy our reports or other filings made with the SEC at the SEC's Public

Reference Room, located at 450 Fifth Street, N.W., Washington, DC 20549. You can also access information that we file electronically on the SEC's website at WWW.SEC.GOV.

We do not presently have a website. However, as soon as practicable after filing with or furnishing to the SEC, we will provide at no cost, paper or electronic copies of our Annual Reports on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K and amendments to those reports. Requests should be directed to:

Berkshire Bancorp Inc.
Investor Relations
160 Broadway
New York, NY 10038

Business of the Bank - General. The Bank's principal business consists of gathering deposits from the general public and investing those deposits primarily in loans, debt obligations issued by the U.S. Government, its agencies, and business corporations, and mortgage-backed securities. The Bank currently operates from five deposit-taking offices in New York City and four deposit-taking offices in Orange and Sullivan Counties, New York. In July 1995, the Bank

opened a branch in Brooklyn, in January 2001, the Bank opened a branch in downtown Manhattan and in March 2001, as a result of the merger with Goshen Bank, the Bank acquired two branches in Goshen, NY, a branch in Harriman, NY and a branch in Bloomingburg, NY. These branches provide the Bank with customary retail banking offices. On March 22, 2001, the Company purchased a parcel of land and building located in mid-town Manhattan for a total purchase price of $3.49 million in cash. In January 2003, the Bank relocated its main office to and opened a branch at this mid-town Manhattan location. The Bank opened two additional branches in Brooklyn, New York during 2003.

The Bank's principal loan types are residential and commercial mortgage loans and commercial non-mortgage loans, both unsecured and secured by personal property. The Bank's revenues come principally from interest on loans and investment securities. The Bank's primary sources of funds are deposits and proceeds from principal and interest payments on loans and investment securities.

Operating Plan. The Bank's operating plan concentrates on obtaining deposits from a variety of businesses, professionals and retail customers and investing those funds in conservatively underwritten loans. Due to the Bank's underwriting criteria, its deposits have significantly exceeded the level of satisfactory loans available for investment in recent years. Hence, the Bank has, in recent years, invested a portion of its available funds in investment and mortgage-backed securities.

Market Area. The Bank draws its customers principally from the New York City metropolitan area and, since the merger with Goshen Bank in 2001, the Villages of Goshen and Harriman, New York and their surrounding communities, representing most of Orange County, NY. The Bank also has a branch in Bloomingburg, New York, just over the border between Orange and Sullivan

Counties. Predominantly rural with numerous small towns, many residents of Orange and Sullivan Counties work in New York City. Consequently, the health of the economy in the New York City metropolitan area has, and will continue to have a direct effect on the economic well being of residents and businesses in these Counties. From time to time, the Bank may make loans or accept deposits from outside these areas, but such transactions generally represent outgrowths of existing local customer relationships.

Competition. The Bank's principal competitors for deposits are other commercial banks, savings banks, savings and loan associations and credit unions in the Bank's market areas, as well as money market mutual funds, insurance companies, securities brokerage firms and other financial institutions, many of which are substantially larger in size than the Company. The Bank's competition for loans comes principally from commercial banks, savings banks, savings and loan associations, mortgage bankers, finance companies and other institutional lenders. Many of the institutions which compete with the Bank have much greater financial and marketing resources than the Bank. The Bank's principal methods of competition include loan and deposit pricing, maintaining close ties with its local communities, the quality of the personal service it provides, the types of business services it provides, and other marketing programs.

Operations of the Bank. Reference is made to the information set forth in Item 7 herein ("Management's Discussion and Analysis of Financial Condition and Results of Operations") for information as to various aspects of the Bank's operations, activities and conditions.

In March, 2001, pursuant to the terms of an Agreement and Plan of Reorganization dated August 16, 2000 (the "Agreement"), we completed the merger with GSB Financial Corporation, a Delaware corporation, a savings and loan holding company ("GSB Financial"), and its wholly-owned subsidiary, Goshen Savings Bank, a federal savings bank, chartered and existing under the laws of the United States ("Goshen Bank"). GSB Financial was merged with and into Berkshire and Goshen Bank was merged with and into The Berkshire Bank. Holders of the common stock of GSB Financial received $20.75 in cash for each share of common stock of GSB Financial held by them, or, in the alternative, at their election, 0.6027 shares of Berkshire's common stock. As a result of this transaction, 978,032 shares of GSB Financial common stock were converted into 589,460 shares of Berkshire common stock, and 974,338 shares of GSB Financial common stock were purchased for $20.75 per share, totaling approximately $20.2 million.

This transaction was accounted for under the purchase method of accounting. Goodwill of $7.5 million was recorded in the transaction. Effective January 1, 2002, we adopted Statement of Financial Accounting Standard No. 142, Goodwill and Intangible Assets which eliminates the amortization of goodwill and requires an annual impairment test. As of December 31, 2003, we have completed the transitional testing of our intangible assets, including goodwill. We did not identify any impairment on our outstanding goodwill.

On November 7, 2002, we sold our 24.9% interest in a merchant credit card processing company for $285,000, which represents our initial purchase price in December 1999. We accounted for our interest in this company under the equity method of accounting and have recorded approximately $200,000 in net losses

since December 1999. The initial purchase price to Berkshire was received in full during 2003.

Subsidiary Activities. The Bank is permitted under New York State law and federal law to own subsidiaries for certain limited purposes, generally to engage in activities which are permissible for a subsidiary of a national bank. The Bank has one subsidiary, Berkshire Agency, Inc., a company engaged in the title insurance business.

Regulation. Berkshire is a bank holding company under federal law and registered as such with the Federal Reserve. The Bank is a commercial bank chartered under the laws of New York State. It is subject to regulation at the state level by the New York Superintendent of Banks and the New York Banking Board, while at the federal level its primary regulator is the FDIC.

Both Berkshire and the Bank are subject to extensive state and federal regulation of their activities. The following discussion summarizes certain banking laws and regulations that affect Berkshire and the Bank. Proposals to change these laws and regulations are frequently proposed in Congress, in the New York State legislature, and before state and federal bank regulatory agencies. The likelihood and timing of any changes and the impact such changes might have on the Company are impossible to determine with any certainty. A change in applicable laws or regulations, or a change in the way such laws or regulations are interpreted by regulatory agencies or courts, may have a material impact on the business, operations and earnings of the Company, the nature and effect of which cannot now be predicted.

Bank Holding Company Regulation. The Federal Reserve is authorized to make regular examinations of the Company and its nonbank subsidiaries. Under federal law and Federal Reserve regulations, the activities in which the Company and its nonbank subsidiaries may engage are limited. The Company may not acquire direct or indirect ownership or control of more than 5% of the voting shares of any company, including a bank, without the prior approval of the Federal Reserve, except as specifically authorized under federal law and Federal Reserve regulations. The Company, subject to the approval of the Federal Reserve, may acquire more than 5% of the voting shares of non-banking corporations if those corporations engage in activities which the Federal Reserve deems to be so closely related to banking or managing or controlling banks as to be a proper incident thereto. These limitations also apply to activities in which the Company engages directly rather than through a subsidiary. However, pursuant to Section 103 of the Gramm-Leach-Bliley Act, the Company may elect, provided it meets certain conditions, to engage in a significantly broader range of activities or own shares of companies that engage in such broader activities, those that are determined to be financial in nature or incidental to such financial activity or complementary in certain situations, to a financial activity. The Company has not so elected.

The Federal Reserve has enforcement powers over the Company and its non-bank subsidiaries. This allows the Federal Reserve, among other things, to stop activities that represent unsafe or unsound practices or constitute violations of law, rules, regulations, administrative orders or written agreements with a federal bank regulator. These powers may be exercised through the issuance of cease-and-desist orders, the imposition of civil money penalties or other actions.

Federal Reserve Capital Requirements. The Federal Reserve requires that the Company, as a bank holding company, must maintain certain minimum ratios of capital to assets. The Federal Reserve's regulations divide capital into types. Primary capital includes common equity, surplus, undivided profits, perpetual preferred stock, mandatory convertible instruments, the allowance for loan and lease losses, contingency and other capital reserves, and minority interests in equity accounts of consolidated subsidiaries. Secondary capital includes limited-life preferred stock, subordinated notes and debentures and certain unsecured long term debt.

The Federal Reserve requires that bank holding companies maintain a minimum ratio of primary capital to total assets of 5.5% and a minimum level of total capital (primary plus secondary capital) equal to 6% of total assets. In calculating capital ratios, the allowance for loan losses, which is a component of primary capital, is added back in determining total assets. Certain capital components, such as debt and perpetual preferred stock, are includable as capital only if they satisfy certain definitional tests.

The Company must also meet a risk-based capital standard. Capital, for the risk-based capital requirement, is divided into Tier I capital and Supplementary capital, determined as discussed below in connection with the FDIC capital requirements imposed on the Bank. The Federal Reserve requires that the Bank maintain a ratio of total capital (defined as Tier I plus Supplementary capital) to risk-weighted assets of at least 8%, of which at least 4% must be Tier I capital. Risk weighted assets are also determined in a manner comparable to the determination of risk-weighted assets under FDIC regulations as discussed below.

At December 31, 2003 and 2002, the Company satisfied all applicable Federal Reserve minimum capital requirements.

Source of Strength Doctrine. It is the Federal Reserve policy that bank holding companies must serve as a source of financial strength to its subsidiary depository institutions and must commit all available resources to support such institutions even if it might not otherwise do so. Although this "source of strength" policy has been challenged in litigation, the Federal Reserve continues to take the position that it has authority to enforce it. The Federal Reserve also has the authority to terminate any activity of the Company that constitutes a serious risk to the financial soundness or stability of the Bank or, in extreme cases, to terminate its control of any bank or nonbank subsidiaries.

Inter-state Banking. Bank holding companies may generally acquire banks in any state. Federal law also permits a bank to merge with an out-of-state bank and convert any offices into branches of the resulting bank if both states have not opted out of interstate branching; permits a bank to acquire branches from an out-of-state bank if the law of the state where the branches are located permits the interstate branch acquisition; and permits banks to establish and operate new interstate branches whenever the host state opts-in to that authority. Bank holding companies and banks that want to engage in such activities must be adequately capitalized and managed.

The New York Banking Law generally authorizes interstate branching in New York as a result of a merger, purchase of assets or similar transaction. An out of state bank may not first enter New York by opening a new branch in New York, but once a branch is acquired as described in the preceding sentence, additional new branches may be opened.

Regulation of the Bank. In general, the powers of the Bank are limited to the express powers described in the New York Banking Law and powers incidental to the exercise of those express powers. The Bank is generally authorized to

accept deposits and make loans on terms and conditions determined to be acceptable to the Bank. Loans may be unsecured, secured by real estate, or secured by personal property. The Bank may also invest assets in bonds, notes or other debt securities which are not in default and certain limited classes of equity securities including certain publicly traded equity securities in an amount aggregating not more than 2% of assets or 20% of capital. The Bank may also engage in a variety of other traditional activities for commercial banks, such as the issuance of letters of credit.

The exercise of these state-authorized powers is limited by FDIC regulations and other federal laws and regulations. In particular, FDIC regulations limit the investment activities of state-chartered, FDIC-insured banks such as the Bank.

Under FDIC regulations, the Bank generally may not directly or indirectly acquire or retain any equity investment that is not permissible for a national bank. In addition, the Bank may not directly or indirectly through a subsidiary, engage as "principal" in any activity that is not permissible for a national bank unless the FDIC has determined that such activities would pose no risk to the applicable FDIC insurance fund and the Bank is in compliance with applicable regulatory capital requirements. FDIC regulations permit real estate investments under certain circumstances. The Bank does not engage in real estate investing activity.

Loans to One Borrower. With certain exceptions, the Bank may not make loans or other extensions of credit to a single borrower, or certain related groups of borrowers, in an aggregate amount in excess of 15% of the Bank's net worth, plus an additional 10% of the Bank's net worth if such amount is secured by certain types of readily marketable collateral. In addition, the Bank is not permitted to make a mortgage loan in excess of 15% of capital stock, surplus fund and undivided profits.

FDIC Capital Requirements. The FDIC requires that the Bank maintain certain minimum ratios of capital to assets. The FDIC's regulations divide capital into two tiers. The first tier ("Tier I") includes common equity, retained earnings, certain non-cumulative perpetual preferred stock (excluding auction rate issues) and minority interests in equity accounts of consolidated subsidiaries, minus goodwill and other intangible assets (except mortgage servicing rights and purchased credit card relationships subject to certain limitations). Supplementary ("Tier II") capital includes, among other items, cumulative perpetual and long-term limited-life preferred stock, mandatory convertible securities, certain hybrid capital instruments, term subordinated debt and the allowance for loan, subject to certain limitations, less required deductions.

The FDIC requires that the highest rated banks maintain a Tier I leverage ratio (Tier I capital to adjusted total assets) of at least 3.0%. All other banks subject to FDIC capital requirements must maintain a Tier I leverage ration of 4.0% to 5.0% or more. As of December 31, 2003 and 2002, the Bank's Tier I leverage capital ratio was 7.0% and 7.8%, respectively.

The Bank must also meet a risk-based capital standard. The risk-based standard requires the Bank to maintain total capital (defined as Tier I and Supplementary capital) to risk-weighted assets of at least 8%, of which at least

4% must be Tier I capital. In determining the amount of risk-weighted assets, all assets, plus certain off-balance sheet assets, are multiplied by a risk-weight of 0% to 100%, based on the risks the FDIC believes are inherent in the type of asset. As of December 31, 2003 and 2002, the Bank maintained a 18.3% and 18.5% Tier I risk-based capital ratio and a 19.1% and 19.4% total risk-based capital ratio, respectively.

In addition to the foregoing regulatory capital requirements, the FDIC Improvements Act of 1991 created a "prompt corrective action" framework, under which decreases in a depository institution's capital category trigger various supervisory actions. Pursuant to implementing regulations adopted by the FDIC, for purposes of the prompt corrective action provisions, a state-chartered, nonmember bank, such as the Bank, is deemed to be well capitalized if it has: a total risk-based capital ratio of 10% or greater; a Tier I risk-based capital ratio of 6% or greater; and a leverage ratio of 5% or greater. As of December 31, 2003 and 2002, the Bank was well capitalized under all three of these standards.

Community Reinvestment Act. The Bank must, under federal law, meet the credit needs of its community, including low and moderate income segments of its community. The FDIC is required, in connection with its examination of the Bank, to assess whether the Bank has satisfied this requirement. Failure to satisfy this requirement could adversely affect certain applications which the Bank may make, such as branch applications, merger applications, and applications for

permission to purchase branches. In the case of Berkshire, the Federal Reserve will assess the record of each subsidiary bank in considering certain applications by Berkshire. The New York Banking Law contains similar provisions applicable to the Bank. As of the most recent Community Reinvestment Act examinations by the FDIC and the New York State Banking Department, the Bank received satisfactory ratings.

Dividends From the Bank to the Company. One source of funds for Berkshire to pay dividends to its stockholders is dividends from the Bank to Berkshire. Under the New York Banking Law, the Bank may pay dividends to Berkshire, without regulatory approval, equal to its net profits for the year in which the payment is made, plus retained net profits for the two previous years, subject to certain limits not generally relevant. The Bank's retained net profits for the 2002 and 2003 calendar years totaled approximately $12.12 million. However, the ability of Berkshire to pay future dividends and meet its other financial obligations is not presently dependent upon the receipt of dividends from the Bank.

Under federal law, the Bank may not make any capital distribution to Berkshire, including any dividend or repurchase of the Bank's stock, if, after making such distribution, the Bank fails to meet the required minimum capital ratio requirements discussed below. The FDIC may prohibit the Bank from paying dividends if, in its opinion, the payment of dividends would constitute an unsafe or unsound practice.

Transactions With Related Parties. The Company, its direct non-banking subsidiaries and other companies controlled by shareholders who control the Company are affiliates, within the meaning of the Federal Reserve Act, of the

Bank and its subsidiaries. The Bank's authority to engage in transactions with its "affiliates" is limited by Sections 23A and 23B of the Federal Reserve Act. Section 23A limits the aggregate amount of transactions with any individual affiliate to 10% of the capital and surplus of the Bank and also limits the aggregate amount of transactions with all affiliates to 20% of the Bank's capital and surplus. Extensions of credit to affiliates must be secured by certain specified collateral, and the purchase of low quality assets from affiliates is generally prohibited. Section 23B provides that certain transactions with affiliates, including loans and asset purchases, must be on terms and under circumstances, including credit standards, that are at least as favorable to the Bank as those prevailing at the time for comparable transactions with non-affiliated companies. In the absence of comparable transactions, such transactions may only occur under terms and circumstances, including credit standards, that in good faith would be offered to or would apply to non-affiliated companies.

The Bank may make loans to its and the Company's directors, executive officers, and 10% stockholders, as well as to entities controlled by them, subject to specific federal and state limits. Among other things, these loans must (a) be made on terms that are substantially the same as, and follow credit underwriting procedures that are not less stringent than, those prevailing for comparable transactions with unaffiliated persons and that do not involve more than the normal risk of repayment or present other unfavorable features and (b) not exceed certain limitations on the amount of credit extended to such persons, individually and in the aggregate, which limits are based, in part, on the amount of the Bank's capital. In addition, extensions of credit in excess of certain limits must be approved by the Bank's Board of Directors. However, the Bank may make loans to executive officers, directors and principal stockholders on preferential terms, provided the extension of credit is made pursuant to a benefit or compensation program of the Bank that is widely available to employees of the Bank or its affiliates and does not give preference to any insider over other employees of the Bank or affiliate. The Bank has no such benefit or compensation programs (see Item. 2 - Properties for additional information).

Enforcement. The FDIC and the Banking Department have enforcement authority over the Bank. The Superintendent may order the Bank to appear and explain an apparent violation of law, to discontinue unauthorized or unsafe practices and to keep prescribed books and accounts. If any director or officer of the Bank has violated any law, or has continued unauthorized or unsafe practices in conducting the business of the Bank after having been notified by the Superintendent to discontinue such practices, the New York Banking Board may remove the individual from office after notice and an opportunity to be heard.

The Superintendent also may take over control of the Bank under specified statutory criteria.

The FDIC's enforcement authority includes, among other things, the ability to assess civil money penalties, to issue cease and desist orders and to remove directors and officers. As indicated above, the FDIC is required to take prompt action to correct deficiencies in banks which do not satisfy specified FDIC capital ratio requirements. Dividends, other capital distributions or the payment of management fees to any controlling person are prohibited if,

following such distribution or payment, a bank would be undercapitalized. An undercapitalized bank must file a plan to restore its capital within 45 days after being notified that it is undercapitalized. Undercapitalized, significantly undercapitalized and critically undercapitalized institutions are subject to increasing prohibitions on permitted activities, and increasing levels of regulatory supervision, based upon the severity of their capital problems. The FDIC is required to monitor closely the condition of an undercapitalized bank. Enforcement action taken by the FDIC can escalate to the appointment of a conservator or receiver of a critically undercapitalized bank.

Insurance of Accounts. Deposit insurance premiums payable to the FDIC are based upon the perceived risk of the institution to the FDIC insurance fund. The FDIC assigns an institution to one of three capital categories: (a) well capitalized, (b) adequately capitalized or (c) undercapitalized. The FDIC also assigns an institution to one of three supervisory categories based on an evaluation by the institution's primary federal regulator and information that the FDIC considers relevant to the institution's financial condition and the risk posed to the deposit insurance funds. Deposit insurance premiums depend on an institution's capital and supervisory categories. At present, the Bank pays no deposit insurance premium based upon its risk-based categorization.

However, the Bank must pay a share of the cost of the bonds issued in the late 1980s to recapitalize the now defunct Federal Savings and Loan Insurance Corporation. The Bank must pay an annual assessment for this purpose, which for fiscal 2003 was equal to 0.0168% of its insured deposits and which is recorded as a deposit insurance premium expense for financial statement purposes. Beginning in 2004, the assessment was revised to 0.0154% of the Bank's insured deposits.

Reserve Requirements. The Bank must maintain non-interest-earning reserves against its transaction accounts (primarily NOW and regular checking accounts). The Bank is generally able to satisfy reserve requirements with cash on hand and other non-interest bearing deposits which it maintains for other purposes, so the reserve requirements do not impose a material financial burden on the Bank.

Governmental Policies. Our earnings are significantly affected by the monetary and fiscal policies of governmental authorities, including the Federal Reserve. Among the instruments of monetary policy used by the Federal Reserve to implement these objectives are open-market operations in U.S. Government securities and Federal funds, changes in the discount rate on member bank borrowings and changes in reserve requirements against member bank deposits. These instruments of monetary policy are used in varying combinations to influence the overall level of bank loans, investments and deposits, and the interest rates charged on loans and paid for deposits. The Federal Reserve frequently uses these instruments of monetary policy, especially its open-market operations and the discount rate, to influence the level of interest rates and to affect the strength of the economy, the level of inflation or the price of the dollar in foreign exchange markets. The monetary policies of the Federal Reserve have had a significant effect on the operating results of banking institutions in the past and are expected to continue to do so in the future. It is not possible to predict the nature of future changes in monetary and fiscal policies, or the effect which they may have on our business and earnings.

Personal Holding Company Status. For the fiscal years ended December 31, 2003, 2002 and 2001, the Company has been deemed to be a Personal Holding Company (a "PHC"), as defined in the Internal Revenue Code. As a PHC, we may be required to pay an additional income tax or issue a dividend to our shareholders in an amount based upon the PHC Internal Revenue Code formulas, which is primarily based upon net income. Accordingly, on December 4, 2001, the Board of Directors of the Company declared a cash dividend in the amounts of $.04 per common share. No such dividend was required to be paid in fiscal 2003 and 2002. (See Dividends in Item 5).

Employees. On March 25, 2004, Berkshire had one full time employee and the Bank employed approximately 90 full time and 8 part time employees. The Bank's employees are not represented by a collective bargaining unit, and the Bank considers its relationship with its employees to be good.

ITEM 2. Properties.

The following are Berkshire's and the Bank's principal facilities as of March 25, 2004:

Location	Operations	Approximate Floor Area (Sq. Ft.)	Approximate Annual Rent	Lease Expiration
New York, NY	Executive Offices	1,500	$18,000	(1)(3)
New York, NY	Main Bank Office and Bank Branch	9,700	Owned	Feb 2008 (4)
Brooklyn, NY	Bank Branch	4,500	$131,000	March 2008
Brooklyn, NY	Bank Branch	1,433	$ 34,800	March 2008
Brooklyn, NY	Bank Branch	2,592	$102,000	December 2012
New York, NY	Bank Branch	5,500	$237,000	June 2005 (2) (3)
Goshen, NY	Bank Branch	10,680	Owned	
Harriman, NY	Bank Branch	1,623	Owned	
Bloomingburg, NY	Bank Branch	1,530	$ 25,000	August 2005

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(1) Rented on a month to month basis from a company affiliated with Mr. Moses Marx, a director of the Company.

(2) Leased from a company affiliated with Mr. Marx, a director of the Company.

(3) Management believes the annual rent paid is comparable to the annual rent that would be paid to non-affiliated parties in a similar commercial transaction for similar commercial space.

(4) Leased by the Bank from the Company at an annual rent of $375,000 which management believes is comparable to the annual rent that would be paid by non-affiliated parties in a similar commercial transaction for similar commercial space.

ITEM 3. Legal Proceedings.

In the ordinary course of operations, the Bank is a party to routine litigation involving claims incidental to its banking business. Management believes that no current litigation, threatened or pending, to which the Bank or its assets is a party, poses a substantial likelihood of potential loss or exposure which would have a material adverse effect on the financial condition or results of operations of the Bank.

ITEM 4. Submission of Matters to a Vote of Security Holders.

Not Applicable.

PART II

ITEM 5. Market for Registrant's Common Equity and Related Stockholder Matters.

The Company's Common Stock trades on the Nasdaq National Market System under the symbol BERK.

The following table sets forth, for the periods indicated, the high and low sales prices for the Company's Common Stock as reported by the National Association of Securities Dealers, Inc.

	High	Low
Fiscal Year Ended December 31, 2003		
January 1, 2003 to March 31, 2003	34.45	31.85
April 1, 2003 to June 30, 2003	39.50	32.50
July 1, 2003 to September 30, 2003	44.50	35.00
October 1, 2003 to December 31, 2003	51.00	41.50

	High	Low
Fiscal Year Ended December 31, 2002		
January 1, 2002 to March 31, 2002	28.74	27.66
April 1, 2002 to June 30, 2002	32.00	27.81
July 1, 2002 to September 30, 2002	32.476	29.62
October 1, 2002 to December 31, 2002	34.31	31.00

As of the close of business on March 25, 2004, there were approximately 2,043 holders of record of the Company's Common Stock.

Dividends

For the fiscal years ended December 31, 2003, 2002 and 2001, the Company has been deemed to be a PHC, as defined in the Internal Revenue Code. As a PHC, we may be required to pay an additional income tax or issue a dividend to our shareholders in an amount based upon applicable Internal Revenue Code formulas, which is primarily based upon net income. Accordingly, on December 4, 2001, the Board of Directors of the Company declared a cash dividend in the amounts of $.04 per common share. No such dividend was required to be paid in fiscal 2003 and 2002.

On March 23, 1999, the Board of Directors adopted a policy of paying regular cash dividends in respect of the Common Stock of the Company, payable in equal semi-annual installments. Pursuant to said policy, the Board of Directors declared and the Company paid cash dividends as follows:

Declaration Date	Record Date	Payment Date	Per Share Amount
March 8, 2001	April 16, 2001	April 30, 2001	$.10
October 5, 2001	October 19, 2001	October 29, 2001	$.10
April 8, 2002	April 23, 2002	April 30, 2002	$.10
October 4, 2002	October 21, 2002	October 29, 2002	$.12
April 8, 2003	April 23, 2003	April 30, 2003	$.12
October 3, 2003	October 21, 2003	October 29, 2003	$.15

The declaration, payment and amount of such dividends in the future is within the discretion of the Board of Directors and will depend upon our earnings, capital requirements, financial condition and other relevant factors.

Equity Compensation Plans

See Part III, Item 12 for information concerning the Company's equity compensation plans.

ITEM 6. Selected Financial Data.

BERKSHIRE BANCORP INC. AND SUBSIDIARIES

Five Year Financial Highlights (a)

The following is a summary of certain financial information with respect to the Company at and for the fiscal years ended December 31, 2003, 2002, 2001 and 2000, and at and for the proforma twelve months ended December 31, 1999. This information is derived from and should be read in conjunction with the Company's financial statements and notes thereto included elsewhere in this Form 10-K.

	December 31,				
	2003	2002	2001	2000	1999(b)
	(Dollars in thousands,except per share data)				
Balance Sheet Data:					
Total Assets	$905,669	$683,738	$536,365	$244,023	$192,130
Loans, net	292,163	273,182	250,010	74,515	64,668
Investment securities	569,848	371,458	242,579	117,060	89,497

Goodwill, net	18,549	18,549	18,438	11,543	12,073
Deposits	604,255	473,818	338,776	137,647	104,087
Stockholders' equity	103,490	98,525	95,992	79,107	78,070
Interest income	34,426	32,242	24,941	14,019	9,852
Interest expense	13,647	13,416	11,877	5,184	3,101
Net interest income before provision for loan losses	20,779	18,826	13,064	8,835	6,751
Provision for loan losses	240	387	287	55	55
Net interest income	20,539	18,439	12,777	8,780	6,696
Investment securities gains	2,746	1,539	637	13,288	10,731
Other income	1,237	748	786	1,330	578
Other expenses	11,463	10,780	7,838	3,829	3,489
Amortization of goodwill	--	--	935	635	730
Income before income taxes	13,059	9,946	5,427	18,934	13,786
Provision for income taxes	5,644	4,349	2,128	6,868	5,527
Net income	$ 7,415	$ 5,597	$ 3,299	$ 12,066	$ 8,259
Net income per share:					
Basic	$ 3.35	$ 2.44	$ 1.41	$ 5.76	$ 3.88
Diluted	$ 3.30	$ 2.43	$ 1.41	$ 5.76	$ 3.65
Cash dividends per common share	$ .27	$ .22	$ .24	$ .64	$ .32
Selected Operating Ratios					
Return on average assets (c)	0.9%	0.9%	0.8%	5.8%	7.0%
Return on average equity (c)	7.2%	5.9%	3.5%	14.9%	14.6%
Net interest margin (c)	2.7%	3.3%	3.6%	4.7%	4.9%
Average equity/average assets	12.7%	15.6%	23.8%	39.1%	47.9%
Allowance for loan losses/total loans	0.9%	0.8%	0.8%	1.5%	1.4%

(a) The prior years' amounts have been reclassified to conform to the current years' presentation.

(b) On December 10, 1999, the Company changed its fiscal year end from October 31 to December 31st of each year. This change was effective December 31, 1999. For presentation purposes, proforma operations data is shown for the twelve months ended December 31, 1999.

(c) Selected amounts for the two months ended December 31, 1999 were annualized to calculate ratios.

ITEM 7. Managements' 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. and subsidiaries ("Berkshire", the "Company" or "we" and similar pronouns) for the fiscal years ended December 31, 2003, 2002 and 2001. All references to earnings per share, unless stated otherwise, refer to earnings per diluted share. The discussion should be read in conjunction with the consolidated financial statements and related notes (Notes located in Item 8 herein). Reference is also made to Part I, Item 1 "Business" herein.

Segments

Management has determined that the Company through its wholly owned bank subsidiary, the Bank, operates in one business segment, community banking. The Bank's principal business activity consists of gathering deposits from the general public and investing those deposits in residential and commercial mortgage loans and commercial non-mortgage loans, both unsecured and secured by personal property. In addition, the Bank invests those deposits in debt obligations issued by the U.S. Government, its agencies, business corporations and mortgage-backed securities.

General

On March 30, 2001, the Company acquired GSB Financial Corporation and its wholly owned subsidiary, Goshen Savings Bank ("Goshen Bank"). Goshen Bank was simultaneously merged with and into our wholly owned subsidiary, The Berkshire Bank (the "Bank"). The Company's historic financial statements included in this Form 10-K for the twelve months ended December 31, 2001 do not include the operations of Goshen Bank from January 1, 2001 through March 31, 2001.

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 annual 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.

Discussion of Financial Condition and Results of Operations

Overview

Fiscal Year Ended December 31, 2003 Compared to Fiscal Year Ended December 31, 2002. Net income was $7.42 million, or $3.30 per share, for the fiscal year ended December 31, 2003, compared to $5.60 million, or $2.43 per share, for the fiscal year ended December 31, 2002, an increase of 32.48%. Investment securities, loans and total assets increased by 53.41%, 6.95% and 32.46%, respectively. Two new branches were opened in Brooklyn, New York during 2003 making a total of nine bank branches in operation at years' end.

Fiscal Year Ended December 31, 2002 Compared to Fiscal Year Ended December 31, 2001. Net income was $5.60 million, or $2.43 per share, for the fiscal year ended December 31, 2002, compared to $3.30 million, or $1.41 per share, for the fiscal year ended December 31, 2001, an increase of 69.66%. Investment securities, loans and total assets increased by 53.13%, 9.31% and 27.48%, respectively, due in part to the acquisition of GSB Financial on March 30, 2001.

	Fiscal Year Ended December 31,		
	2003	2002	% Inc.
	(In millions, except per share data)		
Total Assets	$905.7	$683.7	32%
Loans, net	292.2	273.2	7%
Investment Securities	569.8	371.5	53%
Total Liabilities	802.2	585.2	37%
Deposits	604.3	473.8	28%
Borrowings	192.1	104.4	84%
Stockholders' Equity	103.5	98.5	5%
Total Income	38.4	34.5	11%
Interest Income	34.4	32.2	7%
Total Expense	25.4	24.6	3%
Interest Expense	13.6	13.4	1%

Net Interest Income	20.8	18.8	11%
Net Income	7.4	5.6	32%
Diluted Income Per Share	3.30	2.43	36%
Bank Branches	9	7	--

Net Interest Income

Net interest income, represents the difference between total interest income earned on earning assets and total interest expense paid on interest-bearing liabilities. The amount of interest income is dependent upon many factors including: (i) the amount of interest-earning assets that the Company can maintain based upon its funding sources; (ii) the relative amounts of interest-earning assets versus interest-bearing liabilities; and (iii) the difference between the yields earned on those assets and the rates paid on those liabilities. Non-performing loans adversely affect net interest income because they must still be funded by interest-bearing liabilities, but they do not provide interest income. Furthermore, when we designate an asset as non-performing, all interest which has been accrued but not actually received is deducted from current period income, further reducing net interest income.

The Company's average balances, interest, and average yields are set forth on the following table (in thousands, except percentages):

	Twelve Months Ended December 31, 2003			Twelve Months Ended December 31, 2002		
	Average Balance	Interest and Dividends	Average Yield/Rate	Average Balance	Interest and Dividends	Av Yiel
INTEREST-EARNING ASSETS:						
Loans (1)	$291,586	$19,061	6.54%	$265,961	$18,723	7
Investment securities	470,412	15,321	3.26	298,008	13,383	4
Other (2)(5)	3,946	44	1.12	8,479	136	1
Total interest-earning assets	765,944	34,426	4.49	572,448	32,242	5
Noninterest-earning assets	37,844			36,541		
Total Assets	$803,788			$608,989		
INTEREST-BEARING LIABILITIES:						
Interest bearing deposits	201,817	2,593	1.28	116,331	1,644	1
Time deposits	333,112	7,537	2.26	273,452	8,766	3
Other borrowings	125,609	3,517	2.80	86,210	3,006	3
Total interest-bearing liabilities	660,538	13,647	2.07	475,993	13,416	2

Demand deposits	32,592			30,102		
Noninterest-bearing liabilities	8,318			7,586		
Stockholders' equity (5)	102,340			95,308		
Total liabilities and stockholders' equity	$803,788			$608,989		
Net interest income		$20,779			$18,826	
Interest-rate spread (3)			2.42%			2
Net interest margin (4)			2.71%			3
Ratio of average interest-earning assets to average interest bearing liabilities	1.16			1.20		

	Twelve Months Ended December 31, 2001		
	Average Balance	Interest and Dividends	Average Yield/Rate
INTEREST-EARNING ASSETS:			
Loans (1)	$195,296	$15,143	7.75%
Investment securities	154,787	9,156	5.92
Other (2)(5)	15,215	642	4.22
Total interest-earning assets	365,298	24,941	6.83
Noninterest-earning assets	32,993		
Total Assets	$398,291		
INTEREST-BEARING LIABILITIES:			
Interest bearing deposits	85,194	2,291	2.69
Time deposits	155,079	7,867	5.07
Other borrowings	36,510	1,719	4.71
Total interest-bearing liabilities	276,783	11,877	4.29
Demand deposits	21,857		
Noninterest-bearing liabilities	4,802		
Stockholders' equity (5)	94,849		
Total liabilities and stockholders' equity	$398,291		

	========		
Net interest income		$13,064	
		=======	
Interest-rate spread (3)			2.54%
			====
Net interest margin (4)			3.58%
			====
Ratio of average interest-earning assets to average interest bearing liabilities	1.32		
	========		

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(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 for Berkshire Bancorp Inc. (parent only) have been calculated on a monthly basis.

Changes in net interest income may also be analyzed by segregating the volume and rate components of interest income and interest expense. The following tables set forth certain information regarding changes in interest income and interest expense of the Company for the years indicated. For each category of interest-earning assets and interest-bearing liabilities, information is provided on changes attributable to (1) changes in rate (change in rate multiplied by prior volume), (2) changes in volume (changes in volume multiplied by prior rate) and (3) changes in rate-volume (change in rate multiplied by change in volume) (in thousands):

	Twelve Months Ended December 31, 2003 Versus Twelve Months Ended December 31, 2002 Increase (Decrease) Due To		
	Rate	Volume	Total

Interest-earning assets:			
Loans	$(1,330)	$1,668	$ 338
Investment securities	(3,278)	5,216	1,938
Other	(41)	(51)	(92)
Total	(4,649)	6,833	2,184
Interest-bearing liabilities:			
Deposit accounts:			
Interest bearing deposits	(151)	1,100	949
Time deposits	(2,598)	1,369	(1,229)
Other borrowings	(595)	1,106	511
Total	(3,344)	3,575	231
Net interest income	$(1,305)	$3,891	$ 1,953

	Twelve Months Ended December 31, 2002 Versus Twelve Months Ended December 31, 2001 Increase (Decrease) Due To		
	Rate	Volume	Total
Interest-earning assets:			
Loans	$(1,395)	$ 4,975	$3,580
Investment securities	(2,204)	6,431	4,227
Other	(399)	(107)	(506)
Total	(3,998)	11,299	7,301
Interest-bearing liabilities:			
Deposit accounts:			
Interest bearing deposits	(1,090)	443	(647)
Time deposits	(2,884)	3,783	899
Other borrowings	(449)	1,736	1,287
Total	(4,423)	5,962	1,539
Net interest income	$ 425	$ 5,337	$5,762

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.

We seek to maximize our 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.

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 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 $109,000 and $59,000 of classified loans at December 31, 2003 and 2002, respectively, and no loans classified as of December 31, 2001.

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 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 guarantee, 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.

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.

Results of Operations Fiscal Year Ended December 31, 2003 Compared to Fiscal Year Ended December 31, 2002.

General.

References to per share amounts below, unless stated otherwise, refer to diluted shares.

Net Income. Net income for the fiscal year ended December 31, 2003 was $7.42 million, or $3.30 per share, as compared to $5.60 million, or $2.43 per share, for the fiscal year ended December 31, 2003.

The Company's net income is largely dependent on interest rate levels, the demand for the Company's loan and deposit products and the strategies employed to manage the interest rate and other risks inherent in the banking business. Interest rates, as measured by the prime rate, began the year at 4.25%, declined by 25 basis points in late June to 4.00% and remained at that level through December 31, 2003. We have operated in a consistently declining interest rate environment since May 2000 when the prime rate peaked at 9.50% which has also been a period of low inflation, stock market uncertainties, recession and the aftermath of September 11, 2001.

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 such as deposits and borrowings.

For the fiscal year ended December 31, 2003, net interest income increased by $1.95 million, or 10.37%, to $20.78 million from $18.83 million for the fiscal year ended December 31, 2002. The increase in net interest income was the result of a 33.80% growth in the average amount of interest-earning assets to $765.94 million at the end of 2003 from $572.45 million at the end of 2002, partially offset by the 38.77% growth in the average amount of interest-bearing liabilities to $660.54 million from $475.99 million at December 31, 2003 and 2002,

respectively, as well as the difference between the yield on assets compared to the cost of liabilities.

During fiscal 2003, the average yield on interest-earning assets fell to 4.49% from 5.63% in fiscal 2002, a decline of 20.25%, while the average cost of interest-bearing liabilities fell to 2.07% from 2.82%, a decline of 26.60% The interest-rate spread, the difference between the average yield on interest-earning assets and the average cost of interest bearing liabilities, eased by 39 basis points to 2.42% during fiscal 2003 from 2.81% during fiscal 2002.

If interest rates remain stable, we expect to see only moderate pressure on the Company's interest-rate spread and net interest income. Investment securities in our portfolio that have been sold, matured or called by the issuer during fiscal 2003 have been replaced with securities carrying somewhat lower yields and, by design, shorter maturities to protect against a rising interest rate environment. Rates paid on deposit accounts may continue to decline as well, albeit at a slower pace due to competition for deposits in the market place.

Net Interest Margin. Net interest margin, or annualized net interest income as a percentage of average interest-earning assets, declined to 2.71% in fiscal 2003 from 3.29% in fiscal 2002. 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, and to invest such funds in a prudent mix of loans and investment securities. The average amounts of loans and investment securities increased by $25.63 million and $172.40 million, respectively, to $291.59 million and $470.41 million, respectively, in the year ended December 31, 2003, from $265.96 million

and $298.01 million, respectively, in the year ended December 31, 2002.

The average yield on loans declined to 6.54% in 2003 from 7.04% in 2002 as older loans with higher rates, commercial and residential mortgage loans, were paid off, matured, and/or refinanced at lower rates. During periods of low and stable interest rates, as was the case during 2003, borrowers gravitate towards fixed-rate loans to lock in a low interest rate, whereas adjustable rate loans are generally preferred when interest rates are high. One-to-four family mortgage loans, approximately 57% of our loan portfolio at December 31, 2003, are particularly sensitive to changes in interest rates.

The average amounts of interest-bearing deposits and time deposits increased by $85.49 million and $59.66 million, respectively, to $201.82 million and $333.11 million, respectively, in fiscal year 2003, from $116.33 million and $273.45 million, respectively, in fiscal year 2002. Borrowed funds increased by $39.40 million to $125.61 million in 2003 from $86.21 million in the 2002. During fiscal year 2003, the average rates paid on interest-bearing deposits, time deposits and borrowed funds declined to 1.28%, 2.26% and 2.80%, respectively, from 1.41%, 3.21% and 3.49%, respectively in fiscal year 2002.

Interest Income. Total interest income for the fiscal year ended December 31, 2003 increased by $2.18 million, or 6.77%, to $34.43 million from $32.24 million for the fiscal year ended December 31, 2002. The increase was the result of the 33.80% increase in the average amount of total interest-earning assets to $765.94 million in fiscal year 2003 from $572.45 million in fiscal 2002. Interest income on loans and investment securities increased to $19.06 million and $15.32 million, respectively, in fiscal year 2003, from $18.72 million and $13.38 million, respectively in fiscal year 2003.

Interest Expense. Total interest expense for the fiscal year ended December 31, 2003 increased by $231,000, or 1.72%, to $13.65 million from $13.42 million for the fiscal year ended December 31, 2002. The increase in interest expense was due primarily to the 38.77% increase in the average amount of total interest-bearing liabilities, all but offset by the 26.60% decline in the average rate paid on such balances. Interest expense increased to $2.59 million on interest-bearing deposits and decreased to $7.54 million on time deposits during fiscal year 2003, from $1.64 million and $8.77 million, respectively, during fiscal year 2002. Interest expense on borrowings, which are generally invested in earning assets of similar maturities, increased to $3.52 million in fiscal year 2003 from $3.01 million in fiscal year 2002.

Non-Interest Income. Non-interest income consists primarily of realized gains on sales of marketable securities and service fee income. For the fiscal year ended December 31, 2003, total non-interest income increase by $1.70 million, or 74.16%, to $3.98 million from $2.29 million for the fiscal year ended December 31, 2002. Investment securities gains increased to $2.75 million in fiscal year 2003 from $1.54 million in fiscal 2002, as we sold securities during 2003, realizing gains, and purchased new securities with shorter maturities. Service charges on deposit accounts increased by $92,000 to $640,000 in fiscal year 2003 from $548,000 in fiscal year 2002.

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 year ended December 31, 2003 increased by $683,000, or 6.34%, to $11.46 million from $10.78 million for the year ended December 31, 2002. The increase was largely due to the $690,000 increase in salaries and employee benefits resulting from the additional personnel required to operate our expanding business.

Provision for Income Tax. During the years ended December 31, 2003 and 2002, we recorded income tax expense of $5.64 million and $4.35 million, respectively. The tax provisions for federal, state and local taxes recorded for 2003 and 2002 represent effective tax rates of 43.22% and 43.73%, respectively.

Results of Operations Fiscal Year Ended December 31, 2002 Compared to Fiscal Year Ended December 31, 2001.

General. On March 30, 2001, Berkshire, through its wholly-owned subsidiaries, the Bank and Greater American Finance Group, Inc., completed its merger with GSB Financial (see Note A of Notes to Consolidated Financial Statements). This transaction was accounted for under the purchase method of accounting and, accordingly, the results of operation for the Company include only the results of operation of GSB Financial for the nine month period from April 1 through December 31, 2001. The Company acquired total loans, assets and deposits of $134.06 million, $190.04 million and $127.86 million, respectively.

Net Income. Net income for the fiscal year ended December 31, 2002 was $5.60 million, or $2.43 per share, as compared to $3.30 million, or $1.41 per share, for the fiscal year ended December 31, 2001. The increase was due in part to the acquisition of GSB Financial referenced above.

On January 1, 2002, the Company adopted Statement of Financial Accounting Standards ("SFAS") No. 142, thereby eliminating annual goodwill amortization expense of approximately $1.0 million. Had SFAS No. 142 been in effect on January 1, 2001, net income in fiscal 2001 would have been $4.23 million, or $1.81 per share.

Interest rates, as measured by the prime rate, stabilized at 4.75% throughout the first ten months of 2002. During 2001, in contrast, the prime rate declined from 9.00% at the beginning of the year to 4.75% at years' end.

Net Interest Income. The Company's primary source of revenue is net interest income, or the difference between interest income on earning assets and interest expense on interest-bearing liabilities.

For the fiscal year ended December 31, 2002, net interest income increased by approximately $5.76 million, or 44.11%, to $18.83 million from $13.06 million for the fiscal year ended December 31, 2001. The year over year increase in net interest income was the result of two factors. Firstly, the $207.15 million, or 56.71%, increase in average interest-earning assets to $572.45 million from $365.30 million in fiscal 2001, partially offset by the $199.21 million, or 71.97%, increase in average interest-bearing liabilities to $475.99 million from $276.78 million in fiscal 2001. The second factor contributing to the increase in net interest income was the difference between the yield on assets compared to the cost of liabilities. The average yield on interest-earning assets in 2002 declined to 5.63% from 6.83% in 2001, a decline of 120 basis points, or 17.57%, however, the average cost of interest-bearing liabilities in 2002 declined to 2.82% from 4.29%, a steeper decline of 147 basis points, or 34.27% 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, improved to 2.81% in fiscal 2002 from 2.54% in fiscal 2001.

Net Interest Margin. Net interest margin, or annualized net interest income as a percentage of average interest-earning assets, declined to 3.29% in fiscal 2002 from 3.58% in fiscal 2001.

During fiscal 2002, the Company made use of the prevailing interest rate environment to secure deposits and to borrow funds at what we believe to be attractive rates, and to invest such funds in loans and investment securities. The average amounts of loans and investment securities increased by $70.67 million and $143.22 million, respectively, to $265.96 million and $298.01 million, respectively, in fiscal 2002 from $195.30 million and $154.79 million, respectively, in fiscal 2001. Time deposits and borrowings increased by $118.37 million and $49.70 million, respectively, during 2002 to $273.45 million and $86.21 million, respectively, from $155.08 million and $36.51 million, respectively, during 2001.

Interest Income. Total interest income for the fiscal year ended December 31, 2002 increased by $7.30 million, or 29.27%, to $32.24 million from $24.94 million for the fiscal year ended December 31, 2001. The increase was the result of the higher levels of average interest-earning assets during fiscal 2002 over fiscal 2001. The average amount of loans and investment securities increased by 36.18% and 92.53%, respectively, contributing $18.72 million and $13.38 million of interest income, respectively, compared to $15.14 million and $9.16 million of interest income, respectively, in fiscal 2001.

As may be expected during a period of falling interest rates, the average yield on interest-earning assets declined to 5.63% during fiscal 2002 from 6.83% in fiscal 2001. The average yield on loans declined to 7.04% from 7.75% and we expect this trend may continue as homeowners refinance their existing mortgage loans, commercial loans at higher rates are paid off and/or renewed, and new mortgage loans and commercial loans are made, all at today's lower rates. The average yield on investment securities has declined as well, to 4.49% in 2002 from 5.92% in 2001, as securities in our portfolio with above market rates have either matured or have been called by the issuer, and have been replaced by securities that meet our investment policy criteria, albeit with lower yields.

Interest Expense. Total interest expense for the fiscal year ended December 31, 2002 increased by $1.54 million, to $13.42 million from $11.88 million for the fiscal year ended December 30, 2001. The increase is due to the overall increase of $199.21 million in the average amount of interest-bearing liabilities to $475.99 million in fiscal 2002 from $276.78 million in fiscal 2001. Interest bearing deposits and time deposits increased by 62.23% to $389.78 million in 2002 from $240.27 million in 2001. Borrowings increased by 136.13% to $86.21 million in 2002 from $36.51 million in 2001 as a result of our strategy of employing excess capital to fund the growth of our business. The increase in total interest expense was partially offset by the decline in the average rates paid on interest-bearing liabilities to 2.82% during the 2002 period from 4.29% during the 2001 period.

Non-Interest Income. Non-interest income consists primarily of realized gains on sales of investment securities and service fee income. For the fiscal year ended December 31, 2002, total non-interest income was $2.29 million, compared to $1.42 million for the fiscal year ended December 31, 2001. Service fee income

increased to $548,000 in fiscal 2002 from $395,000 in fiscal 2001 as a result of the growth in deposits at the Bank. Investment securities gains increased to $1.54 million in 2002 from $637,000 in 2001, and other non-interest income declined to $200,000 in 2002 from $391,000 in 2001.

Non-Interest Expense. Non-interest expense includes salaries and employee benefits, occupancy and equipment expenses, professional fees and other operating expenses associated with the day-to-day operations of the Company. Total non-interest expense for the fiscal year ended December 31, 2002 was $10.78 million as compared to $8.77 million for the fiscal year ended December 31, 2001. The year to year increases are due primarily to increases in salaries and employee benefits and net occupancy expenses resulting from the expansion of the business.

Provision for Income Tax. During the fiscal year ended December 31, 2002, the Company recorded income tax expense of $4.35 million, compared to income tax expense of $2.13 million for the fiscal year ended December 31, 2001. The tax provisions for federal, state and local taxes recorded for fiscal 2002 and 2001 represent effective tax rates of 43.73% and 39.21%, respectively. The increase in the effective rate is primarily due to the elimination of the non-deductible amortization expense of goodwill.

Investment Activities

General. The investment policy of the Bank is designed primarily to provide satisfactory yields while maintaining adequate liquidity, a balance of high quality, diversified investments, and minimal risk. The Bank does not as a rule invest in equity securities. The largest component of the Bank's securities investments, representing more than 50% of total investment securities, are debt securities issued by the Federal Home Loan Mortgage Corporation (Freddie Mac), the Federal National Mortgage Association (Fannie Mae) or the Government National Mortgage Association (Ginnie Mae). The remainder of the Bank's debt securities investments are primarily short term debt securities issued by the United States or its agencies. The Bank maintains a small portfolio of less than $4 million of high-yield corporate debt securities. Recognizing the higher credit risks of these securities, the Bank underwrites these securities in a manner similar to its loan underwriting procedures.

As required by the Statement of Financial Accounting Standard No. 115 ("SFAS No. 115"), securities are classified into three categories: trading, held-to-maturity and available-for-sale. Securities that are bought and held principally for the purpose of selling them in the near term are classified as trading securities and are reported at fair value with unrealized gains and losses included in trading account activities in the statement of income. Securities that the Bank has the positive intent and ability to hold to maturity are classified as held-to-maturity and reported at amortized cost. All other securities are classified as available-for-sale. Available-for-sale securities are reported at fair value with unrealized gains and losses included, on an after-tax basis, as a separate component of net worth. The Bank does not have a trading securities portfolio and has no current plans to maintain such a portfolio in the future. The Bank generally classifies all newly purchased debt securities as available for sale in order to maintain the flexibility to sell those securities if the need arises. The Bank has a limited portfolio of

securities classified as held to maturity, represented principally by securities purchased a number of years ago.

Federal Home Loan Bank Stock. The Bank owns stock of the Federal Home Loan Bank of New York (the "FHLBNY") which is necessary for it to be a member of the FHLBNY. Membership requires the purchase of stock equal to 1% of the Bank's residential mortgage loans. If the Bank borrows from the FHLBNY, the Bank must own stock at least equal to 5% of its borrowings.

The following table sets forth the cost and fair value of available-for-sale and held-to-maturity securities as of the dates indicated:

	December 31,					
	2003		2002		2001	
	Cost	Fair Value	Cost	Fair Value	Cost	Fair Value
	(In thousands)					
Available-For-Sale						
U.S. Treasury Notes	$ 39,941	$ 39,847	$ 20,110	$ 20,213	$ 30,012	$ 30,038
U.S. Government Agencies	419,175	416,753	301,224	303,597	170,610	170,156
Mortgage-backed securities	93,875	97,448	6,256	6,262	2,493	2,499
Corporate notes	1,570	1,662	3,878	4,076	751	639
Municipal securities	991	1,061				
Marketable equity securities and other	12,305	12,366	36,383	36,477	37,547	37,634
Total	$567,857	$569,137	$367,851	$370,625	$241,413	$240,966
Held-To-Maturity						
U.S. Government Agencies	$ 711	$ 715	$ 833	$ 835	$ 1,613	$ 1,598
Total	$ 711	$ 715	$ 833	$ 835	$ 1,613	$ 1,598

The following tables summarize the Company's available-for-sale and held-to-maturity securities at December 31, 2003:

	December 31, 2003		
	Weighted Average Yield	Cost	Fair Value
	(Dollars in thousands)		

Available-For-Sale			
U.S. Treasury Notes			
Due after one year through five years	1.28%	$ 39,941	$ 39,847
		39,941	39,847
U.S. Government Agencies Obligations			
Due within one year		--	--
Due after one year through five years	2.90	61,115	61,145
Due after five years through ten years	4.56	196,934	195,168
Due after ten years	3.92	161,126	160,440
		419,175	416,753
Municipal Obligations			
Due after ten years	5.44	991	1,061
		991	1,061
Mortgage-backed securities			
Due after ten years	4.55	93,875	97,448
		93,875	97,448
Corporate Notes			
Due within one year		--	--
Due after one year through five years	9.68	1,570	1,662
		1,570	1,662
Common Stocks	--	90	90
Preferred Stocks	11.84	1,178	1,239
Money market funds	1.02	7,150	7,150
Federal Home Loan Bank Stock	0.00	3,887	3,887
		12,305	12,366
		$567,857	$569,137
Held-To-Maturity			
U.S. Government Agencies Obligations			
Due after one year through five years	3.13	74	74
Due after five years through ten years	2.50	70	70
Due after ten years	6.13	567	571
		$ 711	$ 715

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 loans are either made to individuals or personally guaranteed by the principals of the business to which the loan is made. At December 31, 2003, 2002 and 2001 , the Company had total loans, net of unearned income of $294.76 million, $275.50 million and $252.23 million,

respectively, and an allowance for loan losses of $2.59 million, $2.32 million and $2.03 million, respectively. 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.

Interest rates on loans are affected by the demand for loans, the supply of money available for lending, credit risks, the rates offered by competitors and other conditions. These factors are in turn affected by, among other things, economic conditions, monetary policies of the federal government, and legislative tax policies.

In order to manage interest rate risk, the Bank focuses its efforts on loans with interest rates that adjust based upon changes in the prime rate or changes in United States Treasury or similar indices. Generally, credit risks on adjustable-rate loans are somewhat greater than on fixed-rate loans primarily because, as interest rates rise, so do borrowers' payments, increasing the potential for default. The Bank seeks to impose appropriate loan underwriting standards in order to protect against these and other credit related risks associated with its lending operations.

In addition to analyzing the income and assets of its borrowers when underwriting a loan, the Bank obtains independent appraisals on all material real estate in which the Bank takes a mortgage. The Bank generally obtains title insurance in order to protect against title defects on mortgaged property.

Commercial and Mortgage Loans. The Bank originates commercial mortgage loans secured by office buildings, retail establishments, multi-family residential real estate and other types of commercial property. Substantially all of the properties are located in the New York City metropolitan area.

The Bank generally makes commercial mortgage loans with loan to value ratios not to exceed 75% and with terms to maturity that do not exceed 15 years. Loans secured by commercial properties generally involve a greater degree of risk than one- to four-family residential mortgage loans. Because payments on such loans are often dependent on successful operation or management of the properties, repayment may be subject, to a greater extent, to adverse conditions in the real estate market or the economy. The Bank seeks to minimize these risks through its underwriting policies. The Bank evaluates the qualifications and financial condition of the borrower, including credit history, profitability and expertise, as well as the value and condition of the underlying property. The factors considered by the Bank include net operating income; the debt coverage ratio (the ratio of cash net income to debt service); and the loan to value ratio. When evaluating the borrower, the Bank considers the financial resources and income level of the borrower, the borrower's experience in owning or managing similar property and the Bank's lending experience with the borrower. The Bank's policy requires borrowers to present evidence of the ability to repay the loan without having to resort to the sale of the mortgaged property. The Bank also seeks to focus its commercial mortgage loans on loans to companies with operating businesses, rather than passive real estate investors.

Commercial Loans. The Bank makes commercial loans to businesses for inventory financing, working capital, machinery and equipment purchases,

expansion, and other business purposes. These loans generally have higher yields than mortgages loans, with maturities of one year, after which the borrower's financial condition and the terms of the loan are re-evaluated.

Commercial loans tend to present greater risks than mortgage loans because the collateral, if any, tends to be rapidly depreciable, difficult to sell at full value and is often easier to conceal. In order to limit these risks, the Bank evaluates these loans based upon the borrower's ability to repay the loan from ongoing operations. The Bank considers the business history of the borrower and perceived stability of the business as important factors when considering applications for such loans. Occasionally, the borrower provides commercial or residential real estate collateral for such loans, in which case the value of the collateral may be a significant factor in the loan approval process.

Residential Mortgage Loans (1 to 4 family loans). The Bank makes residential mortgage loans secured by first liens on one-to-four family owner-occupied or rental residential real estate. At December 31, 2003 and 2002, approximately $169.59 million and $180.73 million, respectively, or 57.4% and 65.4%, respectively, of the Company's total loan portfolio consisted of such

loans. The Company offers both adjustable rate mortgages ("ARMS") and fixed-rate mortgage loans. The relative proportion of fixed-rate loans versus ARMs originated by the Bank depends principally upon current customer preference, which is generally driven by economic and interest rate conditions and the pricing offered by the Bank's competitors. At December 31, 2003 and 2002, approximately 12% and 11%, respectively, of the Bank's residential one-to-four family owner-occupied first mortgage portfolio were ARMs and approximately 88% and 89%, respectively, were fixed-rate loans. The percentage represented by fixed-rate loans tends to increase during periods of low interest rates. The ARMs generally carry annual caps and life-of-loan ceilings, which limit interest rate adjustments.

The Bank's residential loan underwriting criteria are generally comparable to those required by the Federal National Mortgage Association ("FNMA") and other major secondary market loan purchasers. Generally, ARM credit risks are somewhat greater than fixed-rate loans primarily because, as interest rates rise, the borrowers' payments rise, increasing the potential for default. The Bank's teaser rate ARMs (ARMs with low initial interest rates that are not based upon the index plus the margin for determining future rate adjustments) were underwritten based on the payment due at the fully-indexed rate.

In addition to verifying income and assets of borrowers, the Bank obtains independent appraisals on all residential first mortgage loans and title insurance is required at closing. Private mortgage insurance is required on all loans with a loan-to-value ratio in excess of 80% and the Bank requires real estate tax escrows on such loans. Real estate tax escrows are voluntary on residential mortgage loans with loan-to-value ratios of 80% or less.

Fixed-rate residential mortgage loans are generally originated by the Bank for terms of 15 to 30 years. Although 30 year fixed-rate mortgage loans may adversely affect our net interest income in periods of rising interest rates, the Bank originates such loans to satisfy customer demand. Such loans are generally originated at initial interest rates which exceed the fully indexed

rate on ARMs offered at the same time. Fixed-rate residential mortgage loans originated by the Bank generally include due-on-sale clauses, which permit the Bank to demand payment in full if the borrower sells the property without the Bank's consent. Due-on-sale clauses are an important means of adjusting the rates on the Bank's fixed-rate mortgage loan portfolio, and the Bank will generally exercise its rights under these clauses if necessary to maintain market yields.

ARMs originated in recent years have interest rates that adjust annually based upon the movement of the one year treasury bill constant maturity index, plus a margin of 2.00% to 2.75%. These loans generally have a maximum interest rate adjustment of 2% per year, with a lifetime maximum interest rate adjustment, measured from the initial interest rate, of 5.5% or 6.0%.

The Bank offers a variety of other loan products including residential single family construction loans to persons who intend to occupy the property upon completion of construction, home equity loans secured by junior mortgages on one-to-four family owner-occupied residences, and short-term fixed-rate consumer loans either unsecured or secured by monetary assets such as bank deposits and marketable securities or personal property.

Origination of Loans. Loan originations can be attributed to depositors, retail customers, telephone inquiries, advertising, the efforts of the Bank's loan officers, and referrals from other borrowers and real estate brokers and builders. The Bank originates loans primarily through its own efforts. Occasionally, the Bank may obtain loan opportunities as a result of referrals from loan brokers.

At December 31, 2003, the Bank's total capital, net of goodwill and loan loss reserves, was approximately $60.7 million and thus it was generally not permitted to make loans to one borrower in excess of approximately $9.1 million, with an additional amount of approximately $6.1 million being permitted if secured by readily marketable collateral. The Bank was also not permitted to make any single mortgage loan in an amount in excess of approximately $9.1 million. At December 31, 2003, the Bank was in compliance with these standards.

Delinquency Procedures. When a borrower fails to make a required payment on a loan, the Bank attempts to cause the deficiency to be cured by contacting the borrower. The Bank reviews past due loans on a case by case basis, taking the action it deems appropriate in order to collect the amount owed. Litigation may be necessary if other procedures are not successful. Judicial resolution of a past due loan can be delayed if the borrower files a bankruptcy petition because collection action cannot be continued unless the Bank first obtains relief from the automatic stay provided by the Bankruptcy Code.

If a non-mortgage loan becomes delinquent and satisfactory arrangements for payment cannot be made, the Bank seeks to realize upon any personal property collateral to the extent feasible and collect any remaining amount owed from the borrower through legal proceedings, if necessary.

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.

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

	December 31,					
	2003		2002		2001	
	Amount	% of Total	Amount	% of Total	Amount	% of Total
	(Dollars in thousands)					
Commercial and professional loans	$ 22,228	7.5%	$ 16,704	6.0%	$ 19,130	7.6%
Secured by real estate						
1 - 4 family	169,589	57.4	180,730	65.4	165,195	65.5
Multi family	6,608	2.2	8,958	3.2	11,186	4.4
Non-residential (commercial)	94,956	32.2	65,809	23.8	51,893	20.6
Consumer	2,239	0.7	4,051	1.6	4,689	1.8
Other	--	--	--	--	140	0.1
Total loans	295,620	100.0%	276,252	100.0%	252,233	100.0%
Less:						
Allowance for loan losses	(2,593)		(2,315)		(2,030)	
Unearned fees	(864)		(755)		(193)	
Loans, net	$292,163		$273,182		$250,010	

	December 31, 2000		October 31, 1999 (1)	
	Amount	% of Total	Amount	% of Total
	(Dollars in thousands)			

Commercial and professional loans	$ 9,419	12.5%	$ 6,824	11.3%
Secured by real estate			51,300	84.7
1 - 4 family	25,677	34.0		
Multi family	4,765	6.3		
Non-residential (commercial)	34,968	46.2		
Consumer	229	0.3	1,932	3.2
Other	565	0.7	501	0.8
Total loans	75,623	100.0%	60,557	100.0%
Less:				
Allowance for loan losses	(1,108)		(905)	
Unearned fees	(275)		--	
Loans, net	$74,240		$59,652	

(1) Information is prepared on a proforma basis for comparability purposes. Balances stated are not reflected in the historical financial statements of the Company.

Impaired loan balance, nonaccrual loans and loans greater than 90 days still accruing

The following table sets forth certain information regarding nonaccrual loans, including the ratio of such loans to total assets as of the dates indicated, and certain other related information. The Bank had no foreclosed real estate during these periods and no loans past due more than 90 days still accruing at December 31, 2003 and 2002, respectively.

	December 31,				October 31,
	2003	2002	2001	2000	1999(1)
	(Dollars in Thousands)				
Nonaccrual loans:					
Commercial and professional loans	$ --	$--	$ 9	$--	$ --
Secured by real estate	109	59	--	--	121
Total nonaccrual loans	109	59	9	--	121
Total nonperforming loans	$109	$59	$ 9	$--	$121
Total nonperforming loans to total assets	.01%	--	--	--	.07%

(1) Information is prepared on a proforma basis for comparability purposes. Balances stated are not reflected in the historical financial statements of the Company.

The following tables present information regarding the Company's total allowance for loan losses as well as the allocation of such amounts to the various categories of loans at the dates indicated (dollars in thousands):

	December 31, 2003		
	Allowance for Loan Losses	Percent of Allowance	Percent of Total Loans
Commercial and professional loans	$ 300	11.6%	0.10%
Secured by real estate			
1 - 4 family	424	16.3	0.14
Multi family	89	3.4	0.03
Non-residential	1,198	46.2	0.41
Consumer and other	30	1.2	0.01
General allowance (1)	552	21.3	0.19
Total allowance for loan losses	$2,593	100.0%	0.88%

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(1) The allowance for loan losses is allocated to specific loans as necessary.

	December 31, 2002		
	Allowance for Loan Losses	Percent of Allowance	Percent of Total Loans
Commercial and professional loans	$ 225	9.7%	0.08%
Secured by real estate			
1 - 4 family	452	19.5	0.16
Multi family	121	5.2	0.04
Non-residential	888	38.4	0.32
Consumer and other	55	2.4	0.02
General allowance (1)	574	24.8	0.21
Total allowance for loan losses	$2,315	100.0%	0.83%

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(1) The allowance for loan losses is allocated to specific loans as necessary.

	December 31, 2001		
	Allowance for Loan Losses	Percent of Allowance	Percent of Total Loans
Commercial and professional loans	$ 188	9.3%	0.07%
Secured by real estate			
1 - 4 family	804	39.6	0.32
Multi family	84	4.1	0.03
Non-residential	790	38.9	0.32
Consumer and other	24	1.2	0.06
General allowance (1)	140	6.9	0.06
Total allowance for loan losses	$2,030	100.0%	0.79%

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(1) The allowance for loan losses is allocated to specific loans as necessary.

	December 31, 2000		
	Allowance for Loan Losses	Percent of Allowance	Percent of Total Loans
Commercial and professional loans	$ 89	8.0%	0.12%
Secured by real estate	654	59.0	0.86
Personal and other	13	1.2	0.02
General allowance (1)	352	31.8	0.47%
Total allowance for loan losses	$1,108	100.0%	1.47%

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(1) The allowance for loan losses is allocated to specific loans as necessary.

October 31, 1999(2)

	Allowance for Loan Losses	Percent of Allowance	Percent of Total Loans
Commercial and professional loans	$ 69	7.6%	0.11%
Secured by real estate	569	63.0	0.94
Personal and other	77	8.5	0.13
General allowance (1)	190	20.9	0.31
Total allowance for loan losses	$905	100.0%	1.49%

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(1) The allowance for loan losses is allocated to specific loans as necessary.

(2) Information is prepared on a proforma basis for comparability purposes. Balances stated are not reflected in the historical financial statements of the Company.

The following tables set forth information regarding the aggregate maturities of the Company's loans in the specified categories and the amount of such loans which have fixed and variable rates.

	December 31, 2003			
	Within 1 Year	1 to 5 Years	After 5 Years	Total
	(In thousands)			
Fixed Rate				
Commercial, financial and agricultural	$ 2,164	$15,496	$145,725	$163,385
Non-residential	3,881	13,405	33,591	50,877
Total fixed rate	$ 6,045	$28,901	$179,316	$214,262
Adjustable Rate				
Commercial, financial and agricultural	7,583	11,111	18,585	37,279
Non-residential	19,162	8,971	15,946	44,079
Total adjustable rate	$26,745	$20,082	$ 34,531	$ 81,358
Total	$32,790	$48,983	$213,847	$295,620

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):

	Years Ended December 31,				Two Months Ended December 31,
	2003	2002	2001	2000	1999
Average loans outstanding	$291,586	$265,961	$195,296	$70,357	$61,691
Allowance at beginning of period	2,315	2,030	1,108	923	905
Charge-offs:					
Commercial and other loans	4	199	97	--	--
Real estate loans	13	--	--	--	--
Total loans charged-off	17	199	97	--	--
Recoveries:					
Commercial and other loans	55	97	41	130	8
Real estate loans	--	--	--	--	--
Total loans recovered	55	97	41	130	8
Net recoveries (charge-offs)	38	(102)	(56)	130	8
Provision for loan losses charged to operating expenses	240	387	287	55	10
Acquisition of GSB	--	--	691	--	--
Allowance at end of period	$ 2,593	$ 2,315	$ 2,030	$ 1,108	$ 923
Ratio of net recoveries (charge-offs) to average loans outstanding (2)	0.01%	(.03)%	(.02)%	.18%	.08%
Allowance as a percent of total loans	0.88%	0.83%	0.80%	1.47%	1.41%
Total loans at end of period	$295,620	$276,252	$252,233	$75,623	$65,591

(1) Information is prepared on a proforma basis for comparability purposes. Balances stated are not reflected in the historical financial statements of the Company.

(2) Net recoveries have been annualized to calculate ratios for comparability purposes.

Deposits

The Bank concentrates on obtaining deposits from a variety of businesses, professionals and retail customers. The Bank offers a number of different deposit programs, including statement savings accounts, NOW accounts, money market deposits accounts, checking accounts and certificates of deposits with terms from seven days to five years. Deposit account terms vary according to the minimum balance required, the time period the funds must remain on deposit and the interest rate, among other factors. The Bank prices its deposit offerings competitively within the market it serves. These products are designed to attract new customers, retain existing customers and create opportunities to offer other bank products or services. While the market and pricing for deposit funds are very competitive, the Bank believes that personalized, quality service is also an important element in retaining core deposit customers.

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

	December 31,					
	2003		2002		2001	
	Average Amount	Average Yield	Average Amount	Average Yield	Average Amount	Average Yield
	(Dollars in thousands)					
Demand deposits	$ 32,592	--	$ 30,102	--	$ 21,857	--
NOW and money market	58,723	1.02%	60,114	1.28%	51,026	2.64%
Savings deposits	143,094	1.95	56,217	1.56	34,168	2.69
Time deposits	333,112	2.26	273,452	3.21	155,079	5.07
Total deposits	$567,521	1.78%	$419,885	2.48%	$262,130	3.89%

The aggregate amount of jumbo certificates of deposit, each with a minimum denomination of $100,000, was approximately $110.08 million, $108.72 million and $68.88 million at December 31, 2003, 2002 and 2001, respectively.

The following table summarizes the maturity distribution of time deposits of $100,000 or more as of December 31, 2003:

	(In thousands)
3 months or less	$ 48,136
Over 3 months but within 6 months	30,913
Over 6 months but within 12 months	22,746
Over 12 months	8,285

Total	$110,080

Short-Term Borrowings

Securities sold under agreements to repurchase generally mature within 30 days from the date of the transactions. Short-term bor