

BERKSHIRE BANCORP INC /DE/
Form 10-Q
August 03, 2006

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

FORM 10-Q

(Mark One)

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

For the quarterly period ended June 30, 2006

or

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

For the transition period from _____ to _____

Commission file number: 0-13649

BERKSHIRE BANCORP INC.

(Exact name of registrant as specified in its charter)

Delaware

(State or other jurisdiction of
incorporation or organization)

94-2563513

(I.R.S. Employer
Identification No.)

160 Broadway, New York, New York

(Address of principal executive offices)

10038

(Zip Code)

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

N/A

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

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

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Indicate by check mark whether the Registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act. Large accelerated filer [] Accelerated filer [] Non-accelerated filer [X]

Indicate by check mark whether the Registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act. Yes [] No [X]

As of July 31, 2006, there were 6,898,556 outstanding shares of the issuers Common Stock, \$.10 par value.

BERKSHIRE BANCORP INC. AND SUBSIDIARIES

FORWARD-LOOKING STATEMENTS

Forward-Looking Statements. Statements in this Quarterly Report on Form 10-Q that are not based on historical fact may be "forward-looking statements" within the meaning of the Private Securities Litigation Reform Act of 1995. Words such as "believe", "may", "will", "expect", "estimate", "anticipate", "continue" or similar terms identify forward-looking statements. A wide variety of factors could cause the Company's actual results and experiences to differ materially from the results expressed or implied by the Company's forward-looking statements. Some of the risks and uncertainties that may affect operations, performance, results of the Company's business, the interest rate sensitivity of its assets and liabilities, and the adequacy of its loan loss allowance, include, but are not limited to: (i) deterioration in local, regional, national or global economic conditions which could result, among other things, in an increase in loan delinquencies, a decrease in property values, or a change in the housing turnover rate; (ii) changes in market interest rates or changes in the speed at which market interest rates change; (iii) changes in laws and regulations affecting the financial services industry; (iv) changes in competition; (v) changes in consumer preferences, (vi) changes in banking technology; (vii) ability to maintain key members of management, (viii) possible disruptions in the Company's operations at its banking facilities, (ix) cost of compliance with new corporate governance requirements, and other factors referred to in the sections of this Quarterly 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 Quarterly Report. Forward-looking statements speak only as of the date they were made and the Company assumes no obligation to update or revise any such statements upon any change in applicable circumstances.

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

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

| | June 30, 2006 |
|--|------------------|
| | |
| ASSETS | |
| Cash and due from banks | \$ 6,561 |
| Interest bearing deposits | 4,053 |
| Federal funds sold | 11,250 |
| | ----- |
| Total cash and cash equivalents | 21,864 |
| Investment Securities: | |
| Available-for-sale | 555,708 |
| Held-to-maturity, fair value of \$482 in 2006 and \$573 in 2005 | 488 |
| | ----- |
| Total investment securities | 556,196 |
| Loans, net of unearned income | 315,891 |
| Less: allowance for loan losses | (3,360) |
| | ----- |
| Net loans | 312,531 |
| Accrued interest receivable | 6,698 |
| Premises and equipment, net | 9,611 |
| Goodwill, net | 18,549 |
| Other assets | 11,026 |
| | ----- |
| Total assets | \$ 936,475 |
| | ===== |
| LIABILITIES AND STOCKHOLDERS' EQUITY | |
| Deposits: | |
| Non-interest bearing | \$ 57,561 |
| Interest bearing | 609,893 |
| | ----- |
| Total deposits | 667,454 |
| Securities sold under agreements to repurchase | 59,880 |
| Long term borrowings | 66,970 |
| Subordinated debt | 22,681 |
| Accrued interest payable | 7,598 |
| Other liabilities | 3,924 |
| | ----- |
| Total liabilities | 828,507 |

| | | |
|---|--|------------|
| Stockholders' equity | | |
| Preferred stock - \$.10 Par value: | | -- |
| 2,000,000 shares authorized - none issued | | |
| Common stock - \$.10 par value | | |
| Authorized -- 10,000,000 shares | | |
| Issued -- 7,698,285 shares | | |
| Outstanding -- | | |
| June 30, 2006, 6,898,556 shares | | |
| December 31, 2005, 6,890,556 shares | | 770 |
| Additional paid-in capital | | 90,600 |
| Retained earnings | | 35,371 |
| Accumulated other comprehensive loss, net | | (11,107) |
| Treasury Stock | | |
| June 30, 2006, 799,729 shares | | |
| December 31, 2005, 807,729 shares | | (7,666) |
| Total stockholders' equity | | 107,968 |
| | | \$ 936,475 |
| | | ===== |

The accompanying notes are an integral part of these statements

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

| | For The Three Months Ended June 30, | | |
|---|---|----------|----------|
| | 2006 | 2005 | 2006 |
| INTEREST INCOME | | | |
| Loans | \$ 5,585 | \$ 4,847 | \$ 11,08 |
| Investment securities | 6,150 | 6,473 | 12,40 |
| Federal funds sold and interest bearing deposits | 81 | 58 | 15 |

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| | | | |
|--|--------|----------|---------|
| Total interest income | 11,816 | 11,378 | 23,65 |
| | ----- | ----- | ----- |
| INTEREST EXPENSE | | | |
| Deposits | 5,345 | 3,224 | 10,20 |
| Short-term borrowings | 453 | 1,008 | 99 |
| Long-term borrowings | 1,147 | 1,353 | 2,35 |
| | ----- | ----- | ----- |
| Total interest expense | 6,945 | 5,585 | 13,55 |
| | ----- | ----- | ----- |
| Net interest income | 4,871 | 5,793 | 10,09 |
| PROVISION FOR LOAN LOSSES | 45 | 45 | 9 |
| | ----- | ----- | ----- |
| Net interest income after provision for loan losses | 4,826 | 5,748 | 10,00 |
| | ----- | ----- | ----- |
| NON-INTEREST INCOME | | | |
| Service charges on deposits | 146 | 145 | 28 |
| Investment securities gains | 2 | 3 | 74 |
| Other income | 158 | 137 | 33 |
| | ----- | ----- | ----- |
| Total non-interest income | 306 | 285 | 1,35 |
| | ----- | ----- | ----- |
| NON-INTEREST EXPENSE | | | |
| Salaries and employee benefits | 2,072 | 2,021 | 4,17 |
| Net occupancy expense | 491 | 477 | 96 |
| Equipment expense | 108 | 95 | 20 |
| FDIC assessment | 22 | 67 | 4 |
| Data processing expense | 91 | 49 | 18 |
| Other | 594 | 669 | 1,21 |
| | ----- | ----- | ----- |
| Total non-interest expense | 3,378 | 3,378 | 6,79 |
| | ----- | ----- | ----- |
| Income before provision for taxes | 1,754 | 2,655 | 4,57 |
| Provision for income taxes | 834 | 1,304 | 2,16 |
| | ----- | ----- | ----- |
| Net income | \$ 920 | \$ 1,351 | \$ 2,41 |
| | ===== | ===== | ===== |
| Net income per share: | | | |
| Basic | \$.13 | \$.20 | \$.3 |
| | ===== | ===== | ===== |
| Diluted | \$.13 | \$.20 | \$.3 |
| | ===== | ===== | ===== |
| Number of shares used to compute net income per share: | | | |
| Basic | 6,895 | 6,764 | 6,89 |
| | ===== | ===== | ===== |
| Diluted | 6,983 | 6,919 | 6,98 |
| | ===== | ===== | ===== |

The accompanying notes are an integral part of these statements.

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

For The Six Months Ended June 30, 2006 and 2005
(In Thousands)

| | Common Shares ----- | Stock Par value ----- | Additional paid-in capital ----- | Accumulated other comprehensive (loss), net ----- | Retained earnings ----- | Treasu stoc ----- |
|---|---------------------------|--------------------------------|---|---|-------------------------------|-------------------------|
| Balance at January 1, 2006 | 7,698 | \$770 | \$90,594 | \$ (8,415) | \$ 33,504 | \$ (7,7 |
| Net income | | | | | 2,416 | |
| Exercise of stock options | | | 6 | | | |
| Other comprehensive (loss) net of reclassification adjustment and taxes | | | | (2,692) | | |
| Comprehensive income (loss) | | | | | | |
| Cash dividends | | | | | (549) | |
| Balance at June 30, 2006 (Unaudited) | 7,698 ===== | \$770 ===== | \$90,600 ===== | \$ (11,107) ===== | \$ 35,371 ===== | \$ (7,6 ===== |
| Balance at January 1, 2005 | 7,698 | \$770 | \$89,543 | \$ (2,602) | \$ 28,983 | \$ (9,0 |
| Net income | | | | | 3,049 | |
| Exercise of stock options | | | 439 | | | 1 |
| Other comprehensive (loss) net of reclassification adjustment and taxes | | | | (1,515) | | |
| Comprehensive income | | | | | | |
| Cash dividends | | | | | (471) | |
| Balance at June 30, 2005 (Unaudited) | 7,698 ===== | \$770 ===== | \$89,982 ===== | \$ (4,117) ===== | \$ 31,561 ===== | \$ (8,9 ===== |

The accompanying notes are an integral part of this statement.

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

| | For The Six Months June 30, |
|--|--------------------------------|
| | ----- 2006 ----- |
| Cash flows from operating activities: | |
| Net income | \$ 2,416 |
| Adjustments to reconcile net income to net cash (used in) provided by operating activities: | |
| Realized gains on investment securities | (743) |
| Net (accretion) amortization of premiums of investment securities | (368) |
| Depreciation and amortization | 359 |
| Provision for loan losses | 90 |
| Decrease (increase) in accrued interest receivable | 86 |
| Increase in other assets | (1,327) |
| Increase in accrued interest payable and other liabilities | 1,966 |
| | ----- |
| Net cash provided by operating activities | 2,479 ----- |
| Cash flows from investing activities: | |
| Investment securities available for sale | |
| Purchases | (187,912) |
| Sales, maturities and calls | 230,033 |
| Investment securities held to maturity | |
| Maturities | 74 |
| Net increase in loans | (6,657) |
| Acquisition of premises and equipment | (1,368) |
| | ----- |
| Net cash provided by (used in) investing activities | 34,170 ----- |

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(in thousands)
(unaudited)

| | For The Six Months June 30, |
|--|--------------------------------|
| | ----- 2006 ----- |
| Cash flows from financing activities: | |
| Net increase in non interest bearing deposits | 7,292 |
| Net decrease in interest bearing deposits | (20,098) |
| (Decrease) increase in securities sold under agreements to repurchase | (13,164) |
| Proceeds from long term debt | -- |
| Repayment of long term debt | (16,231) |
| Proceeds from issuance of subordinated debentures | -- |
| Proceeds from exercise of common stock options | 83 |
| Dividends paid | (549) |
| | ----- |
| Net cash (used in) provided by financing activities | (42,667) |
| | ----- |
| Net (decrease) in cash and cash equivalents | (6,018) |
| Cash and cash equivalents - beginning of period | 27,882 |
| | ----- |
| Cash and cash equivalents - end of period | \$ 21,864 |
| | ===== |
| Supplemental disclosure of cash flow information: | |
| Cash used to pay interest | \$ 11,685 |
| Cash used to pay taxes, net of refunds | \$ 2,825 |

The accompanying notes are an integral part of these statements.

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BERKSHIRE BANCORP INC. AND SUBSIDIARIES Notes to Consolidated Financial Statements June 30, 2006 and 2005

NOTE 1. General

Berkshire Bancorp Inc., a Delaware corporation, is a bank holding company registered under the Bank Holding Company Act of 1956. References herein to "Berkshire", the "Company" or "we" and similar pronouns, shall be deemed to refer to Berkshire Bancorp Inc. and its consolidated subsidiaries unless the context otherwise requires. Berkshire's principal activity is the ownership and management of its wholly owned subsidiary, The Berkshire Bank (the "Bank"), a New York State chartered commercial bank.

The accompanying financial statements of Berkshire Bancorp Inc. and subsidiaries includes the accounts of the parent company, Berkshire Bancorp Inc., and its wholly-owned subsidiaries: The Berkshire Bank, Greater American Finance Group, Inc. and East 39, LLC.

We have prepared the accompanying financial statements pursuant to the rules and regulations of the Securities and Exchange Commission (the "SEC") for interim financial reporting. These consolidated financial statements are unaudited and, in our opinion, include all adjustments, consisting of normal recurring adjustments and accruals necessary for a fair presentation of our consolidated balance sheets, operating results, and cash flows for the periods presented. Operating results for the periods presented are not necessarily indicative of the results that may be expected for 2006 due to a variety of factors. Certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States ("GAAP") have been omitted in accordance with the rules and regulations of the SEC. These consolidated financial statements should be read in conjunction with the audited consolidated financial statements and accompanying notes included in our 2005 Annual Report on Form 10-K.

NOTE 2. Trust Preferred Securities.

As of May 18 2004, the Company established Berkshire Capital Trust I, a Delaware statutory trust, ("BCTI"). The Company owns all the common capital securities of BCTI. BCTI issued \$15.0 million of preferred capital securities to investors in a private transaction and invested the proceeds, combined with the proceeds from the sale of BCTI's common capital securities, in the Company through the purchase of \$15.464 million aggregate principal amount of Floating Rate Junior Subordinated Debentures (the "2004 Debentures") issued by the Company. The 2004 Debentures, the sole assets of BCTI, mature on July 23, 2034 and bear interest at a floating rate, three month LIBOR plus 2.70%.

On April 1, 2005, the Company established Berkshire Capital Trust II, a Delaware statutory trust, ("BCTII"). The Company owns all the common capital securities of BCTII. BCTII issued \$7.0 million of preferred capital securities to investors in a private transaction and invested the proceeds, combined with the proceeds from the sale of BCTII's common capital securities, in the Company through the purchase of \$7.217 million aggregate principal amount of Floating Rate Junior Subordinated Debentures (the "2005 Debentures") issued by the Company. The 2005 Debentures, the sole assets of BCTII, mature on May 23, 2035 and bear interest at a floating rate, three month LIBOR plus 1.95%.

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

Note 2. - (continued)

Based on current interpretations of the banking regulators, the 2004 Debentures and 2005 Debentures (collectively, the "Debentures") qualify under the risk-based capital guidelines of the Federal Reserve as Tier 1 capital, subject to certain limitations. The Debentures are callable by the Company, subject to any required regulatory approvals, at par, in whole or in part, at any time after five years from the date of issuance. The Company's obligations under the Debentures and related documents, taken together, constitute a full, irrevocable and unconditional guarantee on a subordinated basis by the Company of the obligations of BCTI and BCTII under the preferred capital securities sold by BCTI and BCTII to investors. FIN46(R) precludes consideration of the call option embedded in the preferred capital securities when determining if the Company has the right to a majority of BCTI and BCTII expected residual returns. Accordingly, BCTI and BCTII are not included in the consolidated balance sheet of the Company.

The Federal Reserve has issued guidance on the regulatory capital treatment for the trust-preferred securities issued by BCTI and BCTII. This rule would retain the current maximum percentage of total capital permitted for Trust Preferred Securities at 25%, but would enact other changes to the rules governing Trust Preferred Securities that affect their use as part of the collection of entities known as "restricted core capital elements." The rule would take effect March 31, 2009; however, a five year transition period starting March 31, 2004 and leading up to that date would allow bank holding companies to continue to count Trust Preferred Securities as Tier 1 Capital after applying FIN-46(R). Management has evaluated the effects of this rule and does not anticipate a material impact on its capital ratios when the proposed rule is finalized.

NOTE 3. Earnings Per Share

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

| For The Three Months Ended | | | |
|----------------------------|-------------------------|------------------------|-----------------------|
| ----- | | | |
| June 30, 2006 | | | |
| ----- | | | |
| Income (numerator) | Shares (denominator) | Per share amount | Income (numerator) |

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| | (In thousands, except per share data) | | | |
|--|---------------------------------------|-------|--------|----------|
| Basic earnings per share | | | | |
| Net income available to common stockholders | \$ 920 | 6,895 | \$.13 | \$ 1,351 |
| Effect of dilutive securities | | | | |
| Options | -- | 88 | .-- | -- |
| Diluted earnings per share | | | | |
| Net income available to common stockholders plus assumed conversions | \$ 920 | 6,983 | \$.13 | \$ 1,351 |

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

Note 3. - (continued)

| | For The Six Months Ended | | | |
|--|--------------------------|------------------------|------------------------|-----------------------|
| | June 30, 2006 | | | |
| | Income (numerator) | Shares denominator) | Per share amount | Income (numerator) |
| (In thousands, except per share data) | | | | |
| Basic earnings per share | | | | |
| Net income available to common stockholders | \$ 2,416 | 6,893 | \$.35 | \$ 3,049 |
| Effect of dilutive securities | | | | |
| Options | -- | 90 | .-- | -- |
| Diluted earnings per share | | | | |
| Net income available to common stockholders plus assumed conversions | \$ 2,416 | 6,983 | \$.35 | \$ 3,049 |

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NOTE 4. Investment Securities

The following tables summarize held to maturity and available-for-sale investment securities as of June 30, 2006 and December 31, 2005:

| | June 30, 2006 | | |
|---|-------------------|------------------------------|-------------------------------|
| | Amortized Cost | Gross unrealized gains | Gross unrealized losses |
| | (In thousands) | | |
| Held To Maturity Investment Securities | | | |
| U.S. Government Agencies | \$ 488 | \$ -- | \$ (6) |
| | ----- | ----- | ----- |
| Totals | \$ 488 | \$ -- | \$ (6) |
| | ===== | ===== | ===== |

| | December 31, 2005 | | |
|---|-------------------|------------------------------|-------------------------------|
| | Amortized Cost | Gross unrealized gains | Gross unrealized losses |
| | (In thousands) | | |
| Held To Maturity Investment Securities | | | |
| U.S. Government Agencies | \$ 562 | \$ 11 | \$ -- |
| | ----- | ----- | ----- |
| Totals | \$ 562 | \$ 11 | \$ -- |
| | ===== | ===== | ===== |

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Note 4. - (continued)

| | June 30, 2006 | | |
|--|-------------------|------------------------------|-------------------------------|
| | Amortized Cost | Gross unrealized gains | Gross unrealized losses |
| | (In thousands) | | |
| Available-For-Sale | | | |
| Investment Securities | | | |
| U.S. Treasury and Notes | \$ -- | \$ -- | \$ -- |
| U.S. Government Agencies | 424,708 | 4 | (12,846) |
| Mortgage-backed securities | 76,549 | 2 | (3,368) |
| Corporate notes | 37,494 | 96 | (1,526) |
| Municipal Securities | 1,973 | 749 | -- |
| Marketable equity securities and other | 31,682 | 254 | (63) |
| | ----- | ----- | ----- |
| Totals | \$572,406 | \$ 1,105 | \$(17,803) |
| | ===== | ===== | ===== |

| | December 31, 2005 | | |
|--|-------------------|------------------------------|-------------------------------|
| | Amortized Cost | Gross unrealized gains | Gross unrealized losses |
| | (In thousands) | | |
| Available-For-Sale | | | |
| Investment securities | | | |
| U.S. Treasury and Notes | \$ 14,985 | \$ -- | \$ (86) |
| U.S. Government Agencies | 448,196 | -- | (8,551) |
| Mortgage-backed securities | 81,681 | 112 | (2,107) |
| Corporate Notes | 54,590 | 352 | (2,638) |
| Municipal securities | 1,972 | 334 | -- |
| Marketable equity securities and other | 10,351 | 284 | (65) |
| | ----- | ----- | ----- |
| Totals | \$611,775 | \$ 1,082 | \$(13,447) |
| | ===== | ===== | ===== |

Financial Accounting Standards Board ("FASB") Staff Position No. FAS 115-1 and FAS 124-1, "The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments" (the "FSP"), was issued on November 3, 2005 and addresses the determination of when an investment is considered impaired; whether the impairment is other than temporary; and how to measure an impairment loss. The FSP also addresses accounting considerations subsequent to the recognition of an other-than-temporary impairment on a debt security, and requires certain disclosures about unrealized losses that have not been recognized as other-than-temporary impairments. The FSP replaces the impairment guidance in EITF Issue No. 03-1 with references to existing authoritative

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literature concerning other-than-temporary determinations (principally Statement of Financial Accounting Standards ("SFAS") No. 115 and SEC Staff Accounting Bulletin 59). Under the FSP, impairment losses must be recognized in earnings

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

Note 4. - (continued)

equal to the entire difference between the security's cost and its fair value at the financial statement date, without considering partial recoveries subsequent to that date. The FSP also requires that an investor recognize an other-than-temporary impairment loss when a decision to sell a security has been made and the investor does not expect the fair value of the security to fully recover prior to the expected time of sale. Application of the guidance in FSP FAS 115-1 and FAS 124-1 is applicable to reporting periods beginning after December 15, 2005. The company adopted FSP 115-1 and FAS 124-1 in the first quarter of fiscal year 2006, the adoption of which did not have an impact on its operating results and financial condition.

Our available-for-sale portfolio is carried at estimated fair value, with any unrealized gains or losses, net of taxes, reported as accumulated other comprehensive income or loss in stockholders' equity. Our held-to-maturity portfolio, consisting of debt securities for which we have a positive intent and ability to hold to maturity, is carried at amortized cost. We conduct a periodic review and evaluation of the securities portfolio to determine if the value of any security has declined below its cost or amortized cost, and whether such decline is other-than-temporary.

The company has investments in debt and equity securities that have unrealized losses, but an other-than-temporary impairment has not been recognized in its financial statements. Based upon management's review of the available information including the changes in interest rates during the period, current market conditions, applicable industry and company information specific to each investment, the creditworthiness of the issuer, and the Company's ability to hold the investment to maturity. Such unrealized losses are not considered to be other-than-temporary.

NOTE 5. Loan Portfolio

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

| | June 30, 2006 | | December |
|-----------------------------------|------------------------|------------|----------|
| | Amount | % of Total | Amount |
| | ----- | ----- | ----- |
| | (Dollars in thousands) | | |
| Commercial and professional loans | \$ 38,854 | 12.3% | \$ 33,37 |

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| | | | |
|------------------------------|-----------|--------|----------|
| Secured by real estate | | | |
| 1-4 family | 139,949 | 44.1 | 139,93 |
| Multi family | 4,440 | 1.4 | 2,87 |
| Non-residential (commercial) | 132,464 | 41.8 | 132,14 |
| Consumer | 1,182 | 0.4 | 2,01 |
| | ----- | ----- | ----- |
| Total loans | 316,889 | 100.0% | 310,33 |
| | | ===== | |
| Deferred loan fees | (998) | | (1,10) |
| Allowance for loan losses | (3,360) | | (3,26) |
| | ----- | | ----- |
| Loans, net | \$312,531 | | \$305,96 |
| | ===== | | ===== |

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

NOTE 6. Deposits

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

| | June 30, 2006 | | December 31, 2005 | |
|----------------------|---------------|------------------------|-------------------|---------|
| | ===== | | ===== | |
| | Average | Average | Average | Average |
| | Amount | Yield | Amount | Yield |
| | | (Dollars in thousands) | | |
| Demand deposits | \$ 47,767 | -- | \$ 44,739 | -- |
| NOW and money market | 39,426 | 0.62% | 42,756 | 0.56% |
| Savings deposits | 172,174 | 2.61 | 221,374 | 1.99 |
| Time deposits | 412,285 | 3.47 | 338,834 | 2.82 |
| | ----- | ----- | ----- | ----- |
| Total deposits | \$671,652 | 2.83% | \$647,703 | 2.19% |
| | ===== | ===== | ===== | ===== |

NOTE 7. Comprehensive Income

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

| | For The Six Months Ended | | | |
|---|--------------------------|-----------------------------|----------------------|----------------------|
| | June 30, 2006 | | | |
| | Before tax amount | Tax (expense) benefit | Net of tax Amount | Before tax amount |
| | (In thousands) | | | |
| Unrealized gains (losses) on investment securities: | | | | |
| Unrealized holding gains (losses) arising during period | \$ (3,590) | \$ 1,344 | \$ (2,246) | \$ (2,516) |
| Less reclassification adjustment for gains realized in net income | 743 | (297) | 446 | 9 |
| Other comprehensive income, net | \$ (4,333) | \$ 1,641 | \$ (2,692) | \$ (2,525) |
| | ===== | ===== | ===== | ===== |

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

NOTE 8. Accounting For Stock Based Compensation

In December 2004, the Financial Accounting Standards Board (the "FASB") issued Statement No. 123 (revised 2004), "Share-Based Payment" ("SFAS 123(R)") which requires the measurement and recognition of compensation expense for all stock-based compensation payments and supersedes the Company's current accounting under Accounting Principals Board Opinion No. 25, "Accounting for Stock Issued to Employees" (APB 25). SFAS 123(R) is effective for all annual periods beginning after June 15, 2005 or our fiscal year 2006. In March 2005, the Securities and Exchange Commission (the "SEC") issued Staff Accounting Bulletin No. 107 ("SAB 107") relating to the adoption of SFAS 123(R).

The Company adopted SFAS 123(R) in the first quarter of fiscal year 2006, the adoption of which did not have an impact on its operating results and financial condition.

At June 30, 2006, the Company has one stock-based employee compensation plan. Prior to the adoption of SFAS 123(R), the Company accounted for that plan

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under the recognition and measurement principles of APB 25 and related interpretations. Stock-based employee compensation costs were not reflected in net income, as all options granted under the plan had an exercise price equal to the market value of the underlying common stock on the date of the grant. The Company did not grant stock options during the six-month period ended June 30, 2006 or during the fiscal year ended December 31, 2005. We have no plans to grant significant stock options, if any, during the last six months of 2006. Therefore, we do not expect the implementation of FAS 123(R) to affect our financial position or results of operations in the near future.

NOTE 9. Employee Benefit Plans

The Company has a Retirement Income Plan (the "Plan"), a noncontributory plan covering substantially all full-time, non-union United States employees of the Company. The following interim-period information is being provided in accordance with FASB Statement 132(R).

| | For The Three Months Ended June 30, | | For Th Six Months June 30 |
|--------------------------------|---|-----------|---------------------------------|
| | 2006 | 2005 | 2006 |
| Service cost | \$ 90,357 | \$ 79,381 | \$ 172,357 |
| Interest cost | 37,531 | 35,425 | 74,531 |
| Expected return on plan assets | (37,710) | (38,940) | (75,710) |
| Amortization and Deferral: | | | |
| Transition amount | -- | -- | -- |
| Prior service cost | 4,457 | 4,593 | 9,457 |
| (Gain)/loss | 15,429 | 11,228 | 29,429 |
| Net periodic pension cost | 110,063 | 91,687 | 210,063 |

During the fiscal year ending December 31, 2006, we expect to contribute approximately \$333,000 to the Plan. We contributed \$56,000 in April 2006 and \$221,000 in July 2006. We did not make any contributions, required or otherwise, to the Plan in the three and six months ended June 30, 2005.

Note 10. New Accounting Pronouncements

On July 13, 2006, the FASB issued FASB Interpretation No. 48,

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"Accounting for Uncertainty in Income Taxes" ("FIN No. 48"): an interpretation of FASB No. 109. FIN No. 48 clarifies the accounting for uncertainty involved in the recognition and measurement of a tax position taken or expected to be taken in a tax return. FIN No. 48 is effective for fiscal years beginning after December 15, 2006. The application of FIN No. 48 is not expected to have an impact on the company's financial condition or results of operations.

In February 2006, the FASB issued SFAS No. 155, "Accounting for Certain Hybrid Financial Instruments—an amendment of FASB statements No. 133 and 140." This statement permits fair value remeasurement of certain hybrid financial instruments, clarifies the scope of SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities" regarding interest-only and principal-only strips, and provides further guidance on certain issues regarding beneficial interests in securitized financial assets, concentrations of credit risk and qualifying special purpose entities. SFAS No. 155 is effective as of the beginning of the fiscal year that begins after September 15, 2006. The application of SFAS No. 155 is not expected to have an impact on the company's financial condition or results of operations.

In March 2006, the FASB issued SFAS No. 156, "Accounting for Servicing of Financial Assets—an amendment of FASB Statement No. 140." This statement requires an entity to recognize a servicing asset or servicing liability each time it undertakes an obligation to service a financial asset, and that the servicing assets and servicing liabilities be initially measured at fair value. The statement also permits an entity to choose a subsequent measurement method for each class of separately recognized servicing assets and servicing liabilities. SFAS No. 156 is effective as of the beginning of the fiscal year that begins after September 15, 2006. The application of SFAS No. 156 is not expected to have a material impact on the company's financial condition or results of operations.

Internal Control Over Financial Reporting

The current objective of the Bank's Internal Control Program is to allow management to comply with FDICIA requirements and with Section 302 of the Sarbanes-Oxley Act of 2002 (the "Act"). Section 302 of the Act requires the CEO and CFO of the Company to (i) certify that the annual and quarterly reports filed with the Securities and Exchange Commission are accurate and (ii) acknowledge that they are responsible for establishing, maintaining and periodically evaluating the effectiveness of the disclosure controls and procedures. Section 404 of the Act requires management to report on internal control over financial reporting. Presently, the SEC requires the Company to

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first comply with Section 404 by the year ending December 31, 2007.

The Committee of Sponsoring Organizations (COSO) methodology may be used to document and test the internal controls pertaining to the accuracy of Company issued financial statements and related disclosures. COSO requires a review of the control environment (including anti-fraud and audit committee effectiveness), risk assessment, control activities, information and communication, and ongoing monitoring.

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

The following discussion and analysis is intended to provide a better understanding of the consolidated financial condition and results of operations of Berkshire Bancorp Inc., a Delaware corporation. References herein to "Berkshire", the "Company" or "we" and similar pronouns, shall be deemed to refer to Berkshire Bancorp Inc. and its consolidated subsidiaries unless the context otherwise requires. References herein to per share amounts refer to diluted shares. References to Notes herein are references to the "Notes to Consolidated Financial Statements" of the Company located in Item 1 herein.

The accompanying financial statements of Berkshire Bancorp Inc. and subsidiaries includes the accounts of the parent company, Berkshire Bancorp Inc., and its wholly-owned subsidiaries: The Berkshire Bank, Greater American Finance Group, Inc. and East 39, LLC.

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 banking 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 Statement of Financial Accounting Standards ("SFAS") No. 142 ("SFAS No. 142") on January 1, 2002, the Company discontinued

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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 the Bank. 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, 2005, 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.

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

| | For The Three Months Ended June | | | |
|---------------------------------|---------------------------------|------------------------------|-----------------------|--------------------|
| | 2006 | | | |
| | Average Balance | Interest and Dividends | Average Yield/Rate | Average Balance |
| | ----- | ----- | ----- | ----- |
| | (Dollars in Thousands) | | | |
| INTEREST-EARNING ASSETS: | | | | |
| Loans (1) | \$ 312,490 | \$ 5,585 | 7.15% | \$ 288,073 |
| Investment securities | 569,760 | 6,150 | 4.32 | 666,991 |
| Other (2) (5) | 8,237 | 81 | 3.93 | 8,890 |
| | ----- | ----- | ----- | ----- |
| Total interest-earning assets | 890,487 | 11,816 | 5.31 | 963,954 |

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| | | | | |
|--|---------|-------|-------|-----------|
| Noninterest-earning assets | 46,747 | | | 45,186 |
| | ----- | | | ----- |
| Total Assets | 937,234 | | | 1,009,140 |
| | ===== | | | ===== |
| INTEREST-BEARING LIABILITIES: | | | | |
| Interest bearing deposits | 208,559 | 1,223 | 2.35% | 277,810 |
| Time deposits | 411,614 | 4,122 | 4.01 | 306,881 |
| Other borrowings | 146,017 | 1,600 | 4.38 | 262,814 |
| | ----- | ----- | ----- | ----- |
| Total interest-bearing liabilities | 766,190 | 6,945 | 3.63 | 847,505 |
| | | ----- | ----- | |
| Demand deposits | 49,097 | | | 47,331 |
| Noninterest-bearing liabilities | 12,610 | | | 9,391 |
| Stockholders' equity (5) | 109,337 | | | 104,913 |
| | ----- | | | ----- |
| Total liabilities and stockholders' equity | 937,234 | | | 1,009,140 |
| | ===== | | | ===== |
| Net interest income | | 4,871 | | |
| | | ===== | | |
| Interest-rate spread (3) | | | 1.68% | |
| | | | ===== | |
| Net interest margin (4) | | | 2.19% | |
| | | | ===== | |
| Ratio of average interest-earning assets to average interest bearing liabilities | 1.16 | | | 1.14 |
| | ===== | | | ===== |

(1) Includes nonaccrual loans.

(2) Includes interest-bearing deposits, federal funds sold and securities purchased under agreements to resell.

(3) Interest-rate spread represents the difference between the average yield on interest-earning assets and the average cost of interest bearing liabilities.

(4) Net interest margin is net interest income as a percentage of average interest-earning assets.

(5) Average balances are daily average balances except for the parent company which have been calculated on a monthly basis.

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For The Six Months Ended June 30, 2006

| | 2006 | | | |
|--|------------------------|------------------------------|-----------------------|--------------------|
| | Average Balance | Interest and Dividends | Average Yield/Rate | Average Balance |
| | (Dollars in Thousands) | | | |
| INTEREST-EARNING ASSETS: | | | | |
| Loans (1) | \$ 311,256 | \$ 11,089 | 7.13% | \$ 288,186 |
| Investment securities | 582,073 | 12,405 | 4.26 | 669,449 |
| Other (2) (5) | 8,366 | 157 | 3.75 | 12,764 |
| Total interest-earning assets | 901,695 | 23,651 | 5.25 | 970,399 |
| Noninterest-earning assets | 46,551 | | | 43,857 |
| Total Assets | 948,246 | | | 1,014,256 |
| INTEREST-BEARING LIABILITIES: | | | | |
| Interest bearing deposits | 211,600 | 2,367 | 2.24% | 300,686 |
| Time deposits | 412,285 | 7,833 | 3.80 | 301,718 |
| Other borrowings | 155,160 | 3,352 | 4.32 | 251,684 |
| Total interest-bearing liabilities | 779,045 | 13,552 | 3.48 | 854,088 |
| Demand deposits | 47,767 | | | 45,530 |
| Noninterest-bearing liabilities | 11,477 | | | 6,862 |
| Stockholders' equity (5) | 109,957 | | | 107,776 |
| Total liabilities and stockholders' equity | 948,246 | | | 1,014,256 |
| Net interest income | | 10,099 | | |
| Interest-rate spread (3) | | | 1.77% | |
| Net interest margin (4) | | | 2.24% | |
| Ratio of average interest-earning assets to average interest bearing liabilities | 1.16 | | | 1.14 |

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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 are daily average balances except for the parent company which have been calculated on a monthly basis.

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Results of Operations

Results of Operations for the Three and Six Months Ended June 30, 2006 Compared to the Three and Six Months Ended June 30, 2005.

General. Berkshire Bancorp Inc., a bank holding company registered under the Bank Holding Company Act of 1956, has one wholly-owned banking subsidiary, The Berkshire Bank, a New York State chartered commercial bank. The Bank is headquartered in Manhattan and has eleven branch locations, six branches in New York City, four branches in Orange and Sullivan counties New York, and one branch in Ridgefield, New Jersey which opened in May 2006.

Net Income. Net income for the three-month period ended June 30, 2006 was \$920,000, or \$.13 per share, as compared to \$1.35 million, or \$.20 per share, for the three-month period ended June 30, 2005. Net income for the six-month period ended June 30, 2006 was \$2.42 million, or \$.35 per share, as compared to \$3.05 million, or \$.44 per share, for the six-month period ended June 30, 2005.

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. From June 2003 through June 30, 2004, interest rates, as measured by the prime rate, remained constant at 4.00%. On July 1, 2004, inflation fighting actions taken by the Federal Reserve Board resulted in a 25 basis point increase in the prime rate to 4.25%, the first such increase in more than four years. Similar 25 basis point moves taken by the Federal Reserve Board during 2004, 2005 and 2006 have moved the prime rate to its present level of 8.25%. The difference between the yield on short-term, 3-month U.S. Treasury Notes, and long-term, 10-year U.S. Treasury Bonds, referred to as the yield curve is at historic lows.

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 quarter ended June 30, 2006, net interest income decreased by

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\$922,000 to \$4.87 million from \$5.79 million for the quarter ended June 30, 2005. The quarter over quarter decrease in net interest income was due to the 99 basis point increase in the average rates paid on the average amount of interest-bearing liabilities to 3.63% in the 2006 quarter from 2.64% in the 2005 quarter. Partially offsetting such rate increase was the 59 basis point increase in the average yields earned on interest-earning assets to 5.31% in the 2006 quarter from 4.72% in the 2005 quarter. The interest-rate spread, the difference between the average yield on interest-earning assets and the average cost of interest-bearing liabilities, narrowed by 40 basis points to 1.68% in the 2006 quarter from 2.08% in the 2005 quarter.

For the six-month period ended June 30, 2006, net interest income decreased by \$1.85 million to \$10.10 million from \$11.95 million for the six-month period ended June 30, 2005. The period over period decrease in net interest income was due to the 104 basis point increase in the average rates paid on the average amount of interest-bearing liabilities to 3.48% in the 2006 period from 2.44% in the 2005 period. Partially offsetting such rate increase was the 64 basis point increase in the average yields earned on interest-earning assets to 5.25% in the 2006 period from 4.61% in the 2005 period. The interest-rate spread narrowed by 40 basis points to 1.77% in the 2006 period from 2.17% in the 2005 period.

If interest rates remain at current levels or increase slowly over time, 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 2005 have been replaced with securities carrying somewhat lower yields and, by design, shorter maturities to

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partially hedge against a rising interest rate environment. Rates paid on deposit accounts are likely to increase in a rising rate environment due to competition for deposits in the market place. The cost of borrowed funds with floating rather than fixed interest rates will increase as well.

Net Interest Margin. Net interest margin, or annualized net interest income as a percentage of average interest-earning assets, declined by 21 basis points to 2.19% in the second quarter of fiscal 2006 from 2.40% in the second quarter of fiscal 2005, and declined by 21 basis points to 2.24% in the six-month period ended June 30, 2006 from 2.46% in the six-month period ended June 30, 2005. We seek to secure and retain customer deposits with competitive products and rates, and to make strategic use of the prevailing interest rate environment to borrow funds at what we believe to be attractive rates. We invest such deposits and borrowed funds in a prudent mix of fixed and adjustable rate loans, investment securities and short-term interest-earning assets which provided an aggregate average yield of 5.31% and 5.25% in the three and six months ended June 30, 2006, respectively, compared to 4.72% and 4.61% in the three and six months ended June 30, 2005, respectively. The increased yield is the result of the rising interest rate environment discussed above which triggers the upward rate adjustment in our portfolio of adjustable rate loans and investment securities.

For the three months ended June 30, 2006, the average amount of total interest-earning assets decreased by approximately \$73.47 million to \$890.49 million from \$963.95 million for the three months ended June 30, 2005. Loans increased by \$24.42 million, investment securities and other interest-earning

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assets decreased by \$97.23 million and \$653,000, respectively.

For the six months ended June 30, 2006, the average amount of total interest-earning assets decreased by approximately \$68.70 million to \$901.70 million from \$970.40 million for the six months ended June 30, 2005. Loans increased by \$23.07 million, investment securities and other interest-earning assets decreased by \$87.38 million and \$4.40 million, respectively.

Interest Income. Total interest income for the quarter ended June 30, 2006 increased by approximately \$438,000 to \$11.82 million from \$11.38 million for the quarter ended June 30, 2005. Total interest income for the six months ended June 30, 2006 increased by approximately \$1.31 million to \$23.65 million from \$22.35 million for the six months ended June 30, 2005. The increase in total interest income was due to higher average yields on interest-earning assets, partially offset by lower average balances, in the 2006 periods compared to the 2005 periods.

| Three Months Ended June 30, | | | | |
|------------------------------------|--------------------|---------------|--------------------|---------------|
| 2006 | | | 2005 | |
| | Interest Income | % of Total | Interest Income | % of Total |
| (In thousands, except percentages) | | | | |
| Loans | \$ 5,585 | 47.27% | \$ 4,847 | 42.60% |
| Investment Securities | 6,150 | 52.04 | 6,473 | 56.89 |
| Other | 81 | 0.69 | 58 | 0.51 |
| | ----- | ----- | ----- | ----- |
| Total Interest Income | \$11,816 | 100.00% | \$11,378 | 100.00% |

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| Six Months Ended June 30, | | | |
|---------------------------|------|----------|------|
| 2006 | | 2005 | |
| Interest | % of | Interest | % of |

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| | Income | Total | Income | Total |
|-----------------------|------------------------------------|---------|----------|---------|
| | (In thousands, except percentages) | | | |
| Loans | \$11,089 | 46.89% | \$ 9,541 | 42.70% |
| Investment Securities | 12,405 | 52.45 | 12,652 | 56.62 |
| Other | 157 | 0.66 | 152 | 0.68 |
| | ----- | ----- | ----- | ----- |
| Total Interest Income | \$23,651 | 100.00% | \$22,345 | 100.00% |

Loans, which are inherently risky and therefore command a higher return than our conservative portfolio of investment securities, have increased slightly as a percentage of total average interest-earning assets. During the three and six months ended June 30, 2006, the average amounts of our loan portfolio represented 35.09% and 34.52%, respectively, of total interest-earning assets compared to 29.89% and 29.70%, respectively, for the three and six months ended June 30, 2005. The average amount of investment securities have decreased to 63.99% and 64.55% of interest-earning assets during the three and six months of 2006, respectively, compared to 69.19% and 68.98%, respectively, during the three and six months ended June 30, 2005.

| | ----- Three Months Ended June 30, ----- | | | |
|-------------------------------|---|---|-------------------|--|
| | 2006 | | 2005 | |
| | Average Amount | % of Total (In thousands, except percentages) | Average Amount | |
| Loans | \$312,490 | 35.09% | \$288,073 | |
| Investment Securities | 569,760 | 63.99 | 666,991 | |
| Other | 8,237 | 0.92 | 8,890 | |
| | ----- | ----- | ----- | |
| Total Interest-Earning Assets | \$890,487 | 100.00% | \$963,954 | |

| | ----- Six Months Ended June 30, ----- | | | |
|-------------------------------|---|---|-------------------|--|
| | 2006 | | 2005 | |
| | Average Amount | % of Total (In thousands, except percentages) | Average Amount | |
| Loans | \$311,256 | 34.52% | \$288,186 | |
| Investment Securities | 582,073 | 64.55 | 669,449 | |
| Other | 8,366 | 0.93 | 12,764 | |
| | ----- | ----- | ----- | |
| Total Interest-Earning Assets | \$901,695 | 100.00% | \$970,399 | |

Interest Expense. Total interest expense for the quarter ended June 30, 2006

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increased by \$1.36 million to \$6.95 million from \$5.59 million for the quarter ended June 30, 2005. The increase in interest expense was due to the increase in the average rates paid on interest-bearing liabilities, 3.63% and 2.64% in the 2006 and 2005 quarters, respectively, partially offset by the decrease in the average amounts of such liabilities. In 2004 and 2005, we sold \$22.68 million of floating rate junior subordinated debentures (the "Debentures") and used the net proceeds to augment the Bank's capital to allow for business expansion. The interest expense on these Debentures, which is included in other borrowings, was approximately \$428,000 and \$343,000 during the three months ended June 30, 2006 and 2005, respectively.

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| | Three Months Ended June 30, | | | |
|---------------------------|------------------------------------|------------|------------------|------------|
| | 2006 | | 2005 | |
| | Interest Expense | % of Total | Interest Expense | % of Total |
| | (In thousands, except percentages) | | | |
| Interest-Bearing Deposits | \$ 1,223 | 17.61% | \$ 1,170 | 22.4 |
| Time Deposits | 4,122 | 59.35 | 2,054 | 40.5 |
| Other Borrowings | 1,600 | 23.04 | 2,361 | 37.0 |
| Total Interest Expense | \$ 6,945 | 100.00% | \$ 5,585 | 100.0 |

Total interest expense for the six-month period ended June 30, 2006 increased by \$3.15 million to \$13.55 million from \$10.40 million for the six-month period ended June 30, 2005. The increase in interest expense was due primarily to the increase in the average rates paid on interest-bearing liabilities, 3.48% and 2.44% in the 2006 and 2005 periods, respectively, partially offset by the decrease in the average amounts of such liabilities. The interest expense on the Debentures, which is included in other borrowings was, approximately \$852,000 and \$549,000 during the 2006 and 2005 six-month periods, respectively.

| | Six Months Ended June 30, | | | |
|---------------------------|------------------------------------|------------|------------------|------------|
| | 2006 | | 2005 | |
| | Interest Expense | % of Total | Interest Expense | % of Total |
| | (In thousands, except percentages) | | | |
| Interest-Bearing Deposits | \$ 2,367 | 17.47% | \$ 2,508 | 24.1 |
| Time Deposits | 7,833 | 57.80 | 3,607 | 34.6 |
| Other Borrowings | 3,352 | 24.73 | 4,284 | 41.1 |

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| | | | | |
|------------------------|-----------|---------|-----------|---------|
| Total Interest Expense | \$ 13,552 | 100.00% | \$ 10,399 | 100.00% |
|------------------------|-----------|---------|-----------|---------|

Non-Interest Income. Non-interest income consists primarily of realized gains on sales of marketable securities and service fee income. For the three and six months ended June 30, 2006, non-interest income amounted to \$306,000 and \$1.40 million, respectively, compared to non-interest income of \$285,000 and \$554,000 for the three and six months ended June 30, 2005, respectively.

| | Three Months Ended June 30, | | | 2005 | |
|-----------------------------|------------------------------------|-------------|--|------------------------|-------------|
| | 2006 | % | | 2005 | % |
| | Non-Interest Income | of Total | | Non-Interest Income | of Total |
| | (In thousands, except percentages) | | | | |
| Service Charges on Deposits | \$ 146 | 47.72% | | \$ 145 | |
| Investment Securities gains | 2 | 0.65 | | 3 | |
| Other | 158 | 51.63 | | 137 | |
| Total Non-Interest Income | \$ 306 | 100.00% | | \$ 285 | |

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| | Six Months Ended June 30, | | | 2005 | |
|-----------------------------|------------------------------------|-------------|--|------------------------|-------------|
| | 2006 | % | | 2005 | % |
| | Non-Interest Income | of Total | | Non-Interest Income | of Total |
| | (In thousands, except percentages) | | | | |
| Service Charges on Deposits | \$ 286 | 21.04% | | \$ 278 | |
| Investment Securities gains | 743 | 54.68 | | 9 | |
| Other | 330 | 24.28 | | 267 | |
| Total Non-Interest Income | \$ 1,359 | 100.00% | | \$ 554 | |

Non-Interest Expense. Non-interest expense includes salaries and employee

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benefits, occupancy and equipment expenses, legal and professional fees and other operating expenses associated with the day-to-day operations of the Company. Total non-interest expense for the three and six-month periods ended June 30, 2006 was \$3.38 million and \$6.79 million, respectively, compared to \$3.38 million and \$6.57 million for the three and six month-periods ended June 30, 2005, respectively. The increase in the 2006 period is primarily due to the expansion of our business. We have added space and staff to maintain and enhance customer service levels and to insure our compliance with various regulatory matters.

| | Three Months Ended June 30, | | |
|--------------------------------|------------------------------------|------------|----------------------|
| | 2006 | | 2005 |
| | Non-Interest Expense | % of Total | Non-Interest Expense |
| | (In thousands, except percentages) | | |
| Salaries and Employee Benefits | \$ 2,072 | 61.34% | \$ 2,020 |
| Net Occupancy Expense | 491 | 14.54 | 470 |
| Equipment Expense | 108 | 3.20 | 90 |
| FDIC Assessment | 22 | 0.65 | 60 |
| Data Processing Expense | 91 | 2.69 | 40 |
| Other | 594 | 17.58 | 660 |
| Total Non-Interest Expense | \$ 3,378 | 100.00% | \$ 3,370 |

| | Six Months Ended June 30, | | |
|--------------------------------|------------------------------------|------------|----------------------|
| | 2006 | | 2005 |
| | Non-Interest Expense | % of Total | Non-Interest Expense |
| | (In thousands, except percentages) | | |
| Salaries and Employee Benefits | \$ 4,179 | 61.54% | \$ 3,970 |
| Net Occupancy Expense | 966 | 14.22 | 850 |
| Equipment Expense | 204 | 3.00 | 190 |
| FDIC Assessment | 43 | 0.63 | 130 |
| Data Processing Expense | 181 | 2.67 | 90 |
| Other | 1,218 | 17.94 | 1,310 |
| Total Non-Interest Expense | \$6,791 | 100.00% | \$ 6,570 |

Provision for Income Tax. During the three and six-month periods ended June 30, 2006, the Company recorded income tax expense of \$834,000 and \$2.16 million, respectively, compared to income tax expense of \$1.30 million and \$2.79 million, respectively, for the three and six-month periods ended June 30, 2005. The tax provisions for federal, state and local taxes recorded for the first six month of 2006 and 2005 represent effective tax rates of 47.21% and 47.78%, respectively.

Common Stock Repurchases

On May 15, 2003, The Company's Board of Directors authorized the purchase of up to an additional 450,000 shares of its Common Stock in the open market, from time to time, depending upon prevailing market conditions, thereby increasing the maximum number of shares which may be purchased by the Company from 1,950,000 shares of Common Stock to 2,400,000 shares of Common Stock. Since 1990 through December 31, 2004, the Company has purchased a total of 1,844,646 shares of its Common Stock. At June 30, 2005, there were 551,091 shares of Common Stock which may yet be purchased under our stock repurchase plan. We have not repurchased shares of the Company's Common Stock during the six months ended June 30, 2006 or in the fiscal year ended December 31, 2005.

Risk Factors.

Our business faces significant risks. These risks include those described below and may include additional risks and uncertainties not presently known to us or that we currently deem immaterial. Our business, financial condition and results of operations could be materially adversely affected by any of these risks, and the trading price of our common stock could decline.

We operate in the highly competitive banking industry and there can be no assurance that we will be able to compete successfully.

Our ability to maintain our history of strong financial performance and return on investment to shareholders may depend in part on our ability to expand our scope of available financial services as needed to meet the needs and demands of our customers. Our business model focuses on using superior customer service to provide traditional banking services to a growing customer base. However, we operate in an increasingly competitive environment in which our competitors now include securities dealers, brokers, mortgage bankers, investment advisors and finance and insurance companies who seek to offer one-stop financial services to their customers that may include services that we have not been able or allowed to offer to our customers in the past. This increasingly competitive environment is primarily a result of changes in regulation, changes in technology and product delivery systems and the accelerating pace of consolidation among financial services providers. We cannot assure you that we will be able to continue to compete successfully in this environment without expanding the scope of financial services we provide, or that if we need to expand the scope of services that we provide, that we will be able to do so successfully.

Our future success depends on our ability to compete effectively in a highly competitive market and geographic area.

We face substantial competition in all phases of our operations from a variety of different competitors. We encounter competition from other commercial

banks, savings and loan associations, mutual savings banks, credit unions and other financial institutions. Our competitors, including credit unions, consumer finance companies, factors, insurance companies and money market mutual funds, compete with lending and deposit-gathering services offered by us. There is very strong competition for financial services in the New York state areas in which we currently conduct our business. This geographic area includes offices of many of the largest financial institutions in the world. Many of those competing

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institutions have much greater financial and marketing resources than we have. Due to their size, many competitors can achieve larger economies of scale and as a result may offer a broader range of products and services than we do. If we are unable to offer competitive products and services, our earnings may be negatively affected. Some of the financial services organizations with which we compete are not subject to the same degree of regulation as is imposed on bank holding companies like ourselves and on federally insured financial institutions like our banking subsidiary, The Berkshire Bank. As a result, these nonbank competitors have certain advantages over us in accessing funding and in providing various services. The banking business in our current primary market area is very competitive, and the level of competition we face may increase further, which may limit our asset growth and profitability.

Economic conditions either nationally or locally in areas in which our operations are concentrated may be less favorable than expected.

Deterioration in local, regional, national or global economic conditions could result in, among other things, an increase in loan delinquencies, a decrease in property values, a change in housing turnover rate or a reduction in the level of bank deposits. Particularly, a weakening of the real estate or employment market in our primary market areas could result in an increase in the number of borrowers who default on their loans and a reduction in the value of the collateral securing their loans, which in turn could have an adverse effect on our profitability. Substantially all of our real estate loans are collateralized by properties located in these market areas, and substantially all of our loans are made to borrowers who live in and conduct business in these market areas. Any material economic deterioration in these market areas could have an adverse impact on our profitability.

Changes in interest rates could reduce our income and cash flows.

Our income and cash flow and the value of our assets and liabilities depend to a great extent on the difference between the interest rates earned on interest-earning assets such as loans and investment securities, and the interest rates paid on interest-bearing liabilities such as deposits and borrowings. These rates are highly sensitive to many factors which are beyond our control, including general economic conditions and policies of various governmental and regulatory agencies, in particular, the Board of Governors of the Federal Reserve System. Changes in monetary policy, including changes in interest rates, will influence the origination of loans, the returns on our portfolio of investment securities and the amounts paid on deposits. If the rate of interest we pay on deposits and other borrowings increases more than the rate of interest we earn on loans and other investments, our net interest income, and therefore our earnings, could be adversely affected. Our earnings could also be adversely affected if the rates on our loans and other investments fall more quickly than those on our deposits and other borrowings.

We operate in a highly regulated environment; changes in laws and regulations and accounting principles may adversely affect us.

We are subject to extensive state and federal regulation, supervision, and legislation which govern almost all aspects of our operations. These laws may change from time to time and are primarily intended for the protection of customers, depositors, and the deposit insurance funds. The impact of any changes to these laws may negatively impact our ability to expand our services and to increase the value of our business. Regulatory authorities have extensive discretion in the exercise of their supervisory and enforcement powers. They may, among other things, impose restrictions on the operation of a banking institution, the classification of assets by such institution and such institution's allowance for loan losses. Regulatory and law enforcement authorities also have wide discretion and extensive enforcement powers under various consumer protection, civil rights and other laws, including the

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Gramm-Leach-Bliley Act, the Bank Secrecy Act, the Truth-in-Lending Act, the Equal Credit Opportunity Act, the Fair Housing Act and the Real Estate Settlement Procedures Act. These laws also permit private individual and class action lawsuits and provide for the recovery of attorneys fees in certain instances. Any changes to these laws or any applicable accounting principles may negatively impact our results of operations and financial condition. While we cannot predict what effect any presently contemplated or future changes in the laws or regulations or their interpretations would have, these changes could be materially adverse to our investors and stockholders.

We are required to maintain an allowance for loan losses. These reserves are based on management's judgment and may have to be adjusted in the future. Any adjustment to the allowance for loan losses, whether due to regulatory changes, economic conditions or other factors, may affect our financial condition and earnings.

We maintain an allowance for loan losses. The allowance for loan losses is maintained at a level believed adequate by management to absorb losses inherent in the loan portfolio. In conjunction with an internal loan review function that operates independently of the lending function, management monitors the loan portfolio to identify risks on a timely basis so that an appropriate allowance can be maintained. Based on an evaluation of the loan portfolio, management presents a periodic review of the loan loss reserve to the board of directors of the Bank, indicating any changes in the reserve since the last review and any recommendations as to adjustments in the reserve. In making its evaluation, in addition to the factors discussed below, management considers the results of recent regulatory examinations, which typically include a review of the allowance for loan losses as an integral part of the examination process.

In establishing the allowance, management evaluates individual large classified loans and nonaccrual loans, and determines an aggregate reserve for those loans based on that review. An allowance for the remainder of the loan portfolio is also determined based on historical loss experience within the components of the portfolio. These allocations may be modified if current conditions indicate that loan losses may differ from historical experience, based on economic factors and changes in portfolio mix and volume.

In addition, a portion of the allowance is established for losses

inherent in the loan portfolio which have not been identified by the more quantitative processes described above. This determination inherently involves a higher degree of subjectivity, and considers risk factors that may not have yet manifested themselves in historical loss experience. Those factors include changes in levels and trends of charge-offs, delinquencies, and nonaccrual loans, trends in volume and terms of loans, changes in underwriting standards and practices, portfolio mix, tenure of loan officers and management, entrance into new geographic markets, changes in credit concentrations, and national and local economic trends and conditions. While the allowance for loan losses is maintained at a level believed to be adequate by management for estimated losses in the loan portfolio, determination of the allowance is inherently subjective, as it requires estimates, all of which may be susceptible to significant change. Changes in these estimates may impact the provisions charged to expense in future periods. Federal and state regulatory authorities, as an integral part of their examination process, review our loans and allowance for loan losses. We cannot assure you that we will not increase the allowance for loan losses or the regulators will not require us to increase this allowance. Either of these occurrences could negatively impact Berkshire Bancorp's results of operations.

It may be difficult for a third party to acquire us and this could depress our common stock price.

Under our amended and restated certificate of incorporation, we have authorized 2,000,000 shares of preferred stock, which the board of directors may issue with terms, rights, preferences and designations as the board of directors

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may determine and without any vote of the shareholders, unless otherwise required by law. Issuing the preferred stock, depending upon the rights, preferences and designations set by the board of directors, may delay, deter, or prevent a change in control of the Company.

In addition, we have authorized 10,000,000 shares of common stock of which approximately 7.7 million shares have been issued and approximately 6.9 million shares are outstanding. The price of our common stock may be volatile at times since our common stock is thinly traded and one individual owns or controls approximately 50% of our outstanding shares. It may be difficult for a stockholder to sell a significant number of shares at a time and at a price of their choosing or for a third party to purchase sufficient shares on the open market to cause a change in control of the Company, all of which could depress the price of Berkshire Bancorp's common stock.

In addition, federal and state banking laws may restrict the ability of the stockholders to approve a merger or business combination or obtain control of the Company. This may tend to make it more difficult for shareholders to replace existing management or may prevent shareholders from receiving a premium for their shares of our common stock.

Our common stock is not insured by any governmental agency and, therefore, investment in them involves risk.

Our securities are not deposit accounts or other obligation of any bank, and are not insured by the FDIC, or any other governmental agency, and are subject to investment risk, including the possible loss of principal.

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ITEM 3 - QUANTITATIVE AND QUALITATIVE DISCLOSURE ABOUT MARKET RISK

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

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

As additional interest rate management strategy, the Bank borrows funds from the Federal Home Loan Bank, approximately \$66.97 million at June 30, 2006, at fixed rates for a period of one to five years.

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

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

| | Berkshire Bancorp Interest Rate Sensitivity Gap (in thousands, except fo | | |
|--------------------|--|------------------------|----------------------|
| | 3 Months or Less | 3 Through 12 Months | 1 Through 3 Years |
| Federal funds sold | 11,250 | -- | -- |
| (Rate) | 5.19% | | |

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| | | | |
|---|-----------|-----------|-----------|
| Interest bearing deposits in banks | 4,053 | -- | -- |
| (Rate) | 3.98% | | |
| Loans (1) (2) | | | |
| Adjustable rate loans | 62,242 | 8,144 | 21,799 |
| (Rate) | 8.77% | 6.69% | 7.07% |
| Fixed rate loans | 6,864 | 11,513 | 14,846 |
| (Rate) | 7.53% | 6.76% | 6.67% |
| | ----- | ----- | ----- |
| Total loans | 69,106 | 19,657 | 36,645 |
| Investments (3) (4) | 156,044 | 82,243 | 122,644 |
| (Rate) | 3.78% | 3.71% | 4.09% |
| | ----- | ----- | ----- |
| Total rate-sensitive assets | 240,453 | 101,900 | 159,289 |
| | ----- | ----- | ----- |
| Deposit accounts (5) | | | |
| Savings and NOW | 187,294 | -- | -- |
| (Rate) | 2.74% | | |
| Money market | 17,352 | -- | -- |
| (Rate) | 0.79% | | |
| Time Deposits | 159,224 | 239,997 | 6,012 |
| (Rate) | 3.73% | 4.38% | 2.82% |
| | ----- | ----- | ----- |
| Total deposit accounts | 363,870 | 239,997 | 6,012 |
| Repurchase Agreements | 34,880 | 22,000 | 3,000 |
| (Rate) | 4.79% | 2.82% | 3.52% |
| Other borrowings | 280 | 12,082 | 30,064 |
| (Rate) | 4.84% | 3.94% | 3.38% |
| | ----- | ----- | ----- |
| Total rate-sensitive liabilities | 399,030 | 274,079 | 39,076 |
| | ----- | ----- | ----- |
| Interest rate caps | 20,000 | | (20,000) |
| Gap (repricing differences) | (178,577) | (172,179) | 140,213 |
| | ===== | ===== | ===== |
| Cumulative Gap | (178,577) | (350,756) | (210,543) |
| | ===== | ===== | ===== |
| Cumulative Gap to Total Rate Sensitive Assets | (20.10)% | (39.48)% | (23.70)% |
| | ===== | ===== | ===== |

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

(2) Includes nonaccrual loans.

(3) Investments are scheduled according to their respective repricing

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(variable rate loans) and maturity (fixed rate securities) dates.

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

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Provision for Loan Losses.

The allowance for loan losses is the estimated amount considered necessary to cover credit losses inherent in the loan portfolio at the balance sheet date. The allowance is established through the provision for loan losses that is charged against income. In determining the allowance for loan losses, management makes significant estimates and therefore has identified the allowance as a critical accounting policy. The methodology for determining the allowance for loan losses is considered a critical accounting policy by management due to the high degree of judgment involved, the subjectivity of the assumptions utilized, and the potential for changes in the economic environment that could result in changes to the amount of the recorded allowance for loan losses.

The allowance for loan losses has been determined in accordance with accounting principles generally accepted in the United States of America, under which we are required to maintain an allowance for probable losses at the balance sheet date. We are responsible for the timely and periodic determination of the amount of the allowance required. Management believes that the allowance for loan losses is adequate to cover specifically identifiable losses, as well as estimated losses inherent in our portfolio for which certain losses are probable but not specifically identifiable.

Management performs a quarterly evaluation of the adequacy of the allowance for loan losses. The analysis of the allowance for loan losses has two components: specific and general allocations. Specific allocations are made for loans determined to be impaired. Impairment is measured by determining the present value of expected future cash flows or, for collateral-dependent loans, the fair value of the collateral adjusted for market conditions and selling expenses. The general allocation is determined by segregating the remaining loans by type of loan, risk weighting (if applicable) and payment history. Management also analyzes historical loss experience, delinquency trends, general economic conditions, geographic concentrations, and industry and peer comparisons. This analysis establishes factors that are applied to the loan groups to determine the amount of the general allocations. This evaluation is inherently subjective as it requires material estimates that may be susceptible to significant revisions based upon changes in economic and real estate market conditions. Actual loan losses may be significantly more than the allowance for loan losses management has established which could have a material negative effect on the Company's financial results.

On a quarterly basis, the management committee reviews the current status of various loan assets in order to evaluate the adequacy of the allowance

for loan losses. In this evaluation process, specific loans are analyzed to determine their potential risk of loss. This process includes all loans, concentrating on non-accrual and classified loans. Each non-accrual or classified loan is evaluated for potential loss exposure. Any shortfall results in a recommendation of a specific allowance if the likelihood of loss is evaluated as probable. To determine the adequacy of collateral on a particular loan, an estimate of the fair market value of the collateral is based on the most current appraised value available. This appraised value is then reduced to reflect estimated liquidation expenses.

The Company's primary lending emphasis has been the origination of commercial and residential mortgages and commercial and consumer loans and lines of credit. The bank also originates home equity loans and home equity lines of credit. These activities resulted in a loan concentration in commercial and residential mortgages. As a substantial amount of our loan portfolio is collateralized by real estate, appraisals of the underlying value of property securing loans are critical in determining the amount of the allowance required for specific loans. Assumptions for appraisal valuations are instrumental in determining the value of properties. Overly optimistic assumptions or negative changes to assumptions could significantly impact the valuation of a property

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securing a loan and the related allowance determined. The assumptions supporting such appraisals are carefully reviewed by management to determine that the resulting values reasonably reflect amounts realizable on the related loans. Based on the composition of our loan portfolio, management believes the primary risks are increases in interest rates, a decline in the economy, generally, and a decline in real estate market values in the New York metropolitan area. Any one or combination of these events may adversely affect our loan portfolio resulting in increased delinquencies, loan losses and future levels of loan loss provisions. Management considers it important to maintain the ratio of our allowance for loan losses to total loans at an adequate level given current economic conditions, interest rates, and the composition of the portfolio.

The provision for loan losses reflects probable losses resulting from the actual growth and change in composition of our loan portfolio. Management believes the allowance for loan losses reflects the inherent credit risk in our portfolio, the level of our non-performing loans and our charge-off experience.

Although management believes that we have established and maintained the allowance for loan losses at adequate levels, additions may be necessary if future economic and other conditions differ substantially from the current operating environment. Although management uses the best information available, the level of the allowance for loan losses remains an estimate that is subject to significant judgment and short-term change. In addition, the Federal Deposit Insurance Corporation, New State Banking Department, and other regulatory bodies as an integral part of their examination process, will periodically review our allowance for loan losses. Such agencies may require us to recognize adjustments to the allowance based on its judgments about information available to them at the time of their examination.

For the three and six months ended June 30, 2006, we charged-off loans of \$0 and \$1,000, respectively, and recovered loans of \$0 and \$5,000, respectively. For the three and six month ended June 30, 2005, we charged-off loans of \$25,000 and \$25,000, respectively, and recovered loans of \$39,000 and \$89,000, respectively. All recovered amounts in 2006 and 2005 were returned to

the provision for loan loss reserves.

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

| | Three Months Ended June 30, | | Six Mo Ju |
|---|--------------------------------|--------------------|--------------------|
| | 2006 ---- | 2005 ---- | 2006 ---- |
| Average loans outstanding | \$312,490 ===== | \$288,073 ===== | \$311,256 ===== |
| Allowance at beginning of period | 3,315 | 3,022 | 3,266 |
| Charge-offs: | | | |
| Commercial and other loans | -- | 25 | 1 |
| Real estate loans | -- | -- | -- |
| Total loans charged-off | -- | 25 | 1 |
| Recoveries: | | | |
| Commercial and other loans | -- | 39 | 5 |
| Real estate loans | -- | -- | -- |
| Total loans recovered | -- | 39 | 5 |
| Net recoveries (charge-offs) | -- | 14 | 4 |
| Provision for loan losses charged to operating expenses | 45 | 45 | 90 |
| Allowance at end of period | 3,360 ----- | 3,081 ----- | 3,360 ----- |
| Ratio of net recoveries (charge-offs) to average loans outstanding | 0.00% ===== | 0.00% ===== | 0.00% ===== |
| Allowance as a percent of total loans | 1.06% ===== | 1.04% ===== | 1.06% ===== |
| Total loans at end of period | \$316,889 ===== | \$295,216 ===== | \$316,889 ===== |

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Loan Portfolio.

Loan Portfolio Composition. The Company's loans consist primarily of mortgage loans secured by residential and non-residential properties as well as commercial loans which are either unsecured or secured by personal property collateral. Most of the Company's commercial loans are either made to individuals or personally guaranteed by the principals of the business to which the loan is made. At June 30, 2006, we had total gross loans of \$316.89 million, deferred loans fees of \$998,000 and an allowance for loan losses of \$3.36 million. From time to time, the Bank may originate residential mortgage loans and then sell them on the secondary market, normally recognizing fee income in connection with the sale. During the three and six-month periods ended June 30, 2006, the Bank sold approximately \$178,000 and \$2.84 million, respectively, of such loans and recorded in other income, gains of \$1,000 and \$9,000, respectively, on such sales.

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

| | June 30, 2006 | December 31 2005 |
|-----------------------------------|--------------------------|--------------------------|
| | ----- Amount ----- | ----- Amount ----- |
| | (in thousands) | |
| Commercial and professional loans | \$ 38,854 | \$ 33,370 |
| Secured by real estate | | |
| 1-4 family | 139,949 | 139,931 |
| Multi family | 4,440 | 2,874 |
| Non-residential (commercial) | 132,464 | 132,142 |
| Consumer | 1,182 | 2,018 |
| | ----- | ----- |
| Total loans | 316,889 | 310,335 |
| Less: | | |
| Deferred loan fees | (998) | (1,105) |
| Allowance for loan losses | (3,360) | (3,266) |
| | ----- | ----- |
| Loans, net | \$312,531 | \$305,964 |
| | ===== | ===== |

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

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is discontinued, all accrued but unpaid interest is charged against current period income. Once the accrual of interest is discontinued, the Bank records interest as and when received until the loan is restored to accruing status. If the Bank determines that collection of the loan in full is in reasonable doubt, then amounts received are recorded as a reduction of principal until the loan is returned to accruing status. At June 30, 2006 and 2005, we did not have any loans past due more than 90 days and still accruing interest.

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Capital Adequacy

Quantitative measures established by regulation to ensure capital adequacy require the Company and the Bank to maintain minimum amounts and ratios of total and Tier I capital (as defined in the regulations) to risk-weighted assets (as defined), and Tier I capital (as defined) to average assets (as defined). As of June 30, 2006, the most recent notification from the FDIC categorized the Bank as well capitalized under the regulatory framework for prompt corrective action. To be categorized as well capitalized, the Bank must maintain certain Total risk-based, Tier I risk-based, and Tier I leverage ratios. There are no conditions or events since the notification that management believes have changed the Bank's category.

The following tables set forth the actual and required regulatory capital amounts and ratios of the Company and the Bank as of June 30, 2006 and December 31, 2005 (dollars in thousands):

| | Actual | | For Capital Adequacy Purposes | | To be capitaliz prompt co action pr |
|--|-----------|-------|-------------------------------|--------|---|
| | Amount | Ratio | Amount | Ratio | Amount |
| June 30, 2006 | | | | | |
| Total Capital (to Risk-Weighted Assets) | | | | | |
| Company | \$126,572 | 28.4% | \$35,669 | >=8.0% | |
| Bank | 97,461 | 23.0% | 33,905 | >=8.0% | 42,3 |
| Tier I Capital (to Risk-Weighted Assets) | | | | | |
| Company | 123,212 | 27.6% | 17,834 | >=4.0% | |
| Bank | 94,102 | 22.2% | 16,953 | >=4.0% | 25,4 |
| Tier I Capital (to Average Assets) | | | | | |
| Company | 123,212 | 13.0% | 37,930 | >=4.0% | |
| Bank | 94,102 | 10.5% | 35,788 | >=4.0% | 44,7 |

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| | Actual | | For Capital Adequacy Purposes | | To be capitalize prompt cor action pro |
|--|-----------|-------|-------------------------------|--------|---|
| | Amount | Ratio | Amount | Ratio | Amount |
| December 31, 2005 | | | | | |
| Total Capital (to Risk-Weighted Assets) | | | | | |
| Company | \$124,523 | 28.6% | \$34,820 | >=8.0% | - |
| Bank | 95,193 | 23.0% | 33,116 | >=8.0% | 34,411 |
| Tier I Capital (to Risk-Weighted Assets) | | | | | |
| Company | 121,257 | 27.9% | 17,410 | >=4.0% | - |
| Bank | 91,927 | 22.2% | 16,558 | >=4.0% | 20,641 |
| Tier I Capital (to Average Assets) | | | | | |
| Company | 121,257 | 12.2% | 39,651 | >=4.0% | - |
| Bank | 91,927 | 10.1% | 36,495 | >=4.0% | 46,551 |

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Liquidity

The management of the Company's liquidity focuses on ensuring that sufficient funds are available to meet loan funding commitments, withdrawals from deposit accounts, the repayment of borrowed funds, and ensuring that the Bank and the Company comply with regulatory liquidity requirements. Liquidity needs of the Bank have historically been met by deposits, investments in federal funds sold, principal and interest payments on loans, and maturities of investment securities.

For the Company, liquidity means having cash available to fund operating expenses, to pay shareholder dividends, when and if declared by the Company's Board of Directors and to pay the interest on the Debentures issued in May 2004 and April 2005. The ability of the Company to meet all of its obligations, including the payment of dividends, is not dependent upon the receipt of dividends from the Bank. At June 30, 2006, the Company, excluding the Bank, had cash and cash equivalents of approximately \$11.50 million and investment securities available for sale of \$13.33 million.

The Company maintains financial instruments with off-balance sheet risk in the normal course of business to meet the financing needs of its customers. These financial instruments, approximately \$36.90 million at June 30, 2006, include commitments to extend credit and stand-by letters of credit.

At June 30, 2006, the Company had outstanding commitments of approximately \$476.20 million; including \$405 million of time deposits, \$67 million of Federal Home Loan Bank debt and \$4 million of operating leases. These commitments include \$412.44 million that mature or renew within one year, \$37.46

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million that mature or renew after one year and within three years, \$25.72 million that mature or renew after three years and within five years and \$585,000 that mature or renew after five years.

Impact of Inflation and Changing Prices

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

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ITEM 4 - CONTROLS AND PROCEDURES

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

Limitations on the Effectiveness of Controls. The Company's management, including the CEO/CFO, does not expect that its Disclosure Controls and/or its "internal control over financial reporting" as defined in Rule 13(a)-15(f) of the Securities Exchange Act of 1934 ("Internal Control") will prevent all error and all fraud. A control system, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met. Further, the design of a control system must reflect the fact that there are resource constraints, and the benefits of controls must be considered relative to their costs. Because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, within the Company have been detected. These inherent limitations include the realities that judgments in decision-making can be faulty, and that breakdowns can occur because of simple error or mistake. Additionally, controls can be circumvented by the individual acts of some persons, by collusion of two or more people, or by management override of the control. The design of any system of controls also is based in part upon certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions; over time, control may become inadequate because of changes in conditions, or the degree of compliance with the policies or procedures may deteriorate. Because of the inherent limitations in a cost-effective control system, misstatements due to error or fraud may occur and not be detected.

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Conclusions. Based upon the Controls Evaluation, the CEO/CFO has concluded that the Disclosure Controls are effective in reaching a reasonable level of assurance that information required to be disclosed by the Company is recorded, processed, summarized and reported within the time period specified in the SEC's rules and forms. In accordance with SEC requirements, the CEO/CFO notes that during the fiscal quarter ended June 30, 2006, no changes in Internal Control have occurred that have materially affected or are reasonably likely to materially affect Internal Control.

PART II. OTHER INFORMATION

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

The 2006 Annual Meeting of Stockholders was held on May 17, 2006. Each of the five individuals nominated to serve as directors of the Company was elected by the following votes:

| Director ----- | Shares For ----- | Shares Withheld ----- |
|-----------------------|---------------------|--------------------------|
| William L. Cohen | 6,652,992 | 44,065 |
| Thomas V. Guarino | 6,470,440 | 226,617 |
| Moses Marx | 6,507,637 | 189,420 |
| Steven Rosenberg | 6,508,387 | 188,670 |
| Randolph B. Stockwell | 6,646,984 | 50,073 |

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PART II. OTHER INFORMATION - (continued)

As more fully discussed in the Company's Current Report on Form 8-K dated May 16, 2006, Mr. Guarino will resign as a director of the Company effective August 31, 2006.

Item 5. Other Information

Amendment No. 2 to Employment Agreement of David Lukens.

On May 1, 2006, the Bank and David Lukens, the Bank's Executive Vice President and Chief Financial Officer, entered into Amendment No. 2 to the Employment Agreement between the Bank and Mr. Lukens dated January 1, 2001, pursuant to which the term of Mr. Lukens employment with the Bank was extended until June 30, 2008, subject to automatic renewal for up to three additional periods of one year each unless one of the parties otherwise notifies the other between 60 and 90 days prior to the expiration of the then current employment.

Deferred Compensation Plan

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On June 19, 2006, the Board of Directors of the Bank adopted a Deferred Compensation Plan (the "Plan") effective July 1, 2006 pursuant to which key employees of the Bank may defer payment of between 3% and 50% of the compensation that may be earned by them from the Bank or its Affiliates, as defined in the Plan. The Bank may, in its sole discretion, credit additional amounts to the Deferred Compensation Account, as defined in the Plan, of a Participant, as defined in the Plan, from time to time. Following a Participant's termination of employment with the Bank and its Affiliates, the Participant shall receive a distribution of a single sum payment in cash, equal to the value of the Participant's vested Deferred Compensation Account plus a specified Earnings Rate. The Plan provides for earlier distribution in the event of certain specified unforeseeable emergencies, death, disability, and a Change in Control, as defined in the Plan, of the Bank and its Affiliates.

Item 6. Exhibits

| Exhibit Number ----- | Description ----- |
|----------------------------|---|
| 10.1 | Amendment No. 2, dated May 1, 2006, to Employment Agreement, dated January 1, 2001, by and between The Berkshire Bank and David Lukens. + |
| 10.2 | Deferred Compensation Plan of The Berkshire Bank, dated June 27, 2006. + |
| 31 | Certification of Principal Executive and Financial Officer pursuant to Section 302 Of The Sarbanes-Oxley Act of 2002. |
| 32 | Certification of Principal Executive and Financial Officer pursuant to Section 906 Of The Sarbanes-Oxley Act of 2002. |

+ Denotes a management compensation plan or arrangement.

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

BERKSHIRE BANCORP INC.
(Registrant)

Date: July 31, 2006

By: /s/ Steven Rosenberg

Steven Rosenberg
President and Chief
Financial Officer

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EXHIBIT INDEX

| Exhibit Number ----- | Description ----- | Sequential Page Number ----- |
|----------------------------|---|------------------------------------|
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| 32 | Certification of Principal Executive and Financial Officer pursuant to Section 906 Of The Sarbanes-Oxley Act of 2002. | 51 |

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STATEMENT OF DIFFERENCES

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