NEWTEK BUSINESS SERVICES INC
Form 10-Q
August 12, 2010
Table of Contents

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended June 30, 2010

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: 001-16123

NEWTEK BUSINESS SERVICES, INC.

(Exact name of registrant as specified in its charter)

New York	**11-3504638**
(State or other jurisdiction	**(I.R.S. Employer**
of incorporation or organization)	**Identification No.)**
1440 Broadway, 17th floor, New York, NY	**10018**
(Address of principal executive offices)	**(Zip Code)**

Registrant s telephone number, including area code: (212) 356-9500

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 ninety days. Yes x No ¨

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes ¨ No ¨

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of large accelerated filer , accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act (Check one):

Large accelerated Filer	¨	Accelerated filer	¨
Non-accelerated filer	¨	Smaller reporting company	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 August 9, 2010, there were 36,741,921 of the Company s Common Shares outstanding.

Table of Contents

CONTENTS

Table of Contents

Item 1. Financial Statements

NEWTEK BUSINESS SERVICES, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS (UNAUDITED)

FOR THE THREE AND SIX MONTHS ENDED JUNE 30, 2010 AND 2009

(In Thousands, except for Per Share Data)

	Three Months ended June 30,		Six Months Ended June 30,	
	2010	2009	2010	2009
Operating revenues:	$ 28,006	$ 27,077	$ 53,859	$ 51,198
Net change in fair market value of:				
Liability on SBA loans transferred, subject to premium recourse	1,047		2,026	
Credits in lieu of cash and notes payable in credits in lieu of cash	13	473	174	1,010
Total net change in fair market value	1,060	473	2,200	1,010
Operating expenses:				
Electronic payment processing costs	17,249	14,110	33,124	27,054
Salaries and benefits	4,699	4,497	9,688	9,307
Interest	1,017	3,605	2,284	6,122
Depreciation and amortization	1,175	1,570	2,431	3,219
Provision for loan losses	400	509	853	933
Other general and administrative costs	4,012	4,034	8,039	8,426
Total operating expenses	28,552	28,325	56,419	55,061
Income (loss) before income taxes	514	(775)	(360)	(2,853)
Benefit for income taxes	370	131	667	1,145
Net income (loss)	884	(644)	307	(1,708)
Net loss attributable to non-controlling interests	47	7	157	95
Net income (loss) attributable to Newtek Business Services, Inc.	$ 931	$ (637)	$ 464	$ (1,613)
Weighted average common shares outstanding - basic	35,648	35,625	35,648	35,625
Weighted average common shares outstanding - diluted	35,803	35,625	35,796	35,625
Income (loss) per share - basic and diluted	$ 0.03	$ (0.02)	$ 0.01	$ (0.05)

See accompanying notes to these unaudited condensed consolidated financial statements.

3

Table of Contents

NEWTEK BUSINESS SERVICES, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED BALANCE SHEETS

JUNE 30, 2010 AND DECEMBER 31, 2009

(In Thousands, except for Per Share Data)

	June 30, 2010 Unaudited	December 31, 2009 (Note 1)
ASSETS		
Cash and cash equivalents	$ 7,790	$ 12,581
Restricted cash	9,380	6,739
Broker receivable	8,065	6,467
SBA loans held for investment (net of reserve for loan losses of $3,698 and $3,985, respectively)	24,281	23,257
Accounts receivable (net of allowance of $442 and $211, respectively)	8,245	5,012
SBA loans held for sale	323	200
Prepaid expenses and other assets (net of accumulated amortization of deferred financing costs of $2,634 and $2,491, respectively)	6,864	7,502
Servicing asset (net of accumulated amortization and allowances of $4,867 and $4,539, respectively)	2,146	2,436
Fixed assets (net of accumulated depreciation and amortization of $13,570 and $12,276, respectively)	3,156	3,631
Intangible assets (net of accumulated amortization of $11,102 and $10,299, respectively)	3,520	4,218
SBA loans transferred, subject to premium recourse	21,114	
Credits in lieu of cash	42,632	51,947
Goodwill	12,092	12,092
Total assets	$ 149,608	$ 136,082
LIABILITIES AND EQUITY		
Liabilities:		
Accounts payable and accrued expenses	$ 8,575	$ 8,314
Notes payable	18,150	16,298
Deferred revenue	1,805	1,862
Liability on SBA loans transferred, subject to premium recourse	21,176	
Notes payable in credits in lieu of cash	42,632	51,947
Deferred tax liability	2,879	3,634
Total liabilities	95,217	82,055
Commitments and contingencies		
Equity:		
Newtek Business Services, Inc. stockholders equity:		
Preferred stock (par value $0.02 per share; authorized 1,000 shares, no shares issued and outstanding)		
Common stock (par value $0.02 per share; authorized 54,000 shares, 36,688 and 36,674 issued, respectively; 35,653 and 35,648 outstanding, respectively, not including 83 shares held in escrow)	734	733
Additional paid-in capital	57,318	57,302
Accumulated deficit	(4,510)	(4,974)
Treasury stock, at cost (1,035 and 1,026 shares, respectively)	(663)	(649)
Total Newtek Business Services, Inc. stockholders equity	52,879	52,412
Non-controlling interests	1,512	1,615

Total equity	54,391	54,027
Total liabilities and equity	$ 149,608	$ 136,082

See accompanying notes to these unaudited condensed consolidated financial statements.

Table of Contents

NEWTEK BUSINESS SERVICES, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)

FOR THE SIX MONTHS ENDED JUNE 30, 2010 AND 2009

(In Thousands)

	2010	2009
Cash flows from operating activities:		
Net income (loss)	$ 307	$ (1,708)
Adjustments to reconcile net income (loss) to net cash (used in) provided by operating activities:		
Income from tax credits	(1,302)	(4,250)
Accretion of interest expense	1,476	5,260
Fair market value adjustment on SBA loans transferred, subject to premium recourse	(2,026)	
Fair market value adjustment of credits in lieu of cash and notes payable in credits in lieu of cash	(174)	(1,010)
Deferred income taxes	(756)	(1,197)
Depreciation and amortization	2,431	3,219
Provision for loan losses	853	933
Gain on sale/recovery of investments in qualified businesses		(1,039)
Other, net	(31)	201
Changes in operating assets and liabilities:		
Originations of SBA loans held for sale	(123)	(2,669)
Originations of SBA loans transferred, subject to premium recourse	(23,536)	
Liability on SBA loans transferred, subject to premium recourse	25,830	
Proceeds from sale of SBA loans held for sale		8,802
Broker receivable	(1,598)	(1,249)
Prepaid expenses and other assets, accounts receivable and accrued interest receivable	(2,609)	1,541
Accounts payable, accrued expenses and deferred revenue	204	(1,674)
Other, net	(1,059)	(511)
Net cash (used in) provided by operating activities	(2,113)	4,649
Cash flows from investing activities:		
Return of investments in qualified businesses	111	1,909
Purchase of fixed assets and customer merchant accounts	(928)	(899)
SBA loans originated for investment, net	(3,108)	(828)
Proceeds from sales of loans held for investment		400
Payments received on SBA loans	1,292	1,862
Change in restricted cash	(1,620)	(107)
Net cash (used in) provided by investing activities	(4,253)	2,337

See accompanying notes to these unaudited condensed consolidated financial statements.

Table of Contents

NEWTEK BUSINESS SERVICES, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)

FOR THE SIX MONTHS ENDED JUNE 30, 2010 AND 2009 (CONTINUED)

	2010	2009
Cash flows from financing activities:		
Net repayments on bank lines of credit	$ (10,381)	$ (5,203)
Proceeds from bank term note payable	12,500	
Payments on bank term note payable	(268)	
Other	(276)	(41)
Net cash provided by (used in) financing activities	1,575	(5,244)
Net (decrease) increase in cash and cash equivalents	(4,791)	1,742
Cash and cash equivalents - beginning of period	12,581	16,852
Cash and cash equivalents - end of period	$ 7,790	$ 18,594
Supplemental disclosure of cash flow activities:		
Reduction of credits in lieu of cash and notes payable in credits in lieu of cash balances due to delivery of tax credits to Certified Investors	$ 12,460	$ 19,079
Reduction in SBA loans transferred, subject to premium recourse due to SBA loans achieving sale status	$ 2,422	$
Reduction in Liability on SBA loans transferred, subject to premium recourse due to SBA loans achieving sale status	$ 2,631	$
Refinance of line of credit to term loan	$ 2,083	$

See accompanying notes to these unaudited condensed consolidated financial statements.

Table of Contents

NEWTEK BUSINESS SERVICES, INC. AND SUBSIDIARIES

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1 DESCRIPTION OF BUSINESS AND BASIS OF PRESENTATION:

Newtek Business Services, Inc. (Newtek or the Company) is a holding company for several wholly- and majority-owned subsidiaries, including thirteen certified capital companies which are referred to as Capcos, and several portfolio companies in which the Capcos own non-controlling or minority interests. The Company provides a one-stop-shop for business services to the small- and medium-sized business market and uses state of the art web-based proprietary technology to be a low cost acquirer and provider of products and services. The Company partners with companies, credit unions, and associations to offer its services.

The Company s principal business segments are:

Electronic Payment Processing: Marketing third party credit card processing and check approval services to the small- and medium-sized business market.

Web Hosting: CrystalTech Web Hosting, Inc., d/b/a/ Newtek Technology Services (NTS), which offers shared and dedicated web hosting and related services to the small- and medium-sized business market.

Small Business Finance: Primarily consists of Newtek Small Business Finance, Inc. (NSBF), a nationally licensed, U.S. Small Business Administration (SBA) lender that originates, sells and services loans to qualifying small businesses, which are partially guaranteed by the SBA; and CDS Business Services, Inc. d/b/a Newtek Business Credit (NBC), which provides receivable financing.

All Other: Includes results from businesses formed from Investments in Qualified Businesses made through Capco programs which cannot be aggregated with other operating segments.

Corporate Activities: Corporate implements business strategy, directs marketing, provides technology oversight and guidance, coordinates and integrates activities of the segments, contracts with alliance partners, acquires customer opportunities, and owns our proprietary NewTracker referral system. This segment includes revenue and expenses not allocated to other segments, including interest income, Capco management fee income and corporate operations expenses.

Capcos: Thirteen certified capital companies which invest in small- and medium-sized businesses. They generate non-cash income from tax credits and non-cash interest and insurance expenses.

The condensed consolidated financial statements of Newtek Business Services, Inc., its Subsidiaries and consolidated entities (the Company or Newtek) included herein have been prepared by the Company in accordance with accounting principles generally accepted in the United States of America and include all wholly- and majority-owned subsidiaries, and several portfolio companies in which the Capcos own non-controlling minority interests, or those variable interest entities which Newtek is considered to be the primary beneficiary of. All inter-company balances and transactions have been eliminated in consolidation. Non-controlling interests (previously shown as minority interest) are reported below net income (loss) under the heading Net loss attributable to non-controlling interests in the unaudited condensed consolidated statements of operations and shown as a component of equity in the condensed consolidated balance sheets. See New Accounting Standards for further discussion.

The accompanying notes to unaudited condensed consolidated financial statements should be read in conjunction with Newtek s 2009 Annual Report on Form 10-K. These financial statements have been prepared in accordance with instructions to Form 10-Q and Article 10 of Regulations S-X and, therefore, omit or condense certain footnotes and other information normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States. The results of operations for an interim period may not give a true indication of the results for the entire year. The December 31, 2009 condensed consolidated balance sheet has been derived from the audited financial statements of that date but does not include all disclosures required by accounting principles generally accepted in the United States of America.

All financial information included in the tables in the following footnotes is stated in thousands, except per share data.

NOTE 2 SIGNIFICANT ACCOUNTING POLICIES:

Use of Estimates

The preparation of consolidated financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenue and expense during the reporting period. The level of uncertainty in estimates and assumptions increases with the length of time until the underlying transactions are complete. The most significant estimates are with respect to valuation of investments in qualified businesses, asset impairment valuation, allowance for loan losses, valuation of servicing assets, chargeback reserves, tax valuation allowances and the fair value measurements used to value certain financial assets and financial liabilities. Actual results could differ from those estimates.

Revenue Recognition

The Company operates in several different segments. Revenues are recognized as services are rendered and are summarized as follows:

Electronic payment processing revenue: Electronic payment processing income is derived from the electronic processing of credit and debit card transactions that are authorized and captured through third-party networks. Typically, merchants are charged for these processing services on a percentage of the dollar amount of each transaction plus a flat fee per transaction. Certain merchant customers are charged miscellaneous fees, including fees for handling charge-backs or returns, monthly minimum fees, statement fees and fees for other miscellaneous services. Revenues derived from the electronic processing of MasterCard® and Visa® sourced credit and debit card transactions are reported gross of amounts paid to sponsor banks.

The Company also derives revenues from acting as independent sales offices (ISO) for third-party processors (residual revenue) and from the sale of credit and debit card devices. Residual revenue is recognized monthly, based on contractual agreements with such processors to share in the residual income derived from the underlying merchant agreements. Revenues derived from sales of equipment are recognized at the time of shipment to the merchant.

Web hosting revenue: Web hosting revenues are primarily derived from monthly recurring service fees for the use of its web hosting and software support services. Customer set-up fees are billed upon service initiation and are recognized as revenue over the estimated customer relationship period of 2.5 years. Payment for web hosting and related services is generally received one month to three years in advance. Deferred revenues represent customer prepayments for upcoming web hosting and related services.

Income from tax credits: Following an application process, a state will notify a company that it has been certified as a Capco. The state then allocates an aggregate dollar amount of tax credits to the Capco. However, such amount is neither recognized as income nor otherwise recorded in the financial statements since it has yet to be earned by the Capco. The Capco is legally entitled to earn tax credits upon satisfying defined investment percentage thresholds within specified time requirements and corresponding non-recapture percentages. At June 30, 2010, the Company had Capcos in six states and the District of Columbia. Each statute requires that the Capco invest a threshold percentage of Certified Capital in Qualified Businesses within the time frames specified. As the Capco meets these requirements, it avoids grounds under the statute for its disqualification for continued participation in the Capco program. Such a disqualification, or decertification as a Capco, results in a recapture of all or a portion of the allocated tax credits; the proportion of the recapture is reduced over time as the Capco remains in general compliance with the program rules and meets the progressively increasing investment benchmarks.

As the Capco continues to make its investments in Qualified Businesses and, accordingly, places an increasing proportion of the tax credits beyond recapture, it earns an amount equal to the non-recapturable tax credits and records such amount as income from tax credits , with a corresponding asset called credits in lieu of cash , in the accompanying condensed consolidated balance sheets. The amount earned and recorded as income is determined by multiplying the total amount of tax credits allocated to the Capco by the percentage of tax credits immune from recapture (the earned income percentage) under the state statute. To the extent that the investment requirements are met ahead of schedule, and the percentage of non-recapturable tax credits is accelerated, the present value of the tax credit earned is recognized currently and the asset, credits in lieu of cash, is accreted up to the amount of tax credits available to the Certified Investors. If the tax credits are earned before the state is required to make delivery (i.e., investment requirements are met ahead of schedule, but credits can only be used by the certified investor in a future year), then the present value of the tax credits earned are recorded upon completion of the requirements. The receivable is calculated at fair value; see Note 3 for a full discussion. Delivery of the tax credits to the Certified Investors results in a decrease of the receivable and the notes payable in credits in lieu of cash.

The allocation and utilization of Capco tax credits is controlled by the state law applicable to the Capco. In general, the Capco applies for tax credits from the state and is allocated a specific dollar amount of credits which are available to be earned. The Capco provides the state with a list of the Certified Investors, who have contractually agreed to accept the tax credits in lieu of cash interest payments on their notes. The tax credits are claimed by the Certified Investors on their state premium tax return as provided under each state Capco and tax law. State regulations specify the amount of tax credits a Certified Investor can claim and the period in which they can claim them. Each state periodically reviews the Capco s operations to verify the amount of tax credits earned. In addition, the state maintains a list of Certified Investors and, therefore, has the ability to determine whether the Certified Investor is allowed to claim this deduction.

Table of Contents

Sales and Servicing of SBA Loans: NSBF originates loans to customers under the SBA program that generally provides for SBA guarantees of 50% to 90% of each loan, subject to a maximum guarantee amount. Generally, NSBF sells the guaranteed portion of each loan to a third party via an SBA regulated secondary market transaction utilizing SBA form 1086 and retains the unguaranteed principal portion in its own portfolio. SBA form 1086 requires as part of the transferor s representations and warranties that the transferor repay any premium received from the transferee if either the SBA 7(a) loan borrower prepays the loan within 90 days of the transfer settlement date or fails to make one of its first three loan payments after the settlement date in a timely fashion and then proceeds to default within 275 days of the settlement date. Under ASC Topic 860, Transfers and Servicing , effective January 1, 2010, such recourse precludes sale treatment of the transferred guaranteed portions during this warranty period; rather NSBF is required to account for this as a financing arrangement with the transferee. Until the warranty period expires, such transferred loans are classified as SBA loans transferred, subject to premium recourse with a matching liability Liability on SBA Loans Transferred, subject to premium recourse . At the expiration of the warranty period, the sale of the guaranteed portions of these loans as well as the corresponding gain is recognized, and the asset and liability eliminated.

Upon recognition of each loan sale, the Company retains servicing responsibilities and receives servicing fees of a minimum of 1% of the guaranteed loan portion sold. The Company is required to estimate its adequate servicing compensation in the calculation of its servicing asset. The purchasers of the loans sold have no recourse to the Company for failure of customers to pay amounts contractually due.

Upon recognition of the sale of loans to third parties, NSBF separately recognizes at fair value any servicing assets or servicing liabilities first, and then allocates the previous carrying amount between the assets sold and the interests that continue to be held by the transferor (the unguaranteed portion of the loan) based on their relative fair values at the date of transfer. The difference between the proceeds received and the allocated carrying value of the financial assets sold is recognized as a gain on sale of loans.

Each class of servicing assets and liabilities are subsequently measured using either the amortization method or the fair value measurement method. The amortization method, which NSBF has chosen to continue applying to its servicing asset, amortizes the asset in proportion to, and over the period of, the estimated future net servicing income on the underlying sold portion of the loans (guaranteed) and assesses the servicing asset for impairment based on fair value at each reporting date. In the event future prepayments are significant or impairments are incurred and future expected cash flows are inadequate to cover the unamortized servicing assets, additional amortization or impairment charges would be recognized. The Company uses an independent valuation specialist to estimate the fair value of the servicing asset.

In evaluating and measuring impairment of servicing assets, NSBF stratifies its servicing assets based on year of loan and loan term which are key risk characteristics of the underlying loan pools. The fair value of servicing assets is determined by calculating the present value of estimated future net servicing cash flows, using assumptions of prepayments, defaults, servicing costs and discount rates that NSBF believes market participants would use for similar assets.

If NSBF determines that the impairment for a stratum is temporary, a valuation allowance is recognized through a charge to current earnings for the amount the amortized balance exceeds the current fair value. If the fair value of the stratum were to later increase, the valuation allowance may be reduced as a recovery. However, if NSBF determines that impairment for a stratum is other than temporary, the value of the servicing asset and any related valuation allowance is written-down.

Interest and Small Business Administration (SBA) Loan Fees SBA Loans: Interest income on loans is recognized as earned. Loans are placed on non-accrual status if they are 90 days past due with respect to principal or interest and, in the opinion of management, interest or principal on individual loans is not collectible, or at such earlier time as management determines that the collectability of such principal or interest is unlikely. Such loans are designated as impaired non-accrual loans. All other loans are defined as performing loans. When a loan is designated as non-accrual, the accrual of interest is discontinued, and any accrued but uncollected interest income is reversed and charged against current operations. While a loan is classified as non-accrual and the future collectability of the recorded loan balance is doubtful, collections of interest and principal are generally applied as a reduction to principal outstanding.

The Company passes certain expenditures it incurs to the borrower, such as forced placed insurance, insufficient funds fees, or fees it assesses, such as late fees, with respect to managing the loan. These expenditures are recorded when incurred. Due to the uncertainty with respect to collection of these passed through expenditures or assessed fees, any funds received to reimburse the Company are recorded on a cash basis as other income.

Insurance commissions: Revenues are comprised of commissions earned on premiums paid for insurance policies and are recognized at the time the commission is earned. At that date, the earnings process has been completed and the Company can estimate the impact of policy cancellations for refunds and establish reserves. The reserve for policy cancellations is based on historical cancellation experience adjusted by known circumstances.

9

Other income: Other income represents revenues generated by NBC, as well as revenues derived from operating units that cannot be aggregated with other business segments, and one-time recoveries or gains on qualified investments. Revenue is recorded when there is pervasive evidence of an agreement, the related fees are fixed, the service, and or product has been delivered, and the collection of the related receivable is assured. Other income particular to NBC include the following components:

Receivable fees: Receivable fees are derived from the funding (purchase) of receivables from finance clients. The Company recognizes the revenue on the date the receivables are purchased at a percentage of face value as agreed to by the client at which time the Company takes ownership of the receivables. The Company also has arrangements with certain of its clients whereby it purchases the client s receivables and charges interest at a specified rate based on the amount of funds advanced against such receivables. The funds provided are collateralized and the interest income is recognized as earned.

*Late fees: Late f*ees are derived from receivables the Company has already purchased that have gone over a certain period (usually over 30 days) without payment. The client or the client s customer is charged a late fee according to the agreement with the client.

Billing fees: Billing fees are derived from billing-only (non-finance) clients. These fees are recorded when earned, which occurs when the service is rendered.

Other fees: These fees include annual fees, due diligence fees, termination fees, under minimum fees and other fees including finance charges, supplies sold to clients, NSF fees, wire fees and administration fees. These fees are charged upon funding, takeovers or liquidation of finance clients. Finally, the Company also receives commission revenue from various sources.

The detail of total operating revenues included in the condensed consolidated statements of operations is as follows for the three and six months ended:

	Three months ended June 30:		Six months ended June 30:	
(In thousands):	**2010**	**2009**	**2010**	**2009**
Electronic payment processing	$ 20,404	$ 16,881	$ 39,160	$ 32,641
Web hosting	4,813	4,702	9,601	9,374
Interest income	452	430	843	928
Income from tax credits	556	2,714	1,302	4,250
Premium income	193	137	193	582
Servicing fee	674	424	1,132	825
Insurance commissions	204	217	412	417
Other income	710	1,572	1,216	2,181
Totals	$ 28,006	$ 27,077	$ 53,859	$ 51,198

Electronic Payment Processing Costs

Electronic payment processing costs consist principally of costs directly related to the processing of merchant sales volume, including interchange fees, VISA® and MasterCard® dues and assessments, bank processing fees and costs paid to third-party processing networks. Such costs are recognized at the time the merchant transactions are processed or when the services are performed. Two of the most significant components of electronic processing expenses include interchange and assessment costs, which are set by the credit card associations. Interchange costs are passed on to the entity issuing the credit card used in the transaction and assessment costs are retained by the credit card associations. Interchange and assessment fees are billed primarily as a percent of dollar volume processed and, to a lesser extent, as a per transaction fee. In addition to costs directly related to the processing of merchant sales volume, electronic payment processing costs also include residual expenses. Residual expenses represent fees paid to third-party sales referral sources. Residual expenses are paid under various formulae as contracted with such third-party referral sources, but are generally linked to revenues derived from merchants successfully referred to the

Company and that begin using the Company for merchant processing services. Such residual expenses are typically ongoing as long as the referred merchant remains a customer of the Company and are recognized as expenses as related revenues are recognized in the Company s condensed consolidated statements of operations.

Restricted Cash

Restricted cash includes cash collateral relating to a letter of credit; monies due on SBA loan-related remittances and insurance premiums received by the Company and due to third parties; cash held by the Capcos restricted for use in managing and operating the Capco, making qualified investments and for the payment of income taxes; cash held for future repayment under the Capital One loan agreement and a cash account maintained as a reserve against chargeback losses.

Purchased Receivables

Purchased receivables are recorded at the point in time when cash is released to the seller. A majority of the receivables purchased have recourse and are charged back to the seller if aged over 60, 90 or 120 days, depending on contractual agreements. Purchased receivables are included in accounts receivable on the condensed consolidated balance sheet.

Investments in Qualified Businesses

The various interests that the Company acquires in its qualified investments are accounted for under three methods: consolidation, equity method and cost method. The applicable accounting method is generally determined based on the Company s voting interest or the economics of the transaction if the investee is determined to be a variable interest entity.

Consolidation Method. Investments in which the Company directly or indirectly owns more than 50% of the outstanding voting securities, those the Company has effective control over, or those deemed to be a variable interest entity in which the Company is the primary beneficiary are generally accounted for under the consolidation method of accounting. Under this method, an investment s financial position and results of operations are reflected within the Company s condensed consolidated financial statements. All significant inter-company accounts and transactions are eliminated, including returns of principal, dividends, interest received and investment redemptions. The results of operations and cash flows of a consolidated operating entity are included through the latest interim period in which the Company owned a greater than 50% direct or indirect voting interest, exercised control over the entity for the entire interim period or was otherwise designated as the primary beneficiary. Upon dilution of control below 50%, or upon occurrence of a triggering event requiring reconsideration as to the primary beneficiary of a variable interest entity, the accounting method is adjusted to the equity or cost method of accounting, as appropriate, for subsequent periods.

Equity Method. Investees that are not consolidated, but over which the Company exercises significant influence, are accounted for under the equity method of accounting. Whether or not the Company exercises significant influence with respect to an investee depends on an evaluation of several factors including, among others, representation on the investee s Board of Directors and ownership level, which is generally a 20% to 50% interest in the voting securities of the investee, including voting rights associated with the Company s holdings in common, preferred and other convertible instruments in the investee. Under the equity method of accounting, an investee s accounts are not reflected within the Company s condensed consolidated financial statements; however, the Company s share of the earnings or losses of the investee is reflected in the Company s condensed consolidated financial statements.

Cost Method. Investees not accounted for under the consolidation or the equity method of accounting are accounted for under the cost method of accounting. Under this method, the Company s share of the net earnings or losses of such companies is not included in the Company s condensed consolidated financial statements. However, cost method impairment charges are recognized, as necessary, in the Company s condensed consolidated financial statements. If circumstances suggest that the value of the investee has subsequently recovered, such recovery is not recorded until ultimately liquidated or realized.

The Company s debt and equity investments have substantially been made with funds available to Newtek through the Capco programs. These programs generally require that each Capco meet a minimum investment benchmark within five years of initial funding. In addition, any funds received by a Capco as a result of a debt repayment or equity return may, under the terms of the Capco programs, be reinvested and counted towards the Capcos minimum investment benchmarks.

Stock - Based Compensation

All share-based payments to employees are recognized in the financial statements based on their fair values using an option-pricing model at the date of grant.

As of June 30, 2010 and 2009, the Company had two share-based compensation plans. At the Annual Meeting of Shareholders on May 26, 2010, a new plan was approved as a result of which one of the older plans is now suspended. For the three and six months ended June 30, 2010 and

2009, compensation cost charged to operations for those plans was $41,000 and $77,000 in 2010, respectively, and $28,000 and $65,000 in 2009, respectively, and is included in salaries and benefits in the accompanying condensed consolidated statements of operations.

There were no options or restricted stock awards granted during the three or six months ended June 30, 2010.

As of June 30, 2010 and December 31, 2009, there was $0 and $55,000 of total unrecognized compensation costs related to non-vested share-based compensation arrangements granted under the Plans, respectively.

Fair Value

The Company adopted the methods of fair value to value its financial assets and liabilities. The Company carries its credits in lieu of cash, prepaid insurance and notes payable in credits in lieu of cash at fair value. The Company also carries impaired loans and other real estate owned at fair value. Fair value is based on the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. In order to increase consistency and comparability in fair value measurements, the Company utilized a fair value hierarchy that prioritizes observable and unobservable inputs used to measure fair value into three broad levels, which are described below:

Level 1 Quoted prices in active markets for identical assets or liabilities. Level 1 assets and liabilities include debt and equity securities and derivative contracts that are traded in an active exchange market, as well as certain U.S. Treasury, other U.S. Government and agency mortgage-backed debt securities that are highly liquid and are actively traded in over-the-counter markets.

Level 2 Observable inputs other than Level 1 prices, such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities. Level 2 assets and liabilities include debt securities with quoted prices that are traded less frequently than exchange-traded instruments and derivative contracts whose value is determined using a pricing model with inputs that are observable in the market or can be derived principally from or corroborated by observable market data. This category generally includes certain U.S. Government and agency mortgage-backed debt securities, corporate debt securities, derivative contracts and residential mortgage loans held-for-sale.

Level 3 Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities. Level 3 assets and liabilities include financial instruments whose value is determined using pricing models, discounted cash flow methodologies, or similar techniques, as well as instruments for which the determination of fair value requires significant management judgment or estimation. This category generally includes certain private equity investments, retained residual interests in securitizations, residential mortgage servicing rights, and highly structured or long-term derivative contracts.

Income Taxes

Deferred tax assets and liabilities are computed based upon the differences between the financial statement and income tax basis of assets and liabilities using the enacted tax rates in effect for the year in which those temporary differences are expected to be realized or settled. If available evidence suggests that it is more likely than not that some portion or all of the deferred tax assets will not be realized, a valuation allowance is required to reduce the deferred tax assets to the amount that is more likely than not to be realized.

The Company s U.S. Federal and state income tax returns prior to fiscal year 2006 are closed, and management continually evaluates expiring statutes of limitations, audits, proposed settlements, changes in tax law and new authoritative rulings.

Accounting for Uncertainty in Income Taxes

The ultimate deductibility of positions taken or expected to be taken on tax returns is often uncertain. In order to recognize the benefits associated with a tax position taken (i.e., generally a deduction on a corporation s tax return), the entity must conclude that the ultimate allowability of the deduction is more likely than not. If the ultimate allowability of the tax position exceeds 50% (i.e., it is more likely than not), the benefit associated with the position is recognized at the largest dollar amount that has more than a 50% likelihood of being realized upon ultimate settlement. Differences between tax positions taken in a tax return and recognized will generally result in (1) an increase in income taxes currently payable or a reduction in an income tax refund receivable or (2) an increase in a deferred tax liability or a decrease in a deferred tax asset, or both (1) and (2).

Table of Contents

When accounting for uncertainty in income taxes, the Income Tax Topic of the FASB Accounting Standards Codification also provides guidance on:

Derecognizing the benefits associated with a recognized tax position where subsequent events indicate that it is *not* more likely than not that the entity will benefit from the tax position taken

Classification of financial statement elements that result from recognizing benefits associated with uncertain tax positions

Treatment of interest and penalties related to uncertain tax positions

Accounting for uncertain tax positions in interim periods

Disclosure and transition

Concentration of Credit Risk

Financial instruments that potentially subject the Company to a concentration of credit risk consist of cash, cash equivalents and accounts receivable. The Company maintains its cash and cash equivalents with major financial institutions and at times, cash balances with any one financial institution may exceed Federal Deposit Insurance Corporation (FDIC) insured limits.

For the three and six months ended June 30, 2010 and 2009, no single customer accounted for 10% or more of the Company s revenue, or of total accounts receivable.

Fair Value of Financial Instruments

As required by the Financial Instruments Topic of the FASB Accounting Standards Codification, the estimated fair values of financial instruments must be disclosed. Excluding fixed assets, intangible assets, goodwill, and prepaid expenses and other assets (excluding as noted below), substantially all of the Company s assets and liabilities are considered financial instruments as defined under this standard. Fair value estimates are subjective in nature and are dependent on a number of significant assumptions associated with each instrument or group of similar instruments, including estimates of discount rates, risks associated with specific financial instruments, estimates of future cash flows and relevant available market information.

The carrying values of the following balance sheet items approximate their fair values primarily due to their liquidity and short-term or adjustable-yield nature:

Cash and cash equivalents

Restricted cash

Broker receivable

Accounts receivable

Bank notes payable

Accrued interest receivable (included in prepaid expended and other assets)

SBA loans transferred, subject to premium recourse

Accrued interest payable (included in accounts payable and accrued expenses)

Accounts payable and accrued expenses

The carrying values of accounts payable and accrued expenses approximate fair value because of the short-term maturity of these instruments. The carrying value of investments in Qualified Businesses (included in prepaid expenses and other assets), credits in lieu of cash, notes payable in credits in lieu of cash, liability on SBA loans transferred, subject to premium recourse and loans receivable approximate fair value based on management s estimates.

New Accounting Standards

In June 2009, the FASB issued an accounting standard which requires entities to provide more information regarding sales of securitized financial assets and similar transactions, particularly if the entity has continuing exposure to the risks related to transferred financial assets and removes the concept of a qualifying special-purpose entity and limits the circumstances in which a financial asset, or portion of a financial asset, should be derecognized when the transferor has not transferred the entire financial asset to an entity that is not consolidated with the transferor in the financial statements being presented and/or when the transferor

13

has continuing involvement with the transferred financial asset. The new standard became effective for the Company on January 1, 2010 and its effect on asset, liability and revenue recognition is described in this note, under Revenue Recognition, Sales and Servicing of SBA Loans. This accounting standard was subsequently codified into ASC Topic 860, Transfers and Servicing.

In June 2009, the FASB issued an accounting standard which modifies how a company determines when an entity that is insufficiently capitalized or is not controlled through voting (or similar rights) should be consolidated. It clarifies that the determination of whether a company is required to consolidate an entity is based on, among other things, an entity s purpose and design and a company s ability to direct the activities of the entity that most significantly impact the entity s economic performance. It requires an ongoing reassessment of whether a company is the primary beneficiary of a variable interest entity and additional disclosures about a company s involvement in variable interest entities and any significant changes in risk exposure due to that involvement. The new standard became effective for the Company on January 1, 2010 and did not have a material impact on its financial position or results of operations. This accounting standard was subsequently codified into ASC Topic 805, Business Combinations.

In August, 2009, the FASB issued Accounting Standards Update 2009-05, Fair Value Measurements and Disclosures (Topic 820) Measuring Liabilities at Fair Value, which updates ASC 820-10. The update provides clarification that in circumstances in which a quoted price in an active market for the identical liability is not available, a reporting entity is required to measure fair value using one or more of the following techniques:

1. A valuation technique that uses

   a. the quoted price of an identical liability when traded as an asset, or

   b. quoted prices for similar liabilities or similar liabilities when traded as assets.

2. Another valuation technique that is consistent with the principles of Topic 820, examples include an income approach, such as a present value technique, or a market approach, such as a technique that is based on the amount at the measurement date that the reporting entity would pay to transfer the identical liability or would receive to enter into the identical liability.

This standard is effective for financial statements issued for interim and annual periods ending after August 2009. The Company adopted Update 2009-05 effective for the quarter ending September 30, 2009. The adoption did not have a material impact on the Company s disclosures.

On July 21, 2010, the FASB issued Accounting Standards Update No. 2010-20, Disclosures about the Credit Quality of Financing Receivables and the Allowance for Credit Losses , which requires significant new disclosures about the allowance for credit losses and the credit quality of financing receivables. The requirements are intended to enhance transparency regarding credit losses and the credit quality of loan and lease receivables. Under this statement, allowance for credit losses and fair value are to be disclosed by portfolio segment, while credit quality information, impaired financing receivables and nonaccrual status are to be presented by class of financing receivable. Disclosure of the nature and extent, the financial impact and segment information of troubled debt restructurings will also be required. The disclosures are to be presented at the level of disaggregation that management uses when assessing and monitoring the portfolio s risk and performance. This standard is effective for interim and annual reporting periods after December 15, 2010. The Company is currently evaluating the impact of adopting the new standard on the condensed consolidated financial statements.

NOTE 3 FAIR VALUE MEASUREMENTS:

FAIR VALUE OPTION ELECTIONS

Effective January 1, 2008, the Company adopted fair value accounting concurrent with the election of the fair value option. The accounting standard relating to the fair value measurements clarifies the definition of fair value and describes methods available to appropriately measure fair value in accordance with GAAP. The accounting standard applies whenever other accounting standards require or permit fair value measurements. The accounting standard relating to the fair value option for financial assets and financial liabilities allows entities to irrevocably elect fair value as the initial and subsequent measurement attribute for certain financial assets and financial liabilities that are not otherwise required to be measured at fair value, with changes in fair value recognized in earnings as they occur. It also establishes presentation and disclosure requirements designed to improve comparability between entities that elect different measurement attributes for similar assets and liabilities.

On January 1, 2008, the Company elected the fair value option for valuing its Capcos credits in lieu of cash, notes payable in credits in lieu of cash and prepaid insurance.

Table of Contents

On January 1, 2010, the Company elected the fair value option for valuing its liability on SBA loans transferred, subject to premium recourse.

The Company elected the fair value option in order to reflect in its financial statements the assumptions that market participants use in evaluating these financial instruments.

FAIR VALUE OPTION ELECTION CREDITS IN LIEU OF CASH, PREPAID INSURANCE AND NOTES PAYABLE IN CREDITS IN LIEU OF CASH

Under the cost basis of accounting, the discount rates used to calculate the present value of the credits in lieu of cash and notes payable in credits in lieu of cash did not reflect the credit enhancements that the Company s Capcos obtained from Chartis, Inc. (Chartis) (formerly American International Group, Inc.), namely its AA+ rating at such time, for their debt issued to certified investors. Instead the cost paid for the credit enhancements was recorded as prepaid insurance and amortized on a straight-line basis over the term of the credit enhancements.

With the adoption of the fair value measurement of financial assets and financial liabilities and the election of the fair value option, credits in lieu of cash and notes payable in credits in lieu of cash are valued based on the yields at which financial instruments would change hands between a willing buyer and a willing seller when the former is not under any compulsion to buy and the latter is not under any compulsion to sell, both parties having reasonable knowledge of relevant facts. The accounting standards require the fair value of the assets or liabilities to be determined based on the assumptions that market participants use in pricing the financial instrument. In developing those assumptions, the Company identified characteristics that distinguish market participants generally, and considered factors specific to (a) the asset type, (b) the principal (or most advantageous) market for the asset group, and (c) market participants with whom the reporting entity would transact in that market.

Based on the aforementioned characteristics and in view of the Chartis credit enhancements, the Company believes that market participants purchasing or selling its Capcos debt, and therefore its credits in lieu of cash and notes payable in credits in lieu of cash, view nonperformance risk to be equal to the risk of Chartis nonperformance risk and as such both the fair value of credits in lieu of cash and notes payable in credits in lieu of cash should be priced to yield a rate equal to an applicable Chartis U.S. Dollar denominated debt instrument. Because the value of notes payable in credits in lieu of cash directly reflects the credit enhancement obtained from Chartis, the unamortized cost relating to the credit enhancement will cease to be separately carried as an asset on Company s condensed consolidated balance sheets and is incorporated in notes payable in credits in lieu of cash.

Assets and Liabilities Measured at Fair Value on a Recurring Basis as of June 30, 2010 are as follows (in thousands):

	Fair Value Measurements Using:			
	Total	Level 1	Level 2	Level 3
Assets:				
Credits in lieu of cash	$ 42,632	$	$ 42,632	$
Liabilities:				
Notes payable in credits in lieu of cash	$ 42,632	$	$ 42,632	$

Assets and Liabilities Measured at Fair Value on a Recurring Basis as of December 31, 2009 are as follows (in thousands):

	Fair Value Measurements Using:			
	Total	Level 1	Level 2	Level 3
Assets:				
Credits in lieu of cash	$ 51,947	$	$ 51,947	$
Liabilities:				
Notes payable in credits in lieu of cash	$ 51,947	$	$ 51,947	$

Table of Contents

Credits in lieu of cash and Notes payable in credits in lieu of cash

The Company elected to account for both credits in lieu of cash and notes payable in credits in lieu of cash at fair value in order to reflect in its condensed consolidated financial statements the assumptions that market participant s use in evaluating these financial instruments.

Fair value measurements:

The Company s Capcos debt, enhanced by Chartis insurance, effectively bears the nonperformance risk of Chartis. Therefore the Company calculates the fair value of both the Credits in lieu of cash and Notes payable in credits in lieu of cash using the yields of various Chartis notes with similar maturities to each of the Company s respective Capcos debt. The Company elected to discontinue utilizing Chartis 7.70% Series A-5 Junior Subordinated Debentures (the Chartis Debentures) because those long maturity debentures began to trade with characteristics of a preferred stock after Chartis received financing from the United States Government. The Company considers the Chartis Note Basket a Level 2 input under fair value accounting, since it is a quoted yield for a similar liability that is traded in an active exchange market. The Company selected these Chartis Note Baskets as the most representative of the nonperformance risk associated with the CAPCO notes because they are Chartis issued notes, are actively traded and because maturities match Credits in lieu of cash and Notes payable in credits in lieu of cash.

After calculating the fair value of both the Credits in lieu of cash and Notes payable in credits in lieu of cash, the Company compares their values. This calculation is done on a quarterly basis. Calculation differences primarily due to tax credit receipt versus delivery timing may cause the value of the Credits in lieu of cash to differ from that of the Notes payable in credits in lieu of cash. Because the Credits in lieu of cash asset has the single purpose of paying the Notes payable in credits in lieu of cash and has no other value to the Company, Newtek determined that the Credits in lieu of cash should equal the Notes payable in credits in lieu of cash.

On December 31, 2009, the yield on the Chartis Note Basket was 6.92%. As of June 30, 2010, the date the Company revalued the asset and liability, the yields on the Chartis notes averaged 5.42% reflecting changes in interest rates in the marketplace. This decrease in yield increased both the fair value of the credits in lieu of cash and the fair value of the notes payable in credits in lieu of cash. The Company increased the value of the credits in lieu of cash to equal the value of the notes payable in credits in lieu of cash because the credits in lieu of cash can only be used to satisfy the liability and must equal the value of the notes payable in credits in lieu of cash at all times. The net change in fair value reported in the Company s condensed consolidated statements of operations for the three and six months ended June 30, 2010 was a gain of $13,000 and $174,000, respectively.

On December 31, 2008, the yield on the Chartis Note Basket was 11.76%. As of June 30, 2009, the date the Company revalued the asset and liability, the yields on the Chartis notes averaged 18.27% reflecting changes in interest rates in the marketplace. This increase in yield decreased both the fair value of the credits in lieu of cash and the fair value of the notes payable in credits in lieu of cash. The Company reduced the value of the credits in lieu of cash to equal the value of the notes payable in credits in lieu of cash because the credits in lieu of cash can only be used to satisfy the liability and must equal the value of the notes payable in credits in lieu of cash at all times. The net change in fair value reported in the Company s condensed consolidated statements of operations for the three and six months ended June 30, 2009 was a gain of $473,000 and $1,010,000, respectively.

Changes in the future yield of the Chartis issued debt selected for valuation purposes will result in changes to the fair values of the credits in lieu of cash and notes payable in credits in lieu of cash when calculated for future periods; these changes will be reported through the Company s condensed consolidated statements of operations.

FAIR VALUE OPTION ELECTION LIABILITY ON SBA LOANS TRANSFERRED, SUBJECT TO PREMIUM RECOURSE

Effective January 1, 2010, a new accounting standard codified into ASC Topic 860, Transfers and Servicing, requires the Company to establish a new liability related to the guaranteed portion of SBA 7(a) loans contractually sold but subject to premium recourse. Contemporaneous with the adoption of this new accounting standard the Company elected the fair value option for valuing this new liability, which is captioned in the condensed consolidated financial statements as Liability on SBA loans transferred, subject to premium recourse . Management elected to adopt the fair value option election because it more accurately reflects the economic transaction. Within the fair value hierarchy that prioritizes observable and unobservable inputs used to measure fair value, the Company utilizes Level 3 unobservable inputs which reflect the Company s own assumptions about the assumptions that market participants would use in pricing the liability (including assumptions about risk). The Company values the liability based on the probability of payment given the Company s history of returning premium: the transferee will receive 100% of the guaranteed portion from either the borrower or the SBA and approximately 3% of the

16

Table of Contents

premium amount from the Company. The aforementioned return of premiums is triggered by either the borrower s prepayment of the loan within 90 days of the transfer settlement date or the borrower s default within 275 days of the settlement date on loans where any of the borrower s first three payments were delinquent.

Assets and Liabilities Measured at Fair Value on a Recurring Basis as of June 30, 2010 are as follows (in thousands):

	Fair Value Measurements Using:			
	Total	Level 1	Level 2	Level 3
Liabilities:				
Liability on SBA loans transferred, subject to premium recourse	$ 21,176	$	$	$ 21,176

Below is a summary of the activity in the Liability on SBA loans transferred, subject to premium recourse for the six months ended June 30, 2010 (In thousands):

Balance at December 31, 2009	$
Liability on SBA loans transferred, subject to premium recourse	23,605
SBA loans sold, no longer subject to premium recourse	(2,429)
Balance at June 30, 2010	$ 21,176

OTHER FAIR VALUE MEASUREMENTS

Assets and Liabilities Measured at Fair Value on a Non-recurring Basis are as follows (in thousands):

	Fair Value Measurements at June 30, 2010 Using:				
	Total	**Level 1**	**Level 2**	**Level 3**	**Total Losses**
Assets					
Impaired loans	$ 6,147	$	$	$ 6,147	$ (851)
Other real-estate owned	117		117		(4)
Total assets	$ 6,264	$	$ 117	$ 6,147	$ (855)

	Fair Value Measurements at December 31, 2009 Using:				
	Total	**Level 1**	**Level 2**	**Level 3**	**Total Losses**
Assets					
Impaired loans	$ 5,302	$	$	$ 5,302	$ (2,239)
Impaired customer merchant accounts					(126)
Other real-estate owned	132		132		(314)
Total assets	$ 5,434	$	$ 132	$ 5,302	$ (2,679)

17

Table of Contents

Impaired loans

Impairment of a loan is measured based on the present value of expected future cash flows discounted at the loan s effective interest rate, or the fair value of the collateral if the loan is collateral dependent. Impaired loans for which the carrying amount is based on fair value of the underlying collateral are included in assets and reported at estimated fair value on a non-recurring basis, both at initial recognition of impairment and on an on-going basis until recovery or charge-off of the loan amount. The determination of impairment involves management s judgment in the use of market data and third party estimates regarding collateral values. Valuations in the level of impaired loans and corresponding impairment affect the level of the reserve for loan losses.

Impaired customer merchant accounts

Customer merchant accounts are reviewed for impairment whenever events or changes in circumstances indicate that the carrying value may not be recoverable. In reviewing for impairment, the carrying value is compared to the estimated undiscounted future cash flows expected. If such cash flows are not sufficient to support the asset s recorded value, an impairment charge is recognized to reduce the carrying value of the customer merchant account to its estimated fair value. The determination of future cash flows as well as the estimated fair value of customer merchant accounts involves significant estimates on the part of management.

Other real-estate owned (included in Prepaid expenses and other assets)

The estimated fair value of other real-estate owned is calculated using observable market information, including bids from prospective purchasers and pricing from similar market transactions where available. The value is generally discounted between 20-25% based on market valuations as well as expenses associated with securing our interests. Where bid information is not available for a specific property, the valuation is principally based upon recent transaction prices for similar properties that have been sold. These comparable properties share comparable demographic characteristics. Other real estate owned is generally classified within Level 2 of the valuation hierarchy.

NOTE 4 SBA LOANS:

SBA loans are primarily concentrated in the hotel and motel industry (10% of the portfolio) and the restaurant industry (12% of the portfolio), as well as geographically in Florida (27% of the portfolio) and New York (13% of the portfolio). Below is a summary of the activity in the SBA loans held for investment, net of SBA loan loss reserves for the six months ended June 30, 2010 (In thousands):

Balance at December 31, 2009	$ 23,257
SBA loans funded for investment	3,029
Payments received	(1,292)
Provision for SBA loan losses	(853)
Loans foreclosed into real estate owned	(12)
Discount on loan originations, net	152
Balance at June 30, 2010	$ 24,281

Below is a summary of the activity in the reserve for loan losses for the six months ended June 30, 2010 (In thousands):

Balance at December 31, 2009	$ 3,985
SBA loan loss provision	853
Recoveries	45
Loan charge-offs	(1,185)
Balance at June 30, 2010	$ 3,698

18

Table of Contents

Below is a summary of the activity in the SBA loans held for sale for the six months ended June 30, 2010 (In thousands):

Balance at December 31, 2009	$ 200
Originations of SBA Loans held for sale	23,659
SBA loans transferred, subject to premium recourse	(23,536)
Balance at June 30, 2010	$ 323

SBA loans transferred, subject to premium recourse represents fully funded SBA loans which were transferred during the quarter, but cannot yet be considered as sold as a result of the recourse provision under SBA Form 1086. The value of the SBA loans transferred equals the amount of the guaranteed portion of the loans transferred.

All loans are priced at the Prime interest rate plus approximately 2.75% to 3.75%. The only loans with a fixed interest rate are defaulted loans of which the guaranteed portion sold is repurchased from the secondary market by the SBA, while the unguaranteed portion of the loans still remains with the Company. As of June 30, 2010 and December 31, 2009, net SBA loans receivable held for investment with adjustable interest rates amounted to $21,100,000 and $22,549,000, respectively.

For the six months ended June 30, 2010 and 2009, the Company funded approximately $26,489,000 and $ 3,581,000 in loans and transferred approximately $23,536,000 and $8,802,000 of the guaranteed portion of the loans, respectively. Receivables from loans traded but not settled of $8,065,000 and $6,467,000 as of June 30, 2010 and December 31, 2009, respectively, are presented as broker receivable in the accompanying condensed consolidated balance sheets.

The outstanding balances of loans past due ninety days or more and still accruing interest as of June 30, 2010 and December 31, 2009 amounted to $41,000 and $300,000, respectively.

At June 30, 2010 and December 31, 2009, total impaired non-accrual loans amounted to $8,861,000 and $8,324,000, respectively. For the six months ended June 30, 2010 and for the year ended December 31, 2009, the average balance of impaired non-accrual loans was $8,649,000 and $7,773,000, respectively. Approximately $2,713,000 and $3,022,000 of the allowance for loan losses were allocated against such impaired non-accrual loans, respectively. The following is a summary of SBA loans held for investment as of:

(In thousands):	**June 30, 2010**	**December 31, 2009**
Due in one year or less	$ 21	$ 6
Due between one and five years	3,024	2,672
Due after five years	26,372	26,154
Total	29,417	28,832
Less : Allowance for loan losses	(3,698)	(3,985)
Less: Deferred origination fees, net	(1,438)	(1,590)
Balance (net)	$ 24,281	$ 23,257

NOTE 5 SERVICING ASSET:

Servicing rights are recognized as assets when transferred SBA loans are accounted for as sold and the rights to service those loans are retained. The Company measures all separately recognized servicing assets initially at fair value, if practicable. The Company reviews capitalized servicing rights for impairment based on risk strata, which are determined on a disaggregated basis given the predominant risk characteristics of the underlying loans. The predominant risk characteristics are loan term and year of loan origination.

Table of Contents

The changes in the value of the Company s servicing rights for the six months ended June 30, 2010 were as follows:

(In thousands):	
Balance at December 31, 2009	$ 2,436
Servicing assets capitalized	39
Servicing assets amortized	(329)
Balance at June 30, 2010	$ 2,146

The estimated fair value of capitalized servicing rights was $2,146,000 and $2,436,000 at June 30, 2010 and December 31, 2009, respectively. The estimated fair value of servicing assets at both balance sheet dates was determined using a discount rate of 17%, weighted average prepayment speeds ranging from 1% to 13%, depending upon certain characteristics of the loan portfolio, weighted average life of 3.4 years, and an average default rate of 6%. The Company uses an independent valuation specialist to estimate the fair value of the servicing asset.

The unpaid principal balances of loans serviced for others are not included in the accompanying condensed consolidated balance sheets. The unpaid principal balances of loans serviced for others within the NSBF originated portfolio were $161,764,000 and $142,513,000 as of June 30, 2010 and December 31, 2009, respectively. The unpaid principal balances of loans serviced for others which were not originated by NSBF and are outside of the Newtek portfolio were $77,682,000 and $794,000 as of June 30, 2010 and December 31, 2009, respectively.

NOTE 6 BANK NOTES PAYABLE:

In April 2010, the Company closed two five-year term loans aggregating $14,583,000 with Capital One, N.A., of which $12,500,000 refinanced Newtek Small Business Finance s debt to General Electric Commercial Capital (GE) and $2,083,000 refinanced the pre-existing term loan between Capital One and NTS. This financing will support the lending operations of NSBF by providing working capital. The interest rate on the loans is variable based on the monthly LIBOR rate plus 4.25% or Prime plus 2.25%, but no lower than 5.75%. The balance of the two term loans included in bank notes payable on the condensed consolidated balance sheet at June 30, 2010 was $14,316,000 and the interest rate at June 30, 2010 was 5.75%. Interest is paid in arrears along with each monthly principal payment due. The agreement includes such financial covenants as a minimum fixed charge coverage ratio and minimum EBITDA; the Company guarantees these term loans.

In connection with the closing of the Capital One facility, in April 2010, NSBF repaid the outstanding balance of $12,500,000 of its credit facility with GE plus accrued interest of approximately $70,000.

NOTE 7 BENEFIT FOR INCOME TAXES:

The Company s effective tax rate benefit for the three and six month periods ended June 30, 2010 was 72% and 185%, respectively, based on the Company revising its effective tax rate during the second quarter of 2010 to reflect the utilization of an NOL at NSBF for which a reserve had previously been taken. Based on NSBF s current and expected performance, the Company believes there is sufficient evidence to conclude that it is more likely than not that such NOLs will be used for the 2010 tax year.

NOTE 8 NON-CONTROLLING INTEREST:

Resulting from the completion of a statutory merger and acquisition during the quarter ended June 30, 2010, the Company purchased 26% of the non-controlling interest in NBC for approximately $26,000. As a result, the excess of the value of the purchase price over the non-controlling interest balance at the date of purchase, approximately $216,000, was recorded as additional paid-in capital.

During the quarter ended June 30, 2010, unexercised warrants that had entitled holders to interests in two Capcos expired. As a result, the non-controlling interest balance as of the expiration, approximately $136,000, was reclassified to additional paid-in capital.

Table of Contents

NOTE 9 EARNINGS (LOSS) PER SHARE:

Basic earnings (loss) per share is computed based on the weighted average number of common shares outstanding during the period. The dilutive effect of common share equivalents is included in the calculation of diluted loss per share only when the effect of their inclusion would be dilutive.

The calculations of earnings (loss) per share were:

	Three months Ended June 30:		Six months Ended June 30:	
(In thousands except per share data):	**2010**	**2009**	**2010**	**2009**
Numerator for basic and diluted EPS income (loss) available to common shareholders	$ 931	$ (637)	$ 464	$ (1,613)
Denominator for basic EPS weighted average shares	35,648	35,625	35,648	35,625
Effect of dilutive securities	155		148	
Denominator for diluted EPS weighted average shares	35,803	35,625	35,796	35,625
Earnings (loss) per share: Basic and diluted	$ 0.03	$ (0.02)	$ 0.01	$ (0.05)
The amount of anti-dilutive shares/units excluded from above is as follows:				
Stock options	992	1,544	992	1,544
Warrants	266	266	266	266
Contingently issuable shares	83	97	83	97

NOTE 10 SEGMENT REPORTING:

Operating segments are organized internally primarily by the type of services provided. The Company has aggregated similar operating segments into six reportable segments: Electronic payment processing, Web hosting, Small business finance, All other, Corporate and Capcos.

The Electronic payment processing segment is a processor of credit card transactions, as well as a marketer of credit card and check approval services to the small- and medium-sized business market. Expenses include direct costs (included in a separate line captioned electronic payment processing costs), professional fees, salaries and benefits, and other general and administrative costs, all of which are included in the respective caption on the condensed consolidated statements of operations.

The Web hosting segment consists of NTS, acquired in July 2004. NTS s revenues are derived primarily from web hosting services and consist of web hosting and set up fees. NTS generates expenses such as professional fees, payroll and benefits, and depreciation and amortization, which are included in the respective caption on the accompanying condensed consolidated statements of operations, as well as licenses and fees, rent, and general office expenses, all of which are included in other general and administrative costs in the respective caption on the condensed consolidated statements of operations.

The Small business finance segment consists of Small Business Lending, Inc., a lender that primarily originates, sells and services government guaranteed SBA 7(a) loans to qualifying small businesses through NSBF, its licensed SBA lender; the Texas Whitestone Group which manages the Company s Texas Capco and closes loans; and NBC which provides accounts receivable financing, billing and accounts receivable maintenance services to businesses. NSBF generates revenues from sales of loans, servicing income for those loans retained to service by NSBF and interest income earned on the loans themselves. The lender generates expenses for interest, professional fees, salaries and benefits, depreciation and amortization, and provision for loan losses, all of which are included in the respective caption on the condensed consolidated statements of operations. NSBF also has expenses such as loan recovery expenses, loan processing costs, and other expenses that are all included in the other general and administrative costs caption on the condensed consolidated statements of operations.

Table of Contents

The All other segment includes revenues and expenses primarily from qualified businesses that received investments made through the Company s Capcos which cannot be aggregated with other operating segments. The two largest entities in the segment are Newtek Insurance Agency, LLC, an insurance sales operation, and Business Connect, LLC, a provider of sales and processing services.

Corporate activities represent revenue and expenses not allocated to our segments. Revenue includes interest income and management fees earned from Capcos (and included in expenses in the Capco segment). Expenses primarily include corporate operations related to broad-based sales and marketing, legal, finance, information technology, corporate development and additional costs associated with administering the Capcos.

The Capco segment, which consists of the 13 Capcos, generates non-cash income from tax credits, interest income and gains from investments in qualified businesses which are included in other income. Expenses primarily include non-cash interest and insurance expense, management fees paid to Newtek (and included in the Corporate activities revenues), legal, and auditing fees and losses from investments in qualified businesses.

Management has considered the following characteristics when making its determination of its operating and reportable segments:

- the nature of the product and services;
- the type or class of customer for their products and services;
- the methods used to distribute their products or provide their services; and
- the nature of the regulatory environment (for example, banking, insurance, or public utilities).

The accounting policies of the segments are the same as those described in the summary of significant accounting policies.

22

Table of Contents

The following table presents the Company s segment information for the three and six months ended June 30, 2010 and 2009 and total assets as of June 30, 2010 and December 31, 2009 (In Thousands):

	For the three months ended June 30, 2010	For the three months ended June 30, 2009	For the six months ended June 30, 2010	For the six months ended June 30, 2009
Third Party Revenue				
Electronic payment processing	$ 20,407	$ 16,889	$ 39,170	$ 32,663
Web hosting	4,814	4,707	9,604	9,382
Small business finance	1,943	1,564	3,265	3,407
Capcos	596	2,733	1,376	4,311
All other	382	1,320	719	1,706
Corporate activities	532	925	1,240	1,785
Total reportable segments	28,674	28,138	55,374	53,254
Eliminations	(668)	(1,061)	(1,515)	(2,056)
Consolidated Total	$ 28,006	$ 27,077	$ 53,859	$ 51,198
Inter-Segment Revenue				
Electronic payment processing	$ 204	$ 51	$ 295	$ 96
Web hosting	100	87	207	200
Small business finance	189	22	262	36
Capcos	480	543	887	893
All other	3,234	135	3,371	275
Corporate activities	512	520	977	921
Total reportable segments	4,719	1,358	5,999	2,421
Eliminations	(4,719)	(1,358)	(5,999)	(2,421)
Consolidated Total	$	$	$	$
Income (loss) before income taxes				
Electronic payment processing	$ 1,368	$ 1,060	$ 2,452	$ 2,023
Web hosting	1,194	917	2,126	1,833
Small business finance	557	(748)	447	(1,341)
Capcos	(666)	(1,063)	(1,567)	(2,167)
All other	(215)	555	(563)	151
Corporate activities	(1,724			