

NEWTEK BUSINESS SERVICES INC

Form 10-Q

May 13, 2010

Table of Contents

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended March 31, 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)

Edgar Filing: NEWTEK BUSINESS SERVICES INC - Form 10-Q

| | |
|---|--|
| New York (State or other jurisdiction of incorporation or organization) | 11-3504638 (I.R.S. Employer Identification No.) |
| 1440 Broadway, 17th floor, New York, NY (Address of principal executive offices) | 10018 (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 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 <input type="checkbox"/> | Accelerated Filer <input type="checkbox"/> |
| Non-Accelerated Filer <input type="checkbox"/> | Smaller reporting company <input checked="" type="checkbox"/> |

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

As of May 7, 2010, there were 36,727,139 of the Company's Common Shares outstanding.

Table of Contents

CONTENTS

| | PAGE |
|---|-------------|
| PART I - FINANCIAL INFORMATION | |
| Item 1. <u>Financial Statements (Unaudited):</u> | |
| <u>Condensed Consolidated Statements of Operations for the Three Months Ended March 31, 2010 and 2009</u> | 3 |
| <u>Condensed Consolidated Balance Sheets as of March 31, 2010 and December 31, 2009</u> | 4 |
| <u>Condensed Consolidated Statements of Cash Flows for the Three Months Ended March 31, 2010 and 2009</u> | 5 |
| <u>Notes to Unaudited Condensed Consolidated Financial Statements</u> | 7 |
| Item 2. <u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u> | 25 |
| Item 3. <u>Quantitative and Qualitative Disclosures about Market Risk</u> | 35 |
| Item 4. <u>Controls and Procedures</u> | 35 |
| PART II - OTHER INFORMATION | |
| Item 1. <u>Legal Proceedings</u> | 37 |
| Item 6. <u>Exhibits</u> | 37 |
| <u>Signatures</u> | 38 |
| Exhibits | 39 |

Table of Contents**Item 1. Financial Statements****NEWTEK BUSINESS SERVICES, INC. AND SUBSIDIARIES****CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS (UNAUDITED)****FOR THE THREE MONTHS ENDED MARCH 31, 2010 AND 2009****(In Thousands, except for Per Share Data)**

| | 2010 | 2009 |
|--|-------------|-------------|
| Operating revenues | \$ 25,853 | \$ 24,121 |
| Net change in fair market value of: | | |
| Liability on SBA loans transferred, subject to premium recourse | 979 | |
| Credits in lieu of cash and notes payable in credits in lieu of cash | 161 | 537 |
| Total net change in fair market value | 1,140 | 537 |
| Operating expenses: | | |
| Electronic payment processing costs | 15,875 | 12,944 |
| Salaries and benefits | 4,993 | 4,810 |
| Interest | 1,267 | 2,517 |
| Depreciation and amortization | 1,256 | 1,649 |
| Provision for loan losses | 453 | 424 |
| Other general and administrative costs | 4,023 | 4,392 |
| Total operating expenses | 27,867 | 26,736 |
| Loss before income taxes | (874) | (2,078) |
| Benefit for income taxes | 297 | 1,014 |
| Net loss | (577) | (1,064) |
| Net loss attributable to noncontrolling interests | 110 | 88 |
| Net loss attributable to Newtek Business Services, Inc. | \$ (467) | \$ (976) |
| Weighted average common shares outstanding - basic and diluted | 35,648 | 35,625 |
| Loss per share - basic and diluted | \$ (0.01) | \$ (0.03) |

See accompanying notes to these unaudited condensed consolidated financial statements.

Table of Contents**NEWTEK BUSINESS SERVICES, INC. AND SUBSIDIARIES****CONDENSED CONSOLIDATED BALANCE SHEETS****MARCH 31, 2010 AND DECEMBER 31, 2009****(In Thousands, except for Per Share Data)**

| | March 31, 2010 Unaudited | December 31, 2009 (Note 1) |
|---|---|---|
| <u>ASSETS</u> | | |
| Cash and cash equivalents | \$ 9,146 | \$ 12,581 |
| Restricted cash | 7,821 | 6,739 |
| Broker receivable | 9,273 | 6,467 |
| SBA loans held for investment (net of reserve for loan losses of \$4,177 and \$3,985, respectively) | 23,700 | 23,257 |
| Accounts receivable (net of allowance of \$316 and \$211, respectively) | 6,794 | 5,012 |
| SBA loans held for sale | | 200 |
| Prepaid expenses and other assets (net of accumulated amortization of deferred financing costs of \$2,570 and \$2,491, respectively) | 6,841 | 7,502 |
| Servicing asset (net of accumulated amortization and allowances of \$4,707 and \$4,539, respectively) | 2,268 | 2,436 |
| Fixed assets (net of accumulated depreciation and amortization of \$12,947 and \$12,276, respectively) | 3,360 | 3,631 |
| Intangible assets (net of accumulated amortization of \$10,710 and \$10,299, respectively) | 3,904 | 4,218 |
| SBA loans transferred, subject to premium recourse | 11,002 | |
| Credits in lieu of cash | 46,834 | 51,947 |
| Goodwill | 12,092 | 12,092 |
| Total assets | \$ 143,035 | \$ 136,082 |
| <u>LIABILITIES AND EQUITY</u> | | |
| Liabilities: | | |
| Accounts payable and accrued expenses | \$ 9,753 | \$ 8,314 |
| Notes payable | 16,729 | 16,298 |
| Deferred revenue | 1,927 | 1,862 |
| Liability on SBA loans transferred, subject to premium recourse | 11,033 | |
| Notes payable in credits in lieu of cash | 46,834 | 51,947 |
| Deferred tax liability | 3,273 | 3,634 |
| Total liabilities | 89,549 | 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, 36,674 issued; 35,648 outstanding not including 83 shares held in escrow) | 733 | 733 |
| Additional paid-in capital | 57,338 | 57,302 |
| Accumulated deficit | (5,441) | (4,974) |
| Treasury stock, at cost (1,026 shares) | (649) | (649) |
| Total Newtek Business Services, Inc. stockholders' equity | 51,981 | 52,412 |
| Noncontrolling interests | 1,505 | 1,615 |

Edgar Filing: NEWTEK BUSINESS SERVICES INC - Form 10-Q

| | | |
|------------------------------|------------|------------|
| Total equity | 53,486 | 54,027 |
| Total liabilities and equity | \$ 143,035 | \$ 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 THREE MONTHS ENDED MARCH 31, 2010 AND 2009**

(In Thousands)

| | 2010 | 2009 |
|--|----------|------------|
| Cash flows from operating activities: | | |
| Net loss | \$ (577) | \$ (1,064) |
| Adjustments to reconcile net loss to net cash (used in) provided by operating activities: | | |
| Income from tax credits | (746) | (1,536) |
| Accretion of interest expense | 907 | 2,073 |
| Fair market value adjustment on SBA loans transferred, subject to premium recourse | (979) | |
| Fair market value adjustment of credits in lieu of cash and notes payable in credits in lieu of cash | (161) | (537) |
| Deferred income taxes | (361) | (1,069) |
| Depreciation and amortization | 1,256 | 1,649 |
| Provision for loan losses | 453 | 424 |
| Other, net | 88 | 140 |
| Changes in operating assets and liabilities: | | |
| Originations of SBA loans held for sale | | (1,169) |
| Originations of SBA loans transferred, subject to premium recourse | (10,802) | |
| Proceeds from sale of SBA loans held for sale | | 7,302 |
| Broker receivable | 6,467 | |
| Prepaid expenses and other assets, accounts receivable and accrued interest receivable | (1,262) | 1,347 |
| Accounts payable, accrued expenses and deferred revenue | 1,504 | (1,346) |
| Other, net | (223) | (1,182) |
| Net cash (used in) provided by operating activities | (4,436) | 5,032 |
| Cash flows from investing activities: | | |
| Return of investments in qualified businesses | 53 | 908 |
| Purchase of fixed assets and customer merchant accounts | (502) | (500) |
| SBA loans originated for investment, net | (1,476) | (304) |
| Payments received on SBA loans | 621 | 912 |
| Change in restricted cash | (860) | (515) |
| Net cash (used in) provided by investing activities | (2,164) | 501 |

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 THREE MONTHS ENDED MARCH 31, 2010 AND 2009 (CONTINUED)**

| | 2010 | 2009 |
|--|-----------------|------------------|
| Cash flows from financing activities: | | |
| Net proceeds (repayments) on bank notes payable | \$ 431 | \$ (5,857) |
| Liability on SBA loans transferred, subject to premium recourse | 2,739 | |
| Other | (5) | (37) |
| Net cash provided by (used in) financing activities | 3,165 | (5,894) |
| Net decrease in cash and cash equivalents | (3,435) | (361) |
| Cash and cash equivalents - beginning of period | 12,581 | 16,852 |
| Cash and cash equivalents - end of period | \$ 9,146 | \$ 16,491 |
| 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 | \$ 8,064 | \$ 12,730 |
| Addition to broker receivable | \$ 9,273 | \$ |
| Reclassification of SBA loans held for sale to SBA loans transferred, subject to premium recourse | \$ 200 | |
| Addition to liability on SBA loans transferred, subject to premium recourse, before fair value adjustment | \$ 9,273 | \$ |

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) 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. 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 interest in, 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. Noncontrolling interests (previously shown as minority interest) are reported below net income (loss) under the heading Net loss attributable to noncontrolling 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

Table of Contents

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 March 31, 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. 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 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.

Table of Contents

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 percentage of fees is set when entered into an agreement with the client. The Company recognizes the revenue on the date the receivable is purchased. The Company does not take ownership of the receivables until funds are released which then constitutes a purchase of a client's asset. 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 fees 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 months ended:

| (In thousands): | March 31, 2010 | March 31, 2009 |
|-------------------------------|---------------------------|---------------------------|
| Electronic payment processing | \$ 18,756 | \$ 15,761 |
| Web hosting | 4,788 | 4,672 |
| Interest income | 392 | 505 |
| Income from tax credits | 746 | 1,536 |
| Premium income | | 446 |
| Servicing fee | 458 | 400 |
| Insurance commissions | 207 | 200 |
| Other income | 506 | 601 |
| Totals | \$ 25,853 | \$ 24,121 |

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

Edgar Filing: NEWTEK BUSINESS SERVICES INC - Form 10-Q

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 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; and a cash account maintained as a reserve against chargeback losses.

Table of Contents

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 March 31, 2010 and 2009, the Company had two share-based compensation plans. For each of the three months ended March 31, 2010 and 2009, compensation cost charged to operations for those plans was \$36,000 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 months ended March 31, 2010.

As of March 31, 2010 and December 31, 2009, there was \$20,000 and \$55,000 of total unrecognized compensation costs related to non-vested share-based compensation arrangements granted under the Plans, respectively. That cost is expected to be recognized ratably through the month ending July 31, 2010.

Table of Contents***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). 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

Table of Contents

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 months ended March 31, 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 expensed 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 April 2009, the FASB issued an accounting standard to require that disclosures concerning the fair value of financial instruments be presented in interim as well as in annual financial statements. This accounting standard was subsequently codified into ASC Topic 825, *Financial Instruments*. In addition, the FASB issued an accounting standard to provide additional guidance for determining the fair value of a financial asset or financial liability when the volume and level of activity for such asset or liability have decreased significantly and to also provide guidance for determining whether a transaction is an orderly one. This accounting standard was subsequently codified into ASC Topic 820, *Fair Value Measurements and Disclosures*. The FASB also issued an accounting standard which revised and expanded the guidance concerning the recognition and measurement of other-than-temporary impairments of debt securities classified as available for sale or held to maturity. In addition, it required enhanced disclosures concerning such impairment for both debt and equity securities. This accounting standard was subsequently codified into ASC Topic 320, *Investments - Debt and Equity Securities*. The requirements of these

Table of Contents

three accounting standards are effective for interim reporting periods ending after June 15, 2009. Early adoption is permitted for interim periods ending after March 15, 2009, but only if the election is made to adopt all these accounting standards. Disclosures for earlier periods presented for comparative purposes at initial adoption are not required. In periods after initial adoption, comparative disclosures are required only for periods ending after initial adoption. The Company has adopted these accounting standards during the second quarter of 2009.

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 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 June 2009, the FASB issued an accounting standard which established the Codification to become the single source of authoritative accounting principles generally accepted in the United States of America (GAAP) recognized by the FASB to be applied by nongovernmental entities, with the exception of guidance issued by the U.S. Securities and Exchange Commission (the SEC) and its staff. All guidance contained in the Codification carries an equal level of authority. The Codification is not intended to change GAAP, but rather is expected to simplify accounting research by reorganizing current GAAP into approximately 90 accounting topics and providing all the authoritative literature related to a particular topic in one place. The Company adopted this accounting standard in preparing the condensed consolidated financial statements for the quarter ended September 30, 2009 and all subsequent public filings will reference the Codification as the sole source of authoritative literature. The adoption of this accounting standard, which was subsequently codified into ASC Topic 105, *Generally Accepted Accounting Principles*, had no impact on retained earnings and will have no impact on the Company's statements of income and condition.

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.

Subsequent Events

In May 2009, the FASB issued an accounting standard which provides guidance to establish general standards of accounting for and disclosures of events that occur after the balance sheet date but before financial statements are issued or are available to be

Table of Contents

issued. It requires entities to disclose the date through which subsequent events were evaluated as well as the rationale for why that date was selected. This accounting standard is effective for interim and annual periods ending after June 15, 2009 and, accordingly, was adopted by the Company. It requires public entities evaluate subsequent events through the date that the financial statements are issued. This accounting standard was subsequently codified into ASC Topic 855, Subsequent Events. The Company has evaluated subsequent events through the time of filing these condensed consolidated financial statements with the SEC.

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.

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 requires 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 an 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 sheet and is incorporated in notes payable in credits in lieu of cash.

Table of Contents

Assets and Liabilities Measured at Fair Value on a Recurring Basis as of March 31, 2010 are as follows (in thousands):

| | Fair Value Measurements Using: | | | |
|--|---------------------------------------|----------------|----------------|----------------|
| | Total | Level 1 | Level 2 | Level 3 |
| <u>Assets:</u> | | | | |
| Credits in lieu of cash | \$ 46,834 | \$ | \$ 46,834 | \$ |
| <u>Liabilities:</u> | | | | |
| Notes payable in credits in lieu of cash | \$ 46,834 | \$ | \$ 46,834 | \$ |

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 |
| <u>Assets:</u> | | | | |
| Credits in lieu of cash | \$ 51,947 | \$ | \$ 51,947 | \$ |
| <u>Liabilities:</u> | | | | |
| Notes payable in credits in lieu of cash | \$ 51,947 | \$ | \$ 51,947 | \$ |

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 participants 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 March 31, 2010, the date the Company revalued the asset and liability, the yields on the Chartis notes averaged 4.85% 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 months ended March 31, 2010 was a gain of \$161,000.

Table of Contents

On December 31, 2008, the yield on the AIG Note Basket was 11.76%. As of March 31, 2009, the date the Company revalued the asset and liability, the yields on the AIG notes averaged 21.56% 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 months ended March 31, 2009 was a gain of \$537,000.

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 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 March 31, 2010 are as follows (in thousands):

| | Fair Value Measurements Using: | | | |
|---|--------------------------------|---------|---------|-----------|
| | Total | Level 1 | Level 2 | Level 3 |
| <u>Liabilities:</u> | | | | |
| Liability on SBA loans transferred, subject to premium recourse | \$ 11,033 | \$ | \$ | \$ 11,033 |

Below is a summary of the activity in the Liability on SBA loans transferred, subject to premium recourse for the three months ended March 31, 2010 (In thousands):

| | |
|---|-----------|
| Balance at December 31, 2009 | \$ |
| Liability on SBA loans transferred, subject to premium recourse | 11,033 |
| Balance at March 31, 2010 | \$ 11,033 |

Table of Contents**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 March 31, 2010 Using: | | | | Total Losses |
|-------------------------|--|---------|---------|----------|--------------|
| | Total | Level 1 | Level 2 | Level 3 | |
| Assets | | | | | |
| Impaired loans | \$ 5,291 | \$ | \$ | \$ 5,291 | \$ (450) |
| Other real-estate owned | 128 | | 128 | | (4) |
| Total assets | \$ 5,419 | \$ | \$ 128 | \$ 5,291 | \$ (454) |

| | Fair Value Measurements at December 31, 2009 Using: | | | | Total Losses |
|-------------------------------------|---|---------|---------|----------|--------------|
| | Total | Level 1 | Level 2 | Level 3 | |
| 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) |

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.

Table of Contents**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 three months ended March 31, 2010 (In thousands):

| | |
|------------------------------------|-----------|
| Balance at December 31, 2009 | \$ 23,257 |
| SBA loans funded for investment | 1,450 |
| Payments received | (621) |
| Provision for SBA loan losses | (453) |
| Discount on loan originations, net | 67 |
| Balance at March 31, 2010 | \$ 23,700 |

Below is a summary of the activity in the reserve for loan losses for the three months ended March 31, 2010 (In thousands):

| | |
|------------------------------|----------|
| Balance at December 31, 2009 | \$ 3,985 |
| SBA loan loss provision | 453 |
| Recoveries | 8 |
| Loan charge-offs | (269) |
| Balance at March 31, 2010 | \$ 4,177 |

Below is a summary of the activity in the SBA loans held for sale for the three months ended March 31, 2010 (In thousands):

| | |
|--|----------|
| Balance at December 31, 2009 | \$ 200 |
| Originations of SBA Loans held for sale | 10,802 |
| SBA loans transferred, subject to premium recourse | (11,002) |
| Balance at March 31, 2010 | \$ |

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 March 31, 2010 and December 31, 2009, net SBA loans receivable held for investment with adjustable interest rates amounted to \$22,121,000 and \$22,549,000, respectively.

For the three months ended March 31, 2010 and 2009, the Company funded approximately \$12,139,000 and \$1,581,000 in loans and transferred approximately \$11,002,000 and \$7,302,000 of the guaranteed portion of the loans, respectively. Receivables from loans traded but not settled of \$9,273,000 and \$6,467,000 as of March 31, 2010 and December 31, 2009, respectively, are presented as broker receivable in the accompanying condensed consolidated balance sheet.

The outstanding balances of loans past due ninety days or more and still accruing interest as of March 31, 2010 and December 31, 2009 amounted to \$0 and \$300,000, respectively.

Table of Contents

At March 31, 2010 and December 31, 2009, total impaired non-accrual loans amounted to \$8,503,000 and \$8,324,000, respectively. For the three months ended March 31, 2010 and for the year ended December 31, 2009, the average balance of impaired non-accrual loans was \$8,537,000 and \$7,773,000, respectively. Approximately \$3,212,000 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): | March 31, 2010 | December 31, 2009 |
|--------------------------------------|---------------------------|------------------------------|
| Due in one year or less | \$ 17 | \$ 6 |
| Due between one and five years | 2,945 | 2,672 |
| Due after five years | 26,440 | 26,154 |
| Total | 29,402 | 28,832 |
| Less : Allowance for loan losses | (4,177) | (3,985) |
| Less: Deferred origination fees, net | (1,525) | (1,590) |
| Balance (net) | \$ 23,700 | \$ 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 which is performed 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.

The changes in the value of the Company's servicing rights for the three months ended March 31, 2010 were as follows:

| (In thousands): | |
|-------------------------------|--------------|
| Balance at December 31, 2009 | \$ 2,436 |
| Servicing assets amortized | (168) |
| Balance at March 31, 2010 | \$ 2,268 |

The estimated fair value of capitalized servicing rights was \$2,268,000 and \$2,436,000 at March 31, 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 were \$150,571,000 and \$142,513,000 as of March 31, 2010 and December 31, 2009, respectively.

NOTE 6 LOSS PER SHARE:

Basic 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.

Table of Contents

The calculations of loss per share were:

| (In thousands except per share data): | Three Months Ended March 31, 2010 | Three Months Ended March 31, 2009 |
|--|--|--|
| Numerator: | | |
| Numerator for basic and diluted loss per share loss available to common shareholders | \$ (467) | \$ (976) |
| Denominator: | | |
| Denominator for basic and diluted loss per share weighted average shares | 35,648 | 35,625 |
| Loss per share: Basic and diluted | \$ (0.01) | \$ (0.03) |

The amount of anti-dilutive shares/units excluded from the above calculation is as follows:

| | Three Months Ended March 31, 2010 | Three Months Ended March 31, 2009 |
|------------------------------------|--|--|
| Stock options and restricted stock | 1,236 | 1,701 |
| Warrants | 50 | 212 |
| Contingently issuable shares | 83 | 97 |

NOTE 7 SUBSEQUENT EVENTS:

In April 2010, the Company closed two five year term loans aggregating \$14,583,000 with Capital One, N.A. which facilitated the refinancing of Newtek Small Business Finance's debt to General Electric Commercial Capital (GE) as well as the current 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 loan is variable based on the monthly LIBOR rate plus 4.25% or Prime plus 2.25%, but no lower than 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 8 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.

Edgar Filing: NEWTEK BUSINESS SERVICES INC - Form 10-Q

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 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.

Table of Contents

The following table presents the Company's segment information for the periods ended March 31, 2010 and 2009 and total assets as of March 31, 2010 and December 31, 2009 (In Thousands):

| | For the three months ended March 31, 2010 | For the three months ended March 31, 2009 |
|--|--|--|
| Third Party Revenue | | |
| Electronic payment processing | \$ 18,763 | \$ 15,774 |
| Web hosting | 4,790 | 4,675 |
| Small business finance | 1,322 | 1,843 |
| Capcos | 780 | 1,578 |
| All other | 337 | 386 |
| Corporate activities | 708 | 860 |
| Total reportable segments | 26,700 | 25,116 |
| Eliminations | (847) | (995) |
| Consolidated Total | \$ 25,853 | \$ 24,121 |
| Inter Segment Revenue | | |
| Electronic payment processing | \$ 91 | \$ 45 |
| Web hosting | 107 | 113 |
| Small business finance | 73 | 14 |
| Capcos | 407 | 350 |
| All other | 137 | 140 |
| Corporate activities | 465 | 401 |
| Total reportable segments | 1,280 | 1,063 |
| Eliminations | (1,280) | (1,063) |
| Consolidated Total | \$ | \$ |
| Income (loss) before benefit for income taxes | | |
| Electronic payment processing | \$ 1,084 | \$ 963 |
| Web hosting | 932 | 916 |
| Small business finance | (110) | (593) |
| Capcos | (901) | (1,103) |
| All other | (348) | (404) |
| Corporate activities | (1,531) | (1,857) |
| Totals | \$ (874) | \$ (2,078) |
| Depreciation and amortization | | |
| Electronic payment processing | \$ 416 | \$ 460 |
| Web hosting | 490 | 792 |
| Small business finance | 212 | 229 |
| Capcos | 3 | 16 |
| All other | 45 | 30 |
| Corporate activities | 90 | 122 |

| | | | | |
|---------------|----|-------|----|-------|
| Totals | \$ | 1,256 | \$ | 1,649 |
|---------------|----|-------|----|-------|

Table of Contents

| | As of March 31, 2010 | As of December 31, 2009 |
|-------------------------------|----------------------------|-------------------------------|
| Identifiable assets | | |
| Electronic payment processing | \$ 9,740 | \$ 12,295 |
| Web hosting | 11,734 | 12,382 |
| Small business finance | 58,959 | 43,109 |
| Capcos | 55,183 | 59,679 |
| All other | 4,773 | 5,125 |
| Corporate activities | 2,646 | 3,492 |
| Consolidated total | \$ 143,035 | \$ 136,082 |

Table of Contents**Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations.**

The following discussion and analysis of our financial condition and results of operations is intended to assist in the understanding and assessment of significant changes and trends related to the results of operations and financial position of the Company together with its subsidiaries. This discussion and analysis should be read in conjunction with the condensed consolidated financial statements and the accompanying notes.

This Quarterly Report on Form 10-Q contains forward-looking statements. Additional written or oral forward-looking statements may be made by Newtek from time to time in filings with the Securities and Exchange Commission or otherwise. The words believe, expect, seek, anticipate and intend and similar expressions identify forward-looking statements, which speak only as of the date the statement is made. Such forward-looking statements are within the meaning of that term in Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. Such statements may include, but are not limited to, projections of income or loss, expenditures, acquisitions, plans for future operations, financing needs or plans relating to our services, as well as assumptions relating to the foregoing. Forward-looking statements are inherently subject to risks and uncertainties, some of which cannot be predicted or quantified. Future events and actual results could differ materially from those set forth in, contemplated by or underlying the forward-looking statements. Newtek does not undertake, and specifically disclaims, any obligation to publicly release the results of revisions which may be made to forward-looking statements to reflect the occurrence of anticipated or unanticipated events or circumstances after such statements.

We also need to point out that our Capcos operate under a different set of rules in each of the 8 jurisdictions and that these place varying requirements on the structure of our investments. In some cases, particularly in Louisiana, we don't control the equity or management of a qualified business but that cannot always be presented orally or in written presentations.

For the quarter ended March 31, 2010, the Company substantially reduced its loss before income taxes to \$(874,000) from \$(2,078,000) in the same quarter of 2009. This reduction in loss resulted from continued improvements in business operations producing an increase in revenue and reductions in operating expenses other than electronic payment processing costs. We had a net loss of \$(467,000), an improvement of \$509,000 over 2009 primarily from the improvement in operations. Total revenues increased by \$1,732,000 to \$25,853,000, or 7.2%, from \$24,121,000 for the quarter ended March 31, 2009 principally due to increased revenues in the Electronic payment processing and Web hosting segments offset by a decrease in revenues from our Small business finance (see below), Capco and All other segment. The reduction in the net loss from the first quarter of 2009 reflects improvements in income from operations for all segments: Electronic payment processing from a gain in margin (margin on a percentage basis continued to decrease and will continue to negatively impact profitability for the segment) and a reduction in expenses other than electronic payment processing costs; Web hosting from improved sales and reduced depreciation and amortization; Small business finance from increased loan origination and loan servicing and receivables factoring; and Capco, All other segments and Corporate from reductions in expenses.

Beneficial pricing in the secondary market for guaranteed loan sales, the current 90% guaranty rate for SBA 7(a) loans, and healthy demand for loans from borrowers due to the shortage of loans provided by conventional lenders contributed to a healthy operating environment for the Company's SBA lender. However, the Small business finance segment revenues were negatively impacted by the effects of ASC Topic 860,

Transfers and Servicing which resulted in first quarter sales of SBA loans held for sale via SBA regulated secondary market transactions being accounted for as financings (the circumstances that give rise to this accounting treatment are discussed above). In addition to requiring the Company to wait the 90 to 275 days for the premium warranty periods required by the SBA to expire in order to recognize revenue, ASC Topic 860 also results in the creation of a new asset, SBA loans transferred, subject to recourse, and a new liability, Liability for SBA loans transferred, subject to recourse. In the case of the asset, the Company no longer controls the transferred guaranteed portion nor derives economic benefit from it other than collection of servicing income. Although the asset resides on the Company's balance sheet it cannot transfer it again; the new owner (deemed transferee or lender by ASC Topic 860) has the right to transfer the asset at any time to a third party or place it into a pool for securitization. The warranty that gave rise to the accounting treatment occurs in the unlikely event of either the Company's borrower prepaying their loan to the transferee or defaulting on the loan in which case the SBA makes the payment to the transferee. In neither case will the Company be making the payment of the guaranteed portion. Economically, the Company is only liable for that amount lent to the Company over the par amount of the guaranteed portion, likely to be returned under the warranty; the non-returned part will be subsequently earned as premium upon recognition of the sale. Historically, over the past seven years, this has equaled about 3% in the aggregate of the premium amount. By electing to fair value the liability to its true economic value the segment and the company benefited from a gain approximating the difference between the premium amount and the amount potentially to be returned to the transferee.

Table of Contents

In April 2010, the Company closed two five year term loans aggregating \$14,583,000 with Capital One, N.A. which refinanced Newtek Small Business Finance's \$12,500,000 debt to General Electric Commercial Capital as well as the existing \$2,083,000 term loan between Capital One and NTS. This financing supports the lending operations of NSBF by providing working capital. Future SBA lending operations will be funded from internal sources while the Company uses its cash flow to pay down these loans over the next five years. The Company guarantees these term loans.

The Company's effective income tax rate decreased from approximately 48% in the first quarter of 2009 to approximately 34% in the first quarter of 2010 mainly due to a release of a valuation allowance that occurred in 2009. In 2009, the Company determined certain losses that previously had been valued at zero will be utilized against current and future tax profits of the Company and therefore released a valuation allowance related to those previously reserved assets.

The decrease in the Company's cash and cash equivalents from \$12,581,000 to \$9,146,000 primarily reflects effects from the resumption of lending by the Company's SBA lender for a second consecutive quarter. Partially the decline represents timing differences between the transfer of the guaranteed portions of the loans and receipt of cash thereon that increased \$2,806,000 over the amount from year end and partially it reflects the Company using its cash resources rather than a financing line to support its SBA lender origination of SBA loans. Overall, we believe that throughout 2010 the Company has and will continue to enjoy improvements from increased revenues and both the full year benefit from the expense reductions made previously as well as the continuing cost cutting efforts in 2010.

The Company's reportable business segments are:

Electronic Payment Processing: Credit card and debit card processing, check conversion and ACH solutions for the small- and medium-sized business market.

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

Small Business Finance: Newtek Small Business Finance, Inc., a nationally licensed, U.S. Small Business Administration lender that originates, sells and services loans to qualifying small businesses, which are partially guaranteed by the SBA. Texas Whitestone Group performs the closing function for all SBA 7(a) loans underwritten by NSBF. CDS Business Services, Inc. (d/b/a Newtek Business Credit) provides financing services to businesses by purchasing their receivables at a discounted rate. In addition, the Company provides billing and accounts receivable maintenance services to businesses.

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. Revenue and expenses not allocated to our 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.

Segment Results:

The results of the Company's reportable segments for the three months ended March 31, 2010 and 2009 are discussed below.

Table of Contents**Electronic Payment Processing**

| (In thousands): | Three months ended March 31: | | \$ Change | % Change |
|--|---------------------------------|---------------|---------------|------------|
| | 2010 | 2009 | | |
| Revenue: | | | | |
| Electronic payment processing | \$ 18,756 | \$ 15,760 | \$ 2,996 | 19% |
| Interest income | 7 | 14 | (7) | (50)% |
| Total revenue | 18,763 | 15,774 | 2,989 | 19% |
| Expenses: | | | | |
| Electronic payment processing costs | 15,872 | 12,941 | 2,931 | 23% |
| Salaries and benefits | 1,081 | 1,132 | (51) | (5)% |
| Professional fees | 88 | 55 | 33 | 60% |
| Depreciation and amortization | 416 | 460 | (44) | (10)% |
| Other general and administrative costs | 222 | 223 | (1) | % |
| Total expenses | 17,679 | 14,811 | 2,868 | 19% |
| Income before income taxes | \$ 1,084 | \$ 963 | \$ 121 | 13% |

Electronic payment processing revenue increased \$2,989,000 or 19% between years principally due to the overall impact of growth in organic revenue of 20% while revenues from acquired portfolios decreased overall revenue growth by 1% between periods due to merchant attrition. The growth in organic revenue was partially due to the impact of an increase in the average number of merchants under contract between years of 8%. The remaining increase in organic revenue between periods is due to an increase in the average monthly processing volume per merchant. The increase in the average monthly processing volume per merchant is due in part to the addition of several larger volume processing merchants as well as year-over-year growth in processing volumes from existing merchants between periods.

Electronic payment processing costs increased \$2,931,000 or 23% between years. Electronic payment processing costs resulting from acquired portfolios had the overall effect of decreasing such costs by approximately 1% between periods due to merchant attrition. Organic electronic payment processing costs had the effect of increasing total electronic payment processing cost by 24% between years. As a percent of processing revenues, processing revenues less electronic payment processing cost (margin) declined approximately 2.5% from 17.9% in 2009 to 15.4% in 2010. A lower contribution to margin from acquired portfolios contributed 0.7% to the decline in margin. The remaining decline in margin of 1.8% is attributable to increased contractual residual rates paid to some third-party sales referral sources coupled with the impact on margin of the mix of new merchants sold by such third-parties. The overall margin percentage derived from merchants sold or acquired through other sales channels was unchanged between periods. Margin on a dollar basis increased by \$65,000 period over period.

Excluding electronic payment processing costs, other costs decreased \$63,000 between periods. Depreciation and amortization costs decreased \$44,000 between years as the result of previously acquired portfolio intangible assets becoming fully amortized between periods. Remaining costs decreased \$19,000 principally as a result of a change in the mix of personnel staffing between periods.

Income before benefit for income taxes increased \$121,000 to \$1,084,000 in 2010 from \$963,000 in 2009. An increase in the dollar margin of operating revenues less EPP processing costs due to the overall growth in sales volumes processed between periods coupled with cost reductions in other expenses resulted in the increase in income before benefit for income taxes between periods.

Table of Contents**Web Hosting**

| (In thousands): | Three months ended March 31: | | \$ Change | % Change |
|--|---------------------------------|---------------|--------------|-----------|
| | 2010 | 2009 | | |
| Revenue: | | | | |
| Web hosting | \$ 4,788 | \$ 4,672 | \$ 116 | 2% |
| Interest income | 2 | 3 | (1) | (33)% |
| Total revenue | 4,790 | 4,675 | 115 | 2% |
| Expenses: | | | | |
| Salaries and benefits | 1,416 | 1,186 | 230 | 19% |
| Interest | 18 | 33 | (15) | (45)% |
| Professional fees | 144 | 81 | 63 | 78% |
| Depreciation and amortization | 490 | 792 | (302) | (38)% |
| Other general and administrative costs | 1,790 | 1,667 | 123 | 7% |
| Total expenses | 3,858 | 3,759 | 99 | 3% |
| Income before income taxes | \$ 932 | \$ 916 | \$ 16 | 2% |

The segment derives revenue primarily from monthly recurring fees from hosting websites, including monthly plans for shared hosting, dedicated servers and virtual instances. Web hosting revenue between periods increased \$116,000, or 2%, to \$4,788,000 for the three months ended March 31, 2010 over the same period in 2009 due to improved revenue per plan, organic growth of hosted virtual instances, and sales of custom website development services. NTS sales promotions and service and plan enhancements failed to drive growth in plans but did help to improve revenue.

The increase in revenue reflects an increase in average quarterly revenue per plan of 9% to \$76.53 from \$69.94 offset by a decrease in the average number of total plans by 4,240 for the three months ended March 31, 2010 as compared to the same period in 2009, or 6%, to 62,568 from 66,808. Improvement in revenue per plan primarily reflects the greater growth in virtual instances and customers gravitating towards higher-end services combined with additional options and services. The average number of dedicated server plans for the three months ended March 31, 2010, which generate a higher monthly fee versus shared hosting plans, decreased by 38 between periods, or 2%, to an average of 2,202 from an average of 2,240 for the same period in 2009. The average number of shared hosting plans decreased 4,285, or 7%, to 60,187 for the three months ended March 31, 2010, from 64,472 for the same period in 2009; the reduction in shared plans without replacement with new revenue streams has become a drag on revenue growth. The average number of virtual instance plans increased 83, or 87%, to 179 for the three months ended March 31, 2010, from 96 for the same period in 2009. The trend in decreasing total shared and dedicated plan counts began in the fourth quarter of 2008, however, the dedicated server plan counts have increased by 68 in the first quarter 2010 as compared to the fourth quarter of 2009, which had an average count of 2,134. Current economic conditions, although starting to improve, and increased competition continue to have an effect on plan count growth.

Total segment expenses increased by 3%, or \$99,000, as compared to the 2%, or \$115,000, growth in revenues for the three months ended March 31, 2010. The majority of the 3% or \$99,000 increase in expenses between periods reflects an increase in other general and administrative costs of \$123,000, an increase in salaries and benefits of \$230,000, and an increase in professional fees of \$63,000, offset by a decrease in depreciation and amortization of \$302,000 and a decrease in interest expense of \$15,000. The increase in other general and administrative costs was primarily due to a \$61,000 increase in rent and utilities, a \$15,000 increase in processing costs, an \$8,000 increase in licenses and permits, a \$32,000 increase in office and other costs and a \$29,000 increase in bad debt expense. The increases were offset in part by a \$7,000 decrease in internet and communications, a result of renegotiations of internet and telephone contracts, and an approximate decrease of \$15,000 in marketing costs. Salaries and benefits increased \$230,000 mainly due to a \$41,000 increase in benefit costs and an approximate 25% increase in headcount relating to sales and customer service. As a result of salaries and benefits having grown at a higher rate than revenue growth, management has taken action to reduce salaries and benefits expense throughout the rest of the year. The \$302,000 decrease in depreciation and amortization was primarily due to the intangible assets (the customer account and non-compete covenant from the time of acquisition) being fully amortized as of June 30, 2009 and the slowing of capital expenditures as a result of more efficient use of the already existing equipment within the datacenter and the decrease in the number of dedicated sites. The increase of \$63,000 in professional fees was due to higher legal and consulting fees for

Edgar Filing: NEWTEK BUSINESS SERVICES INC - Form 10-Q

the three months ended March 31, 2010. Income before income taxes increased 2% or \$16,000 to \$932,000 for the three months ended 2010 from \$916,000 for the same period in 2009. The improvement in profitability primarily resulted from the slight increase in web site plan revenue combined with a decrease in depreciation and amortization.

Table of Contents**Small Business Finance**

| (In thousands): | Three months ended March 31: | | | |
|---|---------------------------------|-----------------|-----------------|--------------|
| | 2010 | 2009 | \$ Change | % Change |
| Revenue: | | | | |
| Premium income | \$ | \$ 446 | \$ (446) | (100)% |
| Servicing fee | 457 | 400 | 57 | 14% |
| Interest income | 336 | 428 | (92) | (21)% |
| Management fees | 146 | 146 | | % |
| Other income | 383 | 423 | (40) | (9)% |
| Total revenue | 1,322 | 1,843 | (521) | (28)% |
| Net change in fair market value of: | | | | |
| Liability on SBA loans transferred, subject to premium recourse | 979 | | 979 | % |
| Expenses: | | | | |
| Salaries and benefits | 796 | 742 | 54 | 7% |
| Interest | 333 | 418 | (85) | (20)% |
| Management fees | 115 | 115 | | % |
| Professional fees | 140 | 69 | 71 | 103% |
| Depreciation and amortization | 212 | 229 | (17) | (7)% |
| Provision for loan losses | 453 | 424 | 29 | 7% |
| Other general and administrative costs | 362 | 439 | (77) | (18)% |
| Total expenses | 2,411 | 2,436 | (25) | (1)% |
| Loss before income taxes | \$ (110) | \$ (593) | \$ (483) | (81)% |

Revenue is derived primarily from premium income generated by the sale of the guaranteed and unguaranteed portions of SBA loans. The implementation of ASC Topic 860, *Transfers and Servicing*, which became effective January 1, 2010, has delayed the recognition of the premium income. Additionally, the Company derives revenue from interest income on SBA loans held for investment, servicing fee income on the guaranteed portions of SBA loans previously sold, servicing income for loans originated by other lenders for which NSBF is the servicer, and financing and billing services, classified as other income above, provided by Newtek Business Credit (NBC). Most SBA loans originated by NSBF charge an interest rate equal to the Prime rate plus an additional percentage amount; the interest rate resets to the current Prime rate on a monthly or quarterly basis which will result in changes to the amount of interest accrued for that month and going forward and a re-amortization of a loan's payment amount until maturity.

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*. The Company values the liability based on the probability of payment given the Company's history of returning premium: the transferee will receive 100%

Table of Contents

of the guaranteed portion from either the borrower or the SBA and approximately 3% of the premium amount from the Company in instances of default or prepayment during the warranty period. This calculation results in the recognition of the \$979,000 identified above. At the expiration of the warranty period, the sale of the guaranteed portions of these loans as well as the corresponding gain is recognized into premium income, and the asset and liability eliminated. Recognition is estimated to occur from 90 days of settlement date, which for the loans sold in the first quarter 2010 will begin at the end of the second and continue throughout the third quarter of 2010.

As a result of the implementation of ASC Topic 360, the Company did not record premium income during the first quarter 2010 compared with \$446,000 for the three months ended March 31, 2009. During the three months ended March 31, 2010, the Company transferred 17 guaranteed loans aggregating \$11,002,000 compared with 13 guaranteed loans sold aggregating \$7,302,000 in the same period for the prior year. Premiums on guaranteed loan sales averaged 102.4% with 1% servicing in the quarter ended March 31, 2009. At the end of the fourth quarter 2009, the secondary markets stabilized, which resulted in an increase in premiums on guaranteed loan sales for the first quarter 2010 to an average of 109.21%, levels more consistent with those realized prior to the second half of 2008. However, as discussed above the recognition of the revenue from these sales were delayed into future periods.

Servicing fee income related to SBA loans increased by \$57,000 due primarily to the addition of servicing income associated with the FDIC contract, which totaled \$65,000 for the three months ended March 31, 2010; there was no corresponding FDIC income in the prior quarter. This increase was offset by a slight decrease in the average NSBF servicing portfolio. For the quarter ended March 31, 2010, the average NSBF servicing portfolio was \$127,298,000 compared with \$128,282,000 for the three months ended March 31, 2009.

Interest income decreased \$92,000 due primarily to a reduction in the average outstanding portfolio from \$32,313,000 in the first three months of 2009 to \$28,495,000 in the first three months of 2010.

Other income decreased by \$40,000 due to reductions in late payment and other loan-related income at NSBF as well as a reduction in billing services revenue earned by Newtek Business Credit. The average number of billing service customers decreased by 14 from an average of 90 to an average of 76 during the three months ended March 31, 2009 and 2010, respectively.

As a result of the implementation of ASC Topic 360, the Company established a new liability, Liability for SBA loan transferred, subject to recourse to account for transfers of the guaranteed portions sold via SBA regulated secondary market transactions as financings during the duration of the premium warranty period. As discussed above, contemporaneous with the implementation the Company elected to fair value the new liability. As a result, the Company recognized a gain of \$979,000 in the quarter from the reduction of the value of the liability based on its economic likelihood of repayment.

Salaries and benefits increased by \$54,000 as additional staff was added in the originating, servicing and liquidation departments in connection with the resumption of lending that began in the third quarter of 2009. Payroll expense at NBC was consistent with the prior quarter. The Company believes it has adequate staff to service its portfolio and originate loans. Combined headcount increased by 11.8% from 34 at March 31, 2009, to 38 at March 31, 2010.

After deducting the amortization of deferred financing costs associated with the lines of credit held by NSBF and NBC of \$107,000 for the three months ended March 31, 2009 and \$70,000 for the three months ended March 31, 2010, interest expense decreased from \$311,000 to \$263,000 for the same periods, respectively. The decrease in amortization of deferred financing costs for the quarter ended March 31, 2010, was due to the extension of the line of credit under the Fifth Amendment in July 2009 through May 2010 which extended the amortization period of the remaining asset. The decrease in interest expense was attributable to the average line outstanding with GE decreasing from \$16,409,000 to \$11,894,000 quarter over quarter which had a more significant impact than the average interest rate charged increasing from 6.03% to 7.18%, for the quarters ended March 31, 2009 and 2010, respectively. The combined average line outstanding to external sources decreased from \$18,232,000 to \$14,004,000 for the periods ended March 31, 2009 and 2010, respectively.

Professional fees for the three months ended March 31, 2010 increased by \$71,000 primarily due to the increase in consulting and accounting expenses, which was partially offset by a decrease in legal expense.

Other general and administrative costs decreased by \$77,000 due primarily to a \$95,000 reduction in loan recovery expenses in connection with losses recorded in the prior quarter on foreclosed property and a \$36,000 reduction in force placed insurance at NSBF during the quarter ended March 31, 2010. These cost reductions were partially offset by a \$51,000 increase in loan servicing expenses as a result of the Company resuming loan originations during the current quarter.

Table of Contents

Consideration in arriving at the provision for loan loss includes past and current loss experience, current portfolio composition, future estimated cash flows, and the evaluation of real estate and other collateral as well as current economic conditions. Although the quarterly provision for loan loss decreased slightly quarter over quarter, the reserve for loan losses as compared to the gross portfolio balance increased from \$3,592,000 or 11.7% at March 31, 2009 to \$4,178,000 or 14.4% at March 31, 2010. Total impaired non-accrual loans at March 31, 2009 and March 31, 2010, amounted to \$6,741,000 and \$8,448,000, respectively, with \$2,530,000 or 37.5% and \$3,212,000 or 37.9% of the allowance for loan losses being allocated against such impaired non-accrual loans, respectively. The year over year increase in the reserve balance on an absolute and as a percentage of impaired non-accrual loans reflects the effects the recession has had on NSBF's borrowers and the borrowers assets underlying the loans. We believe that although the economic situation has improved which should result in the stabilization of the amount of impaired non-accrual loans, we cannot predict when the allowance for loan losses will improve.

While premium and interest income decreased for the quarter, the resumption of loan originations and transfers in 2010 coupled with reductions in expenses resulted in an 81% improvement in net loss quarter over quarter.

Capcos

| (In thousands): | Three months ended March 31: | | \$ Change | % Change |
|--|---------------------------------|--------------|----------------|--------------|
| | 2010 | 2009 | | |
| Revenue: | | | | |
| Income from tax credits | \$ 746 | \$ 1,536 | \$ (790) | (51)% |
| Interest income | 29 | 42 | (13) | (31)% |
| Other income | 5 | | 5 | % |
| Total revenue | 780 | 1,578 | (798) | (51)% |
| Net change in fair market value of: | | | | |
| Credits in lieu of cash and Notes payable in credits in lieu of cash | 161 | 537 | (376) | (70)% |
| Expenses: | | | | |
| Interest | 916 | 2,064 | (1,148) | (56)% |
| Management fees | 731 | 880 | (149) | (17)% |
| Professional fees | 104 | 152 | (48) | (32)% |
| Other general and administrative costs | 91 | 122 | (31) | (25)% |
| Total expenses | 1,842 | 3,218 | (1,376) | (43)% |
| Loss before income taxes | \$ (901) | \$ (1,103) | \$ (202) | (18)% |

As described in Note 3 to the condensed consolidated financial statements, effective January 1, 2008, the Company adopted fair value accounting for its financial assets and financial liabilities concurrent with its election of the fair value option for substantially all credits in lieu of cash, notes payable in credits in lieu of cash and prepaid insurance. These are the financial assets and liabilities associated with the Company's Capco notes that are reported within the Company's Capco segment. The table above reflects the effects of the adoption of fair value measurement on the income and expense items (income from tax credits, interest expense and insurance expense) related to the revalued financial assets and liability for the three months ended March 31, 2010 and 2009. In addition, the net change to the revalued financial assets and liability for the three months ended March 31, 2010 and 2009 is reported in the line Net change in fair market value of Credits in lieu of cash and Notes payable in credits in lieu of cash on the condensed consolidated statement of operations.

Revenue is derived primarily from non-cash income from tax credits. The decrease in first quarter 2010 revenue versus the first quarter 2009 reflects the effect of the lower interest rate used under fair value accounting. The amount of future income from tax credits revenue will fluctuate with future interest rates. However, over future periods through 2016, the amount of tax credits, and therefore the income the Company will recognize, will decrease to zero.

Edgar Filing: NEWTEK BUSINESS SERVICES INC - Form 10-Q

Expenses consist primarily of management fees and non-cash interest expense. Management fees decreased 17%, or \$149,000, to \$731,000 for the three months ended March 31, 2010 from \$880,000 for the same period ended 2009. Management fees, which are eliminated upon consolidation, are expected to decline in the future as the Capcos mature and utilize their cash. Interest expense decreased 56%, or \$1,148,000, to \$916,000 for the three months ended March 31, 2010 from \$2,064,000 as a result of the lower interest rate used under the fair value accounting for the period.

Table of Contents

The Company does not anticipate creating any new Capcos in the foreseeable future and the Capco segment will continue to incur losses going forward. The Capcos will continue to earn cash investment income on their cash balances and incur cash management fees and operating expenses. The amount of cash available for investment and to pay management fees will be primarily dependent upon future returns generated from investments in qualified businesses. Income from tax credits will consist solely of accretion of the discounted value of the declining dollar amount of tax credits the Capcos will receive in the future; the Capcos will continue to incur non-cash interest expense.

All Other

| (In thousands): | Three months ended March 31: | | \$ Change | % Change |
|--|---------------------------------|------------|--------------|--------------|
| | 2010 | 2009 | | |
| Revenue: | | | | |
| Interest income | \$ 11 | \$ 16 | \$ (5) | (31)% |
| Insurance commissions | 207 | 200 | 7 | 4% |
| Other income | 119 | 170 | (51) | (30)% |
| Total revenue | 337 | 386 | (49) | (13)% |
| Expenses: | | | | |
| Salaries and benefits | 403 | 492 | (89) | (18)% |
| Professional fees | 57 | 79 | (22) | (28)% |
| Depreciation and amortization | 45 | 30 | 15 | 50% |
| Other general and administrative costs | 180 | 189 | (9) | (5)% |
| Total expenses | 685 | 790 | (105) | (13)% |
| Loss before income taxes | \$ (348) | \$ (404) | \$ (56) | (14)% |

The All Other segment includes revenues and expenses primarily from Newtek Insurance Agency, LLC and qualified businesses that received investments made through the Company's Capcos which cannot be aggregated with other operating segments.

The revenue decrease of \$49,000 is primarily due to the decrease in other income of \$51,000 in the first quarter of 2010 as compared to the first quarter of 2009, primarily due to a recovery of an investment previously written off of \$39,000 in the first quarter of 2009 that has not reoccurred in the first quarter of 2010. Interest income decreased as a result of a decrease in cash and cash equivalents during the first quarter of 2010 as compared with the first quarter of 2009. Insurance commissions remained flat period over period.

Salaries and benefits decreased by \$89,000, or 18% to \$403,000 for the three months ended 2010, as compared to \$492,000 for same period 2009, as a result of management's cost cutting initiatives in the insurance agency and other entities. Professional fees declined by \$22,000, or 28% to \$57,000 for first quarter ended 2010 as compared to \$79,000 for 2009. Other general administrative costs decreased by \$9,000, or 5% to \$180,000 for the first quarter ended 2010, as compared to \$189,000 for 2009.

Table of Contents**Corporate activities**

| (In thousands): | Three months ended March 31: | | \$ Change | % Change |
|--|---------------------------------|--------------|--------------|--------------|
| | 2010 | 2009 | | |
| Revenue: | | | | |
| Management fees | \$ 700 | \$ 848 | \$ (148) | (17)% |
| Interest income | 8 | 3 | 5 | 167% |
| Other income | | 9 | (9) | (100)% |
| Total revenue | 708 | 860 | (152) | (18)% |
| Expenses: | | | | |
| Salaries and benefits | 1,297 | 1,239 | 58 | 5% |
| Professional fees | 255 | 566 | (311) | (55)% |
| Depreciation and amortization | 90 | 122 | (32) | (26)% |
| Other general and administrative costs | 597 | 790 | (193) | (24)% |
| Total expenses | 2,239 | 2,717 | (478) | (18)% |
| Loss before income taxes | \$ (1,531) | \$ (1,857) | \$ (326) | (18)% |

Revenue is derived primarily from management fees earned from the Capcos, which amount to 2.5% of certified capital. Management fee revenue declined 17%, or \$148,000, to \$700,000 for the three months ended March 31, 2010 from \$848,000 for the first quarter of 2009. Management fees, which are eliminated upon consolidation, are expected to continue to decline in the future as the Capcos mature and utilize their cash. If a Capco does not have current or projected cash sufficient to pay management fees, then such fees are not accrued.

Expenses declined \$478,000, or 18%, in the first quarter of 2010 from the comparable period in 2009. Salaries and benefits increased \$58,000 or 5% to \$1,297,000 for the first quarter of 2010 as compared to \$1,239,000 for the same period ended 2009. Professional fees decreased \$311,000, or 55%, during the three months ended March 31, 2010 as compared to the same period in 2009, mainly due to a decrease in legal and audit fees. As a result of the Company's cost cutting initiatives, other general and administrative costs decreased \$193,000 or 24% to \$597,000 for the first quarter of 2010 as compared to \$790,000 for the same period ended 2009.

Critical Accounting Policies and Estimates:

The Company's significant accounting policies are described in Note 1 of the Notes to Condensed Consolidated Financial Statements included in its Form 10-K for the fiscal year ended December 31, 2009. A discussion of the Company's critical accounting policies, and the related estimates, are included in Management's Discussion and Analysis of Results of Operations and Financial Position in its Form 10-K for the fiscal year ended December 31, 2009.

Liquidity and Capital Resources

Cash requirements and liquidity needs over the next twelve months are anticipated to be funded primarily through operating results and available cash and cash equivalents. In April 2010, the Company closed two five year term loans aggregating \$14,583,000 with Capital One, N.A. which refinanced Newtek's SBA lender's \$12,500,000 debt to GE as well as the existing \$2,083,000 term loan between Capital One and NTS. Previously the SBA lender utilized its \$15 million GE line of credit to originate and warehouse the guaranteed and unguaranteed portion of SBA loans; going forward the SBA lender will fund its cash requirements and liquidity needs through available cash and cash equivalents and the cash resources of Newtek. The receivables financing unit utilizes the \$10 million Wells Fargo line of credit to purchase receivables. There are no cross covenants or collateralization between the Wells Fargo lending facility and the Capital One term loans. The availability of the Wells Fargo line of credit and the performance of the Capital One term loans are subject to compliance with certain covenants and collateral requirements as set forth in their respective agreements. The Company guarantees these loans for the subsidiaries: Capital One for the amount borrowed and Wells Fargo for up to \$800,000. As of March 31, 2010 and excluding the subsequently repaid GE line of credit, the Company's unused sources of liquidity consisted of \$9,146,000 in unrestricted cash and cash equivalents and \$456,000 available through the Wells Fargo line of credit (results below show the use of the GE line of credit still extant as of March 31, 2010).

Edgar Filing: NEWTEK BUSINESS SERVICES INC - Form 10-Q

Restricted cash totaling \$7,821,000, which is primarily held in the Capcos, can be used in managing and operating the Capcos, making qualified investments, to repay debt obligations, and for the payment of taxes on capco income.

Table of Contents

In summary, Newtek generated and used cash as follows:

(Dollars in thousands)

| | For the three months ended March 31, | |
|---|--|-----------|
| | 2010 | 2009 |
| Net cash (used in) provided by operating activities | \$ (4,436) | \$ 5,032 |
| Net cash (used in) provided by investing activities | (2,164) | 501 |
| Net cash provided by (used in) financing activities | 3,165 | (5,894) |
| Net decrease in cash and cash equivalents | (3,435) | (361) |
| Cash and cash equivalents, beginning of period | 12,581 | 16,852 |
| Cash and cash equivalents, end of period | \$ 9,146 | \$ 16,491 |

Net cash flows (used in) provided by operating activities decreased \$9,468,000 to \$(4,436,000) for the period ended March 31, 2010 compared to net cash flows provided by operations of \$5,032,000 for the period ended March 31, 2009. This primarily reflects the use of funds for lending and purchasing receivables by our Small business finance segment in the current quarter whereas the 2009 quarter benefitted from the sale of SBA loans held for sale originated in 2008. For the quarter ended March 31, 2009, proceeds from sale of SBA loans held for sale sold via SBA regulated secondary market transactions benefitted from selling \$6,133,000 of Loans held for sale originated in 2008. For the quarter ended March 31, 2010 and reflecting the effects of ASC Topic 860 Transfers and Servicing which became effective on January 1, 2010 (discussed above), the Company transferred, rather than sold, via SBA regulated secondary market transactions, \$11,002,000 of the guaranteed portions of SBA 7(a) loans in return for \$2,739,000 of Cash and \$9,273,000 of Broker receivable. Under ASC Topic 860 the transfer is considered a financing until the end of the premium warranty period. The receipt of Cash and the Broker receivable therefore gave rise to a new liability (Liability for SBA loans transferred, subject to recourse) of \$12,012,000 (subsequently fair valued to \$11,033,000); the transferred loans remain on the financial statements of the Company as a new asset SBA loans transferred, subject to premium recourse . Because 2009 ended with a \$6,467,000 Broker receivable collected at the start of the quarter, net cash used from the originations of SBA loans held for sale and subsequent transfer into SBA loans transferred, subject to premium recourse resulted in the use of \$(4,335,000). Part of this amount was offset by the creation of the Liability for SBA loans transferred, subject to recourse shown in the Cash flows from financing activities described below. The Broker receivable was collected subsequent to quarter end. Upon the expiration of the premium warranty periods for the transferred loans, the transfers will be accounted for as sales, the asset and liability will be eliminated, the gain on fair value for the liability will be reversed, and the gain on sale will be recognized. ASC Topic 860 changed the accounting treatment for the sale of these loans but did not change their effect on the liquidity of the Company.

Net cash (used in) provided by investing activities primarily includes the purchase of fixed assets and customer accounts, activity regarding the unguaranteed portions of SBA loans, changes in restricted cash and activities involving investments in qualified businesses. Net cash (used in) provided by investing activities decreased by \$2,665,000 to cash used of \$(2,164,000) for the period ended March 31, 2010 compared to cash provided of \$501,000 for the period ended March 31, 2009. The decrease was due primarily to a greater amount of SBA loans originated for investment for the three month period, \$(1,476,000) in 2010, versus \$(304,000) in 2009, a lesser return from qualified investments in 2010, \$53,000, as compared to the return of \$908,000 in 2009; and a decrease in Payments received on SBA loans from \$912,000 in 2009 to \$621,000 in 2010. The change in restricted cash provided \$345,000 less cash flows in 2010, or \$(860,000), versus cash flows used of \$(515,000) in 2009.

Net cash flows provided by (used in) financing activities primarily includes the net borrowings (repayments) on bank notes payable to Capital One, Wells Fargo, and GE as well as the cash portion of the Liability for SBA loans transferred, subject to recourse. Net cash flows provided by (used in) financing activities increased by \$9,059,000 to cash provided of \$3,165,000 for the period ended March 31, 2010 from a cash use of \$(5,894,000) for the period ended March 31, 2009. The primary reason for the increase was the 2009 period reflected the repayment of \$(5,857,000) primarily from the application of Proceeds from sale of SBA loans held for sale to the GE line while the current quarter reflected both the \$2,739,000 of cash received from the SBA loans transferred, subject to recourse which is considered a financing under ASC Topic 860 and an increase of \$431,000 of bank loans payable from an increase in use of the Wells Fargo line offset by a decrease in use by the GE line.

Table of Contents

The \$(3,435,000) decrease in cash and cash equivalents in 2010 primarily reflects the timing difference between cash used to fund loan originations and the receipt of cash from the transfer of SBA loans held for sale. Improved revenues and cost cutting initiatives which continue to reduce the Company's cash used to fund operations should continue to benefit liquidity in the future.

Item 3. Quantitative and Qualitative Disclosure about Market Risk.

All of our business activities contain elements of risk. We consider the principal types of risk to be fluctuations in interest rates and loan portfolio valuations. We consider the management of risk essential to conducting our businesses. Accordingly, risk management systems and procedures are designed to identify and analyze our risks, to set appropriate policies and limits and to continually monitor these risks and limits by means of reliable administrative and information systems and other policies and programs.

Because the SBA lender borrowed money to finance its loan portfolio, our net operating income is dependent upon the difference between the rate at which we borrowed funds and the rate at which we lend these funds. The Company had outstanding under its credit line with GE approximately \$11,996,000 at March 31, 2010. The interest rate on the note was variable, based on the current Prime rate plus 3.75%. As of March 31, 2010, the interest rate being charged to NSBF was 7.00%. As described above, in April 2010, the SBA lender refinanced its debt to GE with a five year \$12,500,000 term loan with Capital One, N.A. The interest rate on the Loan is variable based on the monthly LIBOR rate plus 4.25% or Prime plus 2.25%, but no lower than 5.75%. NTS has identical variable interest rates for its Capital One term note.

There can be no assurance that a significant change in market interest rates will not have a material adverse effect on our interest income. In periods of sharply rising interest rates, our cost of funds would increase, which would reduce our net operating income. We have analyzed the potential impact of changes in interest rates on interest income net of interest expense. Assuming that the balance sheet were to remain constant and no actions were taken to alter the existing interest rate sensitivity, a hypothetical immediate 1% change in interest rates would have the effect of a net increase (decrease) in assets by less than 1% for 2010. Although management believes that this measure is indicative of our sensitivity to interest rate changes, it does not adjust for potential changes in credit quality, size and composition of the assets on the balance sheet, and other business developments that could affect a net increase (decrease) in assets. Accordingly, no assurances can be given that actual results would not differ materially from the potential outcome simulated by this estimate.

Additionally, we do not have significant exposure to changing interest rates on invested cash which was approximately \$16,967,000 at March 31, 2010. We do not purchase or hold derivative financial instruments for trading purposes. All of our transactions are conducted in U.S. dollars and we do not have any foreign currency or foreign exchange risk. We do not trade commodities or have any commodity price risk.

We believe that we have placed our demand deposits, cash investments and their equivalents with high credit-quality financial institutions. Invested cash is held almost exclusively at financial institutions with ratings from Standard and Poor's of A- or better. The Company invests cash not held in interest free checking accounts or bank money market accounts mainly in U.S. Treasury only money market instruments or funds and other investment-grade securities. As of March 31, 2010, cash deposits in excess of FDIC and SIPC insurance totaled approximately \$1,652,000 and funds held in U.S. Treasury only money market funds or equivalents in excess of SIPC insurance totaled approximately \$7,467,000.

Item 4. Controls and Procedures.**(a) Evaluation of Disclosure Controls and Procedures**

Our management, with the participation of our Chief Executive Officer and Chief Financial Officer, evaluated the effectiveness of our disclosure controls and procedures as of the end of the period covered by this report. Based on that evaluation, the Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures as of the end of the period covered by this report are effective to provide assurance that the information required to be disclosed by us in reports filed under the Securities Exchange Act of 1934 is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed by an issuer in the reports that it files or submits under the Securities Exchange Act is accumulated and communicated to the issuer's management including its principal executive and principal financial officers, or persons performing similar functions, as appropriate to allow timely decisions regarding required disclosure. A controls system, no matter how well designed and operated, cannot provide absolute assurance that the objectives of the controls systems are met, and no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, within a company have been detected.

Table of Contents

(b) Change in Internal Control over Financial Reporting

No change in our internal control over financial reporting occurred during the quarter ended March 31, 2010 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

Limitations

A control system, no matter how well designed and operated, can provide only reasonable, not absolute, assurances that the control system's objectives will be met. Furthermore, 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 errors or mistakes. Controls can also be circumvented by the individual acts of some persons, by collusion of two or more people, or by management override of the controls. The design of any system of controls 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, controls may become inadequate because of changes in conditions or deterioration in the degree of compliance with its policies or procedures. Because of the inherent limitations in a cost-effective control system, misstatements due to error or fraud may occur and not be detected. We periodically evaluate our internal controls and make changes to improve them.

Table of Contents

PART II - OTHER INFORMATION

Item 1. Legal Proceedings

We are not involved in any material pending litigation. We and/or one or more of our investee companies are involved in lawsuits regarding wrongful termination claims by employees or consultants, none of which are individually or in the aggregate material to Newtek.

Item 6. Exhibits

| Exhibit No. | Description |
|--------------------|---|
| 31.1 | Certification by Chief Executive Officer required by Rule 13a-14(a) and 15d-14(a) under the Exchange Act. |
| 31.2 | Certification by Chief Financial Officer required by Rule 13a-14(a) and 15d-14(a) under the Exchange Act. |
| 32.1 | Certification by Chief Executive and Chief Financial Officers pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. |

Table of Contents

SIGNATURES

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

NEWTEK BUSINESS SERVICES, INC.

Date: May 13, 2010

By: /s/ Barry Sloane
Barry Sloane

Chairman of the Board, Chief Executive Officer and Secretary

Date: May 13, 2010

By: /s/ Seth A. Cohen
Seth A. Cohen

Chief Financial Officer and Treasurer