NEWTEK BUSINESS SERVICES, INC.
Form 10-Q
May 09, 2013
Table of Contents

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended March 31, 2013

OR

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

For the transition period from _________ to _________

Commission File Number: 001-16123

NEWTEK BUSINESS SERVICES, INC.

(Exact name of registrant as specified in its charter)

New York	**11-3504638**
(State or other jurisdiction of	**(I.R.S. Employer**
incorporation or organization)	**Identification No.)**
212 West 35th Street, 2nd Floor, New York, NY	**10001**
(Address of principal executive offices)	**(Zip Code)**

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

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate website, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (Section 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 x 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 (as defined in Rule 12b-2 of the Exchange Act).

Large accelerated filer	¨	Accelerated filer	¨
Non-accelerated filer	¨	Smaller reporting company	x

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

As of May 8, 2013, there were 36,966,672 of the Company s Common Shares outstanding.

Table of Contents

CONTENTS

Table of Contents

Item 1. Financial Information.

NEWTEK BUSINESS SERVICES, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF INCOME (UNAUDITED)

FOR THE THREE MONTHS ENDED MARCH 31, 2013 AND 2012

(In Thousands, except for Per Share Data)

	2013	2012
Operating revenues:		
Electronic payment processing	$ 21,677	$ 20,617
Web hosting and design	4,380	4,693
Premium income	4,259	2,390
Interest income	1,030	722
Servicing fee income NSBF portfolio	614	580
Servicing fee income external portfolios	847	502
Income from tax credits	26	191
Insurance commissions	444	310
Other income	867	724
Total operating revenues	34,144	30,729
Net change in fair value of:		
SBA loans	(376)	(94)
Credits in lieu of cash and notes payable in credits in lieu of cash	19	36
Total net change in fair value	(357)	(58)
Operating expenses:		
Electronic payment processing costs	18,284	17,353
Salaries and benefits	6,056	5,676
Interest	1,303	837
Depreciation and amortization	807	801
Provision for loan losses	118	110
Other general and administrative costs	5,017	4,261
Total operating expenses	31,585	29,038
Income before income taxes	2,202	1,633
Provision for income taxes	(897)	(608)
Net income	1,305	1,025
Net (income) loss attributable to non-controlling interests	147	(6)
Net income attributable to Newtek Business Services, Inc.	$ 1,452	$ 1,019
Weighted average common shares outstanding basic	35,218	35,779

Weighted average common shares outstanding diluted	37,736	36,193
Earnings per share basic and diluted	$ 0.04	$ 0.03

See accompanying notes to these unaudited condensed consolidated financial statements.

3

Table of Contents

NEWTEK BUSINESS SERVICES, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED BALANCE SHEETS

MARCH 31, 2013 AND DECEMBER 31, 2012

(In Thousands, except for Per Share Data)

	March 31, 2013 Unaudited	December 31, 2012 (Note 1)
ASSETS		
Cash and cash equivalents (includes $2,696 and $1,865, respectively, related to VIE)	$ 11,998	$ 14,229
Restricted cash	15,110	8,456
Broker receivable	17,489	16,698
SBA loans held for investment, net (includes $13,266 and $12,910, respectively, related to securitization trust VIE; net of reserve for loan losses of $2,172 and $2,589, respectively)	13,706	14,647
SBA loans held for investment, at fair value (includes $45,323 and $22,931, respectively, related to securitization trust VIE)	49,625	43,055
Accounts receivable (net of allowance of $531and $561, respectively)	13,650	10,871
SBA loans held for sale, at fair value	3,278	896
Prepaid expenses and other assets, net (includes $1,836 and $1,123, respectively, related to securitization trust VIE)	10,997	11,014
Servicing asset (net of accumulated amortization and allowances of $6,995 and $6,750, respectively)	5,177	4,682
Fixed assets (net of accumulated depreciation and amortization of $10,241 and $10,922, respectively)	3,633	3,523
Intangible assets (net of accumulated amortization of $13,973 and $13,855, respectively)	1,450	1,558
Credits in lieu of cash	5,924	8,703
Deferred tax asset, net	2,629	2,318
Goodwill	12,092	12,092
Total assets	$ 166,758	$ 152,742
LIABILITIES AND EQUITY		
Liabilities:		
Accounts payable, accrued expenses and other liabilities	$ 13,130	$ 11,206
Notes payable	33,280	39,823
Note payable securitization trust VIE	41,786	22,039
Capital lease obligation	693	632
Deferred revenue	1,397	1,437
Notes payable in credits in lieu of cash	5,924	8,703
Total liabilities	96,210	83,840
Commitments and contingencies		
Equity:		
Newtek Business Services, Inc. shareholders equity:		
Preferred shares (par value $0.02 per share; authorized 1,000 shares, no shares issued and outstanding)		
Common shares (par value $0.02 per share; authorized 54,000 shares, 36,913 issued; 35,258 and 35,178 outstanding, respectively, not including 83 shares held in escrow)	738	738
Additional paid-in capital	60,841	60,609
Retained earnings (includes $1,466 related to consolidation of VIE on January 1, 2012)	8,458	7,008
Treasury shares, at cost (1,655 and 1,735 shares, respectively)	(1,412)	(1,508)

Total Newtek Business Services, Inc. shareholders equity	68,625	66,847
Non-controlling interests	1,923	2,055
Total equity	70,548	68,902
Total liabilities and equity	$ 166,758	$ 152,742

See accompanying notes to these unaudited condensed consolidated financial statements.

4

Table of Contents

NEWTEK BUSINESS SERVICES, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)

FOR THE THREE MONTHS ENDED MARCH 31, 2013 AND 2012

(In Thousands)

	2013	2012
Cash flows from operating activities:		
Consolidated net income	$ 1,305	$ 1,025
Adjustments to reconcile consolidated net income to net cash used in operating activities:		
Income from tax credits	(26)	(191)
Accretion of interest expense	46	227
Fair value adjustments on SBA loans	377	94
Fair value adjustment of credits in lieu of cash and notes payable in credits in lieu of cash	(19)	(36)
Deferred income taxes	(311)	(864)
Depreciation and amortization	807	801
Accretion of discount	(34)	(41)
Provision for loan losses	118	110
Other, net	308	266
Changes in operating assets and liabilities:		
Originations of SBA loans held for sale	(27,238)	(18,683)
Proceeds from sale of SBA loans held for sale	25,111	18,287
Broker receivable	(791)	(9,013)
Accounts receivable	(2,784)	(2,012)
Prepaid expenses, accrued interest receivable and other assets	(240)	3,488
Accounts payable, accrued expenses and deferred revenue	2,052	(203)
Other, net	(1,208)	186
Net cash used in operating activities	(2,527)	(6,559)
Cash flows from investing activities:		
Return of investments in qualified businesses	970	100
Purchase of fixed assets and customer merchant accounts	(564)	(439)
SBA loans originated for investment, net	(7,640)	(5,838)
Payments received on SBA loans	1,201	946
Change in restricted cash	(1,290)	1,687
Contribution from non-controlling interest	15	
Net cash used in investing activities	(7,308)	(3,544)

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, 2013 AND 2012 (CONTINUED)

	2013	2012
Cash flows from financing activities:		
Net (repayments) proceeds on bank lines of credit	$ (6,530)	$ 8,125
Increase in cash due to consolidation of subsidiary		2,763
Repayments on bank term note payable	(104)	(104)
Issuance of senior notes, net of issuance costs	20,962	
Payments on senior notes	(1,215)	(1,021)
Additions to deferred financing costs	(808)	
Change in restricted cash related to securitization	(4,898)	4,673
Other	197	(193)
Net cash provided by financing activities	7,604	14,243
Net (decrease) increase in cash and cash equivalents	(2,231)	4,140
Cash and cash equivalents beginning of period	14,229	11,201
Cash and cash equivalents end of period	$ 11,998	$ 15,341

Supplemental disclosure of cash flow activities:

	2013	2012
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	$ 2,819	$ 3,069

See accompanying notes to these unaudited condensed consolidated financial statements.

6

Table of Contents

NEWTEK BUSINESS SERVICES, INC. AND SUBSIDIARIES

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1 DESCRIPTION OF BUSINESS AND BASIS OF PRESENTATION:

Newtek Business Services, Inc. (Newtek or the Company) is a holding company for several wholly- and majority-owned subsidiaries, including twelve 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 under the name of Newtek Merchant Solutions.

Small Business Finance: The segment is comprised 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 and management services.

Managed Technology Solutions: CrystalTech Web Hosting, Inc., d/b/a Newtek Technology Services (NTS), offers shared and dedicated web hosting, data storage and backup services, cloud computing plans and related services to the small- and medium-sized business market.

All Other: Businesses formed from investments made through Capco programs and others which cannot be aggregated with other operating segments, including insurance and payroll processing.

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

Capco: Twelve certified capital companies which invest in small- and medium-sized businesses. They generate non-cash income from tax credits and non-cash interest expense and insurance expenses in addition to cash management fees.

The condensed consolidated financial statements of Newtek Business Services, Inc., its subsidiaries and consolidated entities 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 of which Newtek is considered to be the primary beneficiary. All inter-company balances and transactions have been eliminated in consolidation. Non-controlling interests (previously shown as minority interest) are reported below net income (loss) under the heading Net (income) loss attributable to non-controlling interests in the unaudited condensed consolidated statements of income and shown as a component of equity in the condensed consolidated balance sheets. See New Accounting Standards in Note 2 for further discussion.

The accompanying notes to unaudited condensed consolidated financial statements should be read in conjunction with Newtek s 2012 Annual Report on Form 10-K. These financial statements have been prepared in accordance with instructions to Form 10-Q and Article 10 of Regulation 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. In the opinion of management, all adjustments, consisting of normal recurring items, considered necessary for a fair presentation have been included. The results of operations for an interim period may not give a true indication of the results for the entire year. The December 31, 2012 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.

Table of Contents

NOTE 2 SIGNIFICANT ACCOUNTING POLICIES:

Use of Estimates

The preparation of consolidated financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of the consolidated financial statements, and the reported amounts of revenue and expense during the reporting period. The level of uncertainty in estimates and assumptions increases with the length of time until the underlying transactions are complete. The most significant estimates are with respect to valuation of investments in qualified businesses, asset impairment valuation, allowance for loan losses, valuation of servicing assets, charge-back 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 a number of different segments. Revenues are recognized as services are rendered and are summarized as follows:

Electronic payment processing revenue: Electronic payment processing and fee 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.

Web hosting revenue: Managed technology solutions revenue is primarily derived from monthly recurring service fees for the use of its web hosting, web design 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, excluding cloud plans, is generally received one month to one year in advance. Deferred revenues represent customer payments for web hosting and related services in advance of the reporting period date. Revenue for cloud related services is based on actual consumption used by a cloud customer.

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. This guaranteed portion is generally sold to a third party via an SBA regulated secondary market transaction utilizing SBA Form 1086 for a price equal to the guaranteed loan amount plus a premium that includes both an upfront cash payment and the fair value of future net servicing income. Prior to October 1, 2010, NSBF recognized the revenue item Premium on loan sales net of capitalized loan expenses and the discount on the retained unguaranteed portion; subsequent to the adoption of fair value of SBA 7(a) loans on October 1, 2010, NSBF recognizes premium on loan sales as equal to the cash premium plus the fair value of the servicing income. Revenue is recognized on the trade date of the guaranteed portion, except as described below.

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.

Subsequent measurements of each class of servicing assets and liabilities may use either the amortization method or the fair value measurement method. NSBF has chosen to apply the amortization method to its servicing asset, amortizing the asset in proportion to, and over the period of, the estimated future net servicing income on the underlying sold guaranteed portion of the loans and assessing 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. In evaluating and measuring impairment of servicing assets, NSBF stratifies its servicing assets based on year of loan and loan term which are the key risk characteristics of the underlying loan pools. The Company uses an independent valuation specialist to estimate the fair value of the servicing asset 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

Table of Contents

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.

SBA Loan Interest and Fees: Interest income on loans is recognized as earned. A loan is placed on non-accrual status if it exceeds 90 days past due with respect to principal or interest and, in the opinion of management, interest or principal on the loan 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 impaired 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 impaired 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 force 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.

Income from tax credits: Following an application process, a state will notify a company that it has been certified as a Capco. The state or jurisdiction 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 entitled to earn tax credits upon satisfying defined investment percentage thresholds within specified time requirements. Newtek has Capcos operating in five states and the District of Columbia. Each statute requires that the Capco invest a threshold percentage of certified capital (the funds provided by the insurance company investors) in businesses defined as qualified 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 permanent recapture of all or a portion of the allocated tax credits. The proportion of the possible 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 progresses in 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, with a corresponding asset called credits in lieu of cash in the balance sheet.

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) at that point. 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 deliverable to the certified investors. The obligation to deliver tax credits to the certified investors is recorded as notes payable in credits in lieu of cash. On the date the tax credits are utilizable by the certified investors, the Capco decreases credits in lieu of cash with a corresponding decrease to notes payable in credits in lieu of cash.

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.

Other income: Other income represents revenues derived from operating units that cannot be aggregated with other business segments. In addition, other income represents one time recoveries or gains on investments. Revenue is recorded when there is strong evidence of an agreement, the related fees are fixed, the service or product has been delivered, and the collection of the related receivable is assured.

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

Late fees: Late fees are derived from receivables NBC has 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 and NBC records the fees as income in the month in which such receivable becomes past due.

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 re-underwriting 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. The Company also receives commission revenue from various sources.

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. These 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 recognized in the Company s condensed consolidated statements of income.

Restricted Cash

Restricted cash includes cash collateral relating to a letter of credit; monies due on SBA loan-related remittances and insurance premiums received by the Company and due to third parties; cash held by the Capcos restricted for use in managing and operating the Capco, making qualified investments and for the payment of income taxes; cash reserves associated with the securitization, cash set aside to purchase unguaranteed portions originated subsequent to the securitization transaction, cash held in blocked accounts used to pay down bank note payables, cash held for our payroll clients waiting to be remitted to their employees or taxing authority and a cash account maintained as a reserve against electronic payment processing chargeback losses. Following is a summary of restricted cash by segment:

(In thousands):	March 31, 2013	December 31, 2012
Electronic payment processing	$ 408	$ 387
Small business finance	10,209	4,955
All other	1,657	279
Corporate activities	987	987
Capcos	1,849	1,848
Totals	$ 15,110	$ 8,456

Broker Receivable

Broker receivable represents amounts due from third parties for loans which have been traded at period end but have not yet settled.

Purchased Receivables

For clients that are assessed fees based on a discount as well as for clients that are on a prime plus fee schedule, purchased receivables are recorded at the point in time when cash is released to the client. A majority of the receivables purchased with respect to prime plus arrangements are recourse and are sold back to the client if aged over 90 days, depending on contractual agreements. Purchased receivables are included in accounts receivable on the consolidated balance sheets.

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. Investments 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. Investments 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 investments 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.

Securitization Activities

NSBF engaged in a securitization of the unguaranteed portions of its SBA 7(a) loans in 2010, 2011 and 2013. Because the transfer of these assets did not meet the criteria of a sale for accounting purposes, it was treated as a secured borrowing. NSBF continues to recognize the assets of the secured borrowing in Loans held for investment and the associated financing in Notes payable on the consolidated balance sheets.

Share 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. The Company recognizes compensation on a straight-line basis over the requisite service period for the entire award. The Company has elected to adopt the alternative transition method for calculating the tax effects of share-based compensation. The alternative transition method includes a simplified method to establish the beginning balance of the additional paid-in capital pool related to the tax effects of employee share-based compensation, which is available to absorb tax deficiencies.

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. In addition, the Company elected on October 1, 2010 to fair value its SBA loans held for investment and SBA loans held for sale. 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 2009 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).

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.

The Company sells its services to businesses throughout the United States. The Company performs ongoing credit evaluations of its customers financial condition and, generally, requires collateral, such as accounts receivable and/or other assets of the client, whenever deemed necessary.

For the three months ended March 31, 2013 and 2012, no single customer accounted for 10% or more of the Company s revenue or of total accounts receivable at March 31, 2013 and December 31, 2012.

Table of Contents

Fair Value of Financial Instruments

As required by the Financial Instruments Topic of the Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC), 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

Notes payable

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

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

Accounts payable and accrued expenses

The carrying value of investments in Qualified Businesses (included in prepaid expenses and other assets), Credits in lieu of cash and Notes payable in credits in lieu of cash as well as SBA loans held for investment and SBA loans held for sale approximate fair value based on management s estimates.

New Accounting Standards

None.

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 October 1, 2010, the Company elected the fair value option for valuing its SBA 7(a) loans funded on or after that date which are included in SBA loans held for investment and SBA loans held for sale.

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.

Table of Contents

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) (the renamed property and casualty holdings of American International Group, Inc., AIG), namely its AA+ rating at such time, for their debt issued to certified investors. Instead the cost paid for the credit enhancements was recorded as prepaid insurance and amortized on a straight-line basis over the term of the credit enhancements.

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

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

Assets and Liabilities Measured at Fair Value on a Recurring Basis (In thousands):

	Fair Value Measurements at March 31, 2013 Using:				
(In thousands):	**Total**	**Level 1**	**Level 2**	**Level 3**	**Total Gains and (Losses)**
Assets					
Credits in lieu of cash	$ 5,924	$	$ 5,924	$	$
SBA loans held for investment	49,625			49,625	(631)
SBA loans held for sale	3,278		3,278		255
Total assets	$ 58,827	$	$ 9,202	$ 49,625	$ (376)
Liabilities					
Notes payable in credits in lieu of cash	$ 5,924	$	$ 5,924	$	$ 19

14

Table of Contents

Assets and Liabilities Measured at Fair Value on a Recurring Basis (In thousands):

	Fair Value Measurements at December 31, 2012 Using:				
(In thousands):	Total	Level 1	Level 2	Level 3	Total Gains and (Losses)
Assets					
Credits in lieu of cash	$ 8,703	$	$ 8,703	$	$
SBA loans held for investment	43,055			43,055	(851)
SBA loans held for sale	896		896		(162)
Total assets	$ 52,654	$	$ 9,599	$ 43,055	$ (1,013)
Liabilities					
Notes payable in credits in lieu of cash	$ 8,703	$	$ 8,703	$	$ 3
Warrants					(111)
Total liabilities	$ 8,703	$	$ 8,703	$	$ (108)

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

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

Fair value measurements:

The Company s Capcos debt, enhanced by Chartis insurance, effectively bears the nonperformance risk of Chartis. The closest trading comparators are the debt of Chartis parent, AIG. 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 AIG notes with similar maturities to each of the Company s respective Capcos debt (the Chartis Note Basket). The Company elected to discontinue utilizing AIG s 7.70% Series A-5 Junior Subordinated Debentures because those long maturity notes began to trade with characteristics of a preferred stock after AIG 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 the Chartis Note Basket 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, 2012, the yield on the Chartis Note Basket was 1.72%. As of March 31, 2013, the date the Company revalued the asset and liability, the yields on the Chartis notes averaged 1.80% reflecting changes in interest rates in the marketplace. This decrease 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 decreased 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 income for the three months ended March 31, 2013 was a gain of $19,000.

Table of Contents

On December 31, 2011, the yield on the Chartis Note Basket was 5.53%. As of March 31, 2012, the date the Company revalued the asset and liability, the yields on the Chartis notes averaged 3.54% reflecting changes in interest rates in the marketplace. This decrease 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 decreased 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 income for the three months ended March 31, 2012 was a gain of $36,000.

Changes in the future yield of the Chartis Note Basket 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 income.

SBA 7(a) Loans

On October 1, 2010, the Company elected to utilize the fair value option for SBA 7(a) loans funded on or after that date. Management believed that doing so would promote its effort to both simplify and make more transparent its financial statements by better portraying the true economic value of this asset on its balance sheet and statement of income. NSBF originates, funds, and services government guaranteed loans under section 7(a) of the Small Business Act. The SBA does not fully guarantee the SBA 7(a) Loans: An SBA 7(a) Loan is bifurcated into a guaranteed portion and an unguaranteed portion, each accruing interest on the principal balance of such portion at a per annum rate in effect from time to time. NSBF originates variable interest loans, usually set at a fixed index to the Prime rate that resets quarterly. Primarily, NSBF has made SBA 7(a) loans carrying guarantees of 75% and 85% with some originations at 90% for SBA qualified export type businesses; from 2009 through early 2011 under a special program, most of the loans NSBF originated carried a guarantee of 90%. NSBF, both historically and as a matter of its business plan, sells the guaranteed portions via SBA Form 1086 into the secondary market when the guaranteed portion becomes available for sale upon the closing and full funding of the SBA 7(a) loan and retains the unguaranteed portions. Management recognized that the economic value in the guaranteed portion did not inure to NSBF at the time of their sale but rather when the guaranty attached at origination; amortization accounting by its nature does not recognize this increase in value at the true time when it occurred. Under the fair value option, the value of the guarantee is recorded when it economically occurs at the point of the creation of the loan, and is not delayed until when the sale occurs. Contemporaneously, the value of the unguaranteed portion will also be determined to reflect the full, fair value of the loan.

Although the fair value election is for the entire SBA 7(a) loan, the Company primarily sells the guaranteed portions at the completion of funding. The need to record the fair value for the guaranteed portion of the loan will primarily occur when a guaranteed portion is not traded at period end (SBA loans held for sale). The unguaranteed portion retained is recorded under SBA loans held for investment.

SBA Loans Held for Investment

For loans that completed funding before October 1, 2010, SBA loans held for investment are reported at their outstanding unpaid principal balances adjusted for charge-offs, net deferred loan origination costs and the allowance for loan losses. For loans that completed funding on or after October 1, 2010, management elected to fair value SBA loans held for investment within the fair value hierarchy that prioritizes observable and unobservable inputs utilizing Level 3 unobservable inputs which reflect the Company s own expectations about the assumptions that market participants would use in pricing the asset (including assumptions about risk). The Company considers the pricing reflected in its securitization activities to be the best indicator of the fair value discount used to measure loans held for investment. As discussed in the Company s 2012 Annual Report on Form 10-K, the Company was able to securitize its unguaranteed portions of its SBA 7(a) loans and issued notes to investors with S&P ratings of AA and A.

The fair value measurement, currently recorded as a 7.5% upfront discount of the unguaranteed principal balance of SBA loans held for investment, is based upon internal quantitative data on our portfolio with respect to historical default rates and future expected losses as well as the investor price paid for the senior interest in our unguaranteed loans with respect to the 2013 securitized transaction~~s~~, and adjusted for the estimated servicing and interest income to be retained by the trust over an estimated repayment term of three years. This was further adjusted to reflect the estimated default rate on the senior notes based on the default rate on our loan portfolio, assuming a worst case scenario of no recoveries. Should the performance of the underlying loans to the senior notes change, this could impact the assumptions used in the estimated repayment term as well as the estimated

Table of Contents

default rate and thus result in a higher or lower discount rate taken in the future; management reviews these assumptions regularly. If a loan measured at fair value is subsequently impaired, then the fair value of the 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. The significant unobservable inputs used in the fair value measurement of the impaired loans involve management s judgment in the use of market data and third party estimates regarding collateral values. Such estimates are further discounted by 20% - 80% to reflect the cost of liquidating the various assets under collateral. Any subsequent increases or decreases in any of the inputs would result in a corresponding decrease or increase in the reserve for loan loss or fair value of SBA loans, depending on whether the loan was originated prior or subsequent to October 1, 2010. Because the loans bear interest at a variable rate, NSBF does not have to factor in interest rate risk.

Below is a summary of the activity in SBA loans held for investment, at fair value for the three months and year ended March 31, 2013 and December 31, 2012, respectively, (in thousands):

	Three Months Ended March 31, 2013	Year Ended December 31, 2012
Balance, beginning of period	$ 43,055	$ 21,857
SBA loans held for investment, originated	7,588	24,076
Payments received	(387)	(2,027)
Fair value loss	(631)	(851)
Balance, end of period	$ 49,625	$ 43,055

SBA Loans Held For Sale

For guaranteed portions funded, but not yet traded at each measurement date, management elected to fair value SBA loans held for sale within the fair value hierarchy that prioritizes observable and unobservable inputs used to measure fair value utilizing Level 2 assets. These inputs include debt securities with quoted prices that are traded less frequently than exchange-traded instruments or have values determined using a pricing model with inputs that are observable in the market. The secondary market for the guaranteed portions is extremely robust with broker dealers acting as primary dealers. NSBF sells regularly into the market and can quickly price its loans for sale. The Company values the guaranteed portion based on market prices equal to the guaranteed loan amount plus a premium that includes both an upfront cash payment (utilizing quoted prices) and the value of a stream of payments representing servicing income received in excess of NSBF s servicing cost (valued using a pricing model with inputs that are observable in the market).

Other Fair Value Measurements

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

	Fair Value Measurements at March 31, 2013 Using:				
	Total	Level 1	Level 2	Level 3	Total Losses
Assets					
Impaired loans	$ 4,984	$	$	$ 4,984	$ (3)
Other real-estate owned	572		572		(13)
Total assets	$ 5,556	$	$ 572	$ 4,984	$ (16)

	Fair Value Measurements at December 31, 2012 Using:				
	Total	Level 1	Level 2	Level 3	Total Losses
Assets					
Impaired loans	$ 6,965	$	$	$ 6,965	$ (822)

Other real-estate owned	534		534		(168)
Total assets	$ 7,499	$	$ 534	$ 6,965	$ (990)

Table of Contents

Impaired loans

Impairment of a loan is measured based on the present value of expected future cash flows discounted at the loan s effective interest rate, or the fair value of the collateral if the loan is collateral dependent. Impaired loans for which the carrying amount is based on fair value of the underlying collateral are included in assets and reported at estimated fair value on a non-recurring basis, both at initial recognition of impairment and on an on-going basis until recovery or charge-off of the loan amount. The significant unobservable inputs used in the fair value measurement of the impaired loans involve management s judgment in the use of market data and third party estimates regarding collateral values. Such estimates are further discounted by 20% - 80% to reflect the cost of liquidating the various assets under collateral. Valuations in the level of impaired loans and corresponding impairment affect the level of the reserve for loan losses. Any subsequent increases or decreases in any of the inputs would result in a corresponding decrease or increase in the reserve for loan loss or fair value of SBA loans, depending on whether the loan was originated prior or subsequent to October 1, 2010.

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 the Company s interests. Where bid information is not available for a specific property, the valuation is principally based upon recent transaction prices for similar properties that have been sold. These comparable properties share comparable demographic characteristics. Other real estate owned is generally classified within Level 2 of the valuation hierarchy.

NOTE 4 SBA LOANS:

SBA loans are geographically concentrated in New York (12.8%) and Florida (11.3% 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, 2013 (in thousands):

Balance at December 31, 2012	$ 57,702
SBA loans funded for investment	7,588
Fair value adjustment	(631)
Payments received	(1,201)
Provision for SBA loan losses	(118)
Discount on loan originations, net	86
Other real estate owned	(95)
Balance at March 31, 2013	$ 63,331

Below is a summary of the activity in the reserve for loan losses for the three months ended March 31, 2013 (in thousands):

Balance at December 31, 2012	$ 2,589
SBA loan loss provision	118
Recoveries	3
Loan charge-offs	(538)
Balance at March 31, 2013	$ 2,172

Table of Contents

Below is a summary of the activity in the SBA loans held for sale for the three months ended March 31, 2013 (in thousands):

Balance at December 31, 2012	$ 896
Originations of SBA loans held for sale	27,238
Fair value adjustment	255
SBA loans sold	(25,111)
Balance at March 31, 2013	$ 3,278

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, 2013 and December 31, 2012, net SBA loans receivable held for investment with adjustable interest rates amounted to $63,714,000 and $58,382,000, respectively.

For the three months ended March 31, 2013 and 2012, the Company funded approximately $34,826,000 and $24,521,000 in loans and sold approximately $27,238,000 and $18,287,000 of the guaranteed portion of the loans, respectively. Receivables from loans traded but not settled of $17,489,000 and $16,698,000 as of March 31, 2013 and December 31, 2012, respectively, are presented as broker receivable in the accompanying condensed consolidated balance sheets.

The outstanding balances of loans past due over ninety days and still accruing interest as of March 31, 2013 and December 31, 2012 amounted to $1,177,000 and $1,128,000, respectively.

At March 31, 2013 and December 31, 2012, total impaired non-accrual loans amounted to $7,239,000 and $6,965,000, respectively. For the three months ended March 31, 2013 and for the year ended December 31, 2012, the average balance of impaired non-accrual loans was $7,379,000 and $6,935,000, respectively. Approximately $2,085,000 and $2,204,000 of the allowance for loan losses and fair value adjustment 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, 2013		December 31, 2012	
	Fair Value	Cost Basis	Fair Value	Costs Basis
Due in one year or less	$	$ 15	$	$ 40
Due between one and five years		4,492		4,534
Due after five years	53,785	12,364	46,585	13,741
Total	53,785	16,871	46,585	18,315
Less: Allowance for loan losses		(2,172)		(2,589)
Less: Deferred origination fees, net		(993)		(1,079)
Less: Fair value adjustment	(4,160)		(3,530)	
Balance (net)	$ 49,625	$ 13,706	$ 43,055	$ 14,647

NOTE 5 SERVICING ASSET:

Servicing rights are recognized as assets when 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, 2013 were as follows:

(in thousands):

Balance at December 31, 2012	$ 4,682
Servicing rights capitalized	741
Servicing assets amortized	(246)
Balance at March 31, 2013	$ 5,177

19

Table of Contents

During the three months ended March 31, 2012, the Company revised its estimate for the amortization period of the servicing asset from 3.94 years to 5.00 years. Variables supporting this change in the rate of amortization included a decrease in loan prepayment speeds, an extended weighted average maturity date of the loan portfolio, and improvements in the credit standing of its loan customers. The effect of this change resulted in a $43,000 reduction in servicing asset amortization for the three months ended March 31, 2012.

The carrying value of the capitalized servicing asset was $5,177,000 and $4,682,000 at March 31, 2013 and December 31, 2012, respectively, while the estimated fair value of capitalized servicing rights was $6,562,000 and $6,067,000 at March 31, 2013 and December 31, 2012, respectively. The estimated fair value of servicing assets at March 31, 2013 and December 31, 2012 was determined using a discount rate of 11%, weighted average prepayment speeds ranging from 1% to 14%, depending upon certain characteristics of the loan portfolio, weighted average life of 5.00 years, and an average default rate of 5%.

The unpaid principal balances of loans serviced for others are not included in the accompanying condensed consolidated balance sheets. The unpaid principal balances of loans serviced for others within the NSBF originated portfolio were $290,501,000 and $271,548,000 as of March 31, 2013 and December 31, 2012, respectively. The unpaid principal balances of loans serviced for others which were not originated by NSBF and are outside of the Newtek portfolio were $165,225,000 and $176,988,000 as of March 31, 2013 and December 31, 2012, respectively.

NOTE 6 NOTES PAYABLE AND CAPITAL LEASES:

At March 31, 2013 and December 31, 2012, the Company had notes payable and capital leases comprised of the following (in thousands):

	March 31, 2013	December 31, 2012
Notes payable:		
Capital One lines of credit (NSBF)		
Guaranteed line	$ 12,000	$ 12,000
Unguaranteed line	3,410	11,854
Summit Partners Credit Advisors, L.P. (NBS)	8,379	8,288
Sterling National bank line of credit (NBC)	8,588	6,674
Capital One term loan (NTS)	903	1,007
Total notes payable	33,280	39,823
Note payable securitization trust	41,786	22,039
Total notes payable	$ 75,066	$ 61,862
Capital lease obligation	$ 693	$ 632

In the three months ended March 31, 2013, the Company leased certain software with a term of 4 years. The useful life of the software was estimated to be between 7 10 years and includes a bargain purchase element at lease expiration. As a result, the transaction has been recorded as a capital lease. The capitalized cost of the lease transaction was approximately $63,000; the asset was placed in service in March 2013.

In March 2013, the Company completed a third securitization resulting in $20,900,000 of notes being issued in a private placement transaction. The SBA lender transferred the unguaranteed portions of SBA loans in the amount of $23,569,000 and an additional $5,900,000 for new loans to be funded subsequent to the transaction to a special purpose entity, Newtek Small Business Loan Trust 2013-1. The notes received an A rating by S&P, and the final maturity date of the notes is June 25, 2038. The proceeds of the transaction have been and will be used to repay debt and originate new loans.

NOTE 7 STOCK OPTIONS AND RESTRICTED SHARES:

The Company had three share-based compensation plans as of March 31, 2013 and 2012. For the three months ended March 31, 2013 and 2012, compensation cost charged to income for those plans was $166,000 and $142,000, respectively, of which $136,000 and $113,000 are included in salaries and benefits, and $30,000 and $29,000 are included in other general and administrative costs for the three months ended March 31, 2013 and 2012, respectively.

Table of Contents

During the first quarter of 2013, the Company granted certain employees, executives and directors an aggregate of 300,000 restricted shares valued at $556,000. The employee and executive grants have a vesting date of March 1, 2016 while the directors vest July 1, 2015. The fair value of these grants was determined using the fair value of the common shares at the grant date. The restricted shares are forfeitable upon early voluntary or involuntary termination of the employee. Upon vesting, the grantee will receive one common share for each restricted share vested. Under the terms of the plan, these share awards do not include voting rights until the shares vest. The Company recorded $30,000 in share-based compensation in the first quarter of 2013 in connection with the vesting period associated with these grants.

In the second quarter of 2012, Newtek granted certain employees and executives an aggregate of 124,000 restricted shares valued at $184,000. The grants vest on July 1, 2014. The fair value of these grants was determined using the fair value of the common shares at the grant date. The restricted shares are forfeitable upon early voluntary or involuntary termination of the employee. Upon vesting, the grantee will receive one common share for each restricted share vested. Under the terms of the plan, these share awards do not include voting rights until the shares vest. The Company charged $13,000 to share-based compensation expense during the three months ended March 31, 2013 in connection with the vesting period associated with these grants.

In March 2011, Newtek granted certain employees, executives and board of directors an aggregate of 1,142,000 restricted shares valued at $1,941,000. The grants vest on July 1, 2014. The fair value of these grants was determined using the fair value of the common shares at the grant date. The restricted shares are forfeitable upon early voluntary or involuntary termination of the employee. Upon vesting, the grantee will receive one common share for each restricted share vested. Under the terms of the plan, these share awards do not include voting rights until the shares vest. The Company recorded $126,000 and $139,000 in share-based compensation in the first quarter of 2013 and 2012, respectively, in connection with the vesting period associated with these grants.

NOTE 8 INCOME PER SHARE:

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

The calculations of income per share were:

(In thousands except per share data):	**Three Months Ended March 31, 2013**	**Three Months Ended March 31, 2012**
Numerator:		
Numerator for basic and diluted income per share income available to common shareholders	$ 1,452	$ 1,019
Denominator:		
Denominator for basic income per share weighted average shares	35,218	35,779
Effect of dilutive securities	2,518	414
Denominator for diluted income per share weighted average shares	37,736	36,193
Income per share: basic and diluted	$ 0.04	$ 0.03

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

	Three Months Ended March 31, 2013	**Three Months Ended March 31, 2012**
Stock options and restricted shares		782
Warrants	50	50

Contingently issuable shares	83	83

NOTE 9 COMMITMENTS AND CONTINGENCIES:

In the ordinary course of business, the Company may from time to time be party to lawsuits and claims. The Company evaluates such matters on a case by case basis and its policy is to contest vigorously any claims it believes are without compelling merit.

Table of Contents

The Company is currently involved in various contract claims and litigation matters. Management has reviewed all claims against the Company with counsel and has taken into consideration the views of such counsel as to the outcome of the claims, and on that basis the Company has determined that it is reasonably possible that claims will result in a loss in the near term which it estimates to be between $100,000 and $500,000.

NOTE 10 SEGMENT REPORTING:

Operating segments are organized internally primarily by the type of services provided. The Company has aggregated similar operating segments into six reportable segments: Electronic payment processing, Small business finance, Managed technology solutions, 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 income.

The Small business finance segment consists of Small Business Lending, Inc., a lender that primarily originates, sells and services government guaranteed SBA 7(a) loans to qualifying small businesses through NSBF, its licensed SBA lender; the Texas Whitestone Group which manages the Company s Texas Capco; and 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 or contracted 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 income. 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 income.

The Managed technology solutions 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 income, 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 income.

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. Also included in this segment are: Newtek Payroll Services, LLC, a provider of payroll management, payment and tax reporting services, Exponential of New York, LLC, an entity determined to be a subsidiary on January 1, 2012, and Advanced Cyber Security Systems, LLC, (ACS), a start-up company formed to offer web-based security solutions to the marketplace.

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 twelve 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 three months ended March 31, 2013 and 2012 and total assets as of March 31, 2013 and December 31, 2012 (in thousands):

	Three Months Ended March 31, 2013	Three Months Ended March 31, 2012
Third Party Revenue		
Electronic payment processing	$ 21,679	$ 20,618
Small business finance	7,449	4,839
Managed technology solutions	4,394	4,693
All other	646	546
Corporate activities	200	250
Capco	50	200
Total reportable segments	34,418	31,146
Eliminations	(274)	(417)
Consolidated Total	$ 34,144	$ 30,729
Inter Segment Revenue		
Electronic payment processing	$ 606	$ 374
Small business finance	52	11
Managed technology solutions	147	201
All other	240	308
Corporate activities	805	511
Capco	319	208
Total reportable segments	2,169	1,613
Eliminations	(2,169)	(1,613)