Kayne Anderson MLP Investment CO
Form N-CSR
January 17, 2014
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM N-CSR

CERTIFIED SHAREHOLDER REPORT OF REGISTERED

MANAGEMENT INVESTMENT COMPANIES

Investment Company Act file number 811-21593

Kayne Anderson MLP Investment Company

(Exact name of registrant as specified in charter)

811 Main Street, 14th Floor, Houston, Texas	77002
(Address of principal executive offices)	(Zip code)

David Shladovsky, Esq.

KA Fund Advisors, LLC, 811 Main Street, 14th Floor, Houston, Texas 77002

(Name and address of agent for service)

Registrant s telephone number, including area code: (713) 493-2020

Date of fiscal year end: November 30, 2013

Date of reporting period: November 30, 2013

Form N-CSR is to be used by management investment companies to file reports with the Commission not later than 10 days after the transmission to stockholders of any report that is required to be transmitted to stockholders under Rule 30e-1 under the Investment Company Act of 1940 (17 CFR 270.30e-1). The Commission may use the information provided on Form N-CSR in its regulatory, disclosure review, inspection, and policymaking roles.

A registrant is required to disclose the information specified by Form N-CSR, and the Commission will make this information public. A registrant is not required to respond to the collection of information contained in Form N-CSR unless the Form displays a currently valid Office of Management and Budget (OMB) control number. Please direct comments concerning the accuracy of the information collection burden estimate and any suggestions for reducing the burden to Secretary, Securities and Exchange Commission, 450 Fifth Street, NW, Washington, DC 20549-0609. The OMB has reviewed this collection of information under the clearance requirements of 44 U.S.C. § 3507.

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Item 1. Reports to Stockholders.

The report of Kayne Anderson MLP Investment Company (the Registrant) to stockholders for the fiscal year ended November 30, 2013 is attached below.

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MLP Investment Company

KYN Annual Report

November 30, 2013

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CAUTIONARY NOTE REGARDING FORWARD-LOOKING STATEMENTS: This report of Kayne Anderson MLP Investment Company (the Company) contains forward-looking statements as defined under the U.S. federal securities laws. Generally, the words believe, expect, intend, estimate, anticipate, project, will and similar expressions identify forward-looking statements, which generally are not hist in nature. Forward-looking statements are subject to certain risks and uncertainties that could cause actual results to materially differ from the Company s historical experience and its present expectations or projections indicated in any forward-looking statements. These risks include, but are not limited to, changes in economic and political conditions; regulatory and legal changes; master limited partnership (MLP) industry risk; leverage risk; valuation risk; interest rate risk; tax risk; and other risks discussed in the Company s filings with the Securities and Exchange Commission (SEC). You should not place undue reliance on forward-looking statements, which speak only as of the date they are made. The Company undertakes no obligation to update or revise any forward-looking statements made herein. There is no assurance that the Company s investment objectives will be attained.

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KAYNE ANDERSON MLP INVESTMENT COMPANY

LETTER TO STOCKHOLDERS

January 16, 2014

Dear Fellow Stockholders:

We are pleased to report that the year ended November 30, 2013 was another very successful year for the Company. Fueled by a strengthening domestic economy, calendar 2013 will be remembered for the outstanding performance of the broader equity markets. The S&P 500 Index set many new all-time highs during 2013 and generated a total return of over 32% its strongest gain since 1995. While the MLP market, as measured by the Alerian MLP index, did not quite keep pace, it generated a total return of 28%, which is outstanding when considering the fact that this performance was accomplished in a rising interest rate environment. These returns are almost double the returns we projected in last year s annual letter. Most importantly, we believe the outlook for MLPs remains solid and the sector is poised to generate low double digit returns for several years to come.

In 2013, we reached the fifth anniversary of the financial crisis. Our economy has made significant strides in recovering from the great recession, and the outlook for the domestic energy market is distinctly more positive today than it was in 2008. The MLP sector has blossomed into a full-fledged asset class with a market capitalization of over $475 billion during that five-year time period. I can assure you that writing this year s annual letter was much more enjoyable than the one we wrote in January 2009!

As we have discussed in previous annual letters, the Shale Revolution (the development of domestic unconventional resources) continues to be the biggest story in the energy industry. As we predicted two years ago, it has become increasingly clear that the Shale Revolution will have an extremely meaningful impact on the broader domestic economy. Judging by the large number of news articles published in 2013 on the shale plays, hydraulic fracturing and the impact of surging domestic energy production, it is safe to say that most people are aware of the impact unconventional resources are having on all of our day-to-day lives. Job growth related to the energy industry, as well as from increased domestic manufacturing activity, continues to be a boon for the U.S. economy. This impact will continue for many years to come. Plentiful domestic energy supplies and low relative energy prices have led to a resurgence in U.S. manufacturing and positioned the U.S. to become one of the largest exporters of energy products in the world.

The Shale Revolution creates both challenges and opportunities for energy companies. As a result of production increases, significant amounts of new midstream assets must be built to facilitate transportation of this new production to end-users. We believe this creates a tremendous opportunity for Midstream MLPs. Conversely, increased production can put pressure on absolute commodity prices as witnessed by low natural gas and natural gas liquids prices in 2012 and 2013. It can also create very large pricing differences between geographic areas, which can result in producers having to accept substantial discounts to market prices for their production. Further, production in new areas of the country is altering historical transportation routes and, as a result, materially impacting operating results (both positively and negatively) for certain midstream assets. Whether by pipeline or by rail, the transportation of energy products always involves risks, and it is important to understand which management teams are capable of managing these risks. We believe that our team of experienced investment professionals is well positioned to continue to navigate the ever-changing market conditions, as well as identify and capitalize on opportunities as they develop.

We are very proud of the Company s performance during fiscal 2013. One of the measures we employ to evaluate our performance is Net Asset Value Return, which is equal to the change in net asset value per share plus the cash distributions paid during the period, assuming reinvestment through our dividend reinvestment program. For fiscal 2013, the Company delivered a Net Asset Value Return of 29.0%, which was best among its MLP closed end fund peers. Indeed, KYN beat its closest competitor by 2.3% and its average competitor by 6.6%. During the same period, the total return of the Alerian MLP index was 21.6%, a return which KYN outperformed by a remarkable 7.4%. Given our structure as a taxable entity, we are very pleased to have outperformed the Alerian MLP index by such a wide margin. As a reminder, the Alerian MLP index is a non-investable index that does not factor in expenses or corporate taxes.

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The Company also increased its quarterly distribution by 10.9% during the year, and has increased its distribution in each quarter for the last three years (a 26% increase in the distribution rate over that time period). We are very proud of this track record of distribution growth and of the Company s ability to generate distribution growth well in excess of its peers.

Another metric by which we measure the Company s performance is Market Return, which is equal to the change in share price plus the cash distributions paid during the period, assuming reinvestment through our dividend reinvestment program. Our Market Return was 28.2% for fiscal 2013. This measure was slightly below our Net Asset Value Return, as the premium of our share price to NAV decreased slightly during fiscal 2013. The premium was 9.2% on November 30, 2012 and 8.5% on November 30, 2013.

The Company was also successful in raising additional capital during fiscal 2013 to make new investments, raising approximately $978 million through two equity offerings, an at-the-market equity offering program, two mandatory redeemable preferred offerings and two senior notes offerings. We firmly believe that our strong relative performance over the past several years is due, in part, to our ability to raise capital and invest such capital in a way that is accretive to both NAV and expected total returns.

MLP Market Overview

MLPs performed very well during the fiscal year, generating a 21.6% total return. Notably, MLPs delivered this strong performance despite the headwind of rising interest rates. At the beginning of fiscal 2013, the yield on 10-year U.S. Treasury Bonds was 1.61%. By November 30, 2013, the yield on these bonds was 2.74%, an increase of 113 basis points. This rise in rates resulted primarily from the anticipated reduction in the Federal Reserve s quantitative easing, which was a topic of constant speculation throughout much of the year. Over this same time period, the average MLP yield declined from 6.34% to 5.90%, resulting in the MLP spread to Treasuries contracting from 473 basis point to 316 basis points. The spread to Treasuries was abnormally wide at the start of 2013, and we believe market participants were building in a cushion based on the expectation of rising interest rates. In spite of the tightening of the spread to Treasuries, we continue to believe MLP yields are attractive, particularly relative to other income-oriented investments. As illustrated in Figure 1 below, MLP yields are significantly higher than yields for investment grade (Baa) bonds, utilities and REITs.

Figure 1. MLP Yields versus Other Income Alternatives (January 16, 2014)

Current yields are not the whole story, however. As we have highlighted over the years, we believe it is the combination of current yield and distribution growth that has contributed to the strong performance of MLPs and continues to make MLPs a compelling investment opportunity. During 2013, distributions grew 7.1% compared to 7.3% in 2012 and 6.3% in 2011, and we believe that prospects for distribution growth in 2014 are also very strong (we forecast growth in the 7% area). Thus, after taking distribution growth into consideration, MLPs look even more attractive relative to other income alternatives.

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A major driver of distribution growth in the MLP sector has been the significant amounts of capital spent to build the midstream infrastructure required to handle growing oil and natural gas production from the development of unconventional reserves. In calendar 2013, we estimate that MLPs spent in excess of $25 billion on organic capital projects to construct and expand this critical energy infrastructure. We expect MLPs to spend in excess of $20 billion on organic growth projects during 2014. Distribution growth was also driven by acquisitions, and 2013 was one of the most active M&A markets we have ever seen. We estimate that MLPs announced over $65 billion in acquisitions during calendar 2013, including a record three MLP-to-MLP mergers, as well as several large joint ventures between MLPs. While it is difficult to predict merger and acquisition activity, we believe the strategic and competitive dynamics that led to the flurry of activity in 2013 could lead to further consolidation in 2014.

In order to fund these significant capital expenditures, access to the capital markets remains extremely important for MLPs. During calendar 2013, MLPs raised a record level of capital for the fourth consecutive year raising $15 billion in follow-on equity and $32 billion in debt. In addition, at-the-market, or ATM, equity offering programs, through which MLPs can sell equity on a daily basis, became much more popular during the year. We believe that MLPs raised well over $5 billion using ATM programs, which is another record. We expect capital markets in 2014 to be at least as active as they were in 2013 and believe market conditions will be receptive for these deals.

There was also a record number of IPOs in the MLP sector during calendar 2013, with 21 IPOs raising $8.2 billion. Since 2010, there have been 54 IPOs, which is amazing considering there are only 114 MLPs currently trading. While the expansion of the sector has certainly been driven by the Shale Revolution, it is also important to note that quite a few of these new entrants are not traditional midstream MLP businesses. In particular, the recent vintage of IPOs has seen refining, petrochemical, frac sand, wholesale fuel distribution and offshore drilling companies, among others, form MLPs. While we welcome the expansion of the MLP market into other businesses, we believe it is critical to understand the additional risks associated with these new businesses and will only invest in them if we are properly compensated for these additional risks.

At the same time, much larger energy companies such as Marathon Petroleum, Phillips 66 and Valero Energy, having seen the strategic importance of having an MLP, have formed their own MLPs. These MLPs are traditional MLPs and are often structured to have built-in growth for many years and little or no exposure to commodity prices, providing an interesting counter-balance to some of the new entrants with more volatile businesses.

We expect the MLP market to continue to expand across the entire energy sector, as more companies view the formation of an MLP to be a strategic imperative. Furthermore, we expect the increasing diversity and complexity of the sector to create wider disparities in valuation and performance among MLPs. As a result, the message that we have been delivering for several years now is truer today than ever a strong understanding of each MLP s assets, the domestic and international energy markets and the ability to select individual stocks is critical to outperforming the market. We are confident that our team of over 20 seasoned investment professionals is well suited to take advantage of the sector s increasing complexity.

Energy Market Overview

We have been highlighting for several years that the development of unconventional reserves or shale plays is the biggest story in the energy market, and this year is no different. The development of these resources promises to be a multi-decade story. Over the past few years, the focus of activity has shifted from the gas-rich basins such as the Barnett Shale, the Fayetteville Shale and the Haynesville Shale, to more oil-rich and NGL-rich basins such as the Bakken Shale, Eagle Ford Shale, Marcellus Shale and Utica Shale.

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As a result of continued development of shale plays, domestic production of crude oil, NGLs and natural gas grew in 2013 for the fifth consecutive year. Domestic crude oil production is expected to increase by over one million barrels per day in 2013 (a 16% increase), and for the second consecutive year, crude oil production has recorded the largest annual production increase in our country s history. Since its trough in 2008, domestic crude oil production has increased by over 50%. The U.S. is currently the largest producer of natural gas in the world, and many experts are predicting that it will become the largest producer of crude oil in the next five to ten years. Further, as discussed below in more detail, the U.S. is set to become one of the largest exporters of energy products over the next decade.

This rapid increase in production across all commodities is rapidly displacing imports. According to recent EIA data, the U.S. was supplying over one-half of its own crude needs for the first time in almost 20 years and was a net exporter of petroleum products at the highest recorded level since the EIA has been tracking the data. These exports are driven in large part by refined products (exports of crude oil are, with a few minor exceptions, prohibited by U.S. laws), but there has also been significant growth in the export of natural gas liquids, or NGLs. In particular, Enterprise and Targa began operating two newly constructed propane export terminals during 2013. Partly as a result of these projects, propane prices recovered significantly in 2013, rising 59% from their lows in January. Both of these projects are being expanded and several other MLPs are evaluating NGL export projects of their own. There has also been significant interest among MLPs and other energy companies in exporting natural gas as liquefied natural gas, or LNG. The LNG liquefaction projects are multi-billion dollar capital projects and are expected to be placed in service in the second half of this decade. Once in service, the U.S. will become a top exporter of LNG. These export opportunities will create large scale investment opportunities for MLPs and other energy companies, as well as ensure a closer relationship between domestic energy prices and international prices.

There was no shortage of developments in the crude oil markets as well. During the year, we saw crude oil differentials (which is the spread between crude oil prices at different locations) widen to record levels to due excess supply in certain regions. To combat these differentials, a record amount of crude oil production was transported by rail cars and marine transportation in lieu of pipelines during 2013.

Increased production from new producing areas (such as the Bakken Shale and the Marcellus Shale) continues to have a material impact on historical transportation patterns. While this creates opportunities for many, as new midstream assets need to be built to facilitate product movement, it also creates challenges, as changing transportation patterns can put pressure on certain existing midstream assets that are no longer needed. For instance, oil production from the Bakken Shale, which is located in North Dakota, has increased five-fold in the last five years. The vast majority of that production is not consumed in North Dakota and it must be shipped to refineries elsewhere in the U.S. This has overwhelmed the existing midstream infrastructure in the area and created tremendous opportunities for midstream companies to develop both short-term and long-term transportation solutions. In the Marcellus Shale, natural gas and NGL production has increased to levels well above what the Northeast uses for most of the year. This has put pressure on natural gas prices in the region, as insufficient infrastructure exists to move the natural gas to other markets. Additionally, the increased local production reduces the area s need to source natural gas from its traditional supplier the gulf coast of Texas and Louisiana and many of the pipelines from those regions need to be reconfigured in order to maintain their current cash flows. We continue to watch these trends very carefully and position the Company s portfolio accordingly.

2014 Outlook

In summary, our outlook for 2014 is positive. We expect that distribution growth of approximately 7% will lead to another year of low double-digit total returns for the MLP sector. Continued development of unconventional reserves will create plentiful growth opportunities for the sector. While we expect that rising

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interest rates could lead to higher yields for MLPs (which would reduce total returns), we believe this will be a temporary headwind. Ultimately, the sector s attractive yields and prospects for many years of distribution growth will lead to a continuation of strong returns.

Fiscal 2014 is our tenth year of operations. At the time of our IPO in 2004, individual investors in the MLP sector had very few alternatives beyond direct ownership of MLPs. That has changed dramatically over the last ten years investors can choose from a variety of closed-end funds and open-end funds as well as exchange traded products. We continue to believe closed-end funds are the best structure for individual investors to get exposure to the sector. Further, we are extremely proud of our performance and believe we are well positioned to continue to deliver superior returns for our investors.

We look forward to executing on our business plan of achieving high after-tax total returns by investing in MLPs and other midstream companies. We invite you to visit our website at kaynefunds.com for the latest updates.

Sincerely,

Kevin S. McCarthy

Chairman of the Board of Directors,

President and Chief Executive Officer

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PORTFOLIO SUMMARY

(UNAUDITED)

Portfolio Investments by Category

November 30, 2013 **November 30, 2012**

Top 10 Holdings by Issuer

	Holding	Sector	Percent of Total Investments* as of November 30, 2013	2012
1.	Enterprise Products Partners L.P.	Midstream MLP	9.0%	8.9%
2.	MarkWest Energy Partners, L.P.	Midstream MLP	6.0	5.6
3.	Plains All American Pipeline, L.P.	Midstream MLP	5.7	7.1
4.	Williams Partners L.P.	Midstream MLP	5.7	4.3
5.	Energy Transfer Partners, L.P.	Midstream MLP	5.2	0.8
6.	Kinder Morgan Management, LLC	Midstream MLP	5.2	7.5
7.	DCP Midstream Partners, LP	Midstream MLP	4.0	2.5
8.	Crestwood Midstream Partners LP	Midstream MLP	3.9	2.5
9.	ONEOK Partners, L.P.	Midstream MLP	3.5	3.7
10.	Regency Energy Partners LP	Midstream MLP	3.4	3.9

* Includes cash and repurchase agreement (if any).

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KAYNE ANDERSON MLP INVESTMENT COMPANY

MANAGEMENT DISCUSSION

(UNAUDITED)

Company Overview

Kayne Anderson MLP Investment Company is a non-diversified, closed-end fund that commenced operations in September 2004. Our investment objective is to obtain a high after-tax total return by investing at least 85% of our total assets in energy-related master limited partnerships and their affiliates (MLPs) and in other companies that operate assets used in the gathering, transporting, processing, storing, refining, distributing, mining or marketing of natural gas, natural gas liquids, crude oil, refined petroleum products or coal (collectively with MLPs, Midstream Energy Companies).

As of November 30, 2013, we had total assets of $6.3 billion, net assets applicable to our common stock of $3.4 billion (net asset value of $34.30 per share), and 100.4 million shares of common stock outstanding.

Our investments are principally in equity securities issued by MLPs, but we also may invest in debt securities of MLPs and equity/debt securities of other Midstream Energy Companies. As of November 30, 2013, we held $6.2 billion in equity investments and no debt investments.

Recent Events

On September 16, 2013, we completed a public offering of Series G mandatory redeemable preferred stock with a $50 million aggregate liquidation value. The Series G shares pay cash dividends at a rate of 4.60% per annum. The net proceeds from this offering were used to make new portfolio investments, to repay indebtedness, and for general corporate purposes.

On September 24, 2013, we put in place an at-the-market offering program (or ATM program). This ATM program enables us to sell newly issued shares of common stock at the market prices through ordinary brokers transactions. During our fiscal fourth quarter, we sold 0.5 million shares ($18 million) pursuant to the ATM.

Results of Operations For the Three Months Ended November 30, 2013

Investment Income. Investment income totaled $10.9 million for the quarter and consisted primarily of net dividends and distributions on our investments. We received $88.1 million of dividends and distributions, of which $76.3 million was treated as return of capital and $0.8 million was distributions in excess of cost basis. We received $6.0 million of paid-in-kind dividends during the quarter, which are not included in investment income, but are reflected as an unrealized gain.

Operating Expenses. Operating expenses totaled $36.9 million, including $20.2 million of net investment management fees, $10.4 million of interest expense (including non-cash amortization of debt offering costs of $0.5 million), and $1.1 million of other operating expenses. Preferred stock distributions for the quarter were $5.2 million (including non-cash amortization of offering costs of $0.3 million).

Net Investment Loss. Our net investment loss totaled $18.1 million and included a current tax benefit of $3.0 million and deferred income tax benefit of $4.9 million.

Net Realized Gains. We had net realized gains from our investments of $30.0 million, net of $10.1 million of current tax expense and $6.2 million of deferred tax expense.

Net Change in Unrealized Gains. We had a net increase in our unrealized gains of $175.8 million. The net change consisted of a $274.9 million increase in our unrealized gains on investments and a deferred tax expense of $99.1 million.

Net Increase in Net Assets Resulting from Operations. We had an increase in net assets resulting from operations of $187.7 million. This increase was comprised of a net investment loss of $18.1 million, net realized gains of $30.0 million and net increase in unrealized gains of $175.8 million, as noted above.

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KAYNE ANDERSON MLP INVESTMENT COMPANY

MANAGEMENT DISCUSSION

(UNAUDITED)

Results of Operations For the Fiscal Year Ended November 30, 2013

Investment Income. Investment income totaled $40.0 million for the fiscal year and consisted primarily of net dividends and distributions on our investments. We received $310.0 million of dividends and distributions, of which $267.2 million was treated as return of capital and $3.1 million was distributions in excess of cost basis. Return of capital was increased by $0.3 million due to the 2012 tax reporting information that we received in the fiscal third quarter 2013. Interest and other income was $0.3 million. We received $26.3 million of paid-in-kind dividends during the fiscal year, which are not included in investment income, but are reflected as an unrealized gain.

Operating Expenses. Operating expenses totaled $140.1 million, including $72.9 million of net investment management fees, $40.8 million of interest expense (including non-cash amortization of debt offering costs of $2.1 million), and $4.1 million of other operating expenses. Preferred stock distributions for the fiscal year were $22.3 million (including non-cash amortization of offering costs of $2.8 million).

Net Investment Loss. Our net investment loss totaled $69.8 million and included a current tax benefit of $5.4 million and deferred income tax benefit of $24.9 million.

Net Realized Gains. We had net realized gains from our investments of $202.5 million, net of $21.0 million of current tax expense and $96.0 million of deferred tax expense.

Net Change in Unrealized Gains. We had a net increase in our unrealized gains of $603.8 million. The net change consisted of a $952.5 million increase in our unrealized gains on investments and a deferred tax expense of $348.7 million.

Net Increase in Net Assets Resulting from Operations. We had an increase in net assets resulting from operations of $736.5 million. This increase was comprised of a net investment loss of $69.8 million, net realized gains of $202.5 million and net increase in unrealized gains of $603.8 million, as noted above.

Distributions to Common Stockholders

We pay quarterly distributions to our common stockholders, funded generally by net distributable income (NDI) generated from our portfolio investments. NDI is the amount of income received by us from our portfolio investments less operating expenses, subject to certain adjustments as described below. NDI is not a financial measure under the accounting principles generally accepted in the United States of America (GAAP). Refer to the Reconciliation of NDI to GAAP section below for a reconciliation of this measure to our results reported under GAAP.

Income from portfolio investments includes (a) cash dividends and distributions, (b) paid-in-kind dividends received (*i.e.*, stock dividends), (c) interest income from debt securities and commitment fees from private investments in public equity (PIPE investments) and (d) net premiums received from the sale of covered calls.

Operating expenses include (a) investment management fees paid to our investment adviser, (b) other expenses (mostly comprised of fees paid to other service providers), (c) interest expense and preferred stock distributions and (d) current and deferred income tax expense/benefit on net investment income/loss.

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MANAGEMENT DISCUSSION

(UNAUDITED)

Net Distributable Income (NDI)

(amounts in millions, except for per share amounts)

	Three Months Ended November 30, 2013	Fiscal Year Ended November 30, 2013
Distributions and Other Income from Investments		
Dividends and Distributions[1]	$ 88.1	$ 310.0
Paid-In-Kind Dividends and Distributions[1]	6.0	26.3
Interest and Other Income		0.3
Net Premiums Received from Call Options Written		3.2
Total Distributions and Other Income from Investments	94.1	339.8
Expenses		
Investment Management Fee	(20.2)	(72.9)
Other Expenses	(1.1)	(4.1)
Interest Expense	(9.9)	(39.1)
Preferred Stock Distributions	(4.9)	(19.5)
Income Tax Benefit	7.9	30.3
Net Distributable Income (NDI)	**$ 65.9**	**$ 234.5**
Weighted Shares Outstanding	100.1	94.6
NDI per Weighted Share Outstanding	**$ 0.658**	**$ 2.478**
Adjusted NDI per Weighted Share Outstanding	**$ 0.627[2]**	**$ 2.455[2][3]**
Distributions paid per Common Share[4]	**$ 0.610**	**$ 2.350**

(1) See Note 2 (Investment Income) to the Financial Statements for additional information regarding paid-in-kind and non-cash dividends and distributions.

(2) During the three months ended November 30, 2013, Plains All American GP LLC paid a special distribution of $3.2 million. Adjusted NDI excludes this distribution.

(3) Adjusted NDI excludes $0.5 million of premium paid and $0.6 million of accrued dividends as a result of the redemption of Series D mandatory redeemable preferred stock during the second quarter of fiscal 2013.

(4) The distribution of $0.61 per share for the fourth quarter of fiscal 2013 was paid on January 10, 2014. Distributions for fiscal 2013 include the distributions paid in April 2013, July 2013, October 2013 and January 2014.

Payment of future distributions is subject to Board of Directors approval, as well as meeting the covenants of our debt agreements and terms of our preferred stock. In determining our quarterly distribution to common stockholders, our Board of Directors considers a number of factors that include, but are not limited to:

- NDI and Adjusted NDI generated in the current quarter;
- Expected NDI over the next twelve months; and
- Realized and unrealized gains generated by the portfolio.

On December 12, 2013, we declared a quarterly distribution of $0.61 per common share for the fourth quarter of fiscal 2013 (a total distribution of $61.4 million). The distribution represents an increase of 2.5% from the prior quarter s distribution and an increase of 10.9% from the distribution for the quarter ended November 30, 2012. The distribution was paid on January 10, 2014 to common stockholders of record on January 6, 2014.

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MANAGEMENT DISCUSSION

(UNAUDITED)

Reconciliation of NDI to GAAP

The difference between distributions and other income from investments in the NDI calculation and total investment income as reported in our Statement of Operations is reconciled as follows:

GAAP recognizes that a significant portion of the cash distributions received from MLPs is characterized as a return of capital and therefore excluded from investment income, whereas the NDI calculation includes the return of capital portion of such distributions.

GAAP recognizes distributions, received from MLPs, that exceed the cost basis of our securities to be realized gains and are therefore excluded from investment income, whereas the NDI calculation includes these distributions.

NDI includes the value of paid-in-kind dividends and distributions, whereas such amounts are not included as investment income for GAAP purposes, but rather are recorded as unrealized gains upon receipt.

NDI includes commitment fees from PIPE investments, whereas such amounts are generally not included in investment income for GAAP purposes, but rather are recorded as a reduction to the cost of the investment.

Certain of our investments in debt securities were purchased at a discount or premium to the par value of such security. When making such investments, we consider the security s yield to maturity, which factors in the impact of such discount (or premium). Interest income reported under GAAP includes the non-cash accretion of the discount (or amortization of the premium) based on the effective interest method. When we calculate interest income for purposes of determining NDI, in order to better reflect the yield to maturity, the accretion of the discount (or amortization of the premium) is calculated on a straight-line basis to the earlier of the expected call date or the maturity of the debt security.

We may sell covered call option contracts to generate income or to reduce our ownership of certain securities that we hold. In some cases, we are able to repurchase these call option contracts at a price less than the fee that we received, thereby generating a profit. The premium we receive from selling call options, less (i) the premium that we pay to repurchase such call option contracts and (ii) the amount by which the market price of an underlying security is above the strike price at the time a new call option is written (if any), is included in NDI. For GAAP purposes, premiums received from call option contracts sold are not included in investment income. See Note 2 Significant Accounting Policies for a full discussion of the GAAP treatment of option contracts.

The treatment of expenses included in NDI also differs from what is reported in the Statement of Operations as follows:

The non-cash amortization or write-offs of capitalized debt issuance costs and preferred stock offering costs related to our financings is included in interest expense and distributions on mandatory redeemable preferred stock for GAAP purposes, but is excluded from our calculation of NDI.

NDI also includes recurring payments (or receipts) on interest rate swap contracts (excluding termination payments) whereas for GAAP purposes, these amounts are included in the realized gains/losses section of the Statement of Operations.

Liquidity and Capital Resources

Total leverage outstanding at November 30, 2013 of $1,693 million was comprised of $1,175 million of senior unsecured notes (Senior Notes), $69 million outstanding under our unsecured revolving credit facility (the Credit Facility) and $449 million of mandatory redeemable preferred stock. Total leverage represented

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MANAGEMENT DISCUSSION

(UNAUDITED)

27% of total assets at November 30, 2013. As of January 14, 2014, we had $112 million borrowed under our Credit Facility, and we had $1.5 million of cash.

At November 30, 2013, our Credit Facility had a total commitment of $250 million and matures on March 4, 2016. The interest rate varies between LIBOR plus 1.60% and LIBOR plus 2.25%, depending on our asset coverage ratios. Outstanding loan balances accrue interest daily at a rate equal to one-month LIBOR plus 1.60% based on current asset coverage ratios. We pay a fee of 0.30% per annum on any unused amounts of the Credit Facility.

We had $1,175 million of Senior Notes outstanding at November 30, 2013. We have $110 million of Senior Notes that mature in November 2014 that we expect to refinance during the fiscal year. The remaining Senior Notes mature between 2015 and 2025.

As of November 30, 2013, we had $449 million of mandatory redeemable preferred stock outstanding. The mandatory redeemable preferred stock outstanding is subject to mandatory redemption at various dates from 2017 through 2021. On September 16, 2013, we completed a public offering of $50 million of Series G mandatory redeemable preferred stock with a mandatory redemption date of October 1, 2021. The net proceeds from the offering were used to make new portfolio investments, to repay indebtedness, and for general corporate purposes.

At November 30, 2013, our asset coverage ratios under the Investment Company Act of 1940, as amended (the 1940 Act), were 413% for debt and 303% for total leverage (debt plus preferred stock). Our long-term target asset coverage ratio with respect to our debt is 375%, but at times we may be above or below our target depending on market conditions.

As of November 30, 2013, our total leverage consisted of both fixed rate (76%) and floating rate (24%) obligations. At such date, the weighted average interest/dividend rate on our total leverage was 3.51%.

KAYNE ANDERSON MLP INVESTMENT COMPANY

SCHEDULE OF INVESTMENTS

NOVEMBER 30, 2013

(amounts in 000 s)

Description	No. of Shares/Units	Value
Long-Term Investments 180.9%		
Equity Investments[1] 180.9%		
Midstream MLP[2] 149.9%		
Access Midstream Partners, L.P.	2,793	$ 156,883
Arc Logistics Partners LP[3]	795	16,023
Atlas Pipeline Partners, L.P.	626	21,878
Boardwalk Pipeline Partners, LP	192	5,057
Buckeye Partners, L.P.	2,676	182,200
Crestwood Midstream Partners LP	10,763	243,669
Crosstex Energy, L.P.	5,514	146,901
DCP Midstream Partners, LP	5,173	249,221
El Paso Pipeline Partners, L.P.	4,143	172,270
Enbridge Energy Management, L.L.C.[4]	1,108	31,644
Enbridge Energy Partners, L.P.	5,303	159,570
Energy Transfer Partners, L.P.[5]	6,039	327,063
Enterprise Products Partners L.P.[5]	8,895	560,114
Global Partners LP	2,061	73,983
Holly Energy Partners, L.P.	235	7,400
Kinder Morgan Energy Partners, LP	2,329	190,927
Kinder Morgan Management, LLC[4]	4,218	322,951
Magellan Midstream Partners, L.P.	2,850	177,112
MarkWest Energy Partners, L.P.[6]	5,387	372,080
Midcoast Energy Partners, L.P.[3]	864	15,543
Niska Gas Storage Partners LLC	1,814	27,584
NuStar Energy L.P.	1,722	91,894
ONEOK Partners, L.P.	4,109	220,089
Plains All American Pipeline, L.P.[6]	6,902	355,925
PVR Partners, L.P.	5,169	127,683
QEP Midstream Partners, LP	519	11,750
Regency Energy Partners LP	8,797	214,461
Sprague Resources LP[3]	1,285	22,144
Summit Midstream Partners, LP	1,003	33,693
Sunoco Logistics Partners L.P.	201	14,250
Tallgrass Energy Partners, LP	188	4,671
Targa Resources Partners L.P.	2,304	117,640
Western Gas Partners, LP	2,106	134,110
Williams Partners L.P.	6,889	354,022
		5,162,405
Midstream Company 10.1%		
Kinder Morgan, Inc.	1,447	51,419
ONEOK, Inc.	1,510	87,674
Plains GP Holdings, L.P. Unregistered[6][7][8]	6,402	137,087
Targa Resources Corp.	308	24,945

The Williams Companies, Inc.	1,319	46,473
		347,598

See accompanying notes to financial statements.

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KAYNE ANDERSON MLP INVESTMENT COMPANY

SCHEDULE OF INVESTMENTS

NOVEMBER 30, 2013

(amounts in 000 s)

Description	No. of Shares/Units	Value
Shipping MLP 6.8%		
Capital Product Partners L.P.	2,841	$ 25,455
Capital Products Partners L.P. Class B Units[7][9]	3,030	28,879
Dynagas LNG Partners LP[3]	964	18,072
Golar LNG Partners LP	889	28,441
KNOT Offshore Partners LP	385	10,803
Navios Maritime Partners L.P.	857	14,405
Teekay LNG Partners L.P.	663	27,263
Teekay Offshore Partners L.P.	2,508	82,326
		235,644
General Partner MLP 5.0%		
Alliance Holdings GP L.P.	1,935	106,410
Crestwood Equity Partners LP	4,203	64,646
		171,056
Upstream MLP & Income Trust 4.9%		
BreitBurn Energy Partners L.P.	2,202	41,642
Enduro Royalty Trust	718	9,507
EV Energy Partners, L.P.	510	16,669
Legacy Reserves L.P.	682	18,395
LRR Energy, L.P.	403	6,617
Mid-Con Energy Partners, LP	2,352	53,451
Pacific Coast Oil Trust	578	8,231
SandRidge Mississippian Trust II	186	1,753
SandRidge Permian Trust	678	8,883
VOC Energy Trust	282	4,614
		169,762
Other 4.2%		
Alliance Resource Partners, L.P.	201	14,695
Clearwater Trust[6][7][10]	N/A	1,550
Exterran Partners, L.P.	2,355	65,533
Lehigh Gas Partners LP	19	550
Rhino Resource Partners LP	23	261
SunCoke Energy Partners, L.P.	1,301	35,088
USA Compression Partners, LP	1,062	26,023
		143,700
Total Equity Investments (Cost $3,627,551)		6,230,165

Liabilities	
Credit Facility	(69,000)
Senior Unsecured Notes	(1,175,000)
Mandatory Redeemable Preferred Stock at Liquidation Value	(449,000)
Current Tax Liability	(3,730)
Deferred Tax Liability	(1,073,858)
Other Liabilities	(42,774)
Total Liabilities	(2,813,362)
Other Assets	27,113
Total Liabilities in Excess of Other Assets	(2,786,249)
Net Assets Applicable to Common Stockholders	$ 3,443,916

See accompanying notes to financial statements.

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KAYNE ANDERSON MLP INVESTMENT COMPANY

SCHEDULE OF INVESTMENTS

NOVEMBER 30, 2013

(amounts in 000 s)

(1) Unless otherwise noted, equity investments are common units/common shares.

(2) Includes limited liability companies.

(3) Security is not currently paying cash distributions but is expected to pay cash distributions within the next 12 months.

(4) Dividends are paid-in-kind.

(5) In lieu of cash distributions, the Company has elected to receive distributions in additional units through the partnership s dividend reinvestment program.

(6) The Company believes that it is an affiliate of Clearwater Trust, MarkWest Energy Partners, L.P., Plains All American Pipeline, L.P. and Plains GP Holdings, L.P. (Plains GP). See Note 5 Agreements and Affiliations.

(7) Fair valued security, restricted from public sale. See Notes 2, 3 and 7 in Notes to Financial Statements.

(8) The Company holds an interest in Plains All American GP LLC (PAA GP), which controls the general partner of Plains All American, L.P. The Company s ownership of PAA GP is exchangeable into shares of Plains GP Holdings, L.P. (which trades on the NYSE under the ticker PAGP) on a one-for-one basis at the Company s option. See Note 3 Fair Value.

(9) Class B Units are convertible on a one-for-one basis into common units of Capital Product Partners L.P. (CPLP) and are senior to the common units in terms of liquidation preference and priority of distributions. The Class B Units pay quarterly cash distributions of $0.21375 per unit and are convertible at any time at the option of the holder. If CPLP increases the quarterly cash distribution per common unit, the distribution per Class B Unit will increase by an equal amount. If CPLP does not redeem the Class B Units by May 2022, then the distribution increases by 25% per quarter to a maximum of $0.33345 per unit. CPLP may require that the Class B Units convert into common units after May 2015 if the common unit price exceeds $11.70 per unit, and the Class B Units are callable after May 2017 at a price of $9.27 per unit and after May 2019 at $9.00 per unit.

(10) The Company owns an interest in the Creditors Trust of Miller Bros. Coal, LLC (Clearwater Trust) consisting of a coal royalty interest and certain other assets. See Notes 5 and 7 in Notes to Financial Statements.

See accompanying notes to financial statements.

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KAYNE ANDERSON MLP INVESTMENT COMPANY

STATEMENT OF ASSETS AND LIABILITIES

NOVEMBER 30, 2013

(amounts in 000 s, except share and per share amounts)

ASSETS	
Investments at fair value:	
Non-affiliated (Cost $3,368,991)	$ 5,363,523
Affiliated (Cost $258,560)	866,642
Total investments (Cost $3,627,551)	6,230,165
Cash	257
Deposits with brokers	1,311
Receivable for securities sold	9,060
Interest, dividends and distributions receivable	1,783
Deferred debt and preferred stock offering costs and other assets	14,702
Total Assets	6,257,278
LIABILITIES	
Payable for securities purchased	1,933
Investment management fee payable	20,217
Accrued directors fees and expenses	106
Accrued expenses and other liabilities	20,518
Current income tax liability	3,730
Deferred income tax liability	1,073,858
Credit facility	69,000
Senior unsecured notes	1,175,000
Mandatory redeemable preferred stock, $25.00 liquidation value per share (17,960,000 shares issued and outstanding)	449,000
Total Liabilities	2,813,362
NET ASSETS APPLICABLE TO COMMON STOCKHOLDERS	$ 3,443,916
NET ASSETS APPLICABLE TO COMMON STOCKHOLDERS CONSIST OF	
Common stock, $0.001 par value (100,418,659 shares issued and outstanding, 182,040,000 shares authorized)	$ 100
Paid-in capital	2,047,560
Accumulated net investment loss, net of income taxes, less dividends	(736,238)
Accumulated realized gains, net of income taxes	493,123
Net unrealized gains, net of income taxes	1,639,371
NET ASSETS APPLICABLE TO COMMON STOCKHOLDERS	$ 3,443,916
NET ASSET VALUE PER COMMON SHARE	$ 34.30

See accompanying notes to financial statements.

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KAYNE ANDERSON MLP INVESTMENT COMPANY

STATEMENT OF OPERATIONS

FOR THE FISCAL YEAR ENDED NOVEMBER 30, 2013

(amounts in 000 s)

INVESTMENT INCOME			
Income			
Dividends and distributions:			
Non-affiliated investments	$	269,593	
Affiliated investments		40,452	
Total dividends and distributions		310,045	
Return of capital		(267,195)	
Distributions in excess of cost basis		(3,122)	
Net dividends and distributions		39,728	
Interest and other income		275	
Total Investment Income		40,003	
Expenses			
Investment management fees, before investment management fee waiver		73,968	
Administration fees		982	
Professional fees		561	
Custodian fees		543	
Reports to stockholders		413	
Directors fees and expenses		424	
Insurance		212	
Other expenses		977	
Total expenses before waiver, interest expense, preferred distributions and taxes		78,080	
Investment management fee waiver		(1,099)	
Interest expense and amortization of offering costs		40,805	
Distributions on mandatory redeemable preferred stock and amortization of offering costs		22,357	
Total expenses before taxes		140,143	
Net Investment Loss Before taxes		(100,140)	
Current income tax benefit		5,425"bottom" width="11%" style="border-bottom: white;"> —	
Gain on sale of land and building		(308)	—
Loss on disposal of fixed assets		25	—
Prepaid insurance		1,487	(1,660)
Prepaid expenses, accounts receivable and other assets		(532)	(7,329)
Change in restricted cash		2,714	—

Accounts payable, accrued expenses and deferred revenue	(2,258)	(1,744)
Net cash used in operating activities	(2,395)	(13,826)
Cash flows from investing activities:		
Investments in qualified businesses	(6,250)	(2,591)
Return of investments in qualified businesses	6,304	1,501
Purchase of fixed assets	(1,392)	(1,439)
Purchase of customer merchant accounts	(2,531)	(877)
SBA loans originated for investment	(5,019)	(7,893)
Cash paid for repurchase of SBA loans	(1,214)	—
Proceeds from sale of SBA loans held for investment	4,173	6,313
Payments received on SBA loans	3,373	3,116
Proceeds from sale of land and building	1,300	—
Distribution from investee	—	820
Change in restricted cash	1,812	(3,105)
Proceeds from sale of marketable securities and certificates of deposit	14,001	
Other investments	(4)	(34)
Net cash provided by (used in) investing activities	14,553	(4,189)

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NEWTEK BUSINESS SERVICES, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)
FOR THE SIX MONTHS ENDED JUNE 30, 2006 AND 2005 (CONTINUED)

		2006		2005
Cash flows from financing activities:				
Proceeds from issuance of notes payable to certified investors		—		22,824
Cash paid for Coverage A (Syndication of Notes)		—		(6,008)
Repayment of mandatorily redeemable preferred stock		—		(1,500)
Repayments of note payable - other		(7,476)		(520)
Principal repayments of note payable-insurance		(1,938)		(1,692)
Proceeds from note payable - other		299		8,015
Change in restricted cash relating to NSBF financing		—		212
Net proceeds on SBA bank notes payable		722		1,793
Net proceeds from issuance of common stock and other		(267)		713
Net cash (used in) provided by financing activities		(8,660)		23,837
Net increase in cash and cash equivalents		3,498		5,822
Cash and cash equivalents - beginning of period		23,940		29,540
Cash and cash equivalents - end of period	$	27,438	$	35,362
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	$	9,993	$	9,349
Issuance of notes in partial payment for insurance			$	3,000
CrystalTech Web Hosting, Inc. final purchase price allocations to goodwill				
Additions to customer accounts			$	2,082
Additions to intangibles				560
Additions to furniture and fixtures				375
Deductions to goodwill				(3,258)
Net additions to assets and liabilities				241
Net effect on purchase price			$	---

See accompanying notes to these unaudited condensed consolidated financial statements

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NEWTEK BUSINESS SERVICES, INC. AND SUBSIDIARIES
NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1 - SIGNIFICANT ACCOUNTING POLICIES:

Basis of presentation and description of business

The unaudited condensed consolidated financial statements of Newtek Business Services, Inc. and Subsidiaries (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 certified capital companies ("Capco" or "Capcos") own non-controlling minority interest or those of which Newtek is considered to be the primary beneficiary. All inter-company balances and transactions have been eliminated in consolidation. The minority interests are held by members of limited liability companies, which are non-tax paying entities. Accordingly, the minority interest is calculated before income taxes.

The accompanying notes to condensed consolidated financial statements should be read in conjunction with Newtek's 2005 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 the 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 true indication of the results for the entire year.

Currently, the Company is absorbing losses attributable to certain of its minority interest holders. Once these entities return to profitability, the losses will be restored to the Company prior to allocation of profits to the minority holders.

Newtek is engaged in the business of providing financial products and business services to small- and medium-sized businesses through ownership and/or operation of specific primary lines of business as well as organizing Capcos and investing funds made available under the Capco programs in small businesses.

The unaudited condensed consolidated financial statements of Newtek reflect, in the opinion of management, all adjustments necessary to present fairly the financial position of Newtek at June 30, 2006 and its results of operations and cash flows for the three months and six months ended June 30, 2006. All adjustments are of a normal recurring nature.

The following is a summary of each Capco jurisdiction of certification and date of certification:

Capco	State/Jurisdiction of Certification	Date of Certification
WA	New York	May 1998
WP	Florida	December 1998
WI	Wisconsin	October 1999
WLA *	Louisiana	October 1999
WA II	New York	April 2000
WNY III	New York	December 2000
WC	Colorado	December 2001
WAP	Alabama	November 2003
WDC	District of Columbia	November 2004
WNY IV	New York	December 2004
WTX I	Texas	June 2005

WNY V	New York	November 2005

* Includes three additional Capco funds: WLAII, WLAIII, WLAIV

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In general, the Capcos issue debt and equity instruments (“Certified Capital”) to insurance company investors (“Certified Investors”). The Capcos then make targeted investments (“Investments in Qualified Businesses”, as defined under the respective state statutes, or, “Qualified Businesses”) with the Certified Capital raised, which in many cases may be majority-owned or primarily controlled by the Capcos after the investments are consummated. Some Capco programs limit the ownership or control which a Capco may acquire in a Qualified Business, Louisiana and the more recent New York programs for example. Participation in each Capco program legally entitles the Capco to receive (or earn) tax credits from the state upon satisfying quantified, defined investment percentage thresholds and time requirements. In order for the Capcos to maintain their state-issued certifications, the Capcos must make Investments in Qualified Businesses in accordance with these requirements. These state requirements are mirrored in the limitations agreed to by each Capco in its written agreements with its Certified Investors and limit the activities of the Capcos to conducting the business of a Capco. These legal contractual arrangements with the Certified Investors obligate the Capco to refrain from unauthorized activities, to use the proceeds from the notes only for Capco-authorized (i.e., “qualified”) investments and to limit fees for professional services related to making, buying or selling investments.

The Capco can satisfy the interest obligations on the debt instruments issued to Certified Investors, at the Capco’s discretion, by delivering tax credits in lieu of paying cash. The Capcos legally have the right to deliver the tax credits to the Certified Investors. The Certified Investors legally have the right to receive and use the tax credits and would, in turn, use these tax credits to reduce their respective state tax liabilities in an amount usually equal to 100% (WLA, WLPII, and WLPIII -110%) of their certified capital. The tax credits can be utilized over a four to ten-year period at an annual percentage rate established by each Capco legislation, and in some instances are transferable and can be carried forward.

Restricted Cash

Under the terms of the Line of Credit Agreement between Newtek Small Business Finance, Inc. (“NSBF”) , a wholly-owned subsidiary of the Company, and General Electric Capital Corporation (“GE”), all payments received from NSBF’s borrowers are transferred into a restricted bank account. NSBF uses these funds to pay required principal and interest to GE, amounts due to third party participants and certain other required payments. As of June 30, 2006 and December 31, 2005, NSBF restricted cash was $1,324,000 and $4,038,000, respectively.

The cash held by the Capcos is restricted for use in managing and operating the Capcos, making Investments in Qualified Businesses and for the payment of income taxes. Total restricted cash held by the Capcos as of June 30, 2006 and December 31, 2005 was $14,092,000 and $15,904,000, respectively.

Under the terms of the processing agreement between Universal Processing Services of WI, LLC (d/b/a Newtek Merchant Solutions of WI, “NMS-WI”), and its primary processing bank, NMS-WI maintains a cash account as a reserve against chargeback losses. As processing fees are received by the processing bank, a certain percentage is allocated to the cash reserve account. Total restricted cash held at the processing bank at June 30, 2006 and December 31, 2005 totaled $125,000, respectively.

Stock - Based Compensation

Prior to January 1, 2006, the Company applied the disclosure-only provisions of SFAS 123,” Accounting for Stock-Based Compensation” (“SFAS 123”). In accordance with the provisions of SFAS 123, the Company applied APB 25, “Accounting for Stock Issued to Employees” (“APB 25”) and related interpretations in accounting for stock-based compensation plans and, accordingly, did not recognize compensation expense for stock options because we issued options at exercise prices equal to the market value at date of grant.

Effective January 1, 2006, the Company adopted SFAS 123 (revised 2004), “Share-Based Payment”(“SFAS 123R”), which revises SFAS 123 and supersedes APB 25. SFAS 123R requires all share-based payments to employees to be recognized in the financial statements based on their fair values using an option-pricing model at the date of grant. The Company has elected to use the modified prospective method for adoption, which requires compensation expense to be recorded for all unvested stock options and restricted shares beginning in the first quarter of adoption, based on the fair value at the original grant date. Prior year financial statements have not been restated.

In November 2005, the FASB issued FASB Staff Position No. FAS 123R-3, "Transition Election Related to Accounting for the Tax Effects of Share-Based Payment Awards." The Company has elected to adopt the alternative transition method provided in the FASB Staff Position for calculating the tax effects of share-based compensation pursuant to SFAS 123R. 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 subsequent to the adoption of SFAS 123R.

The Newtek Business Services, Inc. 2000 Stock Incentive and Deferred Compensation Plan, as amended in 2006 (the “2000 Plan”), currently provides for the issuance of awards of restricted shares or options for up to a maximum of 4,250,000 common shares. All restricted shares or options have been issued at the fair market value on the date of grant. Options issued generally have a maximum term that ranges from 2 to 10 years and vesting provisions that range from 0 to 3 years.

The Newtek Business Services, Inc. 2003 Stock Incentive Plan (the “2003 Plan”) currently provides for the issuance of awards of restricted shares or options for up to a maximum of 1,000,000 common shares. All restricted shares or options have been issued at the fair market value on the date of grant. Options issued generally have a maximum term that ranges from 2 to 10 years and vesting provisions that range from 0 to 3 years.

A summary of stock option activity under the 2000 and 2003 Plans as of June 30, 2006 and changes during the period then ended is presented below:

Stock Options	Shares (in thousands)	Weighted Average Exercise Price	Weighted Average Remaining Term (in years)	Aggregate Intrinsic Value (in Thousands)
Outstanding December 31, 2005	2,067	$ 3.23		
Granted	—	—		
Exercised	—	—		
Cancelled	(319)	3.50		
Outstanding June 30, 2006	1,748	$ 3.18	5.17	$ 0
Exercisable June 30, 2006	1,698	$ 3.22	5.25	$ 0

There were no options granted during the six months ended June 30, 2006. The weighted average fair market value of options granted during the six months ended June 30 2005, estimated as of the grant date using the Black Scholes Model, was $1.23. There were no options exercised during the six months ended June 30, 2006 and 2005.

A summary of the status of Newtek’s non-vested restricted shares as of June 30, 2006 and changes during the period then ended is presented below:

Non-vested Restricted Shares	Number of Shares (in thousands)	Weighted Average Grant Date Fair Value
Non-vested at December 31, 2005	179	$ 4.22
Granted	72	$ 1.89
Exercised and vested	(73)	$ 2.42
Forfeited	(4)	$ 4.78
Non-vested at June 30, 2006	174	$ 3.99

As of June 30, 2006, there was $298,000 of total unrecognized compensation costs related to non-vested share-based compensation arrangements granted under the 2000 and 2003 Plans. That cost is expected to be recognized ratably through the year ending December 31, 2009. The total fair market value of restricted shares vested during the six months ended June 30, 2006 and 2005 was $176,000 and $284,000, respectively. The Company recognized an income tax benefit of $55,000 and $114,000 in connection with these vested shares.

The adoption of SFAS 123R during the first half of 2006 did not have a material impact, as all options were fully vested by December 31, 2005, except for one option grant which yielded $19,000 of share-based compensation expense for the six months ended June 30, 2006. The Company recognized an income tax benefit of $7,600 in connection with these options.

Under the accounting treatment used through December 31, 2005, the net income for the three and six months ended June 30, 2005 does not include any compensation charges related to options granted to employees. The following table illustrates the proforma effect on Net Loss and Loss per share assuming the Company had applied the fair value recognition provisions of SFAS 123 instead of the intrinsic value method under APB 25 to stock - based employee compensation for the three and six months ended June 30, 2005:

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	Three Months Ended June 30, 2005 (in thousands)	Six Months Ended June 30, 2005 (in thousands)
As reported		
Net income	$ 4,463	$ 1,081
Add: Total stock-based employee compensation expense recognized, net of related tax effects	229	466
Deduct: Total stock based employee compensation expense determined under fair value based method for all awards, net of related tax effects	(470)	(543)
Pro forma net income	$ 4,222	$ 1,011
Net income per share		
Basic - as reported	$ 0.13	$ 0.03
Basic - pro forma	$ 0.12	$ 0.03
Diluted - as reported	$ 0.13	$ 0.03
Diluted - pro forma	$ 0.12	$ 0.03

The fair value of each option granted was estimated using the Black-Scholes Model in 2005 with the following assumptions: expected volatility of 42-48%, risk-free interest rate of 1.98%, respectively, expected dividends of $0 and expected terms of 2-6 years.

Use of Estimates

The preparation of 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 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 asset and tax valuation allowances. Actual results could differ from those estimates.

Fair value of financial instruments

SFAS No. 107, “Disclosures about Fair Value of Financial Instruments,” (“SFAS 107”) requires the disclosure of the estimated fair values of financial instruments. Excluding property and equipment, substantially all of the Company’s assets and liabilities are considered financial instruments as defined by SFAS 107. Fair value is defined as the price at which a financial instrument could be liquidated in an orderly manner over a reasonable time period under present market conditions. 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. Fair value information is supposed to represent estimates of the amounts at which financial instruments could be exchanged in current transactions between willing buyers and sellers engaging in exchange transactions. However, since there are no established trading markets for a significant portion of the Company’s financial instruments, the Companies may not be able to settle their financial instruments immediately; as such, the fair values are not necessarily indicative of the amounts that could be realized through immediate settlements. In addition, the majority of the Company’s financial instruments, such as loans receivable held for investment and bank notes payable, are held to maturity and are realized or paid according to the contractual agreements with the customers or counterparties.

SFAS 107 requires that, where available, quoted market prices are used to estimate fair values. However, because of the nature of the Company's financial instruments, in many instances quoted market prices are not available. Accordingly, the Companies have estimated fair values on the basis of other valuation techniques permitted by SFAS 107, such as discounting estimated future cash flows at rates commensurate with the risks involved, or other acceptable methods. Fair values are required to be estimated without regard to any premium or discount that may result from concentrations of ownership of a financial instrument, possible income tax ramifications, or estimated transaction costs. Fair values are also estimated at a specific point in time and are based on interest rates and other assumptions at that date. As the assumptions underlying these estimates change, the fair values of financial instruments will change.

Because SFAS 107 permits many alternative calculation techniques and because numerous assumptions have been used to estimate the Company's fair values, reasonable comparisons of the Company's fair value information with other financial institutions' fair value information cannot necessarily be made.

The methods and assumptions used to estimate fair values are set forth in the following paragraphs for each major grouping of the Companies' financial instruments.

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
- Bank notes payable
- Accrued interest receivable and payable

The carrying value 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, loans receivable, structured insurance product, notes and loans payable, credits in lieu of cash, and notes payable in credits in lieu of cash approximate fair value based on management's estimates.

New Accounting Pronouncements

In March 2006, the FASB issued Statement of Financial Accounting Standard No. 156 "Accounting for Servicing of Financial Assets—an amendment of FASB Statement No. 140 ("SFAS 156") which amends FASB Statement No. 140, "Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities," with respect to the accounting for separately recognized servicing assets and servicing liabilities. SFAS 156 requires an entity to recognize a servicing asset or servicing liability each time it undertakes an obligation to service a financial asset by entering into a servicing contract in certain situations, requires all separately recognized servicing assets and servicing liabilities to be initially measured at fair value, if practicable, and permits an entity to choose subsequent measurement methods for each class of separately recognized servicing assets and servicing liabilities. SFAS 156 also requires separate presentation of servicing assets and servicing liabilities subsequently measured at fair value in the balance sheet and additional disclosures for all separately recognized servicing assets and servicing liabilities. The Company is currently evaluating the impact of adoption, which is required to be adopted January 1, 2007.

In June 2006, the FASB issued interpretation No. 48, *Accounting for Uncertainty in Income Taxes - an interpretation of FAS No. 109* ("FIN 48"), which clarifies the accounting for uncertainty in income taxes. Currently, the accounting for uncertainty in income taxes is subject to significant and varied interpretations that have resulted in diverse and inconsistent accounting practices and measurements. Addressing such diversity, FIN 48 prescribes a consistent recognition threshold and measurement attribute, as well as clear criteria for subsequently recognizing, derecognizing and measuring changes in such tax positions for financial statement purposes. FIN 48 is effective for fiscal years beginning after December 15, 2006. We have not yet determined the impact of FIN 48 on our consolidated financial position, results of operations, cash flows or financial statement disclosures.

Reclassifications

Certain prior period amounts have been reclassified to conform to the current period presentation.

NOTE 2 - COMMON STOCK:

Pursuant to the terms of the Company's directors' compensation program, in the six months ended June 30, 2006, Newtek issued an aggregate of 45,131 unregistered common shares to the board of directors, valued at $84,500. The fair market values of these grants were determined using the fair value of the underlying common stock at each grant date.

Pursuant to the 2000 and 2003 Plans, the Company issued 39,038 common shares to employees. Newtek also issued 90,000 common shares to various subsidiaries of Genworth Financial in exchange for warrants they held in certain Capcos owned by Newtek. These shares were valued at $186,000 and were accounted for as goodwill.

In March and May 2006, Newtek also granted two employees 3,428 and 18,230 shares of restricted stock valued at $7,400 and $35,000 respectively. Half of the March restricted share grant vest immediately and the other half will vest in the 4th quarter of 2006. The May grant vests in one year. The fair market value of both grants was determined using the fair value of the underlying common stock 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.

NOTE 3 - INVESTMENTS IN QUALIFIED BUSINESSES:

The various interests that the Company acquires in its Investments in Qualified Business are accounted for under three methods: consolidation, equity 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 under the provisions of FIN 46R 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 Consolidated Balance Sheets and Consolidated Statements of Operations. All significant inter-company accounts and transactions, including returns of principal, dividends, interest received and investment redemptions have been eliminated. 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 Consolidated Balance Sheets and Consolidated Statements of Income; however, the Company's share of the earnings or losses of the investee is reflected in the caption "Other income" in the Consolidated Statements of Operations.

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 earnings or losses of such companies is not included in the Consolidated Balance Sheets and Consolidated Statements of Operations. However, cost method impairment charges are recognized, as necessary, in the Consolidated Statement of Operations. If circumstances suggest that the value of the investee has subsequently recovered, such recovery is not recorded until 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 5 years of initial funding. The investments listed below qualify for this purpose. 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 this will be counted towards the Capcos' minimum investment benchmarks.

In accordance with the provisions of Statement of Financial Accounting Standards No. 115 "Accounting for Certain Investments in Debt and Equity Securities," the Company classifies its debt investments as held-to-maturity and such investments are initially recorded at amortized cost. The Company considers several factors in determining whether an impairment exists on the investment, such as the investee's net book value, cash flow, revenue growth and net income. In addition, the Investment Committee considers other factors, such as the economy and the investee company's industry, to determine if an other than temporary decline in value exists in the Company's investment.

HELD TO MATURITY DEBT INVESTMENTS—Summary (In thousands)

		Total
Principal Outstanding at December 31, 2005	$	3,596
Debt investments made		5,961

Return of principal		(6,304)
Principal Outstanding at June 30, 2006	$	3,253

COST INVESTMENTS—Summary (In thousands)

		Total
Total cost investments at December 31, 2005	$	150
Cost investments made		289
Other than temporary decline in value of investments		—
Total cost investments at June 30, 2006	$	439

The Company has not guaranteed any obligation of these investees (other than that of its subsidiary, NSBF), and the Company is not otherwise committed to provide further financial support for the investees. However, from time-to-time, the Company may decide to provide such additional financial support which, as of June 30, 2006 was zero. Should the Company determine that an impairment exists upon its periodic review, and it is deemed to be other than temporary, the Company will write down the recorded value of the asset to its estimated fair value and record a corresponding charge in the Consolidated Statements of Operations.

NOTE 4 - LOANS RECEIVABLE (NON-CAPCO):

Loans receivable are generated by NSBF and are primarily related to entities in the Eastern region of the United States with concentrations in the restaurant and hotel and motel industries.

Below is a summary of the activity in the SBA loan receivable balance, net of SBA loan loss reserves for the six months ended June 30, 2006 (in thousands):

Balance at December 31, 2005	$	32,028
SBA loans originated for investment		5,323
Payments received		(3,373)
SBA loans held for investment, reclassified as held for sale		(2,814)
Loans foreclosed into real estate owned		(215)
Provision for SBA loan losses		(354)
Discount on loan originations, net		(198)
Balance at June 30, 2006	$	30,397

Below is a summary of the activity in the reserve for loan losses balance for the six months ended June 30, 2006 (in thousands):

Balance at December 31, 2005	$	2,304
Provision for SBA loan losses		354
Recoveries		19
Loan charge-offs		(376)
Balance at June 30, 2006	$	2,301

Below is a summary of the activity in the SBA loans held for sale for the six months ended June 30, 2006 (in thousands):

Balance at December 31, 2005	$	1,155
Loan originations for sale		16,417
SBA loans held for investment, reclassified as held for sale		2,814
Loans sold		(17,140)
Balance at June 30, 2006	$	3,246

All loans are priced at the prime interest rate plus approximately 2.75% to 3.75%. As of June 30, 2006 and December 31, 2005, NSBF loans receivable held for investment with adjustable interest rates amounted to $30,043,000 and $34,200,000, respectively.

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 NSBF. As of June

30, 2006 and December 31, 2005, NSBF loans receivable held for investment with fixed interest rates amounted to $4,418,000 and $1,759,000, respectively.

The GE credit line is collateralized by all the loans receivable held for investment and held for sale, in addition to all assets of NSBF.

The outstanding balances of loans past due ninety days or more and still accruing interest as of June 30, 2006 and December 31, 2005 amounted to $0 and $7,300, respectively.

At June 30, 2006 and December 31, 2005, total impaired loans which are not accruing interest amounted to $4,169,000 and $3,693,000, respectively. Approximately $1,031,000 and $907,000 of the allowance for loan losses were allocated against such impaired nonaccrual loans, respectively, in accordance with SFAS 114, “Accounting by Creditors for Impairment of a Loan-An Amendment of FASB No. 5 and 43”.

The following is a summary of Loans Receivable (in thousands) at:

	June 30, 2006	December 31, 2005
Due in one year or less	$ 23	$ 24
Due between one and five years	1,950	1,807
Due after five years	32,552	34,129
Total	34,525	35,960
Less : Allowance for loan losses	(2,301)	(2,304)
Less: Deferred origination fees, net	(1,827)	(1,628)
Balance (net)	$ 30,397	$ 32,028

NOTE 5—SERVICING ASSETS:

NSBF reviews capitalized servicing rights for impairment. This review 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 following summarizes the activity pertaining to servicing assets for the six months ended June 30, 2006 (in thousands):

Balance at December 31, 2005	$ 3,376
Servicing assets capitalized	428
Servicing assets amortized	(422)
Balance at June 30, 2006	3,382
Reserve for impairment of servicing assets:	
Balance at December 31, 2005	(179)
Additions	(0)
Balance at June 30, 2006	(179)
Balance at June 30, 2006 (net of reserve)	$ 3,203

For the six months ended June 30, 2006 and 2005, servicing fees received amounted to $986,000 and $937,000, respectively.

The estimated fair value of capitalized servicing rights was $3,203,000 and $3,197,000 at June 30, 2006 and December 31, 2005, respectively. The estimated fair value of servicing assets at both balance sheet dates was determined using a discount rate of 13.5%, weighted average prepayment speeds ranging from 1% to 19%, weighted average life of 3.9 years, and an average default rate of 3%.

Amortization of servicing assets for the year ended December 31, 2005 on the accompanying Condensed Consolidated Statements of Operations included a cumulative adjustment of approximately $184,000 (a reduction of amortization expenses) due to a change in NSBF’s amortization method. Although this adjustment relates to prior periods, the amount of the adjustment attributable to any prior year would not have been material to the Company's or NSBF’s financial condition or results of operations as reported for that year.

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NOTE 6 - CUSTOMER ACCOUNTS:

On April 13, 2006, a subsidiary of Newtek purchased a merchant processing credit card portfolio with 3,100 customers from Midwest Transaction Group, L.L.C., for a purchase price of $2,500,000. This portfolio has annual processing volume of approximately $240 million.

NOTE 7 - EARNINGS PER SHARE:

Basic earnings 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 earnings per share only when the effect of their inclusion would be dilutive.

The calculations of Net loss per share were:

	Three Months Ended June 30, 2006	Three Months Ended June 30, 2005	Six Months Ended June 30, 2006	Six Months Ended June 30, 2005
	(In Thousands, except for Per Share Data)			
Numerator:				
Numerator for basic and diluted EPS - income (loss) available to common shareholders	$ (2,287)	$ 4,463	$ (5,015)	$ 1,088
Denominator:				
Denominator for basic EPS - weighted average shares	34,696	33,962	34,765	33,927
Effect of dilutive securities	—	82	—	148
Denominator for diluted EPS - weighted average shares	34,696	34,044	34,765	34,075
EPS: Basic	$ (0.07)	$ 0.13	$ (0.14)	$ 0.03
EPS: Diluted	$ (0.07)	$ 0.13	$ (0.14)	$ 0.03
The amount of anti-dilutive shares/units excluded from above is as follows:				
Stock options and restricted stock grants	1,748	1,541	1,748	1,240
Warrants	216	216	216	216
Contingently issuable shares	861	1,069	861	1,069

NOTE 8 - NOTES PAYABLE-OTHER:

In March 2006, CrystalTech Web Hosting, Inc. (“CrystalTech”), a wholly owned subsidiary of the Company, prepaid $4,000,000 of the note payable to Technology Investment Capital Corp. (“TICC”). In conjunction with the prepayment, CrystalTech paid $127,000 in additional interest. In June 2006, CrystalTech prepaid an additional $2,100,000 of the note payable to TICC. The remaining principal payment of $1,900,000 is due in March 2008.

NOTE 9—SBA LINE OF CREDIT:

In February 2006, GE and NSBF entered into a First Amendment to the GE Line of Credit Agreement. The amendment made adjustments to various financial covenants, including a net-worth maintenance level that NSBF had breached. GE has waived, upon the effectiveness of the amendment, specific defaults that would have resulted from the terms of the original agreement.

NOTE 10 - SEGMENT REPORTING:

Operating segments are organized internally primarily by the type of services provided, and in accordance with SFAS 131, "Disclosures About Segments of an Enterprise and Related Information," the Company has aggregated similar operating segments into six reportable segments: SBA lending, electronic payment processing, web hosting, Capcos, corporate activities and all other.

Effective in the fourth quarter of 2005, the Company increased the number of operating segments from four to six. Historically a substantial amount of resources were dedicated to new Capcos and the investment of the proceeds in Qualified Businesses and the managing of these businesses. Since management does not anticipate any new Capcos in the foreseeable future, the Company has changed its internal reporting to better evaluate and manage the existing Capco business, its corporate activities and its portfolio of small businesses included in the all other segment. The segment previously called Capco and other, which management previously evaluated as one integrated segment, is now being evaluated as three segments—Capcos, corporate activities and all other. The segment information for prior periods has been restated to conform to the current disclosure.

The SBA lending segment is NSBF, a 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.

As an SBA lender, 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 also generates expenses such as interest, professional fees, payroll and consulting, depreciation and amortization, and provision for loan losses, all of which are included in the respective caption on the condensed consolidated statement of operations. NSBF also has expenses such as loan recovery expenses, loan processing costs, and other expenses that are all included in the other expenses caption on the condensed consolidated statements of operations.

The electronic payment processing segment is a marketer of credit card and check approval services to the small business market. Revenue generated from electronic payment processing is included on the condensed consolidated statements of income as a separate line item. Expenses include direct costs (included in a separate line captioned electronic payment processing direct costs), professional fees, payroll and consulting, and other expenses, all of which are included in the respective caption on the condensed consolidated statements of operations.

The web hosting segment consists of CrystalTech, acquired in July 2004. CrystalTech's revenues are derived primarily from web hosting services and set up fees. CrystalTech generates expenses such as professional fees, payroll and consulting, 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 expenses in the respective caption on the condensed consolidated statements of operations.

The Capco segment, which consists of the fifteen 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, professional fees consisting of management fees paid to Newtek, legal and auditing fees and losses from Investments in Qualified Businesses.

The all other segment includes revenue and expenses from businesses formed from Investments in Qualified Investments made through the Capco programs which cannot be aggregated with other operating segments.

Corporate activities represent revenue and expenses not allocated to our segments. Revenue includes interest income and management fees earned from Capcos. 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.

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.

	For the three months ended June 30, 2006	For the three months ended June 30, 2005	For the six months ended June 30, 2006	For the six months ended June 30, 2005
Third Party Revenue				
SBA lending	$ 2,361	$ 3,712	$ 4,483	$ 5,934
Electronic payment processing	10,561	8,545	20,037	14,556
Web hosting	3,317	2,673	6,520	4,922
Capcos	2,376	10,520	3,944	11,844
All other	1,338	528	3,229	1,878
Corporate activities	1,244	1,422	2,507	2,737
Total reportable segments	21,197	27,400	40,720	41,871
Eliminations	(1,214)	(1,174)	(2,575)	(2,334)
Consolidated totals	19,983	26,226	38,145	39,537
Inter-Segment Revenue				
SBA lending	$ —	$ —	$ —	$ —
Electronic payment processing	100	69	184	135
Web hosting	17	53	32	53
Capcos	317	136	637	278
All other	459	151	648	313
Corporate activities	538	628	1,069	1,183
Total reportable segments	1,431	1,037	2,570	1,962
Eliminations	(1,431)	(1,037)	(2,570)	(1,962)
Consolidated totals	$ —	$ —	$ —	$ —
Income (loss) before provision (benefit) for income taxes				
SBA lending	$ (102)	$ 1,138	$ (158)	$ 482
Electronic payment processing	723	1,150	1,137	1,104
Web hosting	1,048	918	2,051	1,861
Capcos	(3,185)	5,418	(7,327)	1,737
All other	(601)	(958)	(901)	(1,525)
Corporate activities	(1,237)	(664)	(2,252)	(1,521)
Totals	$ (3,354)	$ 7,002	$ (7,450)	$ 2,138
Depreciation and Amortization				
SBA lending	$ 414	$ 347	$ 810	$ 745
Electronic payment processing	355	225	639	412
Web hosting	614	489	1,172	846

Capcos		47		—		52		—
All other		128		87		261		199
Corporate activities		39		36		78		71
Totals	$	1,597	$	1,184	$	3,012	$	2,273

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Identifiable assets		**As of June 30, 2006**		**As of December 31, 2005**
SBA lending	$	43,964	$	46,501
Electronic payment processing		12,970		9,664
Web hosting		13,757		17,101
Capcos		147,814		156,216
All other		21,812		28,845
Corporate activities		3,213		6,686
Consolidated totals	$	243,530	$	265,013

In February 2006, in connection with the signing of the First Amendment to the GE Line of Credit Agreement, the board of NSBF, a subsidiary of the Company, authorized the issuance of 300 shares of a newly designated Series B Preferred Stock. The shares, valued at $10,000 each, were issued to the Company in exchange for the cancellation of $3,000,000 of subordinated debt owed to the Company. The Company assessed the fair value of the Preferred Stock based on the fair value of the intercompany note extinguished since the transaction was not executed with a third party on an arms length basis. Accordingly, no gain or loss on extinguishment is included in the segment data.

Note 11 - SUBSEQUENT EVENTS:

On July 13, 2006, Craig J. Brunet entered into an employment agreement with the Company which provides for annual base compensation of $240,000 plus participation in future bonus plans and all executive benefit programs available to Company executives. The agreement expires December 31, 2007.

On July 26, 2006, Liberty Media announced that it was acquiring a qualified business in which our Wisconsin Capco has an investment. Terms of the acquisition were not disclosed.

Item 2. Management’s Discussion and Analysis of Financial Condition and Results of Operations.

The following discussion of our financial condition and results of operations should be read together with our consolidated financial statements and the related notes thereto included in another part of this Quarterly Report. This discussion contains certain forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995, that involve substantial risks and uncertainties. When used in this report the words “anticipate,” “believe,” “estimate,” “expect” and similar expressions as they relate to our management or us are intended to identify such forward-looking statements. Our actual results, performance or achievements could differ materially from those expressed in, or implied by, these forward-looking statements. Historical operating results are not necessarily indicative of the trends in operating results for any future period.

Our Capcos operate under a different set of rules in each of the 8 jurisdictions and 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 although at times we don’t always make that distinction.

We are a holding company for several wholly- and majority-owned subsidiaries, including 15 certified capital companies which we refer to as Capcos, and several portfolio companies in which the Capcos own non-controlling minority interests. We are a direct distributor of business services to the small-and medium-sized business market. Our target market represents a very significant marketplace in the US GDP, since approximately 51% of the GDP in the United States comes from small-to medium-size businesses, and nine out of ten businesses in the United States fit into this market segment. As of June 30, 2006, we had over 60,000 customers. We use state of the art Web-based proprietary technology to be a low cost provider of products and services to our small and medium size business clients. We partner with Merrill Lynch, UBS, the Credit Union National Association with its 9,100 credit unions and 8 million members, the Navy Federal Credit Union with 2.5 million members, General Motors Minority Dealers Association, The Veterans Corporation, National Physician's Care, Inc. and the US Women's Chamber of Commerce who have elected to outsource their business services and financial products to us rather than try to provide it for their customers themselves We are deemphasizing our Capco business in favor of growing our operating businesses.

The Company's reportable business segments are:

SBA Lending: Newtek Small Business Finance, a licensed, U.S. Small Business Administration lender that originates, sells and services loans to qualifying small businesses, which are partially guaranteed by the SBA.

Electronic Payment Processing: A marketer of credit card processing and check approval services to the small- and medium-sized business market.

Web Hosting: CrystalTech Web Hosting, Inc. which offers shared and dedicated web hosting to the small- and medium-sized business market.

Capcos: Fifteen 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.

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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: Revenue and expenses not allocated to our other segments, including interest income, Capco management fee income and corporate operations expenses.

Business Segments:

Three months ended June 30, 2006

SBA Lending:

Revenues decreased by $1,351,000 compared to the prior year corresponding period and were primarily affected by a decrease in premium income of $1,393,000 as a result of originating and selling fewer loans.

Loss before income taxes was $102,000, compared to income of $1,138,000 in the corresponding period of 2005 and was primarily affected by:

- A $1,393,000 decrease in premium on sale, partially offset by:
- A decrease in provision for loan loss and line of credit related fees.

Electronic Payment Processing:

Revenues increased by $2,016,000 or 24% compared to the prior year corresponding period and were primarily affected by:

- A 64% growth in total customers from 7,500 to 12,300 as a result of our acquisitions and marketing efforts;
- Merchant portfolios, which included approximately 2,700 customers (included in 12,300), purchased in 2005 and 2006 which generated $218,000 of additional revenue in 2006, partially offset by
- A $900,000 recovery in 2005 of an investment in Merchant Data Systems received from a legal settlement.

Income before income taxes was $723,000, compared to income of $1,150,000 in the corresponding period in 2005 and was primarily affected by:

- A substantial increase in revenue and the leverage of fixed costs, offset by:
- A $900,000 recovery in 2005 of an investment in Merchant Data Systems received from a legal settlement.

Web Hosting:

Revenues increased $644,000 or 24% compared to the corresponding period in the prior year and were primarily affected by:

- An increase in customers from 40,000 to 52,000 and:
- An increase in dedicated hosting customers which generate higher revenue per customer.

Income before income taxes increased $130,000, or 14% compared to the corresponding period and was primarily affected by:

- An increase in revenues and:
- A $129,000 decrease in interest expense due to a decrease in borrowings during the period, partially offset by:
- A decrease in the revenue per shared web hosting customer due to competitive pressures;
- Increased payroll necessary to service the increased base of customers;
- Increased technology costs and depreciation due to capital invested in additional servers to support the growth in shared and dedicated web hosting customers.

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Capcos:

Revenues decreased $8,144,000 or 77% compared to the prior year corresponding period and were primarily affected by:

- A decrease in income from tax credits totaling $8,315,000. In the current period the Company achieved the 25% investment threshold in the WNYIV Capco generating $746,000 in income from tax credits. In the prior period, the Company achieved the 50% investment threshold in the WDC Capco generating $9,259,000 in income from tax credits. Offsetting this decrease is a net increase of $198,000 from other Capcos who achieved investment benchmarks in prior periods.

Loss before income taxes was $3,185,000, compared to income of $5,418,000 in the corresponding period of 2005 and was primarily affected by a decrease in revenue and an increase in interest expense, insurance expense and management fees associated with two additional Capcos.

All Other:

The all other segment includes revenue and expenses from businesses from Investments in Qualified Businesses made through the Capco programs which cannot be aggregated with other operating segments.

Revenues increased $810,000 or 153% compared to the prior year corresponding period and were primarily affected by:

- An increase in revenue totaling $557,000 derived from an investment in the fourth quarter of 2005 in Phoenix Development Group.

The loss before income taxes of $601,000 as compared with a loss of $958,000 in the corresponding period of the prior year was primarily affected by:

- A net reduction in losses for a number of smaller entities, many of which have been closed in the past year, partially offset by:
- An increase in the loss of approximately $130,000 in the insurance related entities.

Corporate Activities:

Revenues decreased slightly due to a decrease in other income offset by an increase in management fee income from two additional Capcos (WTX1 and WNY5) compared to the prior year corresponding period and an increase in interest income.

The loss before income taxes was $1,237,000, compared to a loss of $664,000 in the corresponding period of the prior year.

Six months ended June 30, 2006

SBA Lending:

Revenues decreased by $1,451,000 compared to the prior year corresponding period and were primarily affected by a decrease in premium income of $1,141,000 as a result of originating and selling fewer loans.

Loss before income taxes was $158,000 compared to income of $482,000 in the corresponding period of 2005 and was primarily affected by:

- A $1,141,000 decrease in premium on sale income and a net reduction of $402,000 in recoveries of loan liquidation costs, partially offset by:
- A $747,000 decrease in the provision for loan losses which in 2005 included a $550,000 increase in the provision to cover losses associated with the Commercial Capital Corporation portfolio acquired in 2002, and
- A reduction of $176,000 in professional fees.

Electronic Payment Processing:

Revenues increased $5,481,000, or 38%, compared to the prior year corresponding period and were primarily affected by:

- A 64% growth in customers from 7,500 to 12,300 as a result of our marketing efforts;
- Merchant portfolios, which included approximately 2,700 (included in 12,300) customers, purchased in 2005 and 2006 which generated $360,000 of additional revenue in 2006, partially offset by:
- A $900,000 recovery in 2005 of an investment in Merchant Data Systems received from a legal settlement.

Income before income taxes was $1,137,000, compared to income of $1,104,000 in the corresponding period in 2005 and was primarily affected by:

- A substantial increase in revenue and the leverage of fixed costs, offset by:
- A $900,000 recovery in 2005 of an investment in Merchant Data Systems received from a legal settlement.

Web Hosting:

Revenues increased $1,598,000, or 33%, compared to the corresponding period in the prior year and were primarily affected by:

- An increase in customers from 40,000 to 52,000.
- An increase in dedicated hosting customers which generate higher revenue per customer.

Income before income taxes increased $190,000, or 10% compared to the corresponding period and was primarily affected by:

- An increase in revenues, partially offset by:
- A decrease in the revenue per shared web hosting customer due to competitive pressures;
- Increased technology costs and payroll necessary to service the increased base of customers;
- Increased depreciation due to capital invested in additional servers to support the growth in shared and dedicated web hosting customers , and
- A $137,000 increase in interest expense due to an increase in borrowings during the period.

Capcos:

Revenues decreased $7,900,000 or 67% compared to the prior year corresponding period and were primarily affected by:

- A decrease in income from tax credits totaling $8,118,000. In the current period the Company achieved the 25% investment threshold in the WNYIV Capco generating $746,000 in income from tax credits. In the prior period, the Company achieved the 50% investment threshold in the WDC Capco generating $9,259,000 in income from tax credits. Offsetting this decrease is a net increase of $395,000 from other Capcos who achieved investment benchmarks in prior periods.

Loss before income taxes was $7,327,000, compared to income of $1,737,000 in the corresponding period of 2005 and was primarily affected by a decrease in revenue and an increase in interest expense, insurance expense and management fees associated with two additional Capcos.

All Other:

The all other segment includes revenue and expenses from businesses from Investments in Qualified Businesses made through the Capco programs which cannot be aggregated with other operating segments.

Revenues increased $1,351,000 or 72% compared to the prior year corresponding period and were primarily affected by:

- An increase in revenue totaling $1,573,000 derived from an investment in the fourth quarter of 2005 in Phoenix Development Group; partially offset by:
- A decrease in revenue from Exponential Business Development, Inc. of $650,000.

The loss before income taxes of $901,000 as compared with a loss of $1,525,000 in the corresponding period of the prior year was primarily affected by:

- A profit of $633,000, including a gain on the sale of property of $310,000 in Phoenix Development Group; and
- A net reduction in losses for a number of smaller investments; partially offset by:
- A $514,000 loss in Where Eagles Fly, a Washington D.C. investment; and
- A decrease in profit of $648,000 from Exponential Business Development Company, Inc.

Corporate Activities:

Revenues decreased slightly from $2,737,000 in 2005 to $$2,507,000 in 2006.

The loss before income taxes was $2,252,000, compared to a loss of $1,521,000 in the corresponding period of the prior year.

Comparison of the six months ended June 30, 2006 and June 30, 2005

Revenues decreased by $1,392,000, or 3.5%, to $38,145,000 for the six months ended June 30, 2006, from $39,537,000 for the six months ended June 30, 2005. Income from tax credits from our Capco business decreased by $8,118,000 to $3,280,000 for the six months ended June 30, 2006 from $11,398,000 for the six months ended June 30, 2005.

Electronic payment processing revenue increased by $6,606,000, or 49%, to $20,126,000 for the six months ended June 30, 2006 from $13,520,000 for the six months ended June 30, 2005 due to the increase in electronic payment processing customers. At June 30, 2006, we provided our payment services to over 12,300 customers across the United States, compared to 7,500 customers at June 30, 2005, an increase of 64%. Gross total processing volume increased by 38% to $923,000,000 for the six months ended June 30, 2006 from $669,000,000 for the six months ended June 30, 2005.

Web hosting revenue increased by $1,563,000, or 32%, to $6,474,000 for the six months ended June 30, 2006 from $4,911,000 for the six months ended June 30, 2005. The increase is due to the number of customers the Company provided services to and an increase in dedicated hosting customers which generate higher revenue per customer. At June 30, 2006 and 2005, CrystalTech was providing services to 52,000 and 40,000 customers, respectively.

NSBF (SBA Lender) interest income represents earnings on SBA loan receivables. Other interest income consists of investment income on money market accounts, certificate of deposits, U.S. Treasury notes, marketable securities, non-cash accretions of structured products and interest income on qualified investments. The following table details the changes in these different forms of interest income:

(In thousands)		2006		2005		Change
NSBF (SBA Lender)	$	1,835	$	1,791	$	44
Other interest income		1,501		538		963
	$	3,336	$	2,329	$	1,007

The increase in interest income is generally due to an increase in interest rates on investments and loans for the six months ended June 30, 2006 compared to the same period in 2005.

Income from tax credits from our Capco business decreased by $8,118,000 to $3,280,000 for the six months ended June 30, 2006 from $11,398,000 for the six months ended June 30, 2005. In the current period the Company achieved the 25% investment in the WNYIV Capco generating $746,000 in income from tax credits. In the prior period, the Company achieved the 50% investment threshold in the WDC Capco generating $9,259,000 in income from tax credits. Offsetting this decrease is a net increase of $395,000 from other Capcos who achieved investment benchmarks in prior periods.

Premium income decreased by $1,141,000 to $1,377,000 for the six months ended June 30, 2006 from $2,518,000 for the six months ended June 30, 2005. The decrease in premium income was attributable to NSBF selling 60 guaranteed loans in the six months ended June 30, 2006, aggregating $14,326,000 as compared to 84 loans sold aggregating $22,939,000 in the same period for the prior year. The premiums recognized in connection with these sales were $1,211,000 for the six months ended June 30, 2006 as compared with $1,931,000 in the same period for the prior year.

In addition, in June 2006, NSBF sold $2,814,000 of loans previously classified as held for investment as compared with $6,064,000 in June 2005, for aggregate proceeds of $2,960,000 and $6,314,000, respectively. The carrying value above the amounts sold of $146,000 and $250,000 was recorded as premium income. Also, in connection with these sales, included in premium income for the six months ended June 30, 2006 and 2005 is approximately $20,000 and $337,000, respectively, representing the allocated portion of the remaining discount recorded at the time of loan origination.

Servicing fee income related to SBA loans increased by $48,000 to $986,000 for the six months ended June 30, 2006 from $937,000 for the six months ended June 30, 2005. The increase in servicing fee income was attributable to the average servicing portfolio's growth year over year. The average servicing portfolio for the six months ending June 30, 2006 was $149,000,000 as compared with an average of $141,000,000 for the six months ending June 30, 2005.

Other income decreased by $1,072,000 to $2,134,000 for the six months ended June 30, 2006 from $3,206,000 for the six months ended June 30, 2005. Other income for the six months ended June 30, 2006 included $1,573,000 of revenues from Phoenix Development Group, which operates a hotel and owns real estate in Louisiana. For the six months ended June 30, 2005, other income included a $900,000 recovery of an investment in Merchant Data Systems received from a legal settlement, $749,000 of equity earnings from Exponential Business Development, L.P., as well as approximately $475,000 of other income from the settlement of loan recovery costs from the Small Business Administration.

Electronic payment processing direct costs increased by $4,511,000 to $14,462,000 for the six months ended June 30, 2006 from $9,951,000 for the six months ended June 30, 2005, an increase of 45%, which correlates to the significant increase in this business.

Changes in interest expense are summarized as follows:

(In thousands)		2006		2005		Change
Capco interest expense	$	6,663	$	6,067	$	596
NSBF (SBA Lender) interest expense		1,124		987		137
Other interest expense		1,157		524		633
	$	8,944	$	7,578	$	1,366

The increase in Capco expense relates to the two new Capcos formed in June and December 2005 (WTXI and WNYV) which had a full six months of expense in 2006. The $137,000 increase in SBA interest expense is attributable to the increase in the prime rate as well as an increase in the lending rate. Under the previous lines of credit with Deutsche Bank and Banco Popular, NSBF's lending rate was prime minus 50 basis points and prime, respectively. Under the current credit agreement with GE, the lending rate is prime plus 50 basis points or Base LIBOR plus 275 basis points. These increases were offset by the decrease in the average outstanding lines of credit from $34,003,000 during the six months ended June 30, 2005 to $24,389,000 during the six months ended June 30, 2006.

Consulting, payroll and benefits increased by $23,000 to $8,335,000 for the six months ended June 30, 2006 from $8,312,000 for the six months ended June 30, 2005.

Professional fees increased by $481,000 to $4,020,000 for the six months ended June 30, 2006 from $3,539,000 for the six months ended June 30, 2005.

Depreciation and amortization expense increased by $739,000 to $3,012,000 for the six months ended June 30, 2006 from $2,273,000 for the six months ended June 30, 2005. This is due to the purchase of $3,787,000 of fixed assets since June 30, 2005.

Insurance expense increased by $326,000 to $1,789,000 for the six months ended June 30, 2006 from $1,463,000 for the six months ended June 30, 2005. This increase is primarily due to the additional insurance relating to the new Capcos formed in June and December 2005 (WTXI and WNYV, respectively), totaling $144,000.

Provision for loan losses decreased by $747,000 to $354,000 for the six months ended June 30, 2006 from $1,101,000 for the six months ended June 30, 2005. This decrease was due to NSBF experiencing significant charge-offs in the first six months of 2005, which required management to establish an additional provision in order to maintain its allowance for loan losses at a level which management believed adequately covered inherent losses in the existing loan portfolio. NSBF's charges-offs, in both the acquired CCC portfolio as well as newly originated loans, were $376,000 in the six months ended June 30, 2006 as compared to $1,371,000 in the comparable period in 2005. The higher amount in 2005 was due to the completion of the liquidation process on certain loans from the acquired CCC portfolio and unexpected credit events from the acquired portfolio and newly originated loans.

Management's ongoing estimates of the allowance for loan losses are particularly affected by the changing composition of the loan portfolio over the last few years. The loans acquired from CCC in December 2002, which are more seasoned than those originated by NSBF, comprise 24% of total loans held for investment as of June 30, 2006. Other portfolio characteristics, such as industry concentrations and loan collateral, which also impacts management's estimates of the allowance for loan losses, have also changed since the acquisition. The changing nature of the portfolio and the limited past loss experience on the newly originated portfolio has resulted in management's estimates of the allowance for loan losses being based more on subjective factors and less on empirically derived loss rates. Such estimates could differ from actual results, which may have a material effect on the Company's results of operations or financial condition.

Other expenses increased by $1,384,000 to $4,938,000 for the six months ended June 30, 2006 from $3,554,000 for the six months ended June 30, 2005.

The effective tax benefit and provision for the six months ended June 30, 2006 and 2005 were 33% and 49%, respectively. In both years no tax benefit was recorded for the taxable losses of NSBF as it is not included in the consolidated tax group. There were no material permanent differences in either year.

Net income decreased by $6,103,000 resulting in a net loss of $5,015,000 for the six months ended June 30, 2006 from a net income of $1,088,000 for the six months ended June 30, 2005, due to the decreases in revenue of $1,392,000, increases in total expenses of $8,083,000 and a decreased benefit from minority interest of $113,000, offset by the net increase in the tax benefit of $3,485,000.

Comparison of the three months ended June 30, 2006 and June 30, 2005

Revenues decreased by $6,243,000, or 24%, to $19,983,000 for the three months ended June 30, 2006, from $26,226,000 for the three months ended June 30, 2005. Income from tax credits from our Capco business decreased by $8,118,000 to $3,280,000 for the six months ended June 30, 2006 from $11,398,000 for the six months ended June 30, 2005.

Electronic payment processing revenue increased by $3,185,000, or 42%, to $10,694,000 for the three months ended June 30, 2006 from $7,509,000 for the three months ended June 30, 2005 due to the increase in electronic payment processing customers. At June 30, 2006, we provided our payment services to over 12,300 customers across the United States, compared to 7,500 customers at June 30, 2005, an increase of 64%. Gross total processing volume increased by 45% to $500,000,000 for the three months ended June 30, 2006 from $346,000,000 for the three months ended June 30, 2005.

Web hosting income increased by $648,000, or 24%, to $3,310,000 for the three months ended June 30, 2006 from $2,662,000 for the three months ended June 30, 2005. The increase is due to the number of customers the Company provided services to and an increase in dedicated hosting customers which generate higher revenue per customer. At June 30, 2006 and 2005, CrystalTech was providing services to 52,000 and 42,000 customers, respectively.

NSBF (SBA Lender) interest income represents earnings on SBA loan receivables. Other interest income consists of investment income on money market accounts, certificate of deposits, U.S. treasury notes, marketable securities, non-cash accretions of structured products and interest income on qualified investments. The following table details the changes in these different forms of interest income:

(In thousands)		**2006**		**2005**		**Change**
NSBF (SBA Lender)	$	992	$	953	$	39
Other interest income		931		303		628
	$	1,923	$	1,256	$	667

The increase in interest income is generally due to an increase in interest rates on investments and loans for the three months ended June 30, 2006 compared to the same period in 2005.

Income from tax credits from our Capco business decreased by $8,314,000 to $2,022,000 for the three months ended June 30, 2006 from $10,336,000 for the three months ended June 30, 2005. In the current period the Company achieved the 25% investment threshold in the WNYIV Capco generating $746,000 in income from tax credits. In the prior period, the Company achieved the 50% investment threshold in the WDC Capco generating $9,259,000 in income from tax credits. Offsetting this decrease, in part, is a net increase of $198,000 from other Capcos who achieved investment benchmarks in prior periods.

Premium income decreased by $1,393,000 to $763,000 for the three months ended June 30, 2006 from $2,156,000 for the three months ended June 30, 2005. The decrease in premium income was attributable to NSBF selling 36 guaranteed loans in the three months ended June 30, 2006, aggregating $8,057,000 as compared to 49 loans sold aggregating $17,282,000 in the same period for the prior year. The premiums recognized in connection with these sales were $597,000 for the three months ended June 30, 2006 as compared with $1,569,000 in the same period for the prior year.

In addition, in June 2006, NSBF sold $2,814,000 of loans previously classified as held for investment as compared with $6,064,000 in June 2005, for aggregate proceeds of $2,960,000 and $6,314,000, respectively. The carrying value above the amounts sold of $146,000 and $250,000 was recorded as premium income. Also, in connection with these sales, included in premium income for the three months ended June 30, 2006 and 2005 is approximately $20,000 and $337,000, respectively, representing the allocated portion of the remaining discount recorded at the time of loan origination.

Servicing fee income related to SBA loans remained consistent at $487,000 for the three months ended June 30, 2006 and for the three months ended June 30, 2005. The consistency in revenue correlates with the consistency of the size of the portfolio in which we earn servicing fee income. For the three months ended June 30, 2006 and June 30, 2005, the average portfolio size in which we earned servicing income was approximately $148,000,000.

Other income decreased by $727,000 to $596,000 for the three months ended June 30, 2006 from $1,323,000 for the three months ended June 30, 2005. Other income for the three months ended June 30, 2006 included $557,000 of revenues from Phoenix Development Group. For the three months ended June 30, 2005, other income included a $900,000 recovery of an investment in Merchant Data Systems received from a legal settlement.

Electronic payment processing direct costs increased by $2,085,000 to $7,555,000 for the three months ended June 30, 2006 from $5,470,000 for the three months ended June 30, 2005, an increase of 38%, which correlates to the significant increase in this business.

Changes in interest expense are summarized as follows:

(In thousands)		**2006**		**2005**		**Change**
Capco interest expense	$	3,320	$	3,033	$	287
NSBF (SBA Lender) interest expense		612		535		77
Other interest expense		665		312		353
Total	$	4,597	$	3,880	$	717

The increase in Capco expense relates to the two new Capcos formed in June and December 2005 (WTXI and WNYV) which had a full three months of expense in 2006. The $77,000 increase in SBA interest expense is attributable to the increase in the prime rate as well as an increase in the lending rate. Under the previous lines of credit with Deutsche Bank and Banco Popular, NSBF's lending rate was prime minus 50 basis points and prime, respectively. Under the current credit agreement with GE, the lending rate is prime plus 50 basis points or Base LIBOR plus 275 basis points. These increases were offset by the decrease in the average outstanding lines of credit from $34,491,000 during the three months ended June 30, 2005 to $25,305,000 during the three months ended June 30, 2006.

Consulting, payroll and benefits decreased by $18,000 to $4,196,000 for the three months ended June 30, 2006 from $4,214,000 for the three months ended June 30, 2005.

Professional fees increased by $99,000 to $1,900,000 for the three months ended June 30, 2006 from $1,801,000 for the three months ended June 30, 2005.

Depreciation and amortization expense increased by $413,000 to $1,597,000 for the three months ended June 30, 2006 from $1,184,000 for the three months ended June 30, 2005. This is due to the purchase of $3,787,000 of fixed assets since June 30, 2005.

Insurance expense increased by $144,000 to $887,000 for the three months ended June 30, 2006 from $743,000 for the three months ended June 30, 2005. This increase is primarily due to the additional insurance relating to the new Capcos formed in June and December 2005 (WTXI and WNYS, respectively), totaling $144,000.

Provision for loan losses decreased by $215,000 to $235,000 for the three months ended June 30, 2006 from $450,000 for the three months ended June 30, 2005. This decrease was due to NSBF experiencing significant charge-offs in the second quarter of 2005, which required management to establish an additional provision in order to maintain its allowance for loan losses at a level which management believed adequately covered inherent losses in the existing loan portfolio. NSBF's charges-offs, in both the acquired CCC portfolio as well as newly originated loans, were

$78,000 in the three months ended June 30, 2006 as compared to $608,000 in the comparable period in 2005. The higher amount in 2005 was due to the completion of the liquidation process on certain loans from the acquired CCC portfolio and unexpected credit events from the acquired portfolio and newly originated loans.

Management's ongoing estimates of the allowance for loan losses are particularly affected by the changing composition of the loan portfolio over the last few years. The loans acquired from CCC in December 2002, which are more seasoned than those originated by NSBF, comprise 24% of total loans held for investment as of June 30, 2006. Other portfolio characteristics, such as industry concentrations and loan collateral, which also impacts management's estimates of the allowance for loan losses, have also changed since the acquisition. The changing nature of the portfolio and the limited past loss experience on the newly originated portfolio has resulted in management's estimates of the allowance for loan losses being based more on subjective factors and less on empirically derived loss rates. Such estimates could differ from actual results, which may have a material effect on the Company's results of operations or financial condition.

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Other expenses increased by $861,000 to $2,455,000 for the three months ended June 30, 2006 from $1,594,000 for the three months ended June 30, 2005.

The effective tax benefit and provision for the three months ended June 30, 2006 and 2005 were 32% and 36%, respectively. In both years no tax benefit was recorded for the taxable losses of NSBF as it is not included in the consolidated tax group. There were no material permanent differences in either year.

Net income decreased by $6,750,000 resulting in a net loss of $2,287,000 for the three months ended June 30, 2006 from a net income of $4,463,000 for the three months ended June 30, 2005, due to the decreases in revenue of $6,243,000, increases in total expenses of $4,086,000 and a decreased benefit from minority interest of $27,000, offset by the net increase in the tax benefit of $3,606,000.

Our operating businesses are dependent on the health of the small- and medium-sized segments of the U.S. economy. The continuing rise in interest rates, along with the rise in gas and commodity prices, could have a negative impact on consumer spending which could adversely impact our small business customers. This could also negatively impact the value of commercial and residential real estate, which could adversely impact the loan portfolio of our SBA Lending segment. The inverted yield curve has also made it difficult to originate prime based floating rate SBA loans in our SBA lending segment.

Critical Accounting Policies and Estimates:

The Company's significant accounting policies are described in Note 1 of the Notes to Consolidated Financial Statements included in its Form 10-K for the fiscal year ended December 31, 2005. 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, 2005. There have been no significant changes in the Company's existing accounting policies or estimates since its fiscal year ended December 31, 2005.

Liquidity and Capital Resources
(Dollars in thousands)

	For the Six Months Ended June 30, 2006	2005
Net cash used in operating activities	$ (2,395)	$ (13,826)
Net cash (used in) provided by investing activities	14,553	(4,189)
Net cash (used in) provided by financing activities	(8,660)	23,837
Net increase in cash and cash equivalents	3,498	5,822
Cash and cash equivalents, beginning of period	23,940	29,540
Cash and cash equivalents, end of period	$ 27,438	$ 35,362

Cash requirements and liquidity needs are primarily funded through our capacity to borrow from our $75 million GE line of credit to originate and warehouse the guaranteed and unguaranteed portion of loans of our SBA lending unit and available cash and cash equivalents. The availability of the lending facility is subject to the compliance with certain covenants and collateral requirements as set forth in the agreement. At June 30, 2006, our unused sources of liquidity consisted of unrestricted cash and cash equivalents of $27,438,000 and $2,121,000 available through the lending facility.

In addition, the Company held $4,797,000 in U.S. Treasury Notes which are classified as held for sale and could be converted to cash and cash equivalents. Restricted cash totaling $14,092,000 which is held in Capcos can be used in managing and operating the Capcos, making qualified investments, to repay debt obligations and for the payment of income taxes.

Net cash used in operating activities is affected by noncash revenues and expenses associated with our Capco segments. In the period ended June 30, 2006, noncash interest accretion associated with notes payable in credits in lieu of cash totaled $6,663,000 while the noncash expensing of insurance purchased at the time Capcos were formed totaled $1,487,000. This offset noncash income from tax credits of $3,280,000, thereby generating a noncash loss of $4,870,000. In 2005, interest accretion totaled $6,067,000, the expensing of insurance totaled $1,250,000 and income from tax credits totaled $11,397,000, thereby generating noncash income of $4,080,000.

Net cash provided by investing activities primarily includes the purchase or sale of fixed assets and customer accounts, activity regarding the unguaranteed portions of SBA loans and changes in restricted cash and investments. During 2006, cash was used to purchase $1,392,000 in fixed assets primarily to support increased customers in our web hosting segment and to acquire $2,531,000 in customer merchant accounts. A net decrease in the unguaranteed portion of SBA loans provided $1,313,000. We also received net proceeds of $14,001,000 from the sale of certificates of deposit and marketable securities and $1,812,000 through a reduction in restricted cash held by our Capcos.

Net cash used in financing activities primarily includes changes in notes payable - insurance, the proceeds of which were used to finance Capco activities, notes payable - other which were funds borrowed by CrystalTech Web Hosting, Inc. from TICC and the GE line of credit which is the lending facility for our SBA lending operation.

Notes payable-insurance repayments were $1,938,000 in 2006 and $1,692,000 in 2005. In 2005, the Company borrowed $8,000,000 from TICC, $6,100,000 of which was prepaid through June 30, 2006. In 2006 Phoenix Development Group repaid $1,368,000 in notes payable-other. The GE line of credit payable increased by $721,000 in 2006 and by $1,793,000 in 2005.

Historically Newtek has funded its operations through the issuance of notes to insurance companies through the Capco programs. We do not believe there are any new Capco programs currently being formed and as such are not anticipating any cash flow from new Capco programs for the foreseeable future.

We believe our operating cash flow, available borrowing capacity, existing cash and cash equivalents and other investments should provide adequate funds for continuing operations, investments required under our Capco programs and principal and interest payments on our debt.

FORWARD-LOOKING STATEMENTS

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," 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.

Item 3. Quantitative and Qualitative Disclosures 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 Newtek Small Business Finance, Inc., our SBA lender, borrows money to make loans and investments, our net operating income is dependent upon the difference between the rate at which we borrow funds and the rate at which we invest these funds. The Company had approximately $22,009,000 at June 30, 2006 outstanding on the GE line of credit. Interest rates on such notes are variable at prime plus 0.50 or base LIBOR plus 2.75%. As a result, 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 the first six months of 2006. 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 and cash equivalents, U.S. Treasury notes and marketable securities which was approximately $47,776,000 and $62,506,000 at June 30, 2006 and December 31, 2005, respectively. Newtek invests cash mainly in money market accounts and other investment-grade securities and does not purchase or hold derivative financial instruments for trading purposes.

Item 4. Controls and Procedures.

(a) ***Evaluation of Disclosure Controls and Procedures***. As of the end of the period covered by this report, our management, under the supervision and with the participation of our Chief Executive Officer and Chief Financial Officer, evaluated the effectiveness of the design and operation of our disclosure controls and procedures pursuant to Rule 13a-15(e) of the Securities Exchange Act of 1934, as amended (the "Exchange Act"). Based on that evaluation, the Chief Executive Officer and the Chief Financial Officer have concluded that our disclosure controls and procedures as of the end of the period covered by this report have been designed and are functioning effectively to provide reasonable assurance that the information we (including our consolidated subsidiaries) are required to disclose in reports filed under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission's rules and forms. However, because we had previously determined the existence of a material weakness in our disclosure controls and procedures as of December 31, 2005 and March 31, 2006, and despite the remediation efforts discussed below, and given the relatively short time since the remediation efforts have taken place, there can be no assurance that we have identified and corrected all matters which would constitute, or might lead to future, disclosure control weaknesses.

(b) ***Changes in Internal Controls.*** We have placed significant emphasis on remediation of the previously disclosed material weakness and have added a senior legal officer primarily responsible for internal control development and three professional positions in our accounting and finance staff during the quarter ended June 30, 2006.

(c) ***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. Further, the design of a control system must reflect the fact that there are resource constraints, and the benefits of controls must be considered relative to their costs. Because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, within the Company have been detected. These inherent limitations include the realities that judgments in decision-making can be faulty, and that breakdowns can occur because of simple 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.

PART II - OTHER INFORMATION

Item 2. Unregistered Sales of Equity Securities

On June 20, 2006, pursuant to the terms of the Company's directors' compensation program, the Company issued to its four independent directors a total of 24,006 unregistered common shares with a market valuation as of that date of $1.76. The shares were issued in exchange for the services of the directors on the Board of Directors and its committees in reliance on Section 4(2) of the Securities Act of 1933, as amended.

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

The results of the vote at the Annual Shareholders Meeting were previously reported in the Company's Quarterly Report on Form 10-Q for the quarter ended March 31, 2006.

Item 6. Exhibits

Exhibit No.	Description
31.1	Certification of the Chief Executive Officer, pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2	Certification of the Chief Financial Officer, pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1	Certification of the Chief Executive Officer and Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

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: August 14, 2006	By:	/s/ Barry Sloane Barry Sloane Chairman of the Board, Chief Executive Officer and Secretary
Date: August 14, 2006	By:	/s/ Michael J. Holden Michael J. Holden, Treasurer, Chief Financial Officer, Chief Accounting Officer

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